How to Reform the EU Budget?
A Multidisciplinary Analysis

Hoe de EU-begroting te hervormen?
Een multidisciplinaire analyse
(met een samenvatting in het Nederlands)

Proefschrift

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1. Introduction

1.1. Overview of the thesis

With less than two years to go before the 2007-2013 budgetary package expires, EU Member States are gearing themselves up for the usual thorny negotiations on "who gets what" from the EU budget. In June 2011, the European Commission issued its proposal for the seven-year budgetary package, which will now be debated by the Member States and the European Parliament. For EU budget scholars, there is an inescapable sense of “déjà-vu”: grandiose declarations on a willingness to reform the EU budget are coming from EU institutions and Member-States alike, but the end result will inevitably be an agreement on a budgetary package almost equivalent to the previous one.

The EU budget has long been criticised as being out of touch with the realities of today's EU (Sapir et al., 2003, Begg, 1999, Buti and Nava, 2003). Almost half of the funds are allocated to agriculture, a sector which is declining in Europe. By contrast, areas where the EU is becoming increasingly important, such as home affairs or economic growth policies, are almost not supported by the EU budget.

The structure of the budget is problematic because it was not designed according to a coherent set of principles. Spending programmes were added through the years in an ad-hoc fashion, without any proper assessment of whether there is a case for them to be financed at EU level, or of whether they are being allocated an amount of money proportional to their importance (Buti and Nava, 2003).

Although the past thirty years have seen a growing literature on the EU budget, this consists almost exclusively of policy analysis rather than in-depth academic research, and relies almost entirely on the theories of fiscal federalism. Fiscal federalism is the branch of economics that analyses which functions of a government are best performed at a centralized (or EU) level and which are best done at a decentralized (or national) level (Musgrave, 1959, Oates, 1972).

Although fiscal federalism provides invaluable insights on how the EU budget should be spent, this theory also has serious limitations when it is applied to the EU (Oates, 2002, Ackrill, 2003). It is argued that those limitations help to explain why the insights from the literature have so far largely been ignored by policymakers. This thesis seeks to fill this gap, by proposing a methodology which combines fiscal federalism with other theories, thereby taking into account the specificities of the EU.

The thesis uses a multidisciplinary approach to assess how the budget of the European Union should be reformed. It combines fiscal federalism with a second branch of economics (public sector economics), political science and EU law. From these four disciplines, eleven steps are derived, and this eleven-step analysis is applied to three important areas of the EU budget – cohesion, agriculture and research policy - to assess which (if any) of their funding programmes should be financed at EU level.

The research question addressed by this thesis is therefore: What set of principles should guide the allocation of spending programmes to the EU? In particular, is it possible, through a multidisciplinary approach, to derive a set of principles that takes into account, not only efficiency considerations, but also other factors of relevance?

The research question will be defined in more detail in section 1.5 of this introductory chapter. Before that, the next section (1.2) provides background information on the EU budget and explains the need for analysing this subject. Sections 1.3 and 1.4 explain the need for, and main features of, the multidisciplinary methodology proposed. Section 1.6 gives an outline of the thesis.

1.2 Why study the EU budget now

Since the European Union was founded in 1957, each of its Member States has made a yearly contribution towards a common, EU budget. However, the way in which this EU money is allocated has long been criticized, not only by academics but also by the EU Member States and even by the EU institutions themselves (Sapir et al. (2003), Begg (1999), Buti and Nava (2003)).

The main reason for the dissatisfaction with the EU budget is that the way in which it is spent is considered to be out of touch with the realities of the EU. The current structure of the EU budget - where approximately 42% of the budget is allocated to agriculture, 35% to cohesion funds (funds which support the poorest regions of the EU) and the remaining funds are allocated to several policy areas, such as external action and internal policies – does not correspond to the objectives of the EU.[1]

Most criticisms are directed towards the core of the spending – the Common Agricultural Policy (CAP), which uses approximately 42% of the EU resources. According to most of the economic literature, the CAP is not only wasteful - large amounts of money are being given to a declining industry, in which the EU does not have a comparative advantage (Hoeller, Louppe and Vergriete, 1996) -, but also inefficient - the small and medium-sized farmers, who would need the most support, are generally unable to benefit from CAP programmes (Nunez-Ferrer, 2007) - and even harmful - developing countries, which *do* depend on exporting their agriculture to Europe, cannot compete with the way the EU subsidizes its products (Mahe and Ortalo-Magne, 1999).

However, the structure of the entire budget is problematic as well, because it was not designed according to a defined set of fiscal principles, or in order to meet a concrete set of objectives. Spending programmes were added through the years in an ad-hoc fashion, without any proper assessment of whether there is a case for them to be financed at EU level, or of whether they are

[1] Throughout this thesis, the current spending for each policy area was calculated on the basis of the Preparation of the 2009 Preliminary Draft Budget. They correspond to the actual spending on each area, and not to the official headings of expenditure.

being allocated an amount of money proportional to their importance (Buti and Nava, 2003).

After agriculture, the next big chunk of EU funding goes towards regional funding, which is aimed at helping the EU's poorest regions to "catch up" economically with the EU average, and also at other goals such as promoting employment. While most analysts agree that the share of the budget allocated to these funds (approximately a third of the budget) is appropriate, the way in which these funds are allocated is much criticised (Sapir et al, 2003).

The EU budget is also allocated to a myriad of other policy areas, such as foreign policy, research, culture or transport policy (please see Chapter 2 for a detailed description). While there is a strong case for most of these policies to be at least partly financed at EU level, the amount of money that they receive, and how that money is used in practice, are far from efficient. Many of those areas should benefit from a larger share of the budget than they do at present, as they are areas where money could be best spent collectively than by each Member State individually. As will be shown in Chapter 4, this applies, for example, to funding for research.

The EU budget is therefore being spent in a way that runs counter the basic economic premise that public funding should be spent in an efficient way (Begg (1999), Buti and Nava (2003)). Moreover, as will be seen in the multidisciplinary analysis below, it is also not respecting principles derived from law and political science (such as subsidiarity and legitimacy, among others).

Why is EU money being spent so inefficiently? A historical perspective shows that the absence of a set of fiscal principles so far has led to these suboptimal results. When the budget was initially drawn up by the six founding countries (West Germany, France, Italy, the Netherlands, Belgium and Luxembourg), it was not methodically thought up as a means to meet the objectives of the Union. For that reason, in practice it became a hostage to the negotiations on the EU Treaty. For example, the large spending on a Common Agricultural Policy (CAP) is seen by several authors as a compensation for France (still today, the main beneficiary of EU agricultural funds), for allowing German industrial products to enter the French market (Buti and Nava, 2003). Structural funds, which were created in 1975 but

became a major item in the budget when Spain and Portugal entered the EU in 1986, were seen as a compensation for any disadvantages these countries would suffer from entering the Single Market due to their weaker economies (Buti and Nava, 2003).

Later on, as EU integration progressed and more countries entered the club, the budget was never substantially updated – new countries entering the EU simply accepted to contribute towards it, as part of their new obligations as Member States. The reason is that the way in which the budget is negotiated leaves little room for modifications. There is a very vast literature exploring the causes of this case of political failure, and it is not the subject of this thesis to explore this further. (A brief summary of the findings of this literature is offered in Section 2.5).

As a result, EU spending programs have been created throughout the years in an ad-hoc fashion, without proper assessment of whether there is a case for them to be financed at EU level, and of whether they are being allocated an amount of money proportional to their importance. There is therefore a growing consensus, both within the EU institutions and within the national governments, that the EU budget needs to be radically reformed.

Due to the growing interest for this topic, a lot has been written on the EU budget over the past thirty years. However, despite the abundance of policy analysis reports, the academic literature on the EU budget is scarce (Ackrill and Kay, 2006). In addition, it generally focuses only on the procedural aspects of the EU budget (how it is negotiated), and not on the expenditure aspects (how it is spent). Although several prominent scholars have tackled the subject of how the EU budget should be spent, they did so via reports for research centres, rather than via a full-blown academic analysis (Begg, 1999, 2008, 2009, Sapir, 2003, Gros and Micossi, 2005). Therefore, there is still a need for an academic framework which can provide a basis for decisions on how the EU budget should be spent – this thesis aims to fill that gap.

1.3. The need for a multidisciplinary approach

One of the main premises of this thesis is that a set of principles for the EU budget should be based, not only on theories of fiscal federalism – as has been the case in most of the literature so far – but also on other academic theories. The next paragraphs explain why this is necessary.

Fiscal federalism is the branch of economics that analyses which functions of a government are best performed at a centralized level and which are best done at a decentralized level (Musgrave, 1959, Oates, 1972). When applied to the EU, these theories analyze which policies should be the responsibility of the EU and which should remain national, or the question of "what the EU should do".

Fiscal federalism has become the theory of choice, both for the analysis of the EU budget, and for the analysis of EU policymaking as a whole. This theory allows us to see whether a certain policy can be undertaken more efficiently by the EU or by the national governments, and therefore gives invaluable insights. However, it also has important limitations.

Several authors have admitted that, although fiscal federalism provides useful insights to the analysis of the EU, the fact that the theories are most suited to one single country creates problems for the analysis. However, they all stopped short of suggesting an alternative.

Oates (2002) comments that *"much of the literature, especially the part addressing the assignment of functions, has been developed in the context of the modern nation-state. (...) As such, it doesn't seem to fit very well the cases of emerging «confederations» such as the European Union"*. Ackrill (2003) also argues that *"in the context of the European Union, this [fiscal federalism's] traditional paradigm is not only inadequate but confused, leading to a lack of clarity in the debate"*.

Ackrill (2003) adds that "*the traditional fiscal federalism paradigm, developed in the context of a single country, can lead to erroneous policy prescriptions if applied without qualification to the European Union"*. According to Ackrill this is due to the fact that, when fiscal federalism is applied to a single country, the "central" level of government is the higher

level of government. On the contrary, in the EU, the national governments are more powerful than the EU level. Therefore, the highest level of government does not coincide with the "broadest" in fiscal terms.

Alesina (2001) also identifies three reasons why fiscal federalism is difficult to apply to the EU: the first is that the mobility of individuals between EU countries is very low; the second is that heterogeneity of preferences is much higher within EU countries than within the regions of the same country. The third is particularly relevant for this thesis: the EU budget is very small in comparison to the national budgets.

The theories of fiscal federalism were designed to be applied to the US and other single countries - as opposed to the EU, which is an economic, and in some aspects also political, union between sovereign countries. Although the main reasoning behind fiscal federalism applies equally to both cases, as in both we are choosing how to allocate policies between different levels of government, there are several elements of the theory that should be adapted to the EU, so that it can give better predictions.

This confusion affects particularly the government functions involving spending, because the EU budget is very small in comparison to the national budgets – whilst in a federation generally the opposite takes place, as the central government has the largest budget. This can lead to wrong prescriptions: for example, fiscal federalism generally says that the function of stabilisation should be assigned to the central level of government, as it normally has the largest budget – but in the case of the EU that is not the case. In addition, the EU budget has to abide by a strict balanced budget rule, and is therefore not allowed to be in deficit.

In addition, this thesis identifies two other main problems of applying the theories of fiscal federalism to the EU. Firstly, in the case of an economic union there is the issue of legitimacy. Within a single country or federation, choosing at which level a function of government is performed can depend only on considerations of efficiency, as other than that the level is unimportant; on the contrary, in a political union, the decision to allocate a policy at the EU level means that the country is relinquishing its sole sovereignty over that policy, and that from now on any decisions on that field will have to be made together with the other Member States. Therefore, the

issue of whether it is seen as legitimate by people to transfer the policy to the EU level becomes essential.

Secondly, fiscal federalism analyses typically ignore the fact that most policies are not allocated to a single layer of government but are shared between different levels. This assumes even more importance in the case of the EU, as there is a very large divergence in the extent of EU powers on the different policies. In some fields, such as competition policy, monetary policy or agriculture, the EU has very extensive powers, whilst on others, such as education or social policy, the involvement of the EU is very limited. It is important to keep this differentiation in mind, as it is very different to make a recommendation that the EU should be active on a certain field with exclusive competences or with limited competences.

Finally, the use of fiscal federalism does not replace an analysis based on public sector economics. It is first necessary to assess whether government intervention is required in a certain area, and only then whether this can be best done at EU or national level.

The multidisciplinary method proposed in this thesis addresses these shortcomings, by using the additional fields of study to add the aspects that were missing in fiscal federalism. Namely, the problem identified by Oates (2002) that fiscal federalism was designed for countries and not for “emerging confederations” such as the EU, is addressed by adding the legal and political analyses. Including considerations of political legitimacy into the analysis makes it possible to take into account the fact that it is not sufficient to ascertain that a certain policy can be achieved more efficiently at EU level, for it to be justifiable to reduce national sovereignty in that field. The legal analysis also helps to address this question, as it makes it possible to consider what EU countries agreed would be the role of the EU in each area.

The methodology proposed also addresses the issue identified by Ackrill (2003) that when fiscal federalism is applied to a single country, the "central" level of government is the higher level of government, while, in the EU, the national governments are more powerful than the EU level. Therefore, the highest level of government is also the “broadest” in fiscal terms. The public economics analysis makes it possible to address the fact that the EU budget is

much smaller than a national budget, and therefore it needs to be used in a different way: mainly as an instrument for leveraging national spending and regulatory policies. The political analysis also tackles this issue, by taking into account the general reluctance to increase funding at EU level.

1.4. The methodology proposed

To analyse the EU budget, this thesis proposes a multidisciplinary methodology. It will be explained in detail in Chapter 3, so this section only offers a brief overview. The methodology takes as a starting point fiscal federalism, and completes it with three other field of study: public sector economics as a whole, insights from political science, and EU law. From these four fields, eleven steps are derived, and this eleven-step analysis constitutes a set of principles that can be applied to areas of policymaking, to assess whether they should be funded by the EU budget.

The methodology proposed is multidisciplinary, as opposed to interdisciplinary. Although the subject of analysis – the EU budget – is economic in nature, the methodology used is not only economic. Instead, each of the academic fields is used together with its own methods, tools and insights. The two economic fields are used together with economic methods and tools, but the legal analysis is based solely on methods, tools and literature from law, and similarly the political analysis relies only on the methods and literature from political science. This is therefore a multidisciplinary evaluation of which spending programmes should be at EU level.

Despite the fact that completely different methods are used for each academic lens, this thesis makes it possible to obtain a set of comparable steps and corresponding criteria, which can be used, together, to derive an answer on whether a certain policy programme should be funded by the EU budget.

The first steps of the methodology are derived from EU law. The European Union is ultimately based on a legal agreement between its Member States, so it is important to take law into account when analysing what should be the spending competences of the EU. The primary sources of EU law – ie. the EU Treaty[2] (European Communities, 2010) – will form the basis for this

[2] Throughout this thesis, all references to the "EU Treaty" relate to the Consolidated versions of the Treaty on European Union and of the Treaty on the Functioning of the European Union, together with the annexes and protocols thereto, as they result from the amendments introduced by the Treaty of Lisbon, as published in the Official Journal of the European Union, C83 of 30 March 2010.

analysis, because one of the functions of the EU Treaty is to provide the basis for the competences of the EU. The two steps derived from EU law are:

1. According to the EU Treaty's Part Three, what should be the competences of the EU in this area?
2. According to all other sections of the EU Treaty, what should be the competences of the EU in this area?

The next steps are derived from public economics, the branch of economics that analyses the activities of government. Fiscal federalism is of course itself a sub-field of public economics, but this section focuses on public economics as a whole, and particularly on the tools that the field offers for determining whether there should be public intervention in a certain area. At national level, these theories underpin most public policies, but it is argued that they are often forgotten at the EU level, due to the almost exclusive focus on fiscal federalism.

Public economics is an extremely vast field, so this section has necessarily to focus only on a very limited part of the literature. The first part of the literature that this section will use is the literature that focuses on the rationale for public sector intervention (for example, Barr, 1992, 1994, Stiglitz, 2000). The second type is the literature that focuses on each of the three areas selected by this thesis – cohesion, agriculture and research – and analyses them from an economic perspective (Ackrill, 2005, Aho et al., 2006, de la Fuente, 2002, Ederveen et al., 2006, Faber and Gosh, 2010, Hoeller et al., 1996, Sapir et al., 2005, among others). The steps derived from these fields of literature are:

3. Is the government intervention necessary, either to address a market failure or to meet an equity goal?
4. Should the government intervention be in terms of funding or in terms of regulation?

In addition, a third step is:

8: Can this spending programme at EU level be cost-efficient?

This step will be used as number 8 in the analysis, because it should be assessed after the fiscal federalism analysis. It is preferable to look at cost-efficiency after the assessment of which level of government is more efficient has been made.

The next three steps are taken from fiscal federalism. The first two consist of the main criteria used in "traditional" fiscal federalism, while the third is derived from "second generation" fiscal federalism:

5. Are there externalities or economies of scale that can be best addressed at EU level?
6. Is there a significant heterogeneity of preferences, which makes EU level action problematic?
7. Are there more political failures at EU level or at the national level?

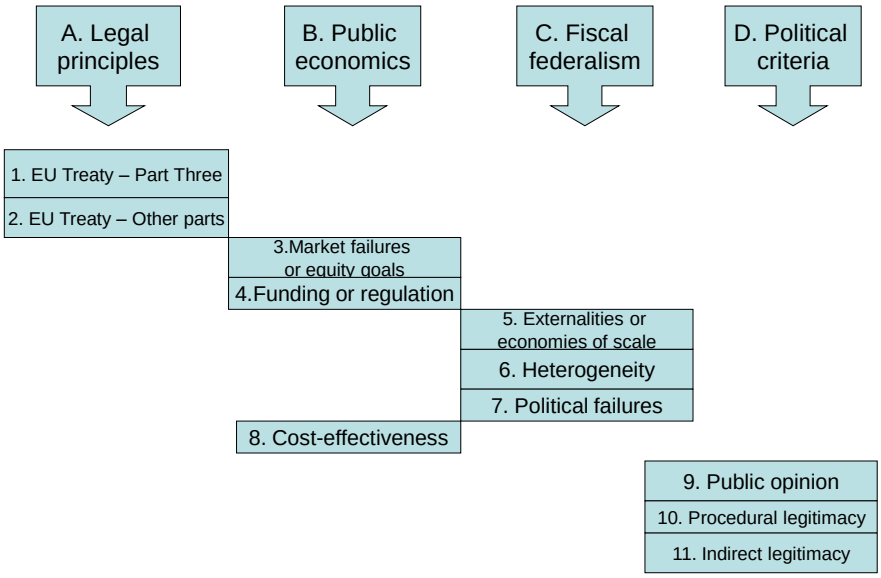
This study argues that, alongside economic factors, an analysis of the EU budget must address political issues. In particular, the main problem in applying fiscal federalism to the EU is that it does not take into account the issue of *legitimacy*, or that for a union between countries such as the EU, the decision to centralise policies depends not only on efficiency considerations, but also on whether it is seen as legitimate to share national sovereignty over those policies. Therefore the political science literature on the legitimacy of the EU will be used to propose the last three steps of the methodology.

The concept of legitimacy is difficult to define and assess, and no consensus has been found on what is the best way to define it. Therefore, as to operationalise it into three steps, this thesis will follow the approach proposed by authors including Scharpf (2000), Lord and Magnette (2002), or Beetham and Lord (1998): to use a combination of factors, instead of relying on just one source of legitimacy. The steps derived are:

9. Is having this policy at EU level supported by public opinion?
10. Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?
11. Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?

The following scheme summarises the eleven conditions just described. It is argued that, the more a certain policy area (or spending programme) meets these conditions, the stronger is the case for it to be funded by the EU budget.

Figure 1: Methodology



This methodology will be developed in detail in chapter 3. In chapter 4, it will be applied to three important areas of EU expenditure: agriculture, cohesion policy and research policy. For each of those areas, an analysis will be made based on the eleven steps.

It should be noted that, although the main topic of this thesis is a public budget, this thesis and the methodology it proposes do not relate to fiscal theory. The reason for this is that the EU budget is too small to have any significant macroeconomic impact. As noted by the McDougall report (McDougall et al., 1977), to have any significant macroeconomic impact, the EU budget would need to be at least 2% to 2.5% of Member States' joint GDP – this would imply doubling the current size of the EU budget.

Although it would be possible to discuss whether the EU budget should be significantly increased so that it could play such a macroeconomic role, this thesis will not engage in that debate, because it takes the total size of the budget as given. This thesis does not question how large the EU budget should be, but only what percentage of the budget should be spent on each policy area. Therefore, strictly speaking, the question addressed here is not "how should different policy areas be funded at EU level" but, "given that the EU is a union between countries with a small budget, how should different policy areas be funded at EU level".

The reason for this is that this thesis wishes to make proposals that are relevant to the current situation, at the current level of integration. Therefore, just as it takes the current level of legislative integration as given, it will also take the current level of budgetary integration as given. For example, when assessing the extent of externalities, this is done based on the current degree of interdependence between EU countries, and not on how much that interdependence would be if the EU was more integrated. Similarly, to consider the possibility of a larger budget would make this analysis less relevant to the current reality, which is that EU Member States would be strongly opposed to any major increase in funding at EU level, and that the EU is a political entity with strong legislative powers but small financial powers.

1.5. Value added of the thesis

The research question addressed by this thesis is therefore: The EU budget has so far been structured in an ad-hoc manner, without following a set of fiscal principles. This has led to a suboptimal use of the funds. What would be an adequate set of fiscal principles for the EU budget? In particular, can a multidisciplinary approach lead to a better set of principles, that takes under account, not only efficiency considerations, but also other factors of relevance?

The research puzzle addressed by this thesis is therefore both normative and methodological. This thesis is not seeking to explain or to measure a phenomenon; on the contrary, it is seeking to both answer a normative question – how should the EU budget be spent – and a methodological puzzle – how to create a multidisciplinary methodological framework that can be used to define how the EU finances should be organised, by completing fiscal federalism with insights from other theories, thereby making it more suited to the analysis of the EU?

This thesis therefore aims to contribute to the literature in those two main ways. The first is to provide a set of principles to underpin the EU budget. The second is to propose a new methodology that can be used, not only for the EU budget, but for the analysis of the EU in general, by completing fiscal federalism with insights from other theories, thereby making it more suited to the analysis of the EU.

Concerning the first element of value added, it is argued that this integrated and multidisciplinary approach was lacking in the previous literature on the EU budget, which has so far focused only on fiscal federalism, while ignoring the insights of the other theories proposed. For that reason, the existing literature on the EU budget has not yet offered a solution on how to reform the budget which is consistent, efficient and realistic, both from a political and from an economic perspective. The objective of this paper is to offer the basis for such an analysis.

In addition, the analysis takes into account two points that are often ignored in the literature on the EU budget. One is that the EU budget should not be assessed in isolation from the national budgets. EU spending programmes co-

exist with national spending programmes, and must be designed with that interaction in mind. The second is that it is not sufficient to analyse policy areas as a whole, without differentiating between the sub-areas within those policies. It is argued that in most policy areas the question is not whether or not there should be EU funding, but which specific programmes within the policy area should be EU funded. While these two points have recently been made by academics, to the knowledge of this author there had as yet not been any comprehensive analysis of the budget that actually follows them[3].

The second element of value added is a new methodology for the analysis of the EU. The literature on fiscal federalism has so far not taken centre stage in the debate on the "future of the EU". This is partly due to the fact that these theories had so far appeared to be out of touch with the reality of the EU, as they ignored political considerations. It is argued that the "European version" of fiscal federalism proposed in this thesis can contribute towards bridging the gap between the academic work and the policy debate on the EU competences.

Concerning the importance of research on the EU budget, it is essential to define what the budget of the EU should be used for, not only to ensure that European tax payers' money is used in an efficient way, but also because it is linked with essential questions about the objectives of the EU.

Why is it of any use to study how the EU budget should be spent, if the political process surrounding it blocks any improvements? The answer is that, although drastic reforms are difficult to achieve, incremental reforms are possible and have been gradually achieved over the past years. Moreover, given the opacity of the EU political system, and the underestimated power of the Commission, academics can have a significant influence. An example is Sapir Report, a report commissioned to a group of independent academics by the EU institutions, which had a clear impact on the drafting of the subsequent budgetary package (Sapir et al., 2003).

[3] This comment refers to analyses of the EU budget as a whole. There have been analyses of specific areas of EU spending that did differentiate between different programmes. An example is the 1997 Buckwell Report on CAP reform (Buckwell et al., 1997), which differentiated between the different programmes under Pillars I and II of the CAP.

Another reason which explains the limited interest of economists for this area so far is its relatively small size: Member States' contributions towards the EU budget are much smaller than their national budgets. However, as a whole, the EU budget does represent over 130 billion Euros – and that sum should not be wasted. Rather, if it was used efficiently, the EU budget could contribute significantly towards the welfare of each person living inside the EU. In addition, the EU budget has an important role to play as a leverage instrument (Nunez-Ferrer, 2010). Even a small sum of money can have a very significant impact, by coming attached to conditions that lead to changes in national policymaking, or by leading to cooperation between Member States in areas where economies of scale and/or externalities are significant.

Although this thesis takes into account the political realities of the EU, it deliberately does not base its proposals on considerations of political economy. That is, a choice was made to propose the optimal structure for the EU budget, and not the structure most likely to be approved by the Member States in the coming negotiations. It is argued that the first step in the analysis is to determine which areas and programmes should be funded by the EU budget. A second step, which is left for future research, will then be to determine which reforms in the direction of the optimal budget can realistically be taken in this review, and which should be left for the future.

This thesis will only look at the *expenditure* side of the budget (what the money should be spent on); it will not look at the *procedures* involved in negotiating the budget, or at the sources of *revenue* of the budget. The reason is that this thesis argues that the key to improving the budget lies, not only in attempting marginal changes to the political process, but also in showing that the budget could be used better. This should contribute towards the creation of a political momentum for a change of the budget, which is essential for any changes to happen.

1.6. Outline of the thesis

Chapter 2 provides the background for this thesis. It describes in detail the EU budget: how it is spent, financed and negotiated, how it has evolved through the years, and why it has proved difficult to reform. It also provides a review of the literature on the EU budget.

Chapter 3 proposes a multidisciplinary methodology to analyse the EU budget, combining fiscal federalism with three other fields of literature - economics of the public sector, EU law and the political science literature on legitimacy.

Chapter 4 applies the methods to three important areas of the EU budget: cohesion, agriculture and research policy. The chapter begins by explaining the importance of a disaggregated analysis, whereby policy areas are not analysed as a whole but by looking at individual areas of spending. The methodology is then applied to each of the three policy areas – for each of them, the eleven steps are applied, and conclusions are derived. The section ends with a proposal, based on the analysis, of how those three areas of the EU budget should be restructured.

Chapter 5 concludes by summarizing and analysing the main findings of the thesis, and making suggestions for further study in this area.

2. Background: The EU Budget

This section offers a comprehensive description of the EU budget. The first three parts look at how the EU budget is spent, negotiated and financed by the Member States. The fourth part describes the historical evolution of the budget. The fifth part looks at why the EU budget was structured in this way and why it has proved so difficult to reform, through a review of the political economy literature on the procedures of the EU budget. The sixth part reviews the literature focusing on the EU budget (the other fields of literature that are relevant to this thesis are covered in depth under Chapter 3 "Methodology").

2.1. Expenditure: How it is spent

We now look at how the EU budget is being spent, under the current, 2007-2013, Multiannual Financial Perspective (MFF). An overview of the entire expenditure structure will be followed by a description of each area of expenditure in more detail.

Overview

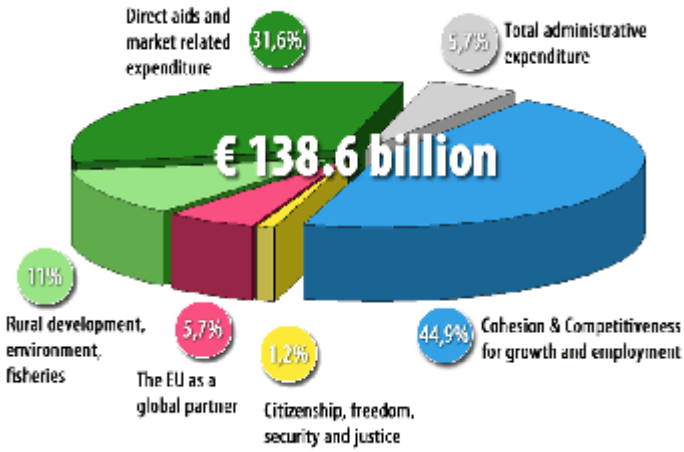
The EU budget currently totals approximately EUR 130 billion each year. Although this may seem like a very large amount, it is in fact very small when compared to a country's national budget, as this will generally amount to almost half of the country's GDP. For example, the budget of the UK amounted in 2011 to 45% of its GDP.

Almost half of that budget is spent on funding for the EU's agricultural policy; a third on cohesion policy (including funding for the poorest regions of the EU); research policy and administrative expenditures each get about 5% of the EU budget; and the rest is divided between all the other policy areas.

However, looking at the official headings of the EU budget, as provided by the European Commission, gives a different impression. This thesis argues that the expenditure structure of the EU budget is being depicted in a

misleading way by the EU institutions. The following graph shows the division of the budget into its six official headings:

Figure 2: EU Budget 2010



Source: European Commission website: http://ec.europa.eu/budget/index_en.htm

Heading 1: Blue area: Cohesion and competitiveness for growth and employment (44.9%). This includes heading 1a: Competitiveness for growth and employment and heading 1b: Cohesion for growth and employment. (Heading 1b corresponds to cohesion policy, and gets most of this share of the funding).

Heading 2: Preservation and management of natural resources: Both green areas (Agriculture (31.6%) plus rural development (11%), so in fact 42.6%).

Heading 3: Citizenship, freedom, security and justice: Yellow area (1.2%)

Heading 4: The European Union as a global partner: Purple area (5.7%)

Heading 5: Administration: Gray area (5.7%)

Heading 6: Compensations (related to the latest enlargement of the Union): Not represented in this graph (0.2%)

This graph attempts to show that the largest share of the budget goes, not to agriculture, but to measures directed at economic growth. This is done by grouping together policies that are in fact completely distinct: cohesion policy, research policy and several other policies that can be seen as linked to economic growth. At the same time, the graph separates agriculture and rural development into two sections, when these are in fact part of the same policy area. Heading 3 also groups together policy areas that are unrelated, in an attempt to disguise the fact that the share of the budget dedicated to freedom, security and justice is very small.

Given that the official headings are misleading, this study will use a different breakdown, based on how much is actually spent under each policy area. To estimate those figures, the European Commission's Activity Based Budgeting report was used. This report shows how the EU budget was spent in great detail, making it possible to find out how much is actually spent for each type of activity, by adding up the budget lines allocated to that activity. The following results were obtained:

Table 1: Breakdown of expenses, based on information from European Commission's Activity Based Budgeting report, 2010

Policy Areas	**Current budget**
Agriculture	42%
Cohesion Policy	35.5%
Administration	5.7%
Research Policy	4.9%
External Policy	2.7%
Development Policy	2%
Transport and Energy	1.9%
Education	0.7%
Freedom, Security and Justice	0.6%
Employment and Social Affairs	0.5%
Health and Consumer Protection	0.3%
Culture	0.2%
Environment	0.2%
Enterprise and Industry	0.2%
Communication	0.07%
Total areas without funding policies	1.8%
TOTAL	100

These numbers show a different picture from that provided by the European institutions. They make it clear that agriculture is still by far the main item in

the budget, while growth-related areas are only benefiting from a very small percentage of the budget.

The second largest area is Cohesion Policy, which receives approximately a third of the budget. Far behind, with close to 5% of the budget, come administration and R&D.

Administrative expenditure will not be analysed in this thesis. That is because the aim of the study is to assess which policies should be funded at EU level, and which should remain at national level. EU administration costs must clearly be funded at EU level, so the question of whether these costs should be funded at EU level, and if so which parts of them, does not apply. Therefore, while EU administrative expenditure is clearly worthy of analysis, the methodology proposed in this thesis is not suited to it.

The methodology proposed in this thesis will therefore be applied to the three areas which, excluding administration, receive the most funding: agriculture, Cohesion Policy and R&D.

I now describe each area of the budget, starting from those that benefit from a larger share of the funding. The policy areas in which the EU does not have funding policies (grouped together as "areas without funding policies" in the table) will not be described in this section, as this thesis focuses only on spending policies. These areas, which include for example competition policy and internal market, involve policies based on legislation rather than funding, so their budget lines are used simply to fund the administrative expenses associated with running them.

Agriculture

When the EU was founded in the 1950s, Member States agreed to give up their national farming policies in favour of a Common Agricultural Policy (CAP). At the time, ensuring food security in Europe was seen as an important objective, and the CAP was considered to be the best way to ensure this. It also de facto mirrored the customs union for free internal trade in industrial goods. Fifty years later, this policy has become controversial; as will be seen in the analysis that follows, its usefulness is being questioned by analysts and policymakers.

Those criticisms have led to successive reforms of the CAP, but today it still represents 42% of the EU budget.[4] This policy consists mainly of support for the farming sector. In the past, this support was done mostly through market interventions, which made food production in the EU artificially competitive. Following reforms, it is now based mainly on direct transfers to the farming sector, which are considered less trade distorting.

In addition, since 2000, the CAP includes "rural development" policies that aim to preserve the countryside. These policies are known as the "second pillar" of the CAP, while the first pillar, made of the policies that existed before, is now called "market policies and income support".

Rural development has three objectives: promoting the competitiveness of agriculture; developing the countryside and the rural environment; promoting quality of life in the rural areas. The first objective is met through subsidies for education, and help to modernise farms and make them more efficient. The second objective is addressed by measures to improve the environment in rural areas. The third objective is mainly focused on finding alternative uses for the rural areas where agriculture is not competitive, such as converting them into tourism.

The budget on agriculture is also divided under those two "pillars". The first pillar (pillar I) is financed by the European Agricultural Guarantee Fund (EAGF), while the second pillar (pillar II) is funded by the European Agricultural Fund for Rural Development (EAFRD). The first pillar is divided among two areas: interventions in agricultural markets and direct aid. As explained above, interventions have gradually been scaled down and today represent only approximately 10% of the CAP budget, while direct payments have become the main item and take up more than half of the CAP funding.

The spending on rural development is distributed among the Member States, who use it according to a National Strategy Plan. This Plan is devised by each country but must respect the EU objectives for rural development.

[4] The percentages of current spending for each policy area were calculated on the basis of the Preparation of the 2009 Preliminary Draft Budget. They correspond to the actual spending on each area, and not to the official headings of expenditure.

Finally, about 1.5% of spending goes to fisheries. Fishermen do not get extensive support as do farmers. The focus of the policy is not on helping fishermen and promoting the fishing industry, but on dividing the waters between the Member States, and, in recent years, preserving the environment and the species of fish. The EU Common Fisheries Policy has four official objectives: to preserve the marine eco-system, to improve the efficiency of the fishing sector, to ensure the standard of living of fishermen, to protect the interests of consumers.

More than half of these funds are spent on the European Fisheries Fund (EFF). The EFF finances help for the fishermen who lose their job due to the decline in the fishing industry, investments for the modernisation of the fishing fleet, and projects for the conservation of the marine eco-system.

Cohesion Policy

Cohesion Policy aims to provide financial help to regions and countries of the EU. It benefits mainly the poorest countries and regions in the EU to help them to catch up with the EU average, but is also given to wealthier regions, to promote employment or cross-border cooperation projects. It accounts for approximately 35% of the total EU budget (EUR 347 billion in the period 2007-2013). This policy has two parts: cohesion funding – funds given to countries (the Member States with GDP lower than 90% of the EU average); and structural funding – funds given to regions. Structural funds get most of the funding (approximately 80%), and only the remaining fifth goes to Cohesion Funds.

In addition, the EU Solidarity Fund helps regions affected by natural disasters, and the Instrument for Pre-Accession Assistance (ISPA) helps future Member States. The EU also provides loans (contrarily to grants, these need to be reimbursed afterwards), under the programmes Jaspers, Jasmine, Jeremy and Jessica.

In this thesis, cohesion policy or regional policy will be the terms used to define the policy as a whole. When referring to all the funds, I will use the term “regional funds”, to avoid confusion due to the fact that the terms

“cohesion funding” and “convergence funding” could refer both to all the funds under this policy, and to only some of them.

This thesis will focus mainly on the structural funds and the cohesion funds, since they represent by far the largest share.

Structural Funds and Cohesion Funds are divided among three objectives:

- Convergence: helping regions with GDP per capita below 75% of EU average. This objective includes most of the structural funds, (around 77%) and also the entirety of the cohesion funds. It is financed by the European Regional Development Fund (ERDF);

- Employment: these funds go to all regions not covered by the previous objective, to promote employment (they account for approximately 20% of the structural funds). These are financed by the European Social Fund (ESF);

- Territorial cooperation – funds to promote cross-border cooperation, through projects involving many countries (they account for only approximately 3% of the structural funds). They are financed by the ERDF.

Convergence Funds

For several years, the main beneficiaries of the convergence funds were Spain, Portugal, (southern) Italy, Ireland and Greece. However, since the 2004 and 2007 enlargements, the twelve new Member States became the main recipients of the funds. In the 2007-2013 period the Cohesion Fund concerns Bulgaria, Cyprus, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia and Slovenia. However, several other countries, including some of the wealthiest in Europe, also benefit from structural funds with the convergence objective, because wealth is defined at the regional level. For example, two regions of the UK receive those funds, as well as several regions in East Germany.

Both cohesion funds and structural funds need to be co-funded at national level, that is the government must always pay a certain percentage of each

project, and the EU pays the remainder (the co-financing rates vary according to country and to the type of project). Cohesion Funds can be used only for projects related to transport or to the environment (including renewable energy). On the contrary, the part of Structural Funds which is directed at convergence objectives includes direct aid to companies (in particular SMEs); infrastructures, such as research, telecommunications, environment, energy and transport; and financial instruments (help to improve the financial system in the country, for example so that it is easier to get loans for investments).

The way in which funding is spent must follow Community Strategic Guidelines set at EU level. At national level, each country has a National Strategic Reference Framework that sets priorities for how the funding should be spent. Each region then devises its Operational Programme, which must follow the priorities set by the National Strategic Reference Framework and the Community Strategic Guidelines.

Employment Funds

The European Social Fund (ESF) provides funding to promote employment and social objectives. It has existed since the creation of the EU in 1957. Over the period 2007-2013 the ESF amounted to approximately 75 billion euros. Funding is given to all the regions in the EU that do not benefit from convergence funding. The regions can then allocate that funding to projects run by both public and private organizations.

Those projects can relate to the following fields of action:

- Promoting employment skills;
- Minimizing the job losses due to changes in the economy and restructuring of businesses, as well as ensuring that workers who lose their job can find a new one fast;
- Helping those who have problems finding employment due for example to their background;
- Promoting education and training;
- Ensuring gender equality in the job market;
- Fighting discrimination;
- Supporting public services that deal with unemployment;

Every seven years, each Member State sets up together with the Commission its Operational Programme for spending the ESF funds. Based on that programme, the regional authorities decide how to allocate the funding.

Territorial Funds

These funds are allocated to projects involving regions in different countries. The objective is to promote partnerships between regions in different EU countries, to allow regions in different countries to learn from each other, to promote partnerships between regions, and to fund projects with economic or social objectives that are best done in cooperation. This also forms part of a wider agenda of “territorial cohesion”, or spatial planning, that has gradually been developed by the EU, albeit in an ad-hoc way (Faludi, 2009).This represents at present a very small share of funding (only 3% of ERDF).

Research Policy

Although Chapter 4 will show that research policy is one of the areas where most analysts believe the EU budget could make a useful contribution, it remains a small share, at about 4.9% of the budget, or approximately 6 700 million euros per year.

This entire amount is spent according to a "Framework Programme" negotiated every seven years. The programme is divided into six categories. The biggest, "cooperation", funds research projects involving international research teams, and amounts to EUR 32,413 billion for the period 2007-2013; "People" gives scholarships and fellowships for researchers (EUR 4,750 billion); "Capacities" funds research infrastructures (EUR 4,097 billion); "Ideas" finances frontier research. The other categories are funding for the EU's Joint Research Centre (JRC), a network of seven research centres across the EU, and the Euratom nuclear research programme.

There are ten areas of research being funded:

- Health includes medical research and technologies to deliver health to patients.

- Food, Agriculture, Fisheries and Biotechnology finances research in those four areas; the focuses are promoting a higher quality of life and preserving the environment.

- Information and Communication Technologies (ICT) finances research on IT and wireless communications.

- Nanosciences, Nanotechnologies, Materials and New Production Technologies (NMP) finances both research and the use by industry of new research for new materials and products.

- Energy finances projects relating to renewable sources of energy, a more efficient energy system and reducing greenhouse gas emissions.

- Environment finances research projects with an environmental objective. The main focus is on climate change, but research on other areas is also financed.

- Transport finances research in transport by air, road, rail and water. It focuses on improving the safety, efficiency, and environmental impact of transport.

- Socio-Economic Sciences and the Humanities funds research in those fields of study which relate to EU policymaking.

- Space finances research related to the exploration of space and to space-based applications such as satellites.

- Security funds research that relates to tackling security threats such as terrorism and crime, as well as improving the security of infrastructures.

The funds are allocated via calls for proposals, where companies, non-profit organisations, research centres and local authorities compete for the funding available. There are three types of projects. *Collaborative projects* are projects carried out by a consortium of participants from different Member States. These can be either research projects or projects that transmit research into new products and technologies. *Networks of excellence* create ongoing

cooperation frameworks between participants. *Co-ordination and support actions* are aimed at supporting research activities.

In fact the total amount allocated to research is larger, as other policy areas also include research funding. For example, part of the structural and cohesion funds are allocated to research, and spending on areas such as energy and environment is in part also going to research.

External Policy

The activities of the EU in external relations are of three main types: defence; relations with other countries; development. Spending accounts for approximately 5.4% of the budget, of which half is allocated to development and the other half to defence and relations with third countries. This section will cover only the two latter policies, and development will be analysed separately in the following section.

EU budget spending on defence is extremely small, at just 0.13% of the budget. However, most of the EU's common initiatives on defence are in fact funded outside the EU budget, by agreements between the Member States. These include the European Defence Agency, the Athena mechanism for common financing of defence operations, and national contributions in terms of resources for the EU Rapid Reaction Forces (military forces that deal with peacekeeping tasks).

The European Defence Agency (EDA) was created in 2004. Based in Brussels, its mission is to support the cooperation of Member States in the production and research for defence equipment. Its annual budget is approximately EUR 20 million, and is financed outside the EU budget.

Athena is a mechanism set up in 2004 to finance the common costs of EU military operations. It is managed by a "special committee" made of representatives from the Member States that contribute to Athena. The special committee meets regularly in the Council, and decisions on funding for operations are taken unanimously. Although Athena has an annual budget, this budget is mainly a forecast, as expenditure will be decided throughout the year depending on the evolving circumstances.

The EU Rapid Reaction Forces (ERRF) are military forces of 1550 soldiers that are directly under the control of the EU. These forces deal only with peacekeeping tasks (known as Petersberg tasks, including maintaining peace in zones where a conflict has recently ended and humanitarian missions) and European Security Strategy tasks (including disarmament and support for third countries combating terrorism).

Concerning relations with third countries, there are three main areas of spending: Neighbourhood policy, enlargement and diplomatic relations. The largest share of spending goes to the EU Neighbourhood Policy: the part of foreign policy that is directed at the countries neighbouring the EU. These include Russia, and the North African countries around the Mediterranean. This policy is directed at strengthening the economic and political cooperation between the EU and those countries.

The second largest share goes to so-called "pre-accession assistance", or financial support for countries that are involved in the process of applying to enter the EU. These include Croatia, Turkey and Macedonia. The remainder is spent on diplomatic relations with other countries.

Development Policy

The EU development policy takes up a bit less than half of the EU funding for external policies, at approximately 2% of the budget. It has three main goals: to give funding to developing countries; to promote better policymaking in those countries; to ensure that the other EU actions take into account development objectives.

The current strategy underlying the policy is spelled out in the 2005 European Consensus for Development, a joint statement by the EU institutions and the Member States which sets out the main objectives of EU development policy (European Commission, 2005). The Consensus identifies nine main areas of action: trade and regional integration; environment; infrastructure, communications and transport; water; energy; rural development and food security; governance, democracy, human rights; conflict prevention; human development; social cohesion and employment.

In addition to the EU budget spending on development, there is a European Development Fund (EDF), which falls outside the budget. The EDF amounts to EUR 22 682 million for the 2008-2013 period, and is mainly allocated to the so-called Africa-Caribbean-Pacific (ACP) countries – these are often countries with which some EU Member States have historical ties.

The EDF has existed since the creation of the EU; there have been attempts by the Commission and European Parliament to include it within the EU budget, but these have so far been rejected by the Member States in the Council.

EU action on development has two main strands: development aid and humanitarian aid. Humanitarian aid has a short-term focus and aims to help people in developing countries, in situations where aid is urgently needed. On the contrary, development aid has a long-term focus and aims to contribute towards the long-term development of countries, namely through incentives to improve the economic policies of governments.

Transport and Energy

Transport and energy policies were, until recently, managed together at EU level, and several spending programmes are still common to both. EU energy policy has recently taken a high profile, due both to environmental concerns and to issues of energy security. One of the main actions of the EU is this area is opening to competition the energy markets of the Member States.

Other EU actions in this area include initiatives to reduce greenhouse gas emissions in all EU countries, common diplomatic initiatives to improve energy relations with third countries, and funding from the EU budget. The funding benefits projects that promote the creation and/or uptake of new technologies relating to renewable energy, fighting climate change and energy efficiency. It is channeled via the Framework Programme for research described above. This spending programme therefore meets both research and energy policy objectives.

The EU common transport policy was started at beginning of EU, as transport between countries was seen as part of a single market. However, until some years ago the action of the EU was very limited, as Member States

could not reach agreement on how to collaborate. Over the past few years it has become increasingly active. The main goal is to promote inexpensive transport between the Member States, namely by opening markets and by creating transport links.

Spending accounts for 1.45% of the budget, with EUR 1.8 billion in total. Almost half of that amount is used to finance the "Trans-European Networks" (TENs), projects of international transport and energy considered to be of strategic importance.

The other half of the funding is divided between six areas. "Inland, air and maritime transport" includes programmes for transport safety, the Galileo satellite system and the Marco Polo programme for logistics. "Conventional and renewable energy" is mainly spent on promoting new sources of energy, such as the intelligent energy programme. "Nuclear energy" is mainly spent on decommissioning nuclear plants. The other areas are research related to energy and transport, security of energy and transport users, and administrative expenditure.

Education

Several studies analyse together education and research. However, these are two separate issues, as evidenced by the fact that, at national level, they are dealt with by different ministries. Similarly, at EU level education is dealt with by the DG Education and Culture, while research is handled by DG Research. This study includes under education primary and secondary education, training and life-long learning. Higher education is analysed in the section on research.

The EU has so far had very little intervention in the field of education, as this policy has remained mainly national. EU action has been mainly focused on programmes directed at promoting the mobility of students, the most well-known being the Erasmus programme, which funds exchange programmes for university students. There are also some programmes for life-long learning and learning of languages.

Funding amounts to only 0.75% of the budget. Most of this funding goes to the six programmes for mobility, life-long learning and languages (including

Erasmus and Comenius, which funds cooperation between schools in different countries). A smaller share is used to fund the European centre for the development of vocational training, the European Training Foundation, and a pilot project for the cooperation of technology institutes.

Freedom, Security and Justice

As its name indicates, EU action in this field is divided into three main strands: justice, freedom and security. The heading of freedom concerns the policies related to the free movement of persons within the EU. This includes immigration and asylum, given that as a consequence of the opening of the borders immigrants can also circulate freely within the EU, so the EU Member States' policies in this area have become interdependent. It also includes controls over common external borders. The heading of security includes fight against crime, and cooperation between national police forces. The heading of justice concerns judicial cooperation. This consists of mechanisms whereby national courts can cooperate, for example in cases of cross-border crime.

Total spending amounts to only 0.6% of the budget. The bulk of the spending goes into the "freedom" heading (over 60%), including about 30% of the total for the protection of the external borders, about 25% for the common policy on immigration and asylum (mainly used for the policies regarding refugees and integration of immigrants) and about 8% for the Schengen and Visa information systems (these are systems that allow Member States to exchange information on the persons circulating between EU countries).

A smaller share of about 12% goes into security, including police cooperation and drugs prevention. Less than 10% goes into "justice". Finally, over 5% goes into fundamental rights, to fund European programmes that are intended to promote those rights.

Employment and Social Affairs

Social policies have so far remained mainly national. At EU level, most action has consisted of coordination of national policies, to ensure that there is a level playing field, seen as desirable due to the free circulation of persons

within the EU. However, there is also a limited amount of legislation and funding at EU level.

The largest part of EU spending on social policies is actually channelled through cohesion policy, via the European Social Fund (ESF), which amounts to a relatively high 7.9% of the budget. The ESF was analysed in the section on Cohesion Policy.

The rest of the spending on social policy is much smaller, and amounts to only 0.7% of the budget. It is divided in five parts. "Working in Europe: social dialogue and mobility" is used to fund programmes to support the mobility of workers within EU countries – such as measures for migrants and the coordination of social security systems – and for dialogue between employers and trade unions.

"Employment, social solidarity and gender equality" funds programmes to promote these three goals, namely through the funding tool PROGRESS (Programme for Employment and Social Security). PROGRESS is used mainly as a complement to ESF funding, for example to ensure that countries benefit from each other's best practices in the use of ESF funding. It funds only public or non-profit bodies.

The Globalisation adjustment fund is used in cases where several people become unemployed due to structural changes. It can draw on up to EUR 500 million each year, depending on the circumstances. The other two parts are very limited funding for the pre-accession instrument which relates to employment policies and administrative expenditure.

Health and Consumer Protection

Consumer protection is the "other side of the coin" from economic integration, as a single market means there must be common standards for the protection of consumers. At EU level, health and consumer protection are grouped into one policy area. This makes sense because EU action in health is mainly focused on consumer protection from health hazards, since all other aspects of health policies have remained national. Therefore EU action on health is very different from national policymaking in this area.

A consumer policy is the group of public policies that ensure that consumers are benefiting as much as possible from the single market in goods and services. These policies are necessary due to market failure; if markets functioned perfectly, consumers would automatically get the best deal from the market, because the interaction of offer and demand would lead to optimal prices and quality and consumers would be aware of all the goods in the market which suit them best. In reality, however, due to market imperfections, consumers do not always get the best deal in terms of price or quality, or they are not sufficiently informed to buy the products that suit them best.

This market failure justifies government intervention. One part of that intervention is to ensure that markets are functioning efficiently – this is handled, not by consumer policy, but by competition policy and industrial policy (or, at the EU level, Internal Market policy). The other part of that policy is to have actions directed at the consumers themselves, to enable them to get the most from the market. This can be done through policies to make consumers more informed, to give them more legal protection or to make enforcement and redress easier.

All national governments in the EU have a consumer policy, generally under the responsibility of a Ministry for Consumer Affairs. At the EU level, consumer policy has also existed since the creation of the EU, since as explained above the creation of a common market for goods and services required agreements between the EU Member States regarding the consumer protection policies applicable to those goods.

As the areas of activity of the EU expanded, so did the remit of consumer policy at EU level. In particular, as services (such as financial services like banking and insurance) were increasingly made part of the single market, consumer policy in these areas had to be partially transferred to the EU level as well.

EU spending in health and consumer issues amounts only to 0.4% of the budget, or about EUR 500 million per year. Of that amount, over half goes into programmes for consumer safety ("food safety, animal health, animal welfare and plant health"). This is spending to monitor the standards of safety in food and livestock to ensure they bring no dangers to public health, as food

and animals can be traded and moved freely across borders. Funding also goes to the European Food Safety Agency and to the European Centre for Disease Prevention.

Smaller amounts go into "public health", "consumer policy" and administrative expenditure. EU action in public health concerns mainly a limited number of areas where it is considered that action at EU level could bring added benefits, such as legislative initiatives for patient mobility. In addition, the "Health Programme" (currently 2008-2013) funds a variety of projects that are related to avoiding health risks, promoting health and disseminating information on health.

Culture

The percentage of the EU budget dedicated to cultural policies is very small – only approximately 0.2% of the budget. The visibility of those policies is nonetheless often high, as by their nature they are more appealing to the media.

Funding is divided among four main areas. "Developing cultural cooperation in Europe", consists mainly of a seven-year Culture Programme, which amounts to 400 million for 2007-2013. This programme funds and promotes cultural projects where there is cooperation between artists in different EU countries. "Youth and Sport" is directed at young people, to promote their participation in civil society and their mobility throughout Europe. This is done via the "Youth in Action" funding programme.

"Citizenship" is funded by the "Europe for Citizens" programme. This programme funds projects by civil society and by individuals, generally with a European theme (such as research on European issues).

Finally, the programme MEDIA supports European cinema and television production. It gives subsidies for the production and dissemination of films, and for the organisation of festivals. The current programme, MEDIA 2007, amounts to 755 million EUR for the period 2007-2013.

Environment

The EU has become increasingly active in the policy area of environment in recent years, mainly as this is seen as an area where there are important externalities and therefore action at EU level can be efficient (as will be seen in Chapter 4). EU action in the field of environment focuses on four areas:

- fighting climate change: programmes to reduce greenhouse gases, including research on eco-friendly practices, and running of international commitments such as the Kyoto protocol;
- protecting nature and biodiversity: preservation of natural systems and habitats, including research, exchange of best practices and publicity campaigns
- health and quality of life: ensuring that pollution does not lead to health problems, including urban development coordination, research on air pollution and awareness raising;
- waste recycling: coordination and best practices.

The priorities of the EU in the area of environment are defined in the 6th Environmental Action Plan 2006-2012.

The section of the budget dedicated to the environment appears at first sight to be very small, with only 0.2% of the budget. However, most of EU funding of environment policies is in fact channelled through the cohesion funds, the research programmes on environmental issues, and programmes for renewable energy. Therefore, in total, it can be considered that the EU spends approximately 5.5% of the budget on environmental policy.

Most of the budget section on environment goes to the LIFE+ instrument (64%). Funding also goes to the European Environmental Agency (8%). The remainder is used on administrative expenditure to support the policy.

LIFE+ is a fund used to promote the environmental objectives of the EU. A small part of the funding is used to cover the operational expenditure of the European Commission's policymaking on the environment, but the greatest part is used to co-finance projects by companies, NGOs and local authorities. Those projects are allocated using "calls for proposals", the aim being that

funding should be allocated to the projects which contribute the most to the EU objectives in this field.

For the period 2007-2013, funding amounts to EUR 2,143 billion. The Commission launches one call per year, and proposals can be submitted either by single organisations or by partnerships of several organisations. Projects can be either national or transnational, provide they take place within the territory of the EU.

Enterprise and Industry

This policy area is focused on a country's industry. It includes promoting the productivity of firms, and helping certain sectors and small businesses. At EU level, this policy includes both support for SMEs, and ensuring that the internal market is working well for specific sectors. Funding amounts to 0.4% of the budget.

The funding for this policy area is divided in four parts: "Competitiveness, industrial policy, innovation and entrepreneurship"; "Internal market"; "Space and security"; "Administrative expenditure".

"Competitiveness, industrial policy, innovation and entrepreneurship" takes up approximately one third of the funding. Most of the funding under this heading is channeled through the Competitiveness and Innovation Framework Programme (CIP). The CIP provides funding to promote the competitiveness of European firms, especially Small and Medium-sized Enterprises (SMEs). The 2007-2013 programme has a total of EUR 3,621 billion.

The CIP is divided into three programmes. The Entrepreneurship and Innovation Programme (EIP) has five main goals: to help access to finance by companies, particularly SMEs, though loans and loan guarantees; to provide support services for businesses in each EU region; to promote innovation by businesses; to make businesses more environmentally friendly; to support public policies that help businesses.

The ICT Policy Support Programme aims to promote the development and wide adoption of ICT in Europe. The Intelligent Energy Europe programme

funds projects to promote the efficient use of energy and the wider use of renewable sources of energy.

The heading "Internal market" (approximately 13%) has funding for the policies needed to support the internal market, such as the harmonization of health and safety rules on products so that they can be traded across borders. In addition, part of the funding goes to the European Medicines Agency.

"Space and security" uses approximately a third of the funding, and aims to promote the competitiveness of the European space industry.

Communication

The European Commission dedicates one of its departments (known as Directorates-General or DG's) to communication between the EU and its citizens. Its objectives are to inform people about the EU, to sound out public opinion of the EU, and to make the EU more democratic by involving citizens. In addition, although this is not explicitly stated by the Commission, it can be argued that this policy is also used as a means to make the EU more popular.

EU communication policy was given greater relevance by the Commission following the rejection of the Constitutional Treaty by French and Dutch referenda in 2005, as the Commission considers that communication issues are at least partly to blame for the "no" votes. In 2005, the European Commission launched a so-called "Plan D" (where "D" stands for democracy, dialogue and debate) to improve communication with citizens (European Commission, 2005).

The amount of funding dedicated to these activities is very small, corresponding to only 0.07% of the budget. Of that amount approximately half is administrative expenditure of DG Communication, while the rest is allocated to activities based on the media, tools to survey public opinion, and financing of projects that promote a better understanding of the EU. Those projects are mainly restricted to one Member State and allocated via calls for proposals issued by the representations of the European Commission in the national capitals.

2. 2. Procedure: How it is negotiated

While this thesis focuses on the expenditure of the EU budget, another aspect of the study of the budget are the political procedures underpinning it. This section provides an overview.

Negotiation of the budget

Overview

The EU budget is negotiated among the Member States according to a procedure defined in the EU Treaty (Articles 312-316). Its main feature is that the most important decisions on the budget are not negotiated every year, but instead every seven years. This allows for continuity in the way in which the funds are spent, and also avoids having to enter difficult negotiations every year.

Every seven years the Member States agree on a framework of spending called the “Multiannual Financial Framework” (MFF). The MFF determines the maximum amounts that can be spent under each of the six budget headings. This solves the main source of friction between the countries, as it more or less determines how much each country will get back from the budget. Then, each year, the EU institutions and the Member States negotiate how the funds will be allocated under each of the six headings, that is, which programmes will benefit more than others from funding in that year. In addition, as the amount fixed for each heading is only a maximum ceiling, these annual negotiations will also determine how much is actually spent each year.

There have been four MFFs so far. The first was the 1988-1992 package, known as the "Delors I" package. The second was the 1993-1999 package, known as "Delors II". The third was the 2000-2006 package, known as "Agenda 2000". The current package covers the 2007-2013 period.

Negotiating the MFF

It was only in the 1980s that the system of agreeing on a budgetary package (previously called “Financial Perspectives”) every seven years was started, as the EU Treaty originally only foresaw annual negotiations. Therefore the MFFs are not a standard legal EU text, but rather an "interinstitutional agreement" between the three EU institutions – the Commission, the Council and the Parliament. However, this agreement is legally binding.

The negotiation process for each MFF starts with a proposal from the European Commission. This proposal is then negotiated and amended by the European Parliament and the Council. The MFF must be approved by majority in the European Parliament, but in the Council it needs to be approved by unanimity.

This procedure is usually started approximately three years before the start of a new MFF, as it is necessary to know well in advance what the funding will be for the next period, so that the Commission services know how to continue their spending programmes. However, the negotiations between the Member States in the Council are so difficult that they often last for over a year, and an agreement is generally only found at the last moment.

For example, the agreement on the MFF for 2007-2013 was only found late at night on the last day of the European Council meeting of December 2005. This was the last opportunity to not jeopardize the distribution of cohesion funds under the new MFF, as if an agreement had been reached later there would not have been sufficient time to organise the distribution of the funding on time.

Negotiating the annual budget

The yearly negotiation procedure (Articles 313-316 of the EU Treaty) starts in the Summer and ends in December of the year preceding the budget year in question. The procedure is described in detail in the box below.

Box 1: Yearly Negotiation Procedures

By 1 July: Each EU institution (except the European Central Bank) draws up estimates of its expenditure for the following financial year. The Commission then consolidates these estimates in a draft budget, which may contain different estimates.

By 1 September: The Commission submits a proposal containing the draft budget to the European Parliament and to the Council

By 1 October: The Council adopts its position on the draft budget and forwards it to the European Parliament, together with a full explanation of the reasons which led it to adopt its position.

By mid-November: If the Parliament accepts the Council position, the budget is adopted. If not, a Conciliation Committee is convened. The Committee is made of representatives from both institutions, and its task is to reach an agreement.

By late November/early December: If the Committee reaches an agreement, and both institutions accept it, the budget is adopted. If the Committee does not reach an agreement within twenty one days from its establishment, or if one or both institutions reject the Committee agreement, the budget is not adopted and the Commission must submit a new draft proposal.

Flexibility in the MFF

Although there are advantages in setting the main lines of the EU budget every seven years, the disadvantage is that this reduces the flexibility of the EU budget, and its ability to adapt to changing circumstances. To counter this problem, there are several rules that have been designed to allow for modifications in the MFF on an annual basis.

Firstly, each year the MFFs are "technically adjusted" by the Commission to account for inflation and changes in Gross National Income (GNI). This is necessary because the ceiling of maximum expenditure is expressed as a percentage of GNI. There can also be changes to the MFF if a new member

State enters the EU or if there are delays relating to the programmes for structural funds.

In addition, the European Commission can propose to the Council and Parliament changes in the MFF to reflect unforeseen circumstances (Article 272 of the EU Treaty). These changes must be approved by the Parliament with majority voting and by the Council either by majority or by unanimous voting, depending on the amount of the change proposed. This is intended to increase the flexibility of the EU budget, making it possible to adapt it to new circumstances.

There are also EU Treaty rules that make it possible to transfer funds between headings, under strict conditions. Finally, a "flexibility instrument" was established in the Interinstitutional Agreement for the 2000-2006 MFF. The flexibility instrument permits the budgetisation of 200 million EUR cumulatively over three years for matters that could not otherwise be financed in each budget year.

Implementation and Auditing

Once the budget has been approved, it must be spent (or "implemented") according to the Annual Budget agreement, and also according to principles of sound financial management defined in the Treaty. The Commission is legally responsible for ensuring that this is the case.

However, most of the budget is actually spent at the national level, as the funds are distributed by the Commission to the Member States, and the national administrations are then responsible for allocating the funds to programmes – this is the case for the two main sections of the budget, agriculture and regional policy. The Commission must therefore ensure that the national authorities spend the funds according to the rules. It does that through requirements for the Member States on the accounting and reporting of how the funds are spent. This is known as "shared implementation".

For the areas where funding is spent directly by the Commission under "centralised management", the Commission DGs follow a procedure aimed at ensuring that all funding is properly spent. The Commission also makes use of "executive agencies" to which it delegates some of its tasks. When money

is spent by those agencies it is called "centralised indirect management". The two other forms of implementation of the budget are "decentralised" (where money is spent by non-EU countries) and "jointly" with international organisations.

One of the EU institutions is dedicated solely to ensuring that the EU budget is spent both according to the law and cost-efficiently: the Court of Auditors. It was created in 1975 and is based in Luxembourg.

The political economy of the EU budget negotiations

There has been a general consensus for many years that the EU budget is not being spent efficiently – yet it has proved to be extremely difficult to reform. The reason is that the negotiations about the EU budget are a textbook case of political failure (Ackrill and Kay, 2007). What follows is a brief introduction to the political economy literature on the political failure surrounding the EU budget. This overview will be very succinct, as political economy is not the main focus of the thesis.

There is a vast literature that analyses this case of political failure, using the different models of the field. A great part of that literature focuses only on the CAP, but as the CAP is the main spending area of the EU budget, and the main source of tensions in the budget negotiations, it is argued that there is not much difference between analysing the political economy of the CAP or of the budget as a whole. This section therefore reviews the literature applying political economy to the negotiations both on the EU budget as a whole and on the CAP only.

The literature on the political economy of the CAP can be divided into two main theoretical frameworks: the institutions framework and the interest groups framework (Kay, 2000). These two frameworks differ in their degree of emphasis on the ability of interest groups to affect decisions to reform the CAP.

The interest groups framework is based on the assumption that interest groups and lobbies have a great influence in the negotiation process, through their influence on the Member States' government representatives and/or on the European Commission (Egdell and Thomson (1999), Moyer and Josling

(1990)). Brooks (1996) argues that the ability of interest groups to exert influence is in great part due to the general ignorance of consumers/voters of the effects and costs of agricultural policy.

Several authors have also looked into the incentive for farmers to engage in political rent-seeking. Krueger (1990) argues that the difficulties that farmers face in engaging in economic rent-seeking (due to the market failures that will be detailed in chapter IV) lead them to engage in political rent-seeking instead. Nello (1984) shows that lobbying brings more benefits than costs to farmers, because their preferences are similar and they form a large group. Nedergaard (2006) points to the existence of an "elite group" of large farmers that have the means of investing in political lobbying.

It should be noted that the Member States' positions on the CAP may also be in the general interest of the countries (for example, the new Member States pushing for a gradual transfer of funding from agriculture to cohesion, as the design of the CAP is not particularly advantageous to their farming sectors) – however, in that case, this is not a political failure, and is instead the natural result of intergovernmental negotiations, which several authors argue is backed by indirect legitimacy (Moravcsic, 2003).

On the other hand, the institutions framework defends that the main factor influencing negotiations on the CAP is the institutional setting and the procedures involved in the negotiation (Mahé and Toe (1996), Kay (1998)). The relative influence of the different EU institutions – particularly the Council, representing the Member States, and the European Commission – and the formal and informal procedures involved become the main factors influencing the outcome of the negotiations. Ackrill and Kay (2006) explore how the changes in the EU budgetary institutions over time have influenced the EU budget negotiations.

Petit et al (1987) highlight the role of the Council of Agricultural Ministers (CoAM) in determining CAP developments, including the pressures exerted at national and at EU level on the agricultural ministers. Kauppi and Widgrén (2007) also show that the bulk of EU budget spending can be attributed to measures of the distribution of voting power in the Council of Ministers, by comparing budget receipts before and after eastern enlargement. Daugbjerg and Swinbank (2007) find that blame-avoidance is an important factor when

analysing the procedures behind CAP negotiations, as ministers and heads of state seek to avoid being blamed for any unpopular decisions.

Ackrill and Kay (2007) look at how the political failures involved in the EU budget negotiations have led to the fact that the Member States have not increased the budget for social and cohesion policies, despite a political willingness to increase EU integration in those areas. They use a number of theoretical concepts from the political economy field to theorize the political failure: the fact that the procedures for negotiating the EU budget are a "zero-sum game", meaning that countries see that one country's gains are another country's losses; the fact that the spending on agriculture is "downwardly sticky", meaning that it is difficult to reduce that spending; the fact that the current procedure leads each member State to attempt to maintain its current situation, therefore enforcing the status-quo.

2. 3. Resources: How it is financed

This section will describe the current system of financing of the EU budget and offer an overview of the main criticisms and proposals for reform. As the focus of this study is the expenditure, and not the financing, of the EU budget, the description of the revenue side will be brief.

Description of the current system

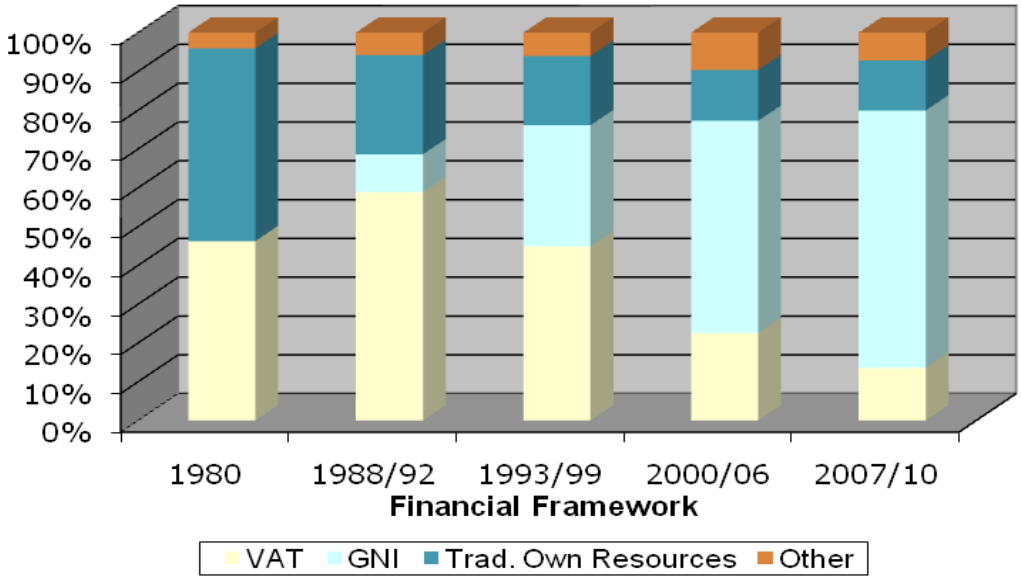
The EU budget is financed by three main sources:

- Traditional own resources: funding from customs duties (the taxes imposed on goods imported from outside the EU). This is known as "own resources" because it is a revenue earned by a common EU policy, and not paid to the EU by the Member States;
- GNI source: each country pays a percentage of its Gross National Income into the EU budget;
- VAT source: each Member State pays some of its revenue from value added taxes into the EU budget. The amount that each Member State is due to pay is determined according to a hypothetical calculation based on a common VAT system.

Although the entire financing system is often still called "own resources", the "own resources" nowadays only accounts for 12% of the financing of the budget.

That is because customs duties have long been insufficient to pay for the budget, and in 1977 the VAT source was introduced. In 1988, it was partly replaced by the GNI source, considered to be a more fair reflection of countries' wealth. That last source has now become the main origin of revenue, and finances 69% of the budget.

Figure 2: Evolution of revenues to the EU budget



Source: INEA elaborations on European Commission data, 2010

Criticisms and suggestions for reform

The main criticism of the budget's financing system is that the main sources of revenue come directly from the Member States and are not "own resources". Therefore countries are able to calculate their exact contribution to the budget and expect to benefit from it proportionately. This is sometimes known as the problem of "juste retour", as countries want their "fair share" out of the budget. As pointed out by Nunez Ferrer (2007), "one fundamental principle of good governance for public budgets is that the revenue and expenditure should be separated as much as possible to ensure that allocation is based on policy priorities."

For that reason, there have been suggestions of an "EU tax" to finance the budget. In a recent study, Begg et al. (2008) suggest that in the near future up to 50% of the budget should come from new "own" resources. They suggest

to create an EU tax related to environmental policies such as a charge on flights or other carbon taxes. In the long run, they defend that the entire budget should be financed out of a corporate income tax or out of central bank income.

However, this would not necessarily solve the problem, as countries could still calculate how much their citizens are paying in total, and consider that as their national contribution to the EU budget. Moreover, it is doubtful that national governments would ever accept any type of EU tax.

Another solution proposed in the literature is a "generalised correction mechanism" or a system whereby countries are compensated for their net contribution to the EU budget. This could allow the separation of decisions on the financing of policies from countries' concerns about how much they pay into the budget.

For example, Heinneman, Mohl and Osterloh (2008) suggest a "generalised but limited correction mechanism", based on a separation between the policies that are intended to have redistributive effects (such as the cohesion policy) from those that have allocative effects (such as policies for research or for external relations). They suggest that countries should receive compensation for the latter but not for the former.

2. 4. Historical evolution

To understand why the EU budget is being spent in this way, and how it can be reformed, it is necessary to understand its historical evolution. This section therefore gives a short overview of how the budget evolved from the start of the EU to today.

Overview

The EU budget grew together with the EU, going from a small sum to finance the day-to-day running of the Union to a complex source of finance that covers almost all areas of policymaking. This growth was not guided – spending programmes were added whenever there was a need to finance a new policy or a new political priority. For example, when a common agricultural policy was created, or when due to enlargements poorer countries entered the EU and a decision was made to help them to catch-up. For many years, there was never a reflection on what should be the purpose of the budget and of what policy areas had a case to be funded at the EU level.

It was only in the late seventies that a debate started on the EU budget – due to the fact that spending on agriculture was going out of control, and many countries felt that they were not benefiting from it. But instead of reforming the budget, Member States simply seeked to make it less politically unacceptable, namely by offering a rebate to the country that was most dissatisfied with the budget: the UK. It was only a few years ago that a real debate on the budget started, this time linked with the issue of what should be the functions of the EU.

Evolution of expenditure and revenue

The first annual budget of the EU (then called European Economic Community), adopted in 1958, only covered administrative expenditure. Over the following years, small budget lines were added to finance new internal policies and programmes, such as the European Social Fund. In 1962, the first agricultural fund was created. This fund grew exponentially throughout the 1960s and agriculture soon became the main item of the budget.

During these first years, the budget was financed by contributions from the Member States. From 1968, this was replaced by the system of "own resources", whereby the budget was financed by customs duties from the EU's common external tariff and agricultural levies from the Common Agricultural Policy.

Towards the end of the sixties, other policies were gradually added to the expenditure of the budget. Structural funding was the next bloc added, then external action. Afterwards the Euratom, or the common research on nuclear energy, was incorporated into the EU budget. The research framework programme and the common fisheries policy were also added to the budget.

During the seventies, as the EU budget grew significantly due mainly to the support for agriculture, tensions began to rise between the Member States. In particular, the UK government became increasingly dissatisfied, as it was one of the main contributors to the EU budget while not benefiting much from the CAP. The UK also argued that its contribution to the EU budget was not in line with its relative wealth. For that reason, in 1984 the "UK rebate" was agreed, allowing the UK to pay less into the EU budget. Between 1980 and 1983, the UK received ad-hoc payments. In 1984, a formula for the rebate was agreed at the Fontainebleau Summit.

As another step to address the tensions between the Member States, from 1988 the negotiations on the budget started to take place, not annually, but as part of a multi-annual framework. The first covered the 1988-1992 period. Attempts were made to reduce spending on agriculture, but with very limited success; at the same time, spending on cohesion policy was increased, partly due to the entry of Spain and Portugal in 1986.

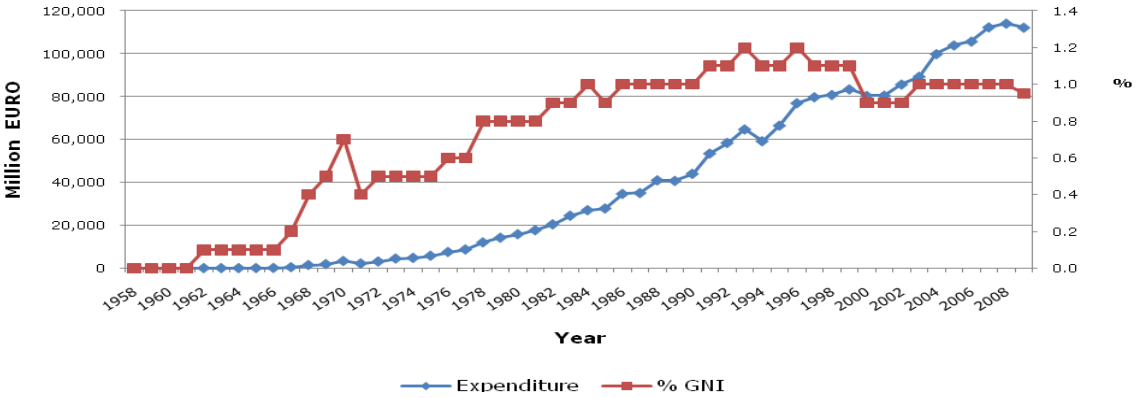
Due to the rise in spending, "own resources" were no longer sufficient to pay for the entire budget, and therefore resources based on VAT and a percentage of GNI were added, respectively in the late seventies and eighties.

In 1992, the adoption of the Maastricht Treaty increased the number of policy areas at EU level, leading to new areas in the 1993-1999 MFF, including justice and home affairs and common foreign and security policy. Also at that time, Member States were able to agree on a reform of the CAP which stopped the perpetual rising of CAP spending.

The entry of ten new Member States in 2004 did not lead to a great increase in spending on cohesion policy, as the "old Member States" started receiving less, and the policy was refocused as to avoid any increase in the total EU budget.

The current Financial Perspective started in 2007 and will run until 2013. Although the Commission attempts to present the budget as being targeted towards economic growth, in fact there were no major changes compared to the previous MFF, and agriculture still accounts for over 40% of the budget, as outlined in Chapter 1.

Figure 3: Evolution of EU budget: expenditure and share of GNI (1958-2009)



Source: INEA elaborations on EU data (European Commission, 2010)

Latest developments

With less than two years to go before the 2007-2013 budgetary package expires, EU Member States are now gearing themselves up for the usual thorny negotiations on "who gets what" from the EU budget. In June of 2011, the European Commission issued its proposal for the seven-year budgetary

package, which is now being debated by the Member States and the European Parliament.

The Commission proposal was, immediately criticised by the Member States. As the Budget Commissioner Janus Levandowsky was just beginning his presentation of the proposals, at a press conference in Brussels in the evening of 29 June 2011, the UK government was already issuing a statement saying that the proposals were "unrealistic". Several other countries soon followed.

The proposals sparked anger above all because they advocate a 5% increase in the budget. This increase is meant to be in line with inflation, but caused outrage in some countries because, in the current austerity climate, national budgets are being cut – so many would expect the same to happen with the EU budget. However, given the relatively small size of the EU budget, it could be argued that this is of little importance.

More important is the overall direction that the EU budget is taking. Despite a growing consensus that the EU budget needs to be significantly reformed, the Commission has proposed a budget that retains essentially the same structure. There had been hopes that a reform of the budget would have been possible, particularly as a result of the "mid-term review" of the budget, which the Commission undertook between 2007 and 2010. At the time when the review process was launched in Autumn 2007, the political climate appeared to be more favourable than under any of the previous attempts at reform. However, this was changed by the subsequent global economic crisis, which resulted in a shift in the priorities of the EU, making EU budget reform less of a priority.

Nonetheless, there has been a very small decline in the budget for agriculture, and a very small rise in the budgets for research and environment. These were small steps in the right direction, but, as willbe seen in the following chapters, the EU budget remains in need of a significant reform.

Developments regarding the competences of the EU

Although this thesis focuses only on the spending functions of the EU, this cannot be done without addressing the wider question of what should be the

competences of the EU in each policy area. For that reason, this section offers a brief overview of the latest developments in that area.

The issue of defining which are the competences, or functions, of the EU (also known as subsidiarity) has gained prominence in the past years, not only in the literature on EU studies, but also in the political debates on the future of the EU. The fact that the EU does not have a clear mandate from its Member States, and that there is no agreement on what that mandate should be, is often seen as one of the reasons for its lack of accountability, its "democratic deficit", and ultimately its growing unpopularity.

For those reasons, the Convention on the Future of Europe, which was set up in 2003 to draft the Constitutional Treaty, had initially intended to propose a listing of the functions of the EU. However, no agreement was ever reached on this point, and the draft which was later rejected by the referenda did not contain such a listing.

Following the rejection of the EU Constitutional Treaty by the French and Dutch voters, the European Union was widely seen as entering an "identity crisis", where it needs to redefine its purpose.

This crisis of confidence had already started with the Maastricht Treaty, which for the first time explicitly said that the EU was no longer just about economic objectives, but also had other, political, objectives (Majone, 2012). Already at the time, a "no" vote in a referendum (the Danish referendum on the Maastricht Treaty of June 1992) had made the crisis more visible. In the nineties the referendum crisis was solved and the Treaty entered into force – but the issues at the root of the dissatisfaction were never dealt with, and have now led to a new crisis.

German Prime Minister Angela Merkel summarized the main problem in a speech on 11 May 2005. Merkel called for a re-think of the functions of the EU, saying that it was no longer sufficient to justify the EU as the best way to avoid more wars among European countries, now that so much time has passed since the Second World War. She said: "I believe a new rationale is more necessary than ever. We must, and I am deeply convinced of this, critically review the state of the European project."[5]

[5] Available in the website of the German federal government: www.bundesregierung.de

The draft constitutional Treaty, which later became the Lisbon Treaty, had intended to address this problem. It included a division of policies between "exclusive, shared and supporting". However, the Lisbon Treaty simply lists all the policy areas in which the EU is involved at the moment, and gives them one of the three labels according to how extensive the EU powers in that area are at the moment. Therefore, this was not a definition of the competences of the EU, but more a description of the current activities of the EU. Therefore, there remains a necessity to define the functions of the EU.

2.5 Literature on the EU budget

The literature on the EU budget follows the division in three aspects of the EU budget introduced above: studies focus either on the expenditure of the budget, on its financing, or on its political economy and negotiations. This section covers only the literature on the expenditure of the EU budget; the literature on the other aspects of the budget was covered more succinctly in the relevant sections.

The literature on the expenditure of the EU budget includes both studies on how EU money should be spent (what concerns us here), and studies that analyse how it is currently spent. The latter generally focus on how much each country gets back from the EU budget. For example, de la Fuente and Domenech (2000) analyse the redistributive effects of the EU budget strictly in terms of EU budget flows in and out of the countries.

As mentioned in the introduction to this thesis, despite the abundance of policy reports on the expenditure of the EU budget, academic work on the subject is rare (Ackrill and Kay, 2006). Most of the literature on how the EU budget should be spent consists, not of refereed publications, but of working papers and policy analyses. These are generally based on fiscal federalism. In addition, there are studies based on the concept of subsidiarity, which is generally analysed from an economic, rather than legal, perspective.

Although the past years have seen a large number of refereed articles on the EU budget, all those articles have focused on the negotiations and procedures behind the EU budget, and not on its expenditure. Therefore they have been covered in the section on political economy, and will not be covered here.

All the studies referred to in this section adopt a critical approach towards the EU budget, and conclude that the structure of its expenditure should be modified. The main insights from this body of literature are as follows (they will be analysed in more depth in chapters 3 and 4). The EU budget should be used to provide public goods[6] with large economies of scale: for example,

6 A public good is a good that is not produced efficiently by the market because it is non-rival (its consumption by one person does not diminish the quantity available for others to consume) and/or non-excludable (it is difficult or even impossible to keep people from consuming the good).

defence policy, internal security (including protection against organized crime or border patrols) and aid to developing countries. It should also be used to fund policies with positive externalities: for example, research and big transport infrastructure. On the contrary, it should not be used to fund policies with big heterogeneity problems: for example, it should not be used to fund the EU countries' welfare policies. Scholars also criticise the fact that the EU budget is often used to reach political deals, rather than spent where it would bring most value added (Begg, 1999).

The first comprehensive application of fiscal federalism to the EU budget was the study known as the McDougall Report (Mc-Dougall, D., 1977). This report was written for the European Commission in 1977, by a group of independent experts. The goal of the study was to assess what should be the role of public spending for the EU – or in other words, how the EU budget should be spent. The authors drew on the insights of fiscal federalism, as well as on a comparison with public finances in five federations and three unitary countries.

In the years that followed, as the EU budget increasingly became a source of criticism, more studies were published on how the EU budget is spent and how it could/should be reformed. Influential authors include Jorge Nunez-Ferrer (2007, 2008), Ian Begg (1999), Brigid Laffan (1997). Buti and Nava (2003) suggested a model to assess whether public goods should be provided at EU or at national level, which is based on the insights of fiscal federalism.

The European Commission also commissioned a report on how the EU budget should be spent in light of the monetary union, at the time when the European Monetary Union (EMU) was created in 1993 (Goodhart et al., 1993). The report found that the EU budget should not be used as a tool for stabilization, but that instead mechanisms should be put in place to deal with country-specific shocks. It also found that, as a rule, most spending programmes should remain national, and that they should only be brought to the EU level when there were clear advantages in doing so.

Arguably the most influential study on the EU budget was the Sapir Report. This report was commissioned by the European Commission to a group of independent academics in 2003. The objective of the report was to assess the European Union's economic policies as a whole, and to make

recommendations on how they could be made more efficient in terms of delivering economic growth. However, although the EU budget was not the main focus of the report, the recommendations made regarding the budget received great attention, and were very influential in the policy field.

The report proposed to divide the budget into three funds – one directed at promoting economic growth, the second at promoting cohesion between the economies of the Member States and the third at financing help towards those affected by the restructuring of the economy. It differs from the conclusion reached in this thesis, which argues that the EU budget should be seen mainly as support for the EU's legislative activities rather than having its own goals.

A very recent study adopts for the first time a multidisciplinary approach (Molle at al, 2008). The Molle report also uses various academic lenses to analyse the EU budget, but its approach differs from this thesis in that it focuses more on the current political reality and political failures. That study was produced after a chapter of this thesis was issued as a working paper, and it includes that working paper in its references. It is clear from the similarity between the two approaches that the report drew considerable inspiration from this thesis' working paper.

Concerning the methodology hat has so far been used in the literature, initially studies used only fiscal federalism (for example, as referred above, Mc Dougall, 1977). In recent years, studies began to also take into account the subsidiarity principle (for example, Begg, 2009). However, prior to this thesis, studies had not yet adopted a multidisciplinary approach – this thesis attempts to fill that gap.

3. Methodology

This chapter proposes a multidisciplinary approach for the analysis of the EU budget. This approach takes as its starting point fiscal federalism - the economic theory that assesses which functions of government are best performed at which level of governance – and adds to it insights from other fields of study.

The chapter begins by examining why fiscal federalism is not sufficient by itself to analyse how the EU budget should be spent. Then, the methodology is proposed. It combines fiscal federalism with three other academic fields: public economics, political science and EU law. Finally, a set of criteria associated with each step of the methodology is proposed; those criteria clarify how it can be assessed if a certain spending programme passes the different steps.

3.1. Why fiscal federalism is not sufficient

The theories of fiscal federalism were designed to be applied to the US, which is a single country - as opposed to the EU, which is a union between sovereign countries. Although the main reasoning behind fiscal federalism applies equally to both cases, as in both we are choosing how to allocate policies between different levels of government, there are several elements of the theory that should be adapted to the EU, so that it can give better predictions. Although various scholars have pointed to this problem (Oates 2002, Ackrill 2003, Alesina 2001), they all stopped short of suggesting an alternative.

Oates (2002) comments that *"much of the literature, especially the part addressing the assignment of functions, has been developed in the context of the modern nation-state. (...) As such, it doesn't seem to fit very well the cases of emerging «confederations» such as the European Union"*. Ackrill (2003) also argues that *"in the context of the European Union, this [fiscal federalism's] traditional paradigm is not only inadequate but confused, leading to a lack of clarity in the debate."*

Ackrill (2003) adds that, when fiscal federalism is applied to a single country, the "central" level of government is the higher level of government. On the contrary, in the EU, the national governments are more powerful than the EU level, and the highest level of government does not coincide with the "broadest" in fiscal terms. Therefore, "*the traditional fiscal federalism paradigm, developed in the context of a single country, can lead to erroneous policy prescriptions if applied without qualification to the European Union*".

The EU budget is very small in comparison to the national budgets – whilst in a federation generally the opposite takes place, as the central government has the largest budget. This can lead to wrong prescriptions: for example, fiscal federalism generally says that the function of stabilisation should be assigned to the central level of government, as it normally has the largest budget – but in the case of the EU that is not the case.

This thesis identifies two other main problems of applying the theories of fiscal federalism to the EU. The first concerns legitimacy. Within a single country or federation, choosing at which level a function of government is performed can depend only on considerations of efficiency; on the contrary, in a political union, the decision to allocate a policy at the EU level means that the country is relinquishing its sole sovereignty over that policy, and that from now on any decisions on that field will have to be made together with the other Member States. Therefore, the issue of whether it is seen as legitimate by people to transfer the policy to the EU level becomes essential.

A second problem is that fiscal federalism typically ignores the fact that most policies are not allocated to a single layer of government but are shared between different levels. This assumes even more importance in the case of the EU, as there is a very large divergence in the extent of EU powers on the different policies. In some fields, such as competition policy, monetary policy or agriculture, the EU has very extensive powers, whilst on others, such as education or social policy, the involvement of the EU is very limited. It is important to keep this differentiation in mind, as it is very different to make a recommendation that the EU should be active on a certain field with exclusive competences or with limited competences.

3.2. A multidisciplinary analysis of the EU budget

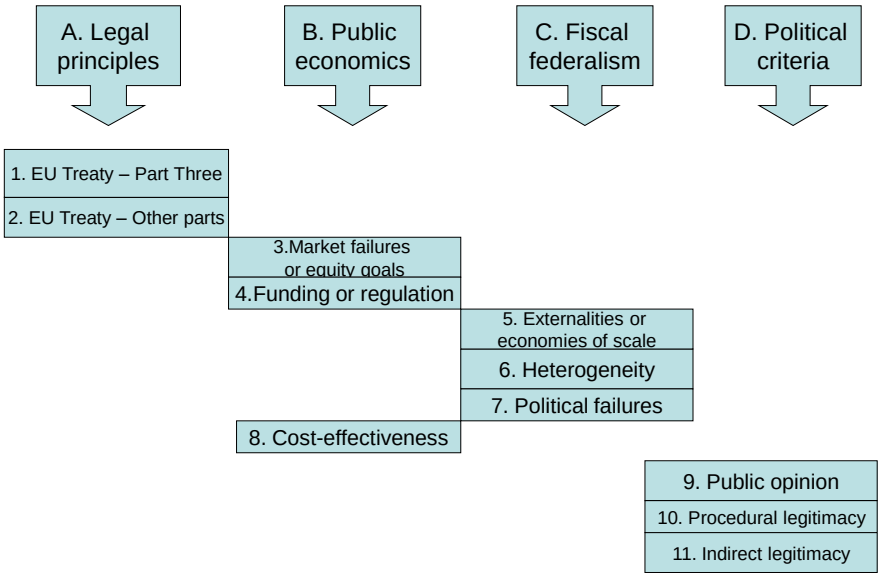
The methodology proposed combines the insights of economics of the public sector, fiscal federalism, political criteria and EU law to analyze the EU budget. From each of these academic fields, this thesis derives a number of insights on how the EU budget should be spent. Those insights are translated into conditions – a policy should be funded by the budget if it passes those conditions.

This methodology is purely multidisciplinary, as each academic field is used together with its own methods and assumptions (as opposed to an interdisciplinary methodology, which would involve combining and mixing methodologies from different academic lenses). However, the insights from the different disciplines are combined into a series of steps, which make it possible to obtain conclusions for each spending programme. In addition, each step will be associated with more narrowly defined criteria, which will make it possible to assess whether each step has been met, based on specific sources of data.

These conditions aim to be *necessary and sufficient* for a funding policy to be allocated to the EU level. They are necessary, in that they all need to be fulfilled to justify EU-level spending. If any of them is not met, the EU spending programme should not exist. They are sufficient, in that, if all the conditions are met, the EU spending programme should be in place.

The following scheme shows the eleven questions that should be asked to assess whether there is a case for a certain policy area or spending programme to be funded by the EU budget.

Figure 1: Methodology



The criteria associated with each step will be described at the end of this chapter. Before that, I will now present the analysis based on each of the academic fields of study.

3.2.1. EU Law

The European Union is based on a legal agreement between its Member States, so, when deciding which activities should be performed at EU or at national level, it is important to take EU law into account. The methodology begins with this field of study because EU law provides us with the objectives foreseen for each policy field at EU level, since those are enshrined in the EU Treaty. That facilitates the analysis with the other fields of study, as it is easier to analyse the policy once its objectives have been made clear.

This section will first provide an overview of EU law, and how it will be used by this thesis. It will then review the literature from EU law on the EU competences. Finally, it will suggest two steps that can be extracted for the analysis.

It is useful to mention from the outset that the legal principle of subsidiarity will be part of this analysis, but will not be its main factor. This principle has attracted much attention and, as explained in the previous chapter, has often been used by analysts to assess which should be the role of the EU and its budget, in combination with fiscal federalism. However, the detailed legal analysis that follows will show that this principle does not add much to the insights already provided by fiscal federalism, while other elements of the EU Treaty provide more useful insights.

3.2.1.1 EU Law: The starting point for the methodology

The European Union was created by the means of a legal agreement between its Member States. Even though the "European Economic Community" (EEC) created in 1957 has evolved significantly into the much more integrated European Union of today, the EU Treaties still form the legal basis for the Union and all its activities. Therefore, to assess which spending programmes should be at EU level, it is important to analyse the insights from EU law on that issue.

EU law is the first step of the analysis because it provides us with insights on the objectives of the EU in each policy area, and the analysis using the other fields of study will need to rely on those insights.

EU law comes from three sources: primary law, secondary law and supplementary law. Primary law consists of the Treaties of the European Union. Secondary sources are legislation produced by the European Union, such as Regulations and Directives. Supplementary sources are unwritten sources, including case law of the European Union's Court of Justice, international law and the general principles of law.

The Treaties that form primary EU law include the founding Treaties that established the EEC, signed in 1957, as well as all the Treaties adopted afterwards to amend the founding Treaties establishing the European Union, the Protocols annexed to those Treaties and the Treaties of accession of new Member States to the EU. To simplify, this thesis will simply refer to the EU Treaty – by this I understand all the Treaties and Protocols that are in place.

Secondary sources of EU law have either a direct effect on the law of Member States (for example, Regulations become part of the national law directly) or an indirect effect (for example, Directives can be transposed into the national law in different ways). Supplementary sources were only intended to complete the first two sources whenever they were not by themselves sufficient to settle an issue in court, but, as will be seen below, they have acquired greater importance than that (Weiler, 1999).

EU law is applied by the courts of the Member States, but the European Court of Justice (ECJ), based in Luxembourg, is the highest court able to interpret it. Legislative power in the EU is shared between the institutions, and depends on the legislative system that applies in each policy area. The European Commission can propose legislation, and the European Parliament and the Council make decisions on whether to accept that legislation.

This thesis will rely above all on the primary sources of law for the analysis of whether each of the three policy areas under analysis should be at EU or at national level, and which aspects of the policy should be performed at which level. The reason for this is that primary law sets the principles and objectives under which the EU should operate, while secondary law simply operationalises the decisions of the EU institutions on how, concretely, the EU is operating, and supplementary sources of law should in theory also be

based on what the Treaty indicates (although, as we will see below, in practice they also play an important role in setting out the EU competences).

This analysis is therefore focused on the legal principles underpinning the EU, rather than on the law that was later derived from those principles. It is argued that the legal principles are crucial for understanding the nature of the EU, which in turn makes it possible to understand its objectives.

3.2.1.2 The EU Law and the EU Competences

This section will analyse the implications of each of the sources of EU law for the definition of EU competences in each policy area, focusing particularly on competences regarding public spending.

Primary Sources

In theory, one of the functions of the EU Treaties is to indicate what are the competences of the EU (Article 1). Indeed, several parts of the EU Treaty focus on that definition of competences. The main ones are: Article 3, which defines the objectives of the EU; Article 5, which defines the principle of conferral, itself based on the principles of subsidiarity and proportionality; Title I, which defines the competences of the EU in different areas; Part Three, which explains in more detail the functions of the EU in each policy area.

The interrelationship between these parts of the Treaty is as follows. Article 3, Article 5 and Title I are all three intended to address the question of which policies should be at EU level. However, while article 3 has been part of the EU Treaty since the beginning, article 5 was only added in 1992 and Title I was only added in 2000. Article 3 states the objectives of the EU in very broad terms, and therefore provides only very general guidance on what the functions of the EU should be. While the EU was still mainly an economic union, this was not a problem, and article 3 was sufficient.

However, with the Maastricht Treaty in 1992, the functions of the EU began to go clearly beyond the realm of economics, which raised questions about how far the EU should go. To address those questions, article 5 on subsidiarity was added. Article 5 was intended to provide a legal tool to

assess whether a certain policy should be at EU level. However, as will be explained below, this tool did not work, as it also does not provide clear guidance.
For that reason, Title I was added by the Treaty of Lisbon in 2000. Its objective was to finally set out in clear terms the limits of EU competences. However, as will be explained below, that objective was again not achieved, as this section of the Treaty was also drafted in vague terms.

The current situation is therefore that neither of the three Treaty articles that were intended to provide guidance on the competences of the EU actually provides much help. For that reason, this thesis argues that the best way to obtain that guidance is via Part Three of the Treaty.

Part Three describes the different EU policies, including their objectives and their main elements. It also often includes guidance on the political procedures to be followed and on limitations to the expansion of the policy (for example, areas which should remain under national sovereignty). While, again, there are no clearly defined borders, this section does provide the most detail on what are the purposes and responsibilities that the Member States sought to assign to the EU level, with respect to each policy area.

All those Treaty provisions therefore do not provide straightforward answers on this issue, as they are "ambiguous" and "open-ended" (Davies, 2006). This has led to "competence creep" (Pollack, 1994) whereby EU competences have been increasing gradually over the years, because their limits are not clearly defined (Weatherill, 2004, Van Prechal and Roermund, 2008). Several authors argue that this situation is problematic, namely as it leads to lack of transparency and to increases in EU powers that may be unwanted, and therefore a definition of the competences is necessary (Dashwood, 1996).

Nonetheless, the Treaty provisions do provide some guidance, which, taken together with the other academic lenses used in this thesis, can help determine which spending programmes should be at EU level. I will now analyse each of these parts of the Treaty, and assess how they can be used to define the functions of the EU budget. In chapter IV, they will be applied to agriculture, cohesion and research. In what follows, the lenght of each sub-section will be proportional to the amount of relevant literature, and to the

amount of insights that can be derived in relation to the EU budget as a whole (since the points relating to specific areas of the budget will be included in chapter IV). This explains why the section on subsidiarity is longer (since, as has been explained, this is the part which has received the most attention from the literature), while the section on Part Three is short (since most of the insights from this part relate to specific areas of the budget, and will therefore be covered in chapter IV).

Title I: Three categories of competences

The Treaty of Lisbon sought to clarify the allocation of competences to the EU, by adding provisions specifically on this issue. Title I divides policies into three types: exclusive, shared and complementary. Exclusive competences are entirely in the hands of the EU: only the EU can legislate in those areas[7]. They are: the customs union; competition policy; monetary policy (for the countries that adopted the euro); external commercial policy; conservation of marine biological resources.

In areas of shared competence, both the EU and Member States can legislate. They include internal market, social policy, cohesion, agriculture and research.

In areas of supplementary competence, the EU can only implement actions to support, coordinate or supplement the activities of Member States, without superseding their competence in those areas. They include health; industry; culture; education; tourism.

Unfortunately, Title I is not seen as very useful by the literature, as it simply formalises the situation that already existed before and was already applied by ECJ case-law (Conway, 2010). Nonetheless, Title I does clarify the situation regarding the areas of supplementary competence, as it is now clear that the EU cannot legislate in those areas.

Moreover, the Title does not clarify the crucial issue: in areas of shared competence, which aspects of the policy should be at EU level, and which

[7] The Member States can only legislate if they are empowered to do so by the EU. or to implement EU legislation

aspects should remain national? However, the other parts of the Treaty to be analysed below do provide useful insights on that issue.

Article 5: Subsidiarity

The concept of *subsidiarity*, which was added to EU law by the 1992 Treaty of Maastricht, says that the EU should only take action in areas where it can be more efficient than the national governments.

EU Treaty, Article 5
1. The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality.

2. Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.

3. Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.

4. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality.

This article was clearly written with the principles of fiscal federalism in mind; it effectively says that the competences of the EU should be determined according to the principles of fiscal federalism, except for the

policies on which the Member States have given "exclusive competence" to the EU.

Pelkmans (2003) suggests a five-step test to apply the principle of subsidiarity in practice (point 5 refers to the principle of proportionality, which here is analysed separately, in the following section):

"1 Identify whether a measure falls within the area of shared competencies (if exclusive to the EC, the subsidiarity test does not apply);
2 Apply the criteria (scale and externalities, Art.5 EC, and possibly other criteria) – this is the "need to act" test;
3 Verify whether credible cooperation is feasible;
4 If 1 and 2 are confirmed, and 3 denied, then the assignment is to the Union level;
5 Define to what extent (proportionality) implementation, monitoring and enforcement should also be assigned to the EC level, or, indeed, can be assigned to the Member States, perhaps in a common framework."

Unfortunately, this test, as well as the Article itself, does not add much to a simple application of the theories of fiscal federalism. The Protocol on subsidiarity and proportionality also does not provide further guidance, as it concerns only the procedures that need to be followed to ensure that the principles are taken into account, not their interpretation. For example, it specifies the way in which the national parliaments need to be consulted.

The condition of subsidiarity therefore largely overlaps with the analysis of fiscal federalism. Nonetheless, it adds to it in four ways:

First, it gives legal backing to the fiscal federalism analysis - therefore, in addition to being a way to measure the relative efficiency of policies at the EU level, fiscal federalism has also become a way to measure their legitimacy from a legal perspective.

Secondly, this article excludes areas of exclusive competence from having to comply with the principles of fiscal federalism. However, this will not preclude us from using fiscal federalism to analyse also those areas, as from a

theoretical perspective there is no reason why it should not also apply to them. The fact that the EU currently has extensive powers in a certain area does not necessarily imply that, from an analytical perspective, the EU should be active in that area.

Thirdly, the article implies that, in cases where the policy could be done equally well at EU level and at national level, it should remain national. This was intended to work as a way of controlling the extent of EU powers and preventing excessive integration. Several authors interpret this as meaning that a policy should only be centralised if there is a clear case that it is more efficient at EU level. For example, Persson, Rolland and Tabelllini (1996) interpret from this condition that "the burden of proof lies on the advocates of centralisation" (Persson, Rolland and Tabelllini, 1996, p. 1).

Finally, it is worth noting that the article refers to each "proposed action", implying that the fiscal federalism analysis should be done for each policy action individually, rather than for the policy area as a whole. This connects with the point made above that this analysis must be done for each line of spending, as opposed to entire areas of spending.

The principle of subsidiarity was also intended to be used at the very beginning of the legislative stages, as, since the principle of subsidiarity was included in the 1992 Maatricht Treaty, the European Commission has agreed to consider it when issuing any proposals (Toulemonde, 1996). However, although the Commission does include a subsidiarity analysis in all its proposals, as well as in its evaluations of existing legislation, it tends to interpret this concept in a very expansive way, partly because this allows it to expand its powers (Swenden, 2004).

Despite these additional insights, the concept of subsidiarity as defined in the Treaty in practice does not add much to the analysis based on fiscal federalism. Nonetheless, this principle will be used as part of the analysis in this methodology.

Point 4 of Article 5 above concerns the principle of proportionality:

4. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

So, if the EU does intervene, the intervention should be proportional, or limited to what is necessary to achieve the objective of the policy.

Article 3: The EU Objectives

Before Article I was inserted into the Lisbon Treaty, the functions of the EU were even more vaguely defined, by what is now Article 3 of the Treaty. This Article sets out the objectives of the EU

EU Treaty, Title I, Article3

1. The Union's aim is to promote peace, its values and the well-being of its peoples.

2. The Union shall offer its citizens an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime.

3. The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.

It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child.

It shall promote economic, social and territorial cohesion, and solidarity among Member States.

It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe's cultural heritage is safeguarded and enhanced.

4. The Union shall establish an economic and monetary union whose currency is the euro.

5. In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter.

6. The Union shall pursue its objectives by appropriate means commensurate with the competences which are conferred upon it in the Treaties.

The third paragraph says that it is an objective of the EU to promote, in the Member-States: "economic progress", "social progress", "employment" and "balanced and sustainable development". That should be done through, "in particular", an "area without internal frontiers", increased "economic and social cohesion" and a "monetary union".

From this paragraph, we can derive three general objectives for the EU: "Economic Progress", "Sustainable Development" (this expression refers to the aim that growth in the EU should not be achieved at the cost of equality, the environment or employment levels) and "Economic and Social Cohesion" (this refers to solidarity among the Member States, and particularly helping the poorer Member States "catch up" economically with the EU average through the so-called "cohesion policies"). This paragraph can therefore be seen as justifying the existence of the EU economic and cohesion policies.

The fifth paragraph defines the EU's "relations with the wider world". This should be done in particular, through a "common foreign and security policy" which includes "a common defence policy". This paragraph therefore justifies the EU activities in the area of external relations and defence.

Point 2 refers to the "EU citizens". The concept of "citizenship" of the Union means that the EU is not only a union of countries, but also a union of the people living in those countries.

This point refers to having an "area of freedom, security and justice", including "free movement of persons", "external border controls", "asylum and immigration" policies and "combating of crime". This objective corresponds to the policy area "Freedom, Security and Justice".

These areas are of course extremely wide, and do not delimit exactly what are the powers of the EU. Since the Lisbon Treaty, this Article has therefore become less relevant, because Title I now offers more detailed guidance on EU competences.

Part Three of the Treaty

The sections of the Treaty discussed above are very vague, and do not offer detailed guidance on the limits of EU competences. However, Part Three of the Treaty goes into more detail on the various policy areas, thereby providing further guidance on what the role of the EU should be in each of them. Although this part also leaves large room for interpretation, it does provide further indications on the EU's role in each policy area.

The methodology will therefore include a step dedicated to what this part of the Treaty indicates regarding the funding of policies by the EU in each of the three areas.

Secondary Sources of EU Law

Secondary sources of EU law are all the legislative acts and agreements produced by the EU. Acts include regulations, directives, decisions, opinions, recommendations, white and green papers. Agreements include international agreements (between the EU and third countries), agreements between Member States, and inter-institutional agreements (between EU institutions). All those acts and agreements must have a legal basis in Treaty articles.

Therefore, while the Treaty establishes the functions and powers of the EU in a certain area, legislative acts put those powers into practice. Therefore, this type of legislation is not useful for our analysis, as it tells us what the competences of the EU *currently are*, rather than what they *should be*.

This thesis therefore does not look at secondary law as a basis for deciding which spending policies should be at EU level; instead it looks at which areas secondary law, insofar as it generates spending, should target.

Supplementary sources: the hidden power of the ECJ

Supplementary sources are ECJ case law, international law and the general principles of law. The ECJ can use those sources when primary and secondary legislation are insufficient to reach a decision on a certain case. Although this was not supposed to be an important source of EU law, ECJ case law in fact plays a crucially important role in the allocation of competences to the EU or the national level (Weiler, 1999, Tridimas, G. and Tridimas, T., 2002, Wernicke, 2007). Due to the fact that EU competences are not clearly set out in the Treaties, the ECJ has had to interpret from the Treaties which aspects of each policy area should be under EU jurisdiction, and therefore an EU competence.

The ECJ has traditionally adopted an expansive approach, whereby its judgments have generally found that the EU did have powers over a certain area (Tridimas, 1999). On several occasions when the ECJ could have used the principle of subsidiarity to reduce the scope of EU legislative actions, it did not do so (Craig and de Burca, 1998). Apart from the fact that the concept of subsidiarity is phrased in vague terms, which makes it difficult to apply it consistently, this is also due to the "supranational mindset of most ECJ judges" (Swenden, 2004, p. 373). Vaubel (2009) also finds that ECJ judges have an incentive to promote more EU integration. This makes them "propagate a political program" instead of being "an objective and impartial interpreter of the law." (Vaubel, 2009, p. 203).

Around ten years ago, the ECJ adopted, for a brief period, a less expansive approach, during which it sought to limit its own powers, by setting limits on how far its competences – and therefore the EU competences – could go (G. and Tridimas, T., 2002).

For example, in the "Tobacco Advertising" case, the ECJ sought to limit its powers, by setting an "appreciable impact" test in relation to the EU principle of "undistorted competition". This test says that, although the ECJ has the power to legislate to ensure that there is undistorted competition in the EU, it can only interfere if the situation in question has an "appreciable impact" on undistorted competition:

"107. In the absence of such a requirement [i.e. for appreciable impact], the powers of the Community legislature would be practically unlimited. National laws often differ regarding the conditions under which the activities they regulate may be carried on, and this impacts directly or indirectly on the conditions of competition for the undertakings concerned. It follows that to interpret Articles 100a, 57(2) and 66 of the Treaty as meaning that the Community legislature may rely on those articles with a view to eliminating the smallest distortions of competition would be incompatible with the principle [of conferral]"

Case 376/98, *Germany v. Parliament* [2000] ECR I-8419 ('*Tobacco Advertising*')

However, in subsequent cases when the ECJ could have used that test, it did not do so (e.g. Cases C-402/05 P and C-415/05 P). Moreover, this test was not extended to other areas of EU policymaking. ECJ case-law is itself also not consistent on this issue. While in some cases the ECJ has sought to create limits for the expansion of EU competences, it has then ignored those limits in subsequent cases (Conway, 2010).

3.2.1.3 The EU Law on the EU Budget

The legal basis for the EU budget is provided by Title II of the EU Treaty entitled "Financial Provisions" (Articles 310 to 325). These articles define the rules governing the budget's revenue, the negotiations of the MFF and the annual budget, the budget's implementation, and measures to combat fraud. However, they do not provide any indications on how the expenditure of the EU budget should be used, or any indications of principles to assess which competences in terms of spending should be at EU level. For that reason, these articles will not be used as part of the methodology. Nonetheless, it is useful to analyse them briefly, as they provide useful background information for our analysis of the EU budget.

Article 310 defines some of the main principles underpinning the EU budget, while Article 311 concerns the financing of the budget, Articles 312 to 316 concern the procedures underpinning the EU budget, Articles 317 to 319 concern the implementation of the budget, Articles 320 to 325 concern common provisions, and Article 326 concerns combating fraud.

EU Treaty, Article 310

1. All items of revenue and expenditure of the Union shall be included in estimates to be drawn up for each financial year and shall be shown in the budget.

The Union's annual budget shall be established by the European Parliament and the Council in accordance with Article 314.

The revenue and expenditure shown in the budget shall be in balance.

2. The expenditure shown in the budget shall be authorised for the annual budgetary period in accordance with the regulation referred to in Article 322.

3. The implementation of expenditure shown in the budget shall require the prior adoption of a legally binding Union act providing a legal basis for its action and for the implementation of the corresponding expenditure in accordance with the regulation referred to in Article 322, except in cases for which that law provides.

4. With a view to maintaining budgetary discipline, the Union shall not adopt any act which is likely to have appreciable implications for the budget without providing an assurance that the expenditure arising from such an act is capable of being financed within the limit of the Union's own resources and in compliance with the multiannual financial framework referred to in Article 312.

5. The budget shall be implemented in accordance with the principle of sound financial management. Member States shall cooperate with the Union to ensure that the appropriations entered in the budget are used in accordance with this principle.

6. The Union and the Member States, in accordance with Article 325, shall counter fraud and any other illegal activities affecting the financial interests of the Union.

Point 1 of this article sets the principle of “equilibrium”, whereby revenue for each year must be equal or inferior to spending for that year - so the EU budget cannot run a deficit.

Since the adoption of the Treaty of Lisbon in 2009, there have been changes to the provisions on the budget. Benedetto (2009) argues that those changes would make a reform of the EU budget more difficult, because, contrarily to public perception, the European Parliament now has less say on the budgetary procedures. So, if we assume that the Parliament is an agent for change, this makes reform more difficult. It is as yet too soon to judge whether this is the case, because the negotiations for the next Multiannual Financial Framework are only just beginning; the next two years will show whether the Treaty of Lisbon fosters or hinders EU budget reform.

In addition, the Interinstitutional Agreement adopted for each new MFF also amends and completes the Treaty rules. This makes it possible to modify and improve budgetary rules every seven years without having to amend the Treaty.

3.2.1.4 Steps derived from this Academic Lens

Two steps will be used to find how EU law can tell us whether a certain area of a policy should be at EU or at national level.

Step 1 focuses only on Part Three of the Treaty since, as explained above, it provides the most insights relevant to this analysis:

Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?

Step 2 looks at all other sections of the EU Treaty:

Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?

3.2.2. Public Sector Economics

On the second column of Figure 1 are criteria derived from concepts of *public sector economics*. Public sector economics is the branch of economics that analyses the activities of government. Fiscal federalism is of course itself a sub-field of public economics, but this section focuses on public economics as a whole, and particularly on the tools that the field offers for determining whether there should be public intervention in a certain area. At the national level, these theories underpin most public policies, but it is argued that they are often forgotten at the EU level, due to the almost exclusive focus on fiscal federalism.

3.2.2.1 Public Economics and the EU Budget

Public economics is an extremely vast field, so this section has necessarily to focus only on a very limited part of the literature. The first part of the literature that this section will use is the literature that focuses on the rationale for public sector intervention. The second type is the literature that focuses on each of the three areas selected by this thesis - agriculture, cohesion and research – and analyses them from an economic perspective. The following paragraphs will expand of those two types of literature.

The literature on the rationale for public intervention explores the role of the public sector, and in particular in which areas it should intervene, and how. It is therefore invaluable for the analysis of how a public budget should be spent. This literature was used as a basis for the selection of the next two steps.

Barr (1992, 1994, 1998) argues that it is necessary to first identify the aims of a public intervention, and secondly the methods by which that intervention should be achieved. While the first question involves a normative, or subjective, element, and the answer may differ depending on the respondent's ideological principles, the second question is positive, objective, and unrelated to ideology.

The aims of a public intervention can, according to Barr, be either efficiency reasons or equity reasons. Efficiency reasons relate only to addressing market failures. Equity reasons, on the contrary, concern redistribution between the wealthier and poorer elements of society.

If this reasoning is applied to the EU budget, we conclude that a budget line should only exist if either:

(i) It is correcting a market failure (for example, positive externalities of research projects can be addressed by providing public funding for research programmes)
(ii) It is contributing towards an equity goal (for example, redistribution from the wealthier to the poorest Member States)

Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?

To answer this question, this thesis will rely both on literature from public economics on the relevant policy area, and on policy documents from the EU institutions that explain what are the stated objectives of each policy.

The usefulness of this step is, firstly, to find whether there is a case for public intervention in a certain area; secondly, identifying the reasons for public intervention is helpful for the next steps of the analysis, as it shows the objectives of the policy, so it is then possible to see whether the policy is meeting those objectives.

It should be noted here that this thesis will focus only on market failures and equity goals that are needed from the perspective of EU countries and/or citizens, as opposed to global welfare. As was seen in the EU law section, although Point 5 of Article 3 of the Treaty states that the EU will promote peace and security worldwide, the Treaty also states that this shall be done only as part of the EU's relations with the wider world. Therefore, this thesis argues that global welfare should only be seen as a constraint that the EU should meet, and not as an objective in itself (except in the case of development policies, which are not analysed in this thesis).

If we conclude that there should be public intervention in a certain area, it is then necessary to assess which type of intervention is needed. The three main types of government intervention are: funding; regulation; public production (Stiglitz, 2001).

Most areas of government intervention involve both spending and regulation, and it is important to use this distinction to assess, in areas where EU action is seen as useful, whether that action should be in terms of funding or regulation. In particular, there should not be spending on a certain policy programme if the same results could be achieved simply by improving the regulatory environment.

This step will rely on literature from public economics that focuses on the policy area in question.

Step 4: Should the government intervention be in terms of funding or in terms of regulation?

In addition, the spending programme must be cost-effective, in that its benefits must be superior to its costs, and the policy should be meeting its stated objectives in a way that is efficient. Thus, even if a spending programme meets a need for public funding and should be at EU level, it is still necessary to assess whether it can, in practice deliver value for money and meet its objectives. In particular, it can be the case that a certain policy area should be funded at EU level, but some of the programmes that are currently in place are not efficient at meeting the objectives of the policy.

This section rely both on empirical literature on how the policy is performing, and on the public economic literature on the policy. The empirical literature will be used with some caution, because the aim of this step is not to assess the current cost-effectiveness of the policy; instead, it aims to assess whether the spending programmes that are part of the policy can potentially be cost-effective.

This step will be inserted at number 8, because it should be assessed after the fiscal federalism analysis. The reason is that it is preferable to assess first whether a certain function can be performed more efficiently at EU level or

at national level, and only then look into the potential cost-effectiveness. The cost-effectiveness analysis can then be applied only to the areas of the policy which are more efficient at EU level than at national level.

Step 8: Can public intervention be cost-effective?

The second type of literature that will be used is the public economics literature that focuses on each of the three policy areas under analysis. While the first type of literature was used mainly as an underpinning for constructing the three steps, this second type will be used to find the answers to the questions asked in each of the steps. Therefore, the authors and sources will be different for each of the chapters.

In this analysis, great importance will be given to the role of the EU budget as a leverage tool. This has been well documented (Nunez Ferrer et al, 2010). While the budget is relatively small in comparison to the budgets of national administrations, it can play a very significant role in promoting EU policy objectives. This can happen via a number of channels:

- the funding may be attached to conditions that oblige the recipient country to undertake reforms;
- there may be co-funding requirements, that lead to an increase in national investment;
- the projects funded may involve the cooperation of different Member States, thereby leading to further integration or fostering the mobility of workers;
- the projects may contribute directly towards policy objectives.

3.2.2.2 Steps derived from this Academic Lens

Three steps will therefore be used to find how public economics can tell us whether a certain area of a policy should be at EU or at national level.

The first focuses on whether there is a need for public intervention in a certain area:

Step 3: Is the spending programme necessary, either to address a market failure or to meet an equity goal?

The second looks at whether that public intervention actually needs to take the form of spending:

Step 4: Does the market failure or equity goal require government action in terms of funding or in terms of regulation?

Finally, step 8 assesses whether the spending programme can be cost-effective at EU level and whether it can meet its stated objectives:

Step 8: Can this spending programme at EU level be cost-efficient?

3.2.3. Fiscal federalism

Fiscal federalism is the branch of economics that analyses which functions of a government are best performed at a centralized level and which are best done at a decentralized level (Musgrave, 1959, Oates, 1972)[8]. When applied to the EU, these theories analyze which policies should be the responsibility of the EU and which should remain national, or the question of what the EU should do. The main premise is that a certain policy should be done at a more central/EU level if this can make the policy more cost-efficient.

This section will first provide an overview of the literature in this field. It will then identify three main factors within fiscal federalism which will be used as the next steps in the analysis.

3.2.3.1 Literature on fiscal federalism

Overview: What is Fiscal Federalism

Fiscal federalism is the branch of economics that analyses which functions of a government are best performed at a centralized level of government and which are best done at a decentralized level. I will first give an overview of the main concepts of fiscal federalism. In the next section I will go into more detail on the different strands of literature within fiscal federalism.

Fiscal federalism looks at three main factors to see if a policy should be centralized:

1) Externalities: externalities occur when the activities of A cause costs (or benefits) to B, for which A does not bear the cost (or does not reap the gain). For example, if a factory causes air pollution, the people living close to the factory will have less air quality; but, unless there are government regulations to that effect, the factory will take that cost under account in its production

[8] In this thesis, fiscal federalism is understood in its wider sense; ie. the allocation of policies between the EU level and the national level, as opposed to focusing only on policies of a fiscal nature. This thesis therefore focuses on the policies which have the potential to generate expenditures.

decisions. Fiscal federalism says that, if there are positive or negative externalities between EU Member States in a certain policy area, that policy area should be done at EU level; that way, the policy will be designed taking under account its effects in the whole EU, whilst if it was done at the national level it would not take into account its effects on other countries.

2) Economies of scale: these occur when the average cost of producing a good decreases if the good is produced in a larger quantity. For example, if an entire factory is used to build just two cars, each of those cars will cost a vast amount of money; but if the same factory builds a million cars, the cost of the factory equipment will be spread between the cars, and each car individually will cost much less. If there are potential gains due to economies of scale, this provides an argument in favour of centralisation.

3) Heterogeneity of preferences: These two factors are balanced against the fact that people in different countries have different tastes, and, if the tastes are very different, the policy should not be centralized, so that each Member State can continue designing the policy in the way that suits its population.

The literature on fiscal federalism has progressively added more criteria to this list, such as inter-jurisdictional competition (Cremer at al., 2004, Sinn, 2003). In addition, the most recent literature, known as "second generation fiscal federalism", inserted political economy factors into fiscal federalism, by taking into consideration political failure, or that government, at any level, realistically does not always act like a benevolent welfare maximiser (it can be corrupt or inefficient, for example). In this second best setting, the allocation of policies among different levels of government can be used as a way to allocate the policy to the level where there are less problems of political economy (Brennan and Buchanan, 1980).

Traditional fiscal federalism

It is often considered that the pioneer of the discipline was Robert Musgrave, who, in his 1959 *Theory of Public Finance*, classified the functions of government into three "branches", specifying which should be done at which level of governance (Musgrave, 1959).

The three "Musgrave branches" are macroeconomic stabilization (the government tries to ensure that the economy is stable, with low unemployment and low inflation; in particular, the government will aim to spend more when it needs to stimulate the economy, and less when it needs to control inflation), income redistribution (the government uses taxes to help the poor and ensure equity by making taxes proportional to individuals' wealth) and resource allocation (the government ensures that the country's resources are used efficiently, by correcting market failures).

Musgrave argued that the central government should be responsible for stabilization and redistribution, while local governments should be responsible for the allocation function. One of his central arguments is that functions should be performed at the level where their benefits are felt.

In the seventies, American economist Wallace Oates refined Musgrave's insights and made fiscal federalism an economic discipline in its own right. In his book entitled "Fiscal Federalism" (Oates, 1972), Oates proposed the "decentralization theorem", which identifies the criteria for an optimal allocation of policies to levels of government. Specifically, the theorem says that, if a public good can be produced by two levels of government at the same cost, it will be more efficient to produce it at the most decentralised level of government.[9] This is because the good can then be produced in a way as to suit the preferences of the local population – the more local the government, the less heterogeneity problems there will be.

The literature that followed up Oates' insights initially focused on the three main criteria described above - externalities, economies of scale and heterogeneity - with research focusing on assessing the relative importance of those factors. This initial list of criteria was then gradually expanded.

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[9] The theorem reads as follows: "For a public good – the consumption of which is defined over geographical subsets of the total population, and for which the costs of providing each level of output of the good in each jurisdiction are the same for the central or for the respective local government – it will always be more efficient (or at least as efficient) for local governments to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified and uniform level of output across all jurisdictions."

In particular, several authors focused on the aspect of inter-jurisdictional competition (Cremer at al. (2004), Sinn (2003)): in decentralised systems, the governments in the different jurisdictions are competing against each other, for example to attract investors or residents. This competition can have positive consequences: it increases efficiency due to competitive pressure and allows the jurisdictions to make use of comparative advantage. However, it can also have negative consequences: tax competition between jurisdictions can lead to a "race to the bottom", resulting in a suboptimal level of taxation.

Second Generation Fiscal Federalism

Since the 1980's, a "second generation" of fiscal federalism has included considerations of political economy into the analysis. Given that the government and the political system have failures - such as imperfect information or rent-seeking behaviour - at which level of government can those political failures be minimized?

Brennan and Buchanan's (1980) "Leviathan restraint hypothesis" said that governments seek to increase their power by increasing the size of the public budget, leading to excessively high levels of taxation. Decentralisation mitigated this problem because this tendency was balanced by the interjurisdictional competition and the race to the bottom.

Eichenberger and Hosp (2001) argue that the decentralisation of policies makes the government more democratic because it makes policies more suited to local preferences and Ebel and Yilmaz (2002) add that it enables citizens to feel more concerned by the political process and become more involved in it. However, Tanzi (1995) argues that there are more chances of corruption at the local level.

Recent work has also explored the role of preferences in more depth. Collignon (2004) argues that preference formation should not be taken as exogenous. Instead, he argues that the EU should actively try to reduce the divergence of preferences between Member States, through a process of deliberation. This would allow EU countries to benefit from the positive effects of economic and political integration, while minimizing the costs of integration that are due to heterogeneity of preferences. Jamet (2011) adds that economic and political integration themselves lead to a reduction in the

divergence of preferences between Member States. So, preferences are endogenous. For example, as shown by Frankel and Rose (1998) the integration of monetary policy leads to closer trade links, which increase the correlation of business cycles.

Theoretical Models

The theoretical literature attempts to formalise fiscal federalism theories through the use of economic models. This is a difficult task, as these theories are based on concepts that cannot be quantified with ease. It is hard, if not impossible, to quantify the differences in tastes between different countries' populations, or to compare the economies of scale resulting from lower average costs to those resulting from more power in the international stage. Nonetheless, authors have put forward economic models that seek to capture these concepts.

Alesina and Spolaore (1997)

In "On the Number and Size of Nations" (Alesina and Spolaore, 1997), the authors construct a model of fiscal federalism which attempts to estimate the trade-off between heterogeneity and economies of scale. For that, the model assumes that heterogeneity in preferences increases with the distances between consumers and their government, while at the same time each government, or layer of government, brings added costs in terms of bureaucracy. The model is based on a utility function.

There are N countries in the world. Each country has a government, which produces a set of public goods. The utility of individuals in each country depends on their income net of taxes and on the public goods that are at their disposal. However, the more distant individuals are from their government, the less utility they get from those public goods, because the goods will not be produced according to their taste. The authors therefore assume that distance coincides with preferences; they are using distance as a proxy for heterogeneity of tastes.

The utility of the individuals is as follows:

$$Y_i = AK_i^{\propto}\left(G_i + \beta \sum_{j \neq i} G_j\right)^{1-\propto}$$

Where g is the utility that the individual derives from the public good, l is the distance between the individual and the government, a is the reduction in the utility that the individual derives from the public good due to the distance. (y –t) is income net of taxes, assumed for simplicity to be the same for all individuals.

To show the benefits of a larger government, Alesina and Spolaore assume that each government has a cost k, which increases the level of taxes t. So, the higher the number of governments in the world, the higher the taxes. The optimal solution for all the individuals will be to have the number of countries that balances k against l.

Alesina and Wacziarg (1999)

In their seminal paper "Is Europe going too Far?", Alesina and Wacziarg (1999) constructed a model of fiscal federalism. The model also shows the trade-off between externalities and heterogeneity, but this time instead of a utility function it consists of a production function for a public good, which is being produced in all EU Member States. In country i, the function takes the form:

$$Y_i = AK_i^{\propto}\left(G_i + \beta \sum_{j \neq i} G_j\right)^{1-\propto}$$

Output Y depends on technology A, capital K and government spending G. There is a positive externality, because the public good produced by country i is in fact also benefiting country j. This externality is represented by the last term in the equation. β measures the extent to which country j benefits from the production of the public good by country i. The government will want to produce the quantity of public goods that maximises income. Due to this

externality, the quantity of public goods that it will choose to produce will be too low, as it does not take into account the externality. However, if the good is produced at the EU level, the externality will be internalised, and the quantity produced of the public good will be optimal.

Alesina and Wacziarg then introduce heterogeneity, which they model by assuming that countries have different levels of capital endowment K. Therefore, they have different optimal quantities of the public good. Centralisation will then entail a cost, because it will force some countries to have too much, and others too little, of the public good.

Whether it is desirable or not to produce the good at EU level depends on the comparison between the benefits of internalising the externality (the quantity of public good is no longer excessively low) and the costs of being forced to choose the same quantity of public good in all Member States (so the quantity of the public good is too low in some Member States and too high in others). To make that comparison, Alesina and Wacziarg divide the income obtained in the case of production at EU level by the income obtained in the case of production at the national level. That ratio will be superior to one if:

$$\beta > \frac{K_2}{K_1}$$

In that case it is best to centralise the policies at EU level. On the contrary, it is best to keep the policies at the national level if:

$$\beta < \frac{K_2}{K_1}$$

Buti and Nava (2003)

In their paper "Towards a European Budgetary System", Buti and Nava (2003) model fiscal federalism as a choice between two inputs. The public good Y is being produced through two inputs: national spending (GN) and EU spending (GEU):

$$Y = F(G_N, G_{EU})$$

GN and GEU have different productivity, respectively α and β. α and β reflect the criteria of fiscal federalism (externalities, economies of scale, heterogeneity). The production function of the good, f(.), is not defined by the authors. The overall public spending on that good is the budget constraint:

$$G = G_N + G_{EU}$$

The welfare maximising solution is to use the combination of inputs GN and GEU which corresponds to the point where the production function is tangent to the budget constraint.

If a good can be produced more efficiently at the national level, α will be superior to β, so the optimal point will correspond to a high value on the GN axis, meaning more production by the national level than by the EU level. The opposite holds if the good can be produced more efficiently at the EU level.

Empirical Literature

The empirical literature attempts to estimate in numerical terms the optimal level of (de)centralisation for public policies. Authors do not attempt to measure in quantitative terms the concepts involved in fiscal federalism, but instead measure the level of fiscal decentralisation in different countries and relate this to factors such as economic growth.

The reason why the literature shies away from attempting to measure the factors involved in fiscal federalism is that this would be a very difficult, if not impossible, task. Concerning heterogeneity, although intuitively it makes perfect sense that people living in Scandinavia have different tastes from those living in the Mediterranean countries, in practice this will be very difficult to quantify.

The same applies to economies of scale. For example, although it makes sense that by having a single foreign policy and speaking with a single voice in the international scene, all EU countries will be able to have more weight in the international scene, this would be impossible to quantify. Another example, relating to externalities, can be found in environmental policy;

although it is clear that pollution does not stop at borders, it is difficult to quantify the extent of the problem.

Moreover, even if it is possible to calculate some of these effects for certain policies (for example, it is possible to estimate the gains in economies of scale from the single market, and this was done by several studies), it is very difficult to compare them across different policies (for example compare these gains with the gains from unifying foreign policy). This makes it impossible to establish a quantitative theory of fiscal federalism, which would indicate by how much each policy should be (de)centralised.

Therefore the literature has focused on measuring the level of fiscal decentralisation and trying to estimate the relation between that and economic factors. Alesina et al. (2001) measure the level of decentralisation by counting the number of legal acts and non-binding "policy acts" per policy at each level of government.

Studies that measure the impact of fiscal decentralisation on economic growth include Davoodi and Zou (1998) and Yilmaz (1999). These authors use cross-country comparisons to attempt to isolate and measure the impact of decentralisation on growth. The various studies come to different conclusions, and several are non-conclusive. The authors do not explore the question of under which conditions decentralization is growth promoting, nor do they conclusions shed any light on that. They simply measure the relation between those variables.

Applications of fiscal federalism to the EU

The most relevant field of literature for this thesis is that which applies fiscal federalism to the European Union. Even when it is not being specifically applied to the EU budget, its insights on how to allocate policies between the EU and the national level can be used to determine what spending functions should be at the EU level.

Initially, theories of fiscal federalism were applied to the United States, as to identify which functions of government should be performed at the level of the federal government, and which should be the responsibility of the states.

However, as EU integration progressed, it became logical to apply these theories to assess which policies should be done at EU-level, and find the optimal distribution of policies between the EU level and the level of the Member States.

Breuss and Eller (2004) offer an excellent review of this field of literature. They summarize its conclusions in what concerns the different policies as follows. The great majority of authors advises the allocation of the following policies mainly to the EU level: single market, competition policy, external trade, monetary policy, defense, foreign policy, international transport and telecommunications. In these areas, authors consider that the benefits from reaping economies of scale and internalising externalities outweigh by far the problems caused by heterogeneity of tastes.

On the contrary, the following policies are generally seen as best left to the national level: agriculture, energy and industry. This is due not only to the lack of significant benefits from centralisation in these areas, but also to political economy arguments, as these policies appear to be more prone to political failure at the EU level. Finally, there is a group of policies where there is disagreement between academics. This includes education and research, social policy and environmental policies.

Studies include Hoeller, Louppe, and Vergriete (1996), who apply fiscal federalism to the EU macroeconomic policies, taxation and spending functions. In their 1996 paper "The Theory of Fiscal Federalism: What does it mean for Europe?", Torsten Persson, Gerard Roland and Guido Tabellini applied second generation fiscal federalism to the EU. They analysed in turn the allocation, distribution and stabilisation branches of EU government, starting from the traditional analysis, and then extending it to include considerations of political economy. In doing so, they attempted to explain why some policy areas which, according to the traditional theory, should be delegated to the EU level, have remained at the national level. For example, they provide several political economy explanations for the discrepancy between theoretical recommendations in the area of defence policy (generally in favour of centralisation) and the current reality (this policy has largely remained national).

3.2.3.2 Applying Fiscal Federalism to this Analysis

To assess whether the EU level or the national level is more efficient, fiscal federalism looks at a number of factors, which constitute the next steps of the analysis. The first two – externalities and economies of scale – have already been defined above, but the following two paragraphs will provide a more detailed definition, since these two concepts are central to the analysis based on fiscal federalism.

Externalities occur when the activities of A cause costs (or benefits) to B, for which A does not bear the cost (or does not reap the gain). For example, if a factory causes air pollution, the people living close to the factory will have less air quality; but, unless there are government regulations to that effect, the factory will take that cost under account in its production decisions. Fiscal federalism says that, if there are positive or negative externalities between EU Member States in a certain policy area, that policy area should be done at EU level; that way, the policy will be designed taking into account its effects in the whole EU, whilst if it was done at the national level it would not take into account its effects on other countries.

Economies of scale occur when the average cost of producing a good decreases if the good is produced in a larger quantity. For example, if an entire factory is used to build just two cars, each of those cars will cost a lot of money; but if the same factory builds a million cars, the cost of the factory equipment will be spread between the cars, and each car individually will cost much less. If there are potential gains due to economies of scale, fiscal federalism says that a policy should be centralized.

Step 5: Are there externalities or economies of scale that can be best addressed at EU level?

These two factors are balanced against the fact that people in different countries have different tastes. If the tastes are very different, the policy should not be centralized, so that each Member State can continue designing the policy in the way that suits its population.

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?

The most recent literature, known as "second generation", added considerations of political economy by taking under consideration political failure, or that government, at any level, realistically does not always act like a benevolent welfare maximiser (it can be corrupt or inefficient, for example). In this second best setting, the allocation of policies among different levels of government can be used as a way to allocate the policy to the level where there are less problems of political economy.

Step 7: Are there more political failures at EU level or at the national level?

3.2.3.3 Steps derived from this Academic Lens

Three steps will therefore be used to find how fiscal federalism can tell us whether a certain area of a policy should be at EU or at national level.

Step 5 assesses whether there are economies of scale to be gained from intervention at EU level, or externalities that can be internalised at EU level.

Step 5: Are there externalities or economies of scale that can be best addressed at EU level?

Step 6 assesses whether the preferences of EU countries in a certain area are similar, or whether their divergence creates difficulties for common policymaking.

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?

Finally, step 7 applies second generation fiscal federalism, and looks at whether political failures can be minimized at EU or at national level.

Step 7: Are there more political failures at EU level or at the national level?

Step 8 was already defined in the section on public economics, so I will now move on to steps 9 to 11, which relate to political science.

3.2.4 Political criteria

This section will address what can be seen as the main problem in applying an analysis based only on fiscal federalism to the EU budget: it does not take into account the issue of legitimacy, or that for a political union such as the EU, the decision to centralise policies depends not only on efficiency considerations, but also on whether it is seen as *legitimate* to reduce national sovereignty over those policies. Therefore this section will use the political science literature on the legitimacy of the EU to propose the last three steps of the methodology. It should be noted that this section will not look into any other aspects of the political science literature, other than those that relate to the concept of legitimacy.

The concept of legitimacy is difficult to define and assess, and no consensus has been found on the best way to define it. Therefore, as to operationalise it into three steps, this thesis will follow the approach proposed by several recent scholars, including Sharpf (2000), Lord and Magnette (2002) and Beetham and Lord (1998): to use a combination of factors, instead of relying on just one source of legitimacy.

The rest of this section is structured as follows. The first part reviews the literature on the concept of legitimacy, focusing particularly on the legitimacy of the European Union. In so doing, it reviews the different factors of legitimation that have been proposed in the literature. The second part selects which of those factors will be used for the analysis in this thesis, and focuses on the interaction between those factors.

3.2.4.1 Legitimacy in the Political Science Literature

As legitimacy is one of the central concepts in political science, the literature on this topic is extremely wide. This section will only provide a very short overview of the main contributions to the literature, and the following section will then cover in more depth the literature focusing on the EU.

Among the most influential definitions of the concept of legitimacy is that which was proposed by Max Weber (Weber, 1964). He proposed that legitimacy originated from “a belief by virtue of which persons exercising

authority are lent prestige" (Weber 1964: 382). He identifies three sources for that belief: tradition, charisma of the rulers and respect for the rule of law.

Beetham's 1993 book "The Legitimation of Power" seeked to refine the definition of the concept, by adding a normative dimension to it. Beetham argued that legitimacy had three sources: the first, closest to Weber's definition, is conformity to the rule of law; the second is expressed consent – the population agrees that the government is legitimate; the third is normative justifiability, whereby rules should be justifiable by reference to shared beliefs. Those beliefs were of two types: "beliefs about the rightful source of political authority" and "beliefs about the appropriate ends or purposes that the government should serve" (Beetham, 1993).

The third criterion says that the government and its actions will be seen as legitimate if they are in accordance with what people expect from a government. Therefore, legitimacy should be assessed not simply by seeing whether citizens are following the rule of law or by measuring public opinion, but also by analysing whether the government is acting in conformity with beliefs and moral principles that are held by the population.

Although some authors criticised Beetham's work for merely rephrasing in a more sophisticated way Weber's definition (see, for example, Barker, 1993), Beetham's contribution was extremely influential, as will be seen in the next section.

3.2.4.2 Legitimacy and the EU

As the EU grew beyond a simple economic union, so grew the debate on whether it is legitimate. This led to the emergence of a body of literature that focuses specifically on the legitimacy of the EU. The existent literature on this topic is notoriously complex to review, due to the fact that authors use concepts in different ways and "start from different normative premises to reach different, even contradictory, conclusions" (Majone, 1998).

In particular, as seen in the previous section, legitimacy is a multi-faceted concept, and it is possible to identify a number of different factors that can be seen as pre-conditions for legitimacy. Authors have tended to focus only on one of those factors when assessing the legitimacy of the EU, and this has led to them reaching different conclusions. However, more recent contributions

have argued that the EU should be assessed via a combination of those factors (Lord and Magnette, 2002).This section will review the main contributions to the literature, and is structured according to the factors that different authors see as requirements for EU legitimacy and/or ways of measuring or assessing EU legitimacy. The next section will discuss why it is possible and recommendable to use a combination of those factors.

Public Consent

The notion of legitimacy is ultimately based on public acceptance, or, in Beetham's terminology, public consent. It should be noted that this factor differs from the other factors introduced so far, because it is at a different level. Public consent can be seen as a product of the other factors. For that reason, several authors do not include it in the "menu" of legitimacy factors. However, Beetham's definition does include public consent on a par with normative justifiability. Moreover, Weatherford (1992) argues that public opinion (which he calls the "micro" level) should be analysed together with the other factors of legitimation (which he calls the "macro" level).

This thesis follows that view and argues that this factor should be considered alongside the others, despite the overlap due to the causal link between them. The main reason is that both types of factors give us complementary insights, so by using both we can learn more about the legitimacy of each area than if we used only one of them. The next section will address in more detail the interaction between the different factors.

Contrary to the other factors, this factor can be measured in a direct, although by no means perfect, way, via surveys of public opinion. Toqueville (1960) brought some of the first insights into how to measure legitimacy, later developed by authors such as Verba (1972).

The Eurobarometer surveys are undertaken by the European Commission to measure the opinion of EU citizens with regards to the EU. The surveys include a question which was designed specifically to measure the opinion of people on which policies should be allocated to the EU level. The answers to

that question will be used in this paper to approximate public opinion.[10] It is important to note that the percentage of acceptance of each policy is an aggregate of the responses in all the Member States, so it is necessary to look also at the national results.

The Eurobarometer surveys have, like any tool for measuring public opinion, their disadvantages, so the results need to be used with caution. In particular, Alesina (2001) points out that the limited sample size decreases the reliability of the results. Nonetheless, despite those limitations, the Eurobarometer survey, and in particular, the "subsidiarity question" have been widely used by authors as the best available "proxy" for measuring public opinion on which areas should be integrated at EU level. For example, Alesina (2001) uses the subsidiarity question to assess whether the opinion of citizens is close to the implications of the literature, pointing out that despite its limitations, this survey is very useful because it is asking about this issue directly. Unger, Van Groezen and Kiiver (2006) also use the Eurobarometer surveys to analyse whether there are significant differences in preferences regarding pension provision across Europe.

Step 9: Is having this policy at EU level supported by public opinion?

Procedural Legitimacy

One of the main conditions for the legitimacy of a government is that it came to power and governs according to an acceptable political process (Dahl, 1956). Nowadays it is generally considered that only a democratic political process is legitimate. Such a process is based on elections and direct contest for the political office, and a system of political institutions which guarantees checking mechanisms on political power.

The vast literature on the EU's "democratic deficit" is mainly concerned with this aspect of legitimacy. The concept of democratic deficit can be defined as "a set of problems – technocratic decision-making, lack of transparency,

[10] Question A24 of Eurobarometer No. 66, December 2006: "For each of the following areas, do you think that decisions should be made by the (NATIONALITY) government or made jointly within the European Union?"

insufficient public participation, excessive use of administrative discretion, inadequate mechanisms of control and accountability – that arise whenever important policy-making powers are delegated to bodies operating at arm's length from government" (Majone, 1998, p. 14). This literature therefore focuses on the political procedures underpinning EU policymaking, and assesses to what extent they are democratic.

This literature is very recent, as concerns about the EU's democratic deficit only became mainstream after the Single European Act and the Maastricht Treaty turned the EU from an economic union into a union involving aspects outside the realm of economics (Majone, 1998).

Most scholars argue that the EU suffers from an important democratic deficit (Hix, 2008). However, a turning point in the literature occurred when two prominent authors, Giandomenico Majone and Andrew Moravcsik, claimed that the EU did not suffer from a democratic deficit. Moravcsik's arguments will be covered under the next sub-section, as they are based on the notion of indirect legitimacy, which will be defined below.

Majone (1998) defended that, when assessing the legitimacy of the EU, one should not adopt the same standards as when assessing the legitimacy of a national government. In particular, he sees the EU as an instrument for delegation of government power similar to independent agencies, such as central banks and public utilities.

Majone's arguments are often reduced to his polemic conclusion that the EU does not suffer from a democratic deficit. In fact, Majone himself admits that the term democratic deficit can be defined in many ways, which will determine the conclusion of the analysis. More interesting from the point of view of this thesis are his conclusions on the type of policy areas that should be delegated to the EU level.

Majone argues that the decisions on which policy areas to delegate to the EU level should be similar to those on which areas to delegate to independent agencies. Therefore, allocative policies are more suited to the EU level than redistributive policies, because when the end result is efficiency this can be done via an independent agency, while if the goal is redistribution or equity a

higher degree of accountability is needed. It is very interesting to note that this result is exactly the opposite of what is advised by fiscal federalism.

At the same time, he also says that redistributive policies can be allocated to the EU level as long as they are balanced by supra-institutional bargaining. That is, any net gains or net losses from the EU budget should be negotiated by the Member States in the Council, rather than decided by the European Commission or the Parliament.

Simon Hix (2008) on the contrary argues that there is a democratic deficit in the EU. He defends that indirect legitimacy is not sufficient to guarantee the legitimacy of the EU, because several important decisions are being taken at EU level without direct control from the national governments. Moreover, many of those decisions are not of the type that should be allocated to an independent agency, because they are not purely pareto-optimal outcomes.

Is it interesting to note that the concepts of legitimacy and "democratic deficit" are often used interchangeably, when they are not synonyms. While democratic political procedures contribute towards legitimacy, legitimacy also involves other elements. In particular, the democratic deficit literature is only concerned with procedural legitimacy, and does not look into the other factors that affect legitimacy. Nonetheless, as the terms are used interchangeably in the literature, this section reviews the literature on both concepts together.

Procedural legitimacy can be used for the analysis proposed in this paper, because it varies greatly between different policy areas. This is because different policy areas require different forms of government intervention, and will therefore be associated with different procedures. For example, some areas require intervention mainly in terms of funding, while others will need regulation. In addition, areas can be at different levels of integration, and some areas are easier to follow by citizens at the EU level than others. Finally, while some areas fit Majone's criterion of involving purely pareto-optimal outcomes, while others do not. This is therefore an important factor in assessing the legitimacy on different policies at EU level.

Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?

Indirect/Legal Legitimacy

It can be argued that the EU has *indirect legitimacy* – since all EU initiatives must be approved by national governments, themselves legitimate, that makes the EU legitimate as well. Moravcsik (2002) defends that this source of legitimacy is sufficient to ensure that the EU does not have a legitimacy problem, and that there is no democratic deficit. That is because, for him, the EU is simply an instrument of the national governments, who still hold the power to make all the important decisions (intergovernmentalist view).

However, most authors argue that this form of legitimacy is not sufficient by itself, since the EU now has policymaking powers that are not under the direct control of national governments (Follesdal and Hix, 2002). In particular, this factor is sufficient to legitimate the intergovernmental part of the EU (the Council), but not its supranational elements (the Commission and the Parliament) (Majone, 1998).

The concept of *legal legitimacy* is closely linked to indirect legitimacy. It requires that the actions of the government are derived from a legal source, and that the government is following legal political procedures. However, it is often understood in a stricter sense. For example, it can be argued that, in the case of the EU, all policies and interventions follow a pre-established legal procedure, and all EU powers and responsibilities have been given to the EU by the national governments, so legal legitimacy exists.

This factor is helpful for the analysis of which policy areas should be at EU level, as it indicates that there will be more legitimacy if areas are handled at an intergovernmental, as opposed to supranational, level.

Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?

3.2.4.3 Factors not used in the Analysis

I will now mention some additional factors of legitimacy, which will not be used directly in this methodology, either because they would duplicate other factors, because they do not help to differentiate between policies, or because their validity is questioned. It is nonetheless important to describe those factors in this thesis, to explain why their absence from the methodology does not undermine its validity.

Technocratic Legitimacy: Another source of legitimacy is related to "output" or "efficiency", or whether the government is being efficient at meeting the needs of the population. Weber (1918) called this "substantive legitimacy", deriving from what the government achieves, rather than how it achieves it. According to this view, the legitimacy of the EU derives from the fact that the EU enables the Member States to address common interests and the EU is legitimate because it provides benefits to citizens. This view would imply that fiscal federalism itself is a way of assessing legitimacy, as it would be legitimate to transfer a policy to the EU level as long as this increases efficiency.

Most authors argue that this factor is, by itself, not sufficient to legitimise the EU (Hix, 1998, Lord and Magnette, 2002). Seeing this factor as sufficient by itself would imply that a dictator, who would be ruling the country against the citizens' will, could be legitimate as long as he tried to ruled it efficiently It is of course highly desirable that government actions are efficient, but this should not be confused with legitimacy.

However, an exception could be made for certain policies, which can be done by "agencies". As seen above, Moravcsik (2002) defends that the EU is an agency of the Member States and therefore it should be independent from the political process, and therefore not subjected to the democratic process, but Hix (2001) argues that this cannot be said to apply to the EU as a whole, because EU policymaking is involved with so many areas and has so much power that it could not be acceptable to say that all that should be exempted from the political process.

This factor will not be used in the methodology, because it would lead to the same conclusions as the analysis based on fiscal federalism.

Collective identity/demos: Another factor of legitimacy is whether the government is representing a group of citizens sharing a collective identity or "demos". In the case of the EU, this would require that citizens identify with the European Union or "feel European". To a large extent this is not the case, as surveys show that people identify much more with their nationality than with the EU.

However, several authors argue that this condition is not necessary, as long as the EU meets other requirements of legitimacy (Sharpf, 1999). Eriksen (1999) argues that, in societies where the principles of democracy are well respected, there is less need for a strong common identity, as democratic institutions ensure that all elements of society are listened to.

This factor will therefore not be used in this analysis, in particular as it would not provide guidance in the differentiation between policies.

Participatory Legitimacy: Another type of legitimacy is that obtained by involving directly the persons concerned in the policymaking process. This is also known as corporate legitimacy (Lord and Magnette, 2002). Corporate legitimacy refers to obtaining legitimacy by negotiating it directly with the people affected. In the EU, this happens via the efforts by the European Commision to involve directly the people affected by policies in the policymaking process, namely via consultations and discussions with stakeholders (European Commission, 2001). Referenda can also be considered part of this type of factor.

However, it is debatable whether this type of participation is desirable, or whether it undermines democracy by effectively allowing certain interest groups to have a direct influence on policymaking. Possibly partly for that reason, this factor is not used by most authors. Therefore, it will also not be used in this methodology.

3.2.4.4 Operationalising Legitimacy

The previous sections have shown that scholars have been arguing over how to define and assess legitimacy, and no consensus has been found on what is the best way to define the concept. For that reason, recent contributions have argued that the best way to assess the legitimacy of the EU is to use a

combination of factors, instead of relying on just one source of legitimacy (Sharpf, 2000, Lord and Magnette, 2002, Beetham and Lord, 1998).

Lord and Magnette (2002) argue that, in practice the EU "mixes and matches" different legitimation principles. They argue that those different principles complement each other. For example, different policymaking procedures at EU level rely on different legitimating principles. Legal initiatives are proposed by a body with technocratic legitimacy – the European Commission – but then need to be accepted by a body with indirect legitimacy – the Council – and a body with claims to procedural legitimacy – the Parliament. Therefore, to assess the EU's legitimacy, it is necessary to use a combination of legitimating factors.

Similarly, Heritier (1999) argues that there can be substitutability between legitimating principles. For example, she argues that direct consultation can be a substitute for parliamentary legitimation. It can also be argued that indirect legitimacy can be a substitute for procedural or parliamentary legitimacy.

This thesis will follow that approach, and will assess the legitimacy of the different policy areas by analysing them according to several legitimating factors. This combined assessment will then result in a conclusion on whether it is legitimate to have the policy, or parts of it, at EU level.

3.2.4.5 Steps derived from this Academic Lens

Three steps will therefore be used to find how the political science literature on the concept of legitimacy can tell us whether a certain area of a policy should be at EU or at national level.

The first looks at whether procedural legitimacy can exist at EU level, in relation to a certain policy:

Step 9: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?

The second focuses on indirect legitimacy – the notion that, since all EU initiatives must be approved by national governments, themselves legitimate, that makes the EU legitimate as well:

Step 10: Is this area of spending at EU level legitimised by indirect legitimacy?

Finally, Step 11 looks at public consent:

Step 11: Does public opinion support having this spending area at EU level?

3.3 Conclusion: Criteria for EU Funding

The analysis above has shown how each of the eleven steps is derived from the literature. However, to make this series of steps easier to apply to spending programmes, I will now associate each step with a number of specific criteria, as well as the sources from which those criteria can be assessed. These criteria are directly derived from the discussion in section 3.2. They are intended to clarify how the assessment of whether a certain step has been met can be made.

Table 2: Criteria for EU Funding

Steps	Criteria	Sources
EU Law		
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	1.1 Does Part Three of the EU Treaty mention specifically that this spending programme should be at EU level?	EU Treaty
	1.2 Does Part Three of the EU Treaty specify which aspects of this funding policy should be at EU level?	EU Treaty; Literature on EU law
Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	2.1 Does this spending programme respect the condition of subsidiarity defined in article 5?	EU Treaty; Literature on EU law; Literature on fiscal federalism
	2.2 Does this spending programme respect the condition of proportionality defined in article 5?	EU Treaty; Literature on EU law
	2.3 Does the remainder of the Treaty indicate that this	EU Treaty; Literature on

	spending programme can/should be at EU level?	EU law
Public economics		
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	3.1 Is this spending programme helping to address one/several market failure(s)?	Literature from public economics on policy area
	3.2 Is this spending programme helping to address one/several equity goal(s)?	Literature from public economics on policy area
Step 4: Should the government intervention be in terms of funding or in terms of regulation?	4.1 Is government intervention of the funding type the best way to tackle the goals identified in step 3?	Literature from public economics on policy area
Fiscal Federalism		
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	5.1 Are there economies of scale to be gained from undertaking this spending programme at EU level?	Literature on fiscal federalism
	5.2 Are there externalities to be addressed by undertaking this spending programme at EU level?	Literature on fiscal federalism
Step 6: Is there a significant heterogeneity of preferences, which	6.1 Are heterogeneities in tastes across EU countries low in this area?	Literature on fiscal federalism

makes EU level action problematic?		
Step 7: Are there more political failures at EU level or at the national level?	7.1 Is/would this spending programme suffer(ing) from political failures at national level, that can/could be remedied y moving it to the EU level?	Literature on second generation fiscal federalism
	7.2 Is/would this spending programme suffer(ing) from political failures at the EU level, that can be remedied by moving it to (or keeping it at) the national level?	Literature on second generation fiscal federalism
Public Economics		
Step 8: Can this spending programme at EU level be cost-efficient?	8.1 Is current spending at EU level cost-effective?	Data on current cost-effectiveness of programmes; Literature on cost-effectiveness
	8.2 Can intervention be potentially cost-effective?	Literature on current and potential cost-effectiveness
Political Science		
Step 9: Is having this policy at EU level supported by public opinion?	9.1 Does the Eurobarometer survey show that a majority of the population support having this policy area at EU level?	Eurobarometer survey
Step 10: Does having	10.1 Is this spending	Political

this area of spending at EU level lead to problems in terms of procedural legitimacy?	programme aimed at allocative rather than redistributive goals? (in which case, according to Majone (1998), there is less need for procedural legitimacy)	procedures underpinning the policy; Majone (1998)
	10.2 To what extent are the political procedures associated with this spending programme controlled by the European Parliament?	Political procedures underpinning the policy
Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	11.1 To what extent is this spending programme controlled by nationally elected representatives, either via the Council or via the national governments?	Political procedures underpinning the policy
	11.2 To what extent are the political procedures associated with this spending programme controlled by the national parliaments?	Political procedures underpinning the policy
	11.3 Is this spending programme aimed at allocative rather than redistributive goals? (in which case, according to Majone (1998), there is less need for indirect legitimacy)	Political procedures underpinning the policy; Majone, 1998

For each of those criteria, three answers are possible: pass; fail; no indication. The spending programme passes the test if the criterion is clearly met; it fails

it if it is clearly not met. However, in some cases it will not be possible to apply a certain criteria to a spending programme – for example, in the EU law analysis, sometimes the EU treaty will not provide any indication on whether a certain type of funding should be undertaken by the EU budget.

The aim of this set of principles is to allow policymakers to make decisions based on a complete and sound knowledge of the advantages and disadvantages of funding a certain area at EU level. However, the analysis highlighted that, for most areas of spending, there is no straightforward answer on whether they should be handled at EU level – instead, there are often trade-offs. For example, it may be economically efficient to fund a certain area at EU level, but not politically legitimate.

In other words, the question of how the EU budget should be spent is by nature a subjective one, so it would not be possible to design a methodology that would provide numerical results, while taking into account all the factors that should enter the analysis. That is why this thesis provides instead a framework that can be used to obtain a result, but that result will depend on the views on the person using it.

This is because there is no straightforward answer on what the (spending or other) competences of the EU should be. The answer depends on a large number of subjective factors, such as one's liking or disliking of the EU, and whether they stand towards the left or towards the right of the political spectrum. Robustness of results can therefore not be provided, as different assumptions, or a different weighting of the criteria, would lead to different results.

4. Application

This chapter will use the multidisciplinary methodology proposed to assess how the EU budget should be spent. The chapter begins by explaining the importance of a disaggregated analysis, whereby areas of policymaking are not assessed as a whole but by looking at the different types of spending within a policy area. The second section then applies the multidisciplinary methodology proposed to the three areas of policymaking selected: agriculture, cohesion policy and research policy. As was shown in chapter 1, these are the three policy areas receiving the most EU spending (excluding administration).

4.1 A disaggregated analysis

The focus of this study will not be on whether each policy area as a whole should be funded by the EU budget, but on which parts of each policy area should be funded by the EU. It is argued that in most policy areas the question is not whether or not there should be EU funding, but which specific programmes within the policy area should be EU funded.

The literature on fiscal federalism and on the EU budget tends to look at policy areas as a whole, without differentiating between the different parts of each policy. This can cause problems, because there is a very large divergence in the extent of EU powers on the different policies. In some fields, such as competition policy, monetary policy or agriculture, the EU has very extensive powers, whilst on others, such as education or social policy, the involvement of the EU is extremely limited.

The recommendations based on the analysis can also diverge significantly for different parts of a same policy area, as will be seen below. It is very different to make a recommendation that the EU should be active in a certain field with exclusive competences or with limited competences.

This analysis will therefore focus on examining which parts, if any, of the policy area should be at EU level, and which should remain national. It will also explore what type of programmes should be put in place at EU level, for

the areas which should be at EU level. The analysis will also reach some conclusions on how those programmes that should be at EU level should be designed at implemented – however, the main emphasis will be on examining which aspects of the policy should be at EU level.

This relates to the second point that EU spending should be analysed in relation to national spending. EU spending programmes co-exist with national spending programmes, and must be designed with that interaction in mind.

4.2 Application of the methodology

This section applies the methodology to each of the policy areas. These areas were described in Chapter 2. Each area ends with a short overview of the main results of the analysis.

4.2.1 Cohesion Policy

This section will analyse whether each of the elements that form cohesion policy should be funded by the EU budget, and via which type of programmes. As seen in Chapter 2, while the largest share of the budget goes to funds aimed at convergence, there are also funds aimed at "regional competitiveness and employment"**.** The analysis will look separately at funds aimed at cohesion and funds aimed at employment.

Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?

Two titles of the Treaty's Part Three are relevant for cohesion funding. Title XVIII (Articles 174 to 178) on the EU cohesion policies, and Title XI (Articles 162 to164) on the ESF.

Title XVIII specifies the objectives of cohesion policy and the procedures to be followed when applying this policy. In particular, Article 174 defines the objectives of the policy as follows:

EU Treaty, Article 174

In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion.

In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions

It states that the objective of the EU cohesion policy is to promote the "harmonious development" of the EU, in particular by "reducing disparities between the levels of development of the various regions". It also specifies that "rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps" should receive special attention. The other articles state that other policies of the EU should also take cohesion objectives into account, and specify the procedures to be followed when implementing this policy.

Article 175 provides the direct legal basis for cohesion funding.

EU Treaty, Article 175

(...) The Union shall also support the achievement of these objectives by the action it takes through the Structural Funds (European Agricultural Guidance and Guarantee Fund, Guidance Section; European Social Fund; European Regional Development Fund), the European Investment Bank and the other existing Financial Instruments.

However, the Title does not give any guidance on how far the competences of the EU in this area should go, particularly as it does not define what is meant by territorial cohesion. In addition, it does not provide any indication on whether the main goal of cohesion policy is to have solidarity between Member States, or whether it is to make the internal market function better, by making the EU economies more similar. As will be seen in the following steps, this lack of clarity is suboptimal.

The article does indicate that this policy should be aimed at "regions", and not at "countries". This can be seen as supporting cohesion funding being given to lagging regions even within the wealthier countries; this issue will be discussed further under the other steps.

Title XI on the European Social Fund is also vaguely phrased. It says that the objective of this fund is to "improve employment opportunities" for workers, without giving a concrete indication of how this should be achieved, or of the scale of the actions to be undertaken.

EU Treaty, Article 162

In order to improve employment opportunities for workers in the internal market and to contribute thereby to raising the standard of living, a European Social Fund is hereby established in accordance with the provisions set out below; it shall aim to render the employment of workers easier and to increase their geographical and occupational mobility within the Union, and to facilitate their adaptation to industrial changes and to changes in production systems, in particular through vocational training and retraining.

Although this article also does not define clearly what the EU should do in this area and where its competences should stop, it does indicate that the competences should include increasing the mobility of workers and helping workers to face industrial changes. That emphasis on those two aspects is clearly due to the fact that they were seen as the areas in which the EU should contribute towards reducing unemployment. The mobility of workers across borders can in theory be best addressed at EU level, and the need to adapt to industrial changes can be seen as a consequence of economic integration (since integration leads to countries being able to specialise and take more advantage of their comparative advantages, and therefore can be at the root of industrial changes).

The current ESF programmes do, strictly speaking, respect the remit defined in the article, as they are all aimed at increasing employment opportunities. However, the emphasis which the article places on promoting the mobility of workers is not achieved in practice. Most projects are not concerned with that aspect, as they tend to have a local or regional focus.

Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?

"Economic, social and territorial cohesion" is an area of shared competence, so both the EU and the Member States can legislate in this area.

Concerning subsidiarity, the analysis based on fiscal federalism below (steps 3, 4 and 5) will show that some aspects of cohesion policy can be performed more efficiently at EU level than at national level, and are therefore justified under this principle.

Concerning proportionality, given that the objectives of cohesion policy are, as seen above, defined very vaguely in the Treaty, it is not possible to say whether the current intervention is sufficient to achieve those objectives.

Article 3 says that the EU "shall promote economic, social and territorial cohesion, and solidarity among Member States." This article therefore implies that cohesion policy is aimed at solidarity between the Member States.

"Social policy" is an area of shared competence, but only for "the aspects defined in this Treaty". The European Social Fund is indeed included in the Treaty, so that makes it an area of shared competence.

Concerning subsidiarity, steps 3 to 5 will show that fiscal federalism does not support this policy at EU level, so this condition is not met. Proportionality therefore does not apply.

Article 3 states that one of the EU objectives is "full employment, social progress and a high level of protection". The ESF is targeted towards those goals, so this condition is met.

The legal analysis of the cohesion objective funding therefore shows that this policy is clearly backed by the EU Treaty. However, the Treaty does not provide guidance on the extent that EU competences should have in this area. It does nonetheless provide a useful indication – that this policy is aimed at "regions" (as opposed to "countries").

The legal analysis of ESF shows that the funding is clearly backed by the Treaty, but that the policy is not respecting the emphasis which the Treaty places on promoting cross-border labour mobility.

Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?

This section will look first at the cohesion objective, and afterwards at the ESF. Cohesion policy is justified both by market failures and by an equity goal. The main market failure is that economic and social disparities between countries or regions that are following the same policy make the economies diverge. In the case of the EU and the internal market, the reasoning is that,

for the single market to work, there is a need for some homogeneity between the countries.

A second arguably less important, market failure is a positive externality: given that EU economies are interconnected due to the Single Market, any improvements in the economic conditions of one country lead to benefits for the EU as a whole (European Commission, 2010b).

In addition, the economic geography literature shows that economic integration can lead to higher "agglomeration forces", resulting in higher growth for some regions, potentially at the expense of others (Krugman, 1991). This phenomenon leads to, on the one hand, higher disparities between regions, but on the other hand, if agglomeration leads to higher efficiency and growth, convergence at the national level (Faber and Ghosh, 2010). This may also provide justification for cohesion policy, to counter this rise in inequality between the regions.

Concerning the equity goal, cohesion policy is also intended as an instrument for solidarity between EU countries. Public economics and fiscal federalism do not provide the tools to assess the desirability of this goal, so this will be assessed under the political section.

Some scholars have questioned whether the objectives of convergence and solidarity should be directed primarily at the regions or at the countries. If the policy is aimed at the regions, clearly it is best to give funding to the poorest regions in the EU. However, if the policy is aimed at the countries, it could be more efficient to fund the richer regions within that country than the poorest, because this would have a more significant effect on increasing the country's growth (Santos, 2009). However, as seen in step 1, the EU Treaty clearly indicates that the policy is aimed at the regions.

I will now analyse employment funding. Government funding for employment can be justified for both efficiency and equity reasons. The efficiency reason is that government intervention can help to reduce the search costs involved in looking for a job/worker, thereby increasing the level of employment in the economy. The equity reason is that the government should intervene to ensure that unemployed people are able to find a job, and to be supported until they find one.

In addition, at EU level there is a further market failure: the lack of mobility of workers between countries increases the mismatch between workers and job opportunities, as workers are not willing or able to relocate to different countries where their skills may be needed.

In addition, although this is not mentioned in the Treaty, the ESF also has other objectives. The European Commission website justifies the employment funds with two reasons:

- To help the development of the richer regions, as to create a knock-on effect throughout the rest of the Union
- To eliminate any remaining pockets of poverty within those regions

The first reason corresponds to a market failure: a positive externality, as, given that the European economies are so interconnected due to the EU, supporting the richer regions, which are the main drivers of growth, has a positive effect on the whole of the Union. The second reason is an equity goal: to eliminate poverty within the richer regions as well.

Finally, although this is not officially a goal of the ESF, it can also be speculated that this fund also exists to ensure that all EU regions benefit from cohesion funding, to ensure that this policy is more well accepted in the wealthier countries. In addition, this policy can also be seen as a way of showing a concern at EU level for social issues. These are political goals, so they will be analysed under the political steps below.

The conclusion from this step is that the European Commission is correctly targeting all regional funds to market failures and equity goals. However, the following steps will find that this is in some of the cases not being done in an effective and legitimate way at EU level.

Step 4: Should the government intervention be in terms of funding or in terms of regulation?

This policy is based on funding. However, the regulations attached to the funding are as important as the funding itself. As seen in chapter 3 (methodology), the EU budget can have leveraging effects, whereby a

relatively small amount of funding has a significant impact on the economy of the recipient. Cohesion funding is one of the best examples of this effect, as it comes attached to conditions that oblige recipients to undertake reforms, and to co-funding requirements that lead to increases in public funding in areas where this is needed for economic growth (Nunez-Ferrer, 2007).

In step 8, we will see that the empirical literature backs this, as the success of cohesion funding is linked to whether the recipient country built on the funds to undertake reforms and develop a strategy to improve their infrastructures (Nunez Ferrer, 2007).

Concerning ESF, both funding and regulation are useful to meet its goals. Funding can be useful to create programmes to train jobseekers or help them to find a job, while regulatory measures can be used to promote investment (which itself raises demand for labour) or to make it easier for businesses to hire new workers.

Step 5: Are there externalities or economies of scale that can be best addressed at EU level?

The fiscal federalism literature generally justifies cohesion policy as necessary to have the Single Market, which itself is justified by fiscal federalism (Hoeller, 2006). This corresponds to the first market failure identified in Step 3: a Single Market requires a certain homogeneity between countries to work effectively. Person, Rolland, Tabellini, 1996, see cohesion policy primarily as a compensation for the possibility that peripheral regions may become more impoverished as a result of integration (this corresponds to the economic geography argument identified in step 1).

Fiscal federalism cannot be used to assess the desirability of the equity goal of redistributing funds from the richest to the poorest countries in the EU, as this theory is only designed to measure relative efficiency. However, it can be used to assess whether the programmes funded by cohesion funds could be more efficient if the own country was paying for those programmes alone. When the funding is allocated to poorer EU countries and allows for programmes that the country would by itself not be able to afford, it can lead to gains in efficiency. On the other hand, if funding goes to wealthy EU

countries, the country itself would be best placed to fund its own policies (Hoeller et al, 2006).

Therefore, fiscal federalism justifies regional funding for regions in the poorest EU countries, but not for the regions in the richest countries. This argument would justify ending cohesion funding both for poorer regions within wealthy countries (for example, Wales in the UK) and the employment funds, as those are in great part directed at the wealthier countries. Fiscal federalism authors focus mainly on the funds with a convergence objective, and do not analyse the ESF. However, for ESF, it is relevant to look at the fiscal federalism recommendations regarding employment and social policy. Although Breuss and Eller (2004) found in their review of the literature that authors have contradictory views in this field, it is argued that a majority concludes that these policies are best maintained at a national level.

Although some authors point to the risk of a "race to the bottom" (Wildasin, 1990, Persson and Tabellini, 1996), whereby EU countries could compete by lowering their levels of taxation, most authors argue that this would be a problem given that labour mobility within the EU is very low (Hoeller et al, 2006, Bureau and Champsaur, 1992).

It could also be defended that the ESF is needed to promote the mobility of workers across borders. However, as was pointed out in step 1, the great majority of ESF programmes are not targeted towards that goal. It is argued that, even if it was re-targeted towards that goal, it would not fulfil it efficiently, for two reasons. Firstly, the ESF programmes are drawn in conjunction with national authorities, and not with a group of countries, so they will need to be national in nature. Secondly, mobility between EU countries is likely to remain very low, due to language and cultural barriers.

Finally, the ESF could also be justified as a compensation for the industrial changes caused by economic integration. However, the fact that those changes are caused by the EU does not by itself justify the allocation of the funding to the EU level.

This fiscal federalism analysis leads to the conclusion that the employment funds should be eliminated altogether; the political section will however show that there are some arguments in favour of keeping them.

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?

No assessment of heterogeneity in regional funding was found in the fiscal federalism literature, but this thesis argues that heterogeneity is not a problem, because the programmes funded by the regional funds are designed and managed at the national level (subject to approval by the European Commission), so they take into account national specificities. The same applies to the ESF, so, even though heterogeneity of preferences is very high in this area (Alesina and Wacziarg, 1999), that is not a problem, as programmes are designed in each country.

Step 7: Are there more political failures at EU level or at the national level?

Persson, Rolland and Tabellini (1996) point out that cohesion policy suffers from a moral hazard problem, because countries and regions receive less funding if their GDP grows closer to the EU average. However, given the relative size of the EU funding the strength of this effect is questionable.

On the contrary, this thesis argues that a second-best setting shows why it is better to fund programmes for infrastructure leading to economic growth at EU level. In the absence of cohesion funds, governments will often dedicate public spending to areas that are politically more rewarding than those needed to increase economic growth, both because they have more immediate positive effects and because they are more popular. Cohesion funds, with their requirement of being co-funded by national budgets, will provide an incentive for national governments to put money into creating the right infrastructures for growth.

This argument does not apply to ESF to the same extent, because programmes to promote employment do bring short-term political rewards, so this is an area where national spending is generally high.

Step 8: Can this spending programme at EU level be cost-efficient?

This section will now assess the potential cost-effectiveness of the different parts of cohesion policy. The objective is to find whether each of the different programmes within cohesion policy can potentially meet its objectives cost-effectively. It will review the literature on the cost-effectiveness of cohesion policy, including both empirical studies and other types of work.

The empirical literature assessing the efficiency of EU Cohesion Policy has so far found mixed results (Ederveen et al, 2003; OECD, 2007). While some authors have found that cohesion policy increased economic growth (Beugelsdijk and Eiffinger, 2005), others found inconclusive results (de la Fuente, 2002) or even negative results (Boldrin and Canova, 2001). Kamps, Leiner-Killinger and Martin point out that cohesion policy can have a negative macroeconomic effect on the recipient countries in periods of unsustainably fast economic growth, due to its short-term demand effects.

These mixed results are partly due to the fact that it is very difficult to measure the effects of cohesion policy. The most important benefits from cohesion policy are not the direct effects from the spending, but the so-called "leverage effects" from the policy (additional public spending in a certain policy area (through co-financing), better project management, strategic approach to investment), which are very difficult to measure (Bachtler and Gorzelack, 2007).

However, the mixed results are not only due to difficulties in empirical analysis. They are also due to the fact that the effectiveness of cohesion funding has differed widely between countries and regions. Ederveen et al. (2006) show that the effectiveness of cohesion funding is closely related to the quality of the institutions of the country. Nunez-Ferrer (2007) argues that this is due to the fact that cost-efficiency has been high in countries that were able to make the most of the structural funds, by putting in place good planning and implementation procedures (such as Spain and Ireland) – whilst it was low in countries that were less efficient in doing so.

Therefore, both the quality of the institutions that were in place initially, and the quality of the institutions and policies that were put in place due to the structural funds, have a great impact on their effectiveness. In addition, as

seen above, cohesion funding is not efficient in wealthier EU countries, because those countries are better placed to deal with their regional funding than the EU (Hoeller et al., 1996). The mixed results of Cohesion Policy can therefore also be partly attributed to the fact that the funding allocated to those countries is not bringing results.

Therefore, both empirical and analytical authors have shown that the effectiveness of cohesion funding depends on whether the funding is put to good use, which itself depends on the quality of the recipient country's institutions and on the effectiveness of the programmes that benefited from the funding. There is therefore a case for making the benefits conditional on results.

A further reason for the mixed results is that, as predicted by the geographical economy literature, the EU has witnessed simultaneously higher disparities between regions, and convergence at the national level (Farole at al, 2011, Faber and Ghosh, 2010).

Another issue of relevance here is whether the policy should be aimed at the convergence of the countries or of the regions. Although it was seen in step 1 that the EU Treaty mentions that cohesion policy is aimed at the regions, step 4 showed that, from the perspective of fiscal federalism, the policy should be aimed at the convergence of countries.

Several authors argue that the policy could be made considerably more efficient by changing the current "regional focus" into a "country focus" (see for example Sapir et al, 2003): at present the poorest regions of each Member State get funding – so even the richest EU countries get funding for their poorest regions. That is undesirable, as it would be more efficient if the richest Member States finance their own lagging regions. Therefore, cohesion policy can potentially be more efficient than it is at present.

The issue of whether the European Commission should give money to the national governments or to the regional governments can also be related to deeper questions about the role of the EU. It can be argued that the members of the EU are countries, not regions, and therefore money should go to the national governments who then decide how to distribute it. However, others may argue that the EU is responsible for its citizens, and therefore can give

money to any level of government. This debate goes beyond the scope of this study, but it is useful to mention it as it will be part of any decision.

Authors also argue that Cohesion Policy lacks efficiency for other reasons. Firstly, it is argued that the policy is hampered by the confusion regarding its objectives. In particular, the policy is aimed simultaneously at convergence and at economic growth (Eriksson, 2005). This is particularly the case since the launch of the Lisbon Strategy in 2000, as since then Cohesion Policy is officially aimed at the Lisbon competitiveness goals, in addition to being aimed at promoting equality between regions.

Aside from the difficulties involved in defining what is competitiveness (Martin, 2003), it is clear that these two objectives can sometimes run counter each other. Nonetheless, it is argued that, in practice, the competitiveness objective is mainly used to decide how to spend the funding within a region, while the cohesion objective is used to distribute funding between regions. This therefore enables the two objectives to co-exist without making the policy less efficient.

Secondly, the administrative requirements are too heavy and the procedures too complicated, as has been admitted by the European Commission itself (European Commission, 2011). This decreases the efficiency of the funding, both because it raises its costs and because it discourages participation. The European Commission addresses this problem in its proposals for the next programming period (European Commission, 2011).

In particular, it proposes to simplify the procedures, reduce the fragmentation between different funding programmes, and make it easier to combine EU funding with the existing national programmes. These proposals are likely to reduce the problem; it is nonetheless inevitable that EU cohesion funding adds an additional level of bureaucracy to regional funding, so this needs to be taken into account when assessing the costs and benefits of EU funding to each region.

Another important criticism is that projects are not properly audited. This causes problems in terms of accountability, which will be addressed in the political science steps below, but also reduces the efficiency of projects, and can lead to the continuation over time of projects that are not delivering

results. The European Commission has also admitted this problem (European Commission, 2011) and addresses it in its proposals. In particular, part of the funding will become conditional on reaching concrete results.

In conclusion, cohesion funding has the potential to be very effective, if is targeted at the poorer EU countries, if the European Commission ensures that beneficiaries either have, or are creating, effective institutions to manage the funding, and if there is effective auditing to ensure results.

Concerning the ESF, there is very little research available on its effectiveness, and the evaluations available focus on individual programmes funded by ESF, rather than on the fund as a whole (for example, Ainsworth and Marlow, 2011). However, the point made above that funding is less efficient when allocated to wealthier EU countries applies to ESF, as this fund is effectively being used to ensure that the wealthier EU regions also benefit from EU transfers.

Step 9: Is having this policy at EU level supported by public opinion?

The Eurobarometer poll indicates 61% of the EU population supports EU action to "support regions facing economic difficulties". This is a high figure , if compared to support for most other policy areas at EU level. There are significant differences between the results of different Member States. For example, while in Cyprus and Malta 84% of those interviewed supported EU policies to support lagging regions, in the UK that number was only 48%, and in Italy 52%. Nonetheless, apart from the UK, in all other countries the majority of the interviewees supported the existence of this policy at EU level.

Contrary to what could be expected, differences in views were not related to how much countries benefit from the policy. For example, although the Netherlands is the EU country that makes a largest contribution to the EU budget in relative terms, it was also one of the strongest supporters of EU cohesion policy with 84%. At the same time, even though southern Italy benefits extensively from EU funding for regional policy, Italy was among the countries least favourable to EU action in this area. There is therefore popular support for this policy, even in countries that are not significant beneficiaries.

Unfortunately the Eurobarometer survey does not tell us the reasons why people support EU intervention in this area. It is possible to speculate that one of the reasons behind the high levels of support is that all countries benefit from cohesion policy, as all regions currently receive some type of funding, even the wealthiest. This gives citizens the impression that they are getting a concrete benefit out of the EU. Therefore, although from an economic perspective most authors agree that the wealthiest regions should not benefit from cohesion funding (as was seen above), from a political perspective this may provide some justification (Millio, 2012).

Distributional fairness is an important issue in relation to cohesion funding. Cohesion funds are by nature intended to be distributed more to some countries than to others. However, this is not generally seen as unfair: as seen above, public opinion is mainly supportive of cohesion funding, and national governments also do not oppose it, even when a country is not a significant beneficiary. This is due both to a perception that this funding helps the single market, and to a sense of solidarity. However, solidarity between citizens of different countries is limited, so an increase in funding much beyond the current level would be opposed. In addition, there is strong opposition to any increase in the EU budget. Therefore, it is likely that this condition will continue to be met, as long as cohesion funding is not increased beyond a certain level.

Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?

This step concerns whether cohesion policy follows a democratic political process, and whether it should do so. It also assesses which parts of cohesion policy should be at EU level.

The political process behind cohesion funding has several stages. At first, a decision is made on how much funding will be allocated to each type of cohesion funding, as well as how much each country will benefit. This decision is made by the Member States in the Council, as part of the negotiations of the EU budget's Multiannual Financial Framework. As seen in Chapter 1, the decisions on the MFF are taken by the Member States' governments at an intergovernmental level. Although in theory the European

Parliament has the power to veto the entire budget, in practice this is only a symbolic threat, so it is excluded from this decision. The first part of the procedure therefore has no parliamentary legitimacy – although, as will be seen in the next section, it has indirect legitimacy.

Once this decision has been made, it is up to the European Commission to negotiate with the national governments of the beneficiary countries, a plan according to which the funds will be spent. This process is, again, insulated from parliamentary intervention, although it has indirect legitimacy because it is done together with the national governments. The only aspect of the policy which follows a parliamentary process are the guidelines and legal documents that define the way in which the policy is run. However, in practice, the plans negotiated between the Commission and the national governments have a lot more relevance in determining how the funds will be spent. This is known as the principle of partnership, whereby decisions are taken together by the Commission, the national governments and the regional authorities (Council Regulation number 2052/1988).

As far as the running of the programme and auditing are concerned, the European Commission is in theory responsible for that, but it does not have the necessary resources to ensure that this is done well. While in some countries the national authorities in charge effectively take over that responsibility and ensure that the funding is used appropriately, that has not always been the case. Therefore, this aspect of the policy is not properly overseen.

Therefore, this policy scores badly in terms of procedural legitimacy, and authors have called for more transparency in the way projects are evaluated and audited (Nunez Ferrer, 2007). The next section will assess whether this is compensated by international legitimacy.

Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?

As explained in the previous section, the decision on which countries benefit from the funding is taken at an intergovernmental level. Therefore, the redistribution aspect of the policy is handled by the countries directly, giving it high indirect legitimacy. This is in accordance with Majone's view of the

EU as similar to an independent agency to which policies involving one pareto optimum should be delegated (Majone, 1998). The decisions which are subjective and involve redistribution are handled nationally, and thereby have indirect legitimacy. This is also in accordance with Moravcsik,'s view of the EU as a simple tool of the Member States, and not a real political entity in itself (2002).

However, as seen in the methodology chapter, while authors such as Majone and Moravcsik, consider that indirect legitimacy is sufficient at EU level, other authors consider that, at this level of EU integration, indirect legitimacy is no longer sufficient (Hix and Follesdal, 2006). This is because the extent of the powers that have been allocated to the EU level, and the importance of the decisions that are therefore taken at that centralised level, require that citizens should have a direct say on them. In this specific case, given that there is a significant amount of taxpayers' money being allocated to this policy, and given that is a redistributive, and therefore highly subjective area, it could be argued that it is not legitimate for this policy to be decided by deals made behind closed doors, as part of a procedure of which the large majority of citizens is unaware.

Detailed results

The following table shows how this policy scored in terms of each of the criteria proposed in the previous chapter. For each criterion, a summary of the results obtained in the analysis above is offered in the last column. A score is also allocated, going from --, to ++. – is allocated if the policy scores very badly in terms of that criterion, and there is therefore a strong case for allocating the spending to the national level, while ++ shows a strong case for allocating it to the EU level.

For some of the steps, the table distinguishes between cohesion funding (CF) and the ESF. A distinction is also made between funding given to poorer EU countries (CF-poorer) and funding given to poorer regions within wealthier EU countries (CF-wealthier).

Table 3: Criteria for EU Funding applied to Cohesion Policy

Steps	Criteria	Result
EU Law		
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	1.1 Does Part Three of the EU Treaty mention specifically that this spending programme should be at EU level?	++ Article 175 provides a legal basis for the cohesion funds and the ESF
	1.2 Does Part Three of the EU Treaty specify which aspects of this funding policy should be at EU level?	CF: ++ Part three states that this policy should support lagging regions (as opposed to countries) so it provides backing to CF for both poorer and wealthier countries ESF + Strictly speaking, the ESF programmes respect their role as described in Part Three. However, they do not follow the Treaty's emphasis on benefiting areas where the EU can bring more value-added
Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	2.1 Does this spending programme respect the condition of subsidiarity defined in article 5?	CF-poorer: + EU-level funding can be more efficient than national funding CF-wealthier: - EU-level funding is not more efficient than national funding ESF: - EU-level funding is

		not more efficient than national funding
	2.2 Does this spending programme respect the condition of proportionality defined in article 5?	+/- It is not possible to assess whether this condition is being met, because the objectives of this policy are too vaguely defined
	2.3 Does the remainder of the Treaty indicate that this spending programme can/should be at EU level?	+ Article 3 indicates that CF and ESF should be at EU level
Public economics		
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	3.1 Is this spending programme helping to address one/several market failure(s)?	Funds for convergence: + Need for homogeneity between countries; externalities; counterbalance agglomeration effect ESF + Search costs; externality; lack of labour mobility
	3.2 Is this spending programme helping to address one/several equity goal(s)?	CF: + equity between countries; equity between regions ESF: + support the unemployed
Step 4: Should the government intervention be in	4.1 Is government intervention of the funding type the best	CF: + redistribution increases equity

terms of funding or in terms of regulation?	way to tackle the goals identified in step 3?	ESF: + Some government funding is justified
Fiscal Federalism		
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	5.1 Are there economies of scale to be gained from undertaking this spending programme at EU level?	- None were identified.
	5.2 Are there externalities to be addressed by undertaking this spending programme at EU level?	CF-poor: + Due to the Single Market, growth in the poorer EU countries results in a positive externality for the richer EU countries, because it increases the homogeneity of the economies CF-wealthy and ESF: +/- Due to the Single Market, growth in the richer EU countries results in a positive externality for all other EU countries. However, this effect is indirect, and it would justify funding for the wealthier regions (not the poorer regions within the country – CF-wealthy) and their most successful sectors (not any remaining pockets of inequality or unemployment – ESF)

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?	6.1 Are heterogeneities in tastes across EU countries low in this area?	+ Programmes are designed specifically for each country, so heterogeneity is not a problem
Step 7: Are there more political failures at EU level or at the national level?	7.1 Is/would this spending programme suffer(ing) from political failures at national level, that can/could be remedied by moving it to the EU level?	CF ++ Short-sighted politicians reluctant to invest in infrastructure
	7.2 Is this spending programme exempt from political failures at the EU level, that could be remedied by moving it to (or keeping it at) the national level?	CF: - This programme is not efficiently supervised at EU level ESF: - +/- Excessive bureaucracy and administrative costs at EU level
Public Economics		
Step 8: Can this spending programme at EU level be cost-efficient?	8.1 Is current spending at EU level cost-effective?	CF: +/- Empirical and analytical studies show that this programme has only been efficient in countries that (a) have the appropriate structures to ensure the funding is well spent and (b) have a GDP inferior to EU average ESF: - Due to the small

		scale of the programmes it is not possible to measure this, but analytical studies show that it is not efficient
	8.2 Can intervention be potentially cost-effective?	CF-poor: ++ Evidence shows that, as long as countries put the correct structures in place, funding can be very efficient CF-rich: - Evidence shows that it has not been effective ESF: - Analyses agree that this funding cannot be effective
Political Science		
Step 9: Is having this policy at EU level supported by public opinion?	9.1 Does the Eurobarometer survey show that a majority of the population support having this policy area at EU level?	+ 61% of EU citizens support this policy. Results for individual countries are also positive, with the sole exception of the UK (48%). This high level of support may be due to the fact that all EU Member States benefit from funding, including wealthier countries.
Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?	10.1 Is this spending programme aimed at redistributive rather than allocative goals? (in which case, according to Majone (1998), there is less	+ This policy is redistributive, so according to this view it does not need to benefit from procedural legitimacy, as long as indirect legitimacy is present

	need for procedural legitimacy and more need for indirect legitimacy)	
	10.2 To what extent are the political procedures associated with this spending programme controlled by the European Parliament?	- The European Parliament has little say on most aspects of this policy
Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	11.1 To what extent is this spending programme controlled by nationally elected representatives, either via the Council or via the national governments?	++ The decisions on how much each country benefits are taken at intergovernmental level by elected national politicians, and the programmes are designed at national level, so there is high indirect legitimacy.
	11.2 To what extent are the political procedures associated with this spending programme controlled by the national parliaments?	+ The decisions taken at intergovernmental level do not have to be approved by the national parliaments, but the programmes have to, as they are co-funded by the national budgets
	11.3 Is this spending programme aimed at allocative rather than redistributive goals? (in which case, according to Majone	+ This programme is redistributive, so it requires high indirect legitimacy, and it does have it

	(1998), there is less need for indirect legitimacy)	

Main results

The analysis has resulted in different outcomes for different types of cohesion funding. The funds from cohesion policy that are directed at the poorest Member States and are aimed at increasing economic growth in those countries are justified very strongly by fiscal federalism, as this can be done more efficiently at EU level (Hoeller at al., 2006). Public economics gives a more ambivalent result – on the one hand, there is a justification for public intervention, and the evidence shows that this can potentially lead to efficient results, as long as the country makes good use of the funds). On the other hand, the evidence on the effectiveness of this policy is mixed (Ederveen et al, 2003), and over the past decades there has been an increase in regional disparities, although accompanied by a convergence at the national level (Farole et al, 2011).

The analysis based on legitimacy shows that cohesion policy is backed by different factors of legitimacy at different stages of its political procedures. Therefore, as this thesis follows the approach taken by Magnette (2002) that factors of legitimacy can be relayed and substitute each other, it is argued that most stages of the procedure are legitimate. The exceptions are the implementation and auditing stages – these are not properly accountable, either at EU or at national level. They are also justified by the legal analysis, as the Treaty provides a strong basis for cohesion policy, and emphasises the role of the EU in promoting solidarity between regions.

Therefore, cohesion funding for the poorest Member States is, on the one hand, supported by most parts of the analysis, but on the other hand, the evidence is mixed and there are problems with implementation, particularly in countries with weaker institutions.

Conversely, where cohesion funding is given to regions in the wealthier Member States and/or with goals other than promoting growth, this is not

supported by the two types of economic analysis. The main reason is that those programmes can be run considerably more efficiently at the national level than at the EU level, both because the wealthier countries have enough resources to fund their own lagging regions and employment programmes, and because the national and local authorities have a better knowledge of the problems to address than officials based in Brussels. Moreover, the structures are already in place for the allocation of funding, while the allocation of EU funding requires an additional layer of bureaucracy.

However, the legitimacy analysis shows that this type of funding can contribute towards a higher public acceptance of cohesion policy; it could therefore be argued that it is needed to make the policy more legitimate. The legal analysis is generally supportive of cohesion funding for poor regions within wealthy states and for employment goals (particularly as the Treaty indicates that this policy should be mainly directed at the regions, and not at the countries), except from the perspective of subsidiarity, as this would be done more efficiently at the national level.

In conclusion, the funding given to poor regions in poor Member States is justified by most aspects of the analysis. Although the evidence is mixed, this thesis argues that this is due to the fact that not all countries have made good use of the funds, and that problem could be solved by improving the implementation and auditing of the funding, and by making it conditional on results. That in turn would also solve the problems identified by the political analysis.

Conversely, the funding given to poorer regions within wealthier countries, and to the remaining regions in the form of employment funds, is not justified by the economic analysis. However, the political and legal analyses point to some advantages. A trade-off was therefore identified, and a political decision needs to be made in relation to those types of funding.

4.2.2 Agriculture

Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?

In the EU Treaty's Part Three, Title III (Articles 38 to 44) is dedicated to agriculture and fisheries. In particular, Article 39 lists the objectives of EU action in agriculture:

EU Treaty, Article 39

1. The objectives of the common agricultural policy shall be:

> *(a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;*
>
> *(b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;*
>
> *(c) to stabilise markets;*
>
> *(d) to assure the availability of supplies;*
>
> *(e) to ensure that supplies reach consumers at reasonable prices.*

This Article gives the EU very extensive competences in agriculture, as it can intervene to promote a very wide range of objectives. Moreover, Article 40, point 3, adds that "in order to enable the common organisation referred to in paragraph 1 to attain its objectives, one or more agricultural guidance and guarantee funds may be set up", therefore providing a legal basis for funding of agriculture.

However, the policy as it currently stands is not actually targeted towards most of these goals. The next steps of the analysis will show that the objectives in points (a) and (e) are not being met by the policy. They will also show that objective (d) should no longer be seen as a necessary role for public intervention.

Moreover, following extensive reforms of the CAP, the policy is now aimed at a range of other objectives, which are not mentioned in the Treaty. As described in Chapter 2, since 1990, the CAP has been divided in two "pillars" – market support and rural development. While the first pillar is still officially attached to the objectives in the Treaty, the second pillar has different objectives, as defined by Council Regulation (EC) N° 1698/2005 of 20 September 2005:

Council Regulation (EC) N° 1698/2005 of 20 September 2005
Recitals 11, 8, 9

To ensure the sustainable development of rural areas it is necessary to focus on a limited number of core objectives at Community level relating to agricultural and forestry competitiveness, land management and environment, quality of life and diversification of activities in those areas, taking into account the diversity of situations, ranging from remote rural areas suffering from depopulation and decline to peri-urban rural areas under increasing pressure from urban centres. (11)

To focus the strategic content of rural development policy in line with the Community's priorities and hereby favour its transparency, the Council should adopt strategic guidelines on a proposal from the Commission. (8)

On the basis of the strategic guidelines, each Member State should prepare its rural development national strategy plan constituting the reference framework for the preparation of the rural development programmes.

Member States and the Commission should report on the monitoring of the national and Community strategy. (9)

These objectives are often grouped under three "axes" of the policy:

- Improving the competitiveness of agriculture and forestry through support for restructuring, development and innovation;
- Improving the environment and the countryside by supporting land management;
- Improving the quality of life in rural areas and encouraging diversification of economic activity;

Therefore, the competences of the EU in agriculture should be modified in order to meet the Treaty objectives. It could also be argued that, in order to meet point

(1e), the competences of the EU in this area should be scaled back, since the EU protection of the agricultural sector is distorting the market and hampering imports from countries that produce cheaper products, resulting in higher prices for consumers. In theory, this objective could also be achieved simply by removing the price distorting effects of the CAP, without necessarily reducing the levels of support. However, while CAP reforms reduced distortions, by its very nature a policy which is aimed at supporting the agricultural sector will necessarily provide an artificial advantage to European farmers in relation to farmers in other parts of the world, resulting in higher prices. The Treaty also specifies that there can be aid for agriculture from the EU budget.

Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?

According to the EU Treaty, agriculture and fisheries are a shared policy, so both the EU and the national level can legislate.

The principle of subsidiarity would justify ending EU funding at the national level, since the fiscal federalism analysis in steps 3-5 will show that it is more efficient at national level. However, as this is a common policy, strictly speaking this principle does not need to be met.

Article 3 does not mention agriculture specifically. It mentions that one of the EU objectives is to promote economic prosperity. Therefore, it could be argued that this would strengthen the case to bring back agricultural funding to the national level, as it is harming the economy by making EU countries artificially competitive in the agricultural sector, and therefore diverting economic resources away from other sectors in which the EU is genuinely competitive (Hoeller at al., 1996).

The conclusion from the legal analysis is therefore ambiguous. On the one hand, the Treaty clearly provides for extensive EU competences in agriculture, including funding. On the other hand, EU funding of the farming sector goes against both the principle of subsidiarity and the EU objective of promoting economic prosperity (except, of course, the prosperity of the farming sector). Moreover, the Treaty is clearly outdated with respect to agriculture, as it does not even include its new official objectives.

Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?

Government intervention in agriculture is justified by the existence of several market failures. In particular, there are positive and negative externalities in agriculture, as agricultural activity produces not just food, but also other outputs that can bring a positive value to society (such as the preservation of the countryside and food security) or a negative value (such as pollution) (OECD, 2008). The fact that agriculture is associated with a range of positive and negative externalities is known as "multifunctionality".

Accordingly, the CAP nowadays has three official goals, which are based on the concept of multifunctionality (European Council, 2006): firstly, the need to preserve the countryside – this implies finding a viable use for agricultural regions, either by making their agricultural production economically sustainable or by transforming them into tourism and preserving the environment. Secondly, preserving the environment of the rural areas, namely by promoting environmentally-friendly agriculture. Thirdly, restructuring the farm sector – as agriculture is a declining sector in Europe, given that developing countries have a comparative advantage in this area, this objective concerns helping farmers to find employment in other sectors.

The first reason corresponds to a market failure: rural areas are a public good, and this could justify government intervention to maintain that public good. The second reason also includes a market failure: government intervention to protect the environment is justified because of negative externalities – the damage to the environment caused by a farm has a negative impact on the entire population, for which the farm does not pay. The third reason corresponds to an equity goal: helping the farmers to find other employment or to make their farms more commercially viable.

The three modern justifications for the CAP (which correspond to pillar II of the CAP) are therefore valid reasons for government intervention – the other steps in this analysis will analyse whether this intervention should be done by the national governments or at the EU level. On the contrary, it is argued that the CAP is not justified by its original objectives, which are still in the Treaty as shown in step 1, and which correspond to pillar I of the CAP.

Concerning the equity goal of ensuring a good standard of living for farmers, there is no justification why the EU budget should support only the workers of the farming sector and not workers in other sectors, particularly since farmers' incomes are not on average lower than incomes of workers in other sectors (OECD, 2003). This is in part because a large number of farmers derives income from sources other than farming; however, the European Commission generally ignores these additional sources of income in its official figures, which gives the impression that farmers are poorer than they are in reality (Kaditi and Nunez Ferrer, 2006). Moreover most of the funding is given to the largest and wealthiest farmers, and this problem remains even after the last reforms (Baldwin, 2005).

Although the European Commission is making attempts to move away from "historical payments" (whereby farmers' benefits are linked to what they used to receive when payments were still linked to the quantity produced), this change is being opposed by some Member States. Moreover, larger farms retain an important advantage in that they have the resources to deal with the significant administrative requirements involved in applying for funding (Kaditi and Nunez Ferrer, 2006). Given the difficulties involved in modifying the CAP, and given the influence that large farmers have on the political process (Nedergaard, 2006) it could take a long time to completely eliminate this problem.

Another original objective of the CAP was that of providing security of food supply. The recent food shortages that occurred in certain parts of the world appeared to provide further ammunition for this argument. For example, the European Commission's DG Agriculture defends the need to preserve the EU's food production potential, 'so as to guarantee long-term food security for European citizens' (European Commission, 2009).

However, this objective is today outdated, since the risk of food shortages in the EU countries, as in all other developed countries, has long become insignificant (Zahrnt, 2011, National Consumer Council, 1989). The recent food shortages actually emphasized this, as none of the EU countries, or other developed countries, was affected by them; only developing countries were affected.

Zahrnt (2011) shows that the share of income that households spend on food in the EU has steadily declined. This is because food is an inferior good, as the

proportion of income spent on food declines as households become wealthier. Therefore, even a ten-fold increase in the price of food would be far off from provoking food scarcity in the EU. Moreover, given the wide variety of countries that are food exporters, instability in any part of the world could be addressed by simply importing from other areas. In addition, in the event of a major crisis the EU would have the resources, space and technology to respond quickly by multiplying its agricultural production.

Concerning the objective of having reasonable prices for consumers, not only does the CAP not meet it, but it even has the opposite effect (OECD, 2008). This is in effect a regressive tax, as it affects more the poorer families, whose percentage of spending on food is higher. In addition, the CAP restricts the choice of foods available – namely because it reduces imports from outside the EU.

Therefore, the original objectives of the CAP, which still figure in the EU Treaty and provide the justification for the biggest share of the CAP (Pillar I), do not provide a justification for intervention in agriculture. The measures under Pillar I are therefore not justified by this analysis. This includes both market support - which, despite having been significantly reduced by successive reforms, still accounts for a tenth of spending under Pillar I – and direct payments to farmers. Those measures could only be justified by a need to ensure food security or to redistribute wealth to farmers – and, as seen above, these objectives are not valid at present.

An exception to this conclusion is that government intervention in agriculture can also be justified by certain specificities of the market, such as the fact that, due to the biological nature of agricultural products, the supply is chronically unstable, for example because it varies with the weather (Nedergaard, 2006). However, this could clearly be done most efficiently by compensating farmers whenever they face particularly difficult weather conditions, as opposed to providing them with a permanent subsidy.

This section has shown that, while there is justification for the spending under Pillar II (the next sections will assess whether it should come from the EU or the national level), there is no justification for the spending under Pillar I. Both direct payments on a permanent basis and market support are not justified by the analysis.

Step 4: Should the government intervention be in terms of funding or in terms of regulation?

Government funding is justified in the case of a public good such as the preservation of the rural areas, to subsidise the production of a good from which the whole society benefits (OECD, 2008). In what concerns the restructuring policies, government funding is also justified to help support the people suffering from the restructuring. In what concerns the environmental goal, both funding and regulation can be required. Funding can be used to provide incentives for farmers to adopt environmentally-friendly methods of production. Therefore the three goals of the CAP can justify government funding.

Step 5: Are there externalities or economies of scale that can be best addressed at EU level?

There is wide agreement in the literature on fiscal federalism that EU policies for agriculture should be scaled back, or even completely handed back to the national level (Breuss and Eller 2004). That is because agriculture fails each of the three fiscal federalism tests to justify allocating a policy at the EU level.

There are no significant externalities between countries in this field, as these affect mainly the national citizens and their territory. The only exceptions are related to the environmental impact between countries, and could generally be best addressed on a bilateral level The preservation of the countryside in a certain country does not bring any direct gains to the citizens of another EU country, nor are the two policies interrelated in any other way. There are also no economies of scale to be gained from a common policy to maintain the countryside, as policies need to be differentiated to adapt to the different conditions of each country.

In addition, some authors argue simply that there is no justification for a policy to fund agriculture, be it at EU or at national level, because this is a

sector where EU countries have no comparative advantage (Hoeller et al., 1996)[11].

It could also be argued that, in order to have one market for agricultural products with undistorted competition, some kind of harmonization is required. However, this does not justify a common agricultural policy, because the same objective could be met via competition policy to ensure a level playing field, including common constraints for state aids.

Moreover, the EU could still contribute towards other policy goals associated with agriculture, via other policymaking tools that are less distorting and more efficient. Among others, regional policy could be used to support the restructuring of the agricultural sectors in poorer Member States, and environmental policy could be used to address the cross-border environmental aspects of agriculture.

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?

At the same time, heterogeneity is high. Firstly, citizens have different views on the preservation of their countryside. While in some countries there is a strong willingness to maintain rural areas, even if at a high cost, in others this concern is less important. A recent special issue of the Eurobarometer focusing on agriculture found that while in Finland 57% of respondents thought that agriculture and rural areas were "very important" concerns, only 31% of respondents gave the same answer in Bulgaria. (European Commission, 2008b)

Secondly, to be effective, these policies must be targeted to the specific region that they are aimed at, since they need to be adapted to the region's potential (for example, some regions are viable as tourist destinations while others not, or in some regions agriculture can be economically sustainable while in others not).

[11] An exception to this argument are products which are specific of a certain European region, and products produced using a more expensive technique – for example, bio products.

Step 7: Are there more political failures at EU level or at the national level?

Second generation fiscal federalism adds that there is a significant case of political failure involved in EU level agricultural policy – offering a further reason to keep these policies at the national level.

The literature on the political economy of the CAP can be divided into two main theoretical frameworks: the institutions framework and the interest groups framework (Kay, 2000). These two frameworks differ in their degree of emphasis on the ability of interest groups to affect decisions to reform the CAP.

The interest groups framework is based on the assumption that interest groups and lobbies have a great influence in the negotiation process, through their influence on the Member States' government representatives and/or on the European Commission (Egdell and Thomson (1999), Moyer and Josling (1990)).

On the contrary, the institutions framework defends that the main factor influencing negotiations on the CAP is the institutional setting and the procedures involved in the negotiation (Mahé and Toe (1996), Kay (1998)). The relative influence of the different EU institutions – particularly the Council, representing the Member States, and the European Commission – and the formal and informal procedures involved become the main factors influencing the outcome of the negotiations.

Due to these political failures, the institutional set-up at EU level leads to negotiating parties being concerned only with their net balances, or how much their net contribution is to the budget, rather than the common good. Moreover, there is a problem of inertia, as once a spending programme is in place, it becomes very difficult to remove it.

Naturally, there would also be political failures at the national level. However, given the extent of these problems at EU level, it is argued that these problems would not be as acute at the national level. In particular, as one of the main problems at EU level is inertia, this problem would be removed if the policy was renationalised, as that would be done according to

today's objectives of public intervention in the agricultural sector, as opposed to the 1950's objectives which are still to a great extent reflected in today's CAP.

Moreover, the fact that the CAP is financed by the EU budget makes the link between taxes paid in EU countries and CAP expenditure indirect and less obvious (Nedergaard, 2006). If agricultural spending was reallocated to the national level, it would be scrutinised by media and citizens, making it less prone to political failure.

Step 8: Can this spending programme at EU level be cost-efficient?

The CAP is highly inefficient at meeting its stated goals; this applies both to the original goals, as listed in Article 39 of the EU Treaty, which underpin Pillar I of the CAP, and to the modern goals, which underpin Pillar II of the CAP.

Concerning the original goals, Nunez Ferrer (2007) demonstrates that the goals of the CAP, as listed in Article 39 of the EU Treaty, are not met by the policy. This is in great part due to the fact that, although Pillar I programmes were in theory designed to meet those objectives, in practice they were to a great extent held hostage by other negotiations that were taking place at the time between EU countries. In particular, several authors argue that the CAP was initially designed to help EU negotiations by benefiting France (Buti and Nava, 2003).

The modern goals of the CAP are also not being met efficiently. Firstly, although Pillar II of the CAP is better targeted towards the new objectives of the CAP, most of the funding still goes to Pillar I, which does very little to meet the new objectives of the CAP. Secondly, the funding given to rural development is not allocated efficiently, because it has been designed according to political pressures to maintain funding for the same beneficiaries, instead of efficiency concerns (Katidi and Nunez-Ferrer, 2006). Therefore, the funding does not follow the "holistic approach" recommended by academic research (Saraceno (2003), OECD (2006)), whereby funding should be targeted to all activities in the rural economy (not just farming) and focus mainly on ensuring that rural areas benefit from the infrastructures and amenities necessary to allow entrepreneurship and avoid depopulation.

Instead, rural development funding is mainly given to farmers, and often supports activities and behaviour that farmers would have undertaken anyway (Zografia, 2007).

Therefore, despite several reforms of the CAP, the main effect of this policy is still to provide an incentive for more agricultural production in Europe, instead of contributing towards the restructuring of that sector. In addition, most of the funding still goes to large intensive farms, thereby not doing much to help the environment or to preserve the countryside (OECD, 2004).

Secondly, even if the policy was targeted towards the right objectives, the other steps in this analysis show that those objectives would be best achieved at the national level, so it is very inefficient to run this policy at the EU level.

Step 9: Is having this policy at EU level supported by public opinion?

The Eurobarometer question shows that public opinion is mixed, with 51% supporting EU action in this area. However, views differed widely between the different Member States. Contrarily to what could be expected, differences in views do not reflect the extent to which countries benefit from EU funding for agriculture, but rather different views on the role that the EU should play in this field.

For example, in Finland only 19% of respondents thought that the EU should have any action in the area of agriculture, while in Denmark 72% thought the EU should be active in this area.

Unexpectedly, given their large share of agriculture in the economy, the new Member States are among those who favour less EU action in this area. For example, Bulgaria, Romania, Hungary and the Czech Republic are among the lowest results. At the same time, the countries who favour it most are not among its main beneficiaries, as they include Luxembourg, Belgium and the Netherlands.

This step therefore gives an ambiguous result, as it shows that opinions on whether agricultural spending should be at EU level are genuinely divided, almost in half, among EU citizens.

Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?

As is the case with cohesion policy, the decisions on how much each country benefits from this policy are taken at an intergovernmental level, by the Member States in the Council. There is therefore no parliamentary legitimacy, but the next step will assess whether there is indirect legitimacy.

Decisions on how to design and implement the policy are shared between the intergovernmental level and the EU legislative procedures involving Commission proposals and decision-making by the Parliament and the Council. At this stage, there is therefore a degree of parliamentary legitimacy – although the legitimacy of the European Parliament can be questioned, given that most EU citizens are unaware of its debates, and vote in EU elections, not according to their views on EU policymaking, but as a way of expressing their support or otherwise for the incumbent government (Hix, 2008). Moreover, the most important decisions are taken at the intergovernmental level.

The running of the policy is then in the hands of the Member States. Although in theory this should be supervised by the Commission, in practice it does not have the resources for that. This policy therefore only benefits from very little parliamentary legitimacy. The next step will assess whether this is compensated by indirect legitimacy.

Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?

It was just seen that this policy is mainly decided at an intergovernmental level. Does that therefore provide it with indirect legitimacy? It is argued that, since this policy is a case of political failure, as was seen in Step 6, the decisions made by Member States do not reflect what national policymakers want, but instead are the outcome of negotiations held hostage by the political failure problems identified above. (With the exception of some countries, such as France, which benefit unproportionately from the CAP and for whom the status quo ensured by the inertia problem actually corresponds to their preferences). It is therefore argued that this policy lacks international legitimacy.

In theory, the lack of parliamentary and indirect legitimacy could be resolved, thereby making this policy politically legitimate at EU level. However, in practice, given the large funding involved, Member States would not allow this to be decided outside the intergovernmental level, and indeed it could be argued that to be legitimate this policy needs to be at the intergovernmental level, as it involves a large amount of redistribution (Moravczic, 2003).

At the same time, it would also be very difficult to solve the political failures that hamper this policy at the EU level, and which keep it from having indirect legitimacy. Whenever large sums are involved, policymakers see negotiations at EU level as a zero sum game. Their perception is that the political risks involved in allowing the net contribution of their country to the EU budget to increase are excessively high, so no country is willing to accept a reduction in its benefits from the CAP.

Detailed Results

The following table shows how this policy scored in terms of each of the criteria proposed in the previous chapter.

Table 4: Criteria for EU Funding applied to Agriculture

Steps	Criteria	Result
EU Law		
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	1.1 Does Part Three of the EU Treaty mention specifically that this spending programme should be at EU level?	++ This is stated in Article 40
	1.2 Does Part Three of the EU Treaty specify which aspects of this funding policy	+ The Treaty gives very wide competences to the EU in this area. However, it is also clear that these Treaty provisions do not reflect the new reality

	should be at EU level?	of the CAP, following its significant reforms
Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	2.1 Does this spending programme respect the condition of subsidiarity defined in article 5?	+/- The condition is not met, as the following steps show that this policy can be more efficient at national level. However, as it is a common policy it is not required to meet it
	2.2 Does this spending programme respect the condition of proportionality defined in article 5?	As the subsidiarity condition is not met, this condition does not apply
	2.3 Does the remainder of the Treaty indicate that this spending programme can/should be at EU level?	- In can be argued that this policy runs counter to the Article 3 objective of promoting economic prosperity
Public economics		
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	3.1 Is this spending programme helping to address one/several market failure(s)?	+/- Agriculture suffers from a range of market failures that justify public intervention. Pillar 2 of the CAP addresses those market failures, and is therefore justified. Pillar 1 of the CAP is not helping to address those market failures, so it is not justified
	3.2 Is this spending programme helping	- Although one of the objectives of this policy is to

	to address one/several equity goal(s)?	promote standards of living of farmers, it is argued that this should not be an equity goal at EU level, because farmers are not worse off than workers in other sectors
Step 4: Should the government intervention be in terms of funding or in terms of regulation?	4.1 Is government intervention of the funding type the best way to tackle the goals identified in step 3?	+ Government spending is required, particularly to address positive externalities
Fiscal Federalism		
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	5.1 Are there economies of scale to be gained from undertaking this spending programme at EU level?	- None were identified.
	5.2 Are there externalities to be addressed by undertaking this spending programme at EU level?	- There are very few externalities between countries. The only exceptions are related to the environmental impact between countries, and could generally be best addressed on a bilateral level
Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?	6.1 Are heterogeneities in tastes across EU countries low in this area?	-- Heterogeneity is high, due both to differences in natural conditions and to differences in tastes

Step 7: Are there more political failures at EU level or at the national level?	7.1 Is/would this spending programme suffer(ing) from political failures at national level, that can/could be remedied by moving it to the EU level?	- If this programme was renationalised, it is likely that there would be problems of political failure at national level; however, it is likely that they would be less severe than at EU level
	7.2 Is this spending programme exempt from political failures at the EU level, that could be remedied by moving it to (or keeping it at) the national level?	- - Agriculture suffers from severe political failures at EU level. Problems include inertia in the political negotiations and capture by interest groups
Public Economics		
Step 8: Can this spending programme at EU level be cost-efficient?	8.1 Is current spending at EU level cost-effective?	- - This spending programme is very inefficient at meeting its objectives. This applies both to the original and to the modern objectives of the CAP. It also applies both to pillar I and to pillar II
	8.2 Can intervention be potentially cost-effective?	- - All the objectives of the CAP are best met at the national level, due to the high level of heterogeneity, the absence of significant externalities or economies of scale, and the existence of major political failures at the EU level

Political Science		
Step 9: Is having this policy at EU level supported by public opinion?	9.1 Does the Eurobarometer survey show that a majority of the population support having this policy area at EU level?	+/- Public opinion is divided, at 51%. Individual country results go from 19% to 72%, and support is not correlated with how much the country benefits from the policy
Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?	10.1 Is this spending programme aimed at redistributive rather than allocative goals? (in which case, according to Majone (1998), there is less need for procedural legitimacy and more need for indirect legitimacy)	+ This policy is redistributive, so according to this view it does not need to benefit from procedural legitimacy, as long as indirect legitimacy is present
	10.2 To what extent are the political procedures associated with this spending programme controlled by the European Parliament?	- The European Parliament has little say on most aspects of this policy
Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	11.1 To what extent is this spending programme controlled by nationally elected representatives, either via the	+/- Most aspects of this policy are decided at intergovernmental level by elected national politicians. However, negotiations are hampered by political failures, so their preferences

	Council or via the national governments?	are not accurately reflected in the results
	11.2 To what extent are the political procedures associated with this spending programme controlled by the national parliaments?	- Most aspects of this policy are decided at intergovernmental level by elected national politicians, but they do not have to be approved by the national parliaments
	11.3 Is this spending programme aimed at allocative rather than redistributive goals? (in which case, according to Majone (1998), there is less need for procedural legitimacy and more need for indirect legitimacy)	+/- Does not apply, as this policy is redistributive

Main Results

From an economic perspective, the analysis has shown that the funding programmes under Pillar I of the CAP (permanent income transfers to farmers and market support) are not justified, either at EU level or at the national level. The programmes under Pillar II of the CAP are justified, as they are the best way to address several market failures. However, they can all be more efficient at the national level than at the EU level. That is due to the high level of heterogeneity, the absence of significant externalities or economies of scale, and the existence of major political failures at the EU level.

The analysis based on legitimacy also shows that this policy is not backed by either procedural or indirect factors of legitimacy at EU level. Procedural legitimacy is low because EU countries are not willing to allow the EU institutions to make decisions affecting how large sums of money are divided between EU countries, so they are taken by government representatives negotiating in the Council, often behind closed doors. Indirect legitimacy is also low, because, even though decisions are taken at intergovernmental level, the negotiation procedures are hampered by severe political failures. The public opinion analysis gave an ambiguous result, as opinion appears to be divided in half.

The legal steps give an ambiguous result. On the one hand, the Treaty gives the EU an extensive mandate in agriculture. On the other hand, the Treaty is clearly outdated, as it has not been sufficiently modified to reflect the very significant changes that have taken place, both in relation to the functioning of the policy, and in relation to its objectives. This undermines the relevance of the EU Treaty in relation to this area. Moreover, the CAP violates the principle of subsidiarity, and it could also be argued that it runs counter to other EU principles enshrined in the Treaty, such as that of promoting prosperity and economic growth.

This analysis has therefore shown that spending in agriculture should not longer exist at EU level, since this area fails almost every step of the test. Although agriculture does meet certain criteria in this methodology (most notably, from a legal perspective), those are not sufficient to counterbalance the strong case for renationalising the CAP which is made in relation to most of the criteria.

4.2.3 Research Policy

Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?

Research is covered by Title XIX, Articles 179-190 in Part Three of the EU Treaty. The articles make clear that the main objective of EU intervention in this area is to promote the cooperation of researchers across borders, to create a "European Research Area". Article 179 reads as follows:

EU Treaty, Article 179

1. The Union shall have the objective of strengthening its scientific and technological bases by achieving a European research area in which researchers, scientific knowledge and technology circulate freely, and encouraging it to become more competitive, including in its industry, while promoting all the research activities deemed necessary by virtue of other Chapters of the Treaties.

2. For this purpose the Union shall, throughout the Union, encourage undertakings, including small and medium-sized undertakings, research centres and universities in their research and technological development activities of high quality; it shall support their efforts to cooperate with one another, aiming, notably, at permitting researchers to cooperate freely across borders and at enabling undertakings to exploit the internal market potential to the full, in particular through the opening-up of national public contracts, the definition of common standards and the removal of legal and fiscal obstacles to that cooperation.

Therefore, EU activities in this area should all involve stimulating cooperation between the Member States. That is indeed the case at present, including for funding – all EU research funding goes to projects that involve cooperation between Member States.

The Treaty does not indicate which areas should be at EU level or national level (with the exception of space policy, which is specifically foreseen by Article 189). However, it states that research activities deemed necessary because of other chapters of the Treaty should be undertaken, indicating that

research is more justified at EU level when it is related to areas where the EU is more active.

Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?

"Research, technological development and space" is an area of shared competence, so both EU and Member States can create legislation. However, the Treaty specifies that any EU initiatives should not “reduce the ability of Member States to set their own policies in this area”. Therefore, although the EU can legislate and create spending programmes in this area, it cannot in any way reduce the Member States’ powers over their national policies.

This implies that any major transfer of competences from the national to the EU level is ruled out, as EU action in this area must be in parallel to national action, rather than replacing it. Therefore, any major increase in spending on this area at EU level is also ruled out.

However, as EU spending in this area is currently very low, there would still be room for increasing it, without this requiring a great increase in EU competences.

Concerning subsidiarity, the following steps will show that the conclusion from the fiscal federalism analysis is very clearly in favour of EU level activities. Concerning proportionality, it can be argued that EU action is currently not sufficient to meet the objective of creating a European research area.

Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?

Public intervention in research is justified by the existence of several market failures. A first failure is *positive externalities*: research by one company leads to new technologies that can be used by the rest of the companies, which did not have to invest in that research (Mansfield et al., 1977). Moreover, research and development is one of the main drivers of economic growth, which can have benefits for the entire society. This is particularly

relevant in the most advanced countries such as European Union countries, where the main source of growth is innovation (Aghion, 2006).

Therefore, given that the return that each individual firm obtains from its investment in research is lower than the return for society as a whole, it is likely that the total investment in research will be sub-optimal. This justifies government intervention to increase the amount invested on research, but also to reduce the externalities via legislation to protect intellectual property.

Another market failure, related to the first one, is that research is often a *public good*, as it can be non-excludable, when it is impossible to keep others from benefiting from the research, and non-rival, as one more firm benefiting from the research does the not reduce the knowledge available. This justifies government intervention to make knowledge excludable through the use of property rights, or through funding or production.

A third market failure justifying public intervention are *economies of scale*. Some types of research are very expensive and can only be undertaken by large companies, or even only by the government. These types of investment are said to have increasing returns to scale over the relevant range of production – this means that they will become cheaper if more is produced. This justifies adapting government policy dealing with competition policy, as to allow in some cases the existence of large firms even if that hampers competition, and public production.

Finally, there is an issue of *asymmetric information*, because potential investors in R&D have less information about the project than the researchers (Hall, 2002). This can make them less willing to invest, which again contributes towards a sub-optimal level of research. Government can intervene through the provision of funding, financing and loan guarantees.

Step 4: Should the government intervention be in terms of funding or in terms of regulation?

The market failures identified in step 1 justify public intervention of three types: funding, regulatory action and public production. Funding of research is justified both by the existence of externalities and by the public good characteristics because, as was discussed, these two market failures lead to

suboptimal provision of research by the market. Public funding can address that problem by subsidising additional production. This can be done via subsidies or tax credits; however, at EU level, only the option of grants is available. Grants can be very useful not only to provide funding but also as incentives that can have a positive impact on firms' R&D strategies, for example via conditions attached to the grants (OECD, 2005).

Regulatory action is also needed to address the market failure of non-excludability through the use of property rights legislation. In addition it is necessary that companies have a regulatory environment that does not diminish the incentives to invest in research, for example through over-regulation and rigid labour markets. Nunez-Ferrer (2007) shows that investment in research is sub-optimal at EU level, not from public sources, but from private sources, and this is due in great part to problems in the regulatory environment. The Aho Report (2006) also identified regulatory problems as the main barrier to investment in R&D.

Finally, public production of research can be justified in some areas, when the costs are too high for the private sector. For example, this can be the case in space or aeronautics. Public production may also be needed for types of research involving a high degree of risk, as it is impossible to foresee whether they will lead to profits. This can be the case for example for research into new low-carbon technologies to adapt to climate change.

Step 5: Are there externalities or economies of scale that can be best addressed at EU level?

The literature on traditional fiscal federalism generally concludes that these policies should be at EU level, due to the existence of economies of scale, as Member States can pool their research capacities and human capital, and avoid the duplication of research (Hoeller et al., 1996). This applies particularly to "strategic areas" of research, where the EU needs to reach a critical mass through collaboration between Member States, as to be globally competitive.

Accordingly, EU funding is only distributed to research projects that involve research centres from different EU countries, as this is a condition to participate in the calls for tender.

EU-level intervention is also justified by externalities – as EU economies are very interrelated, additional R&D investment in one country can lead a positive impact in other Member States, particularly as empirical studies show that R&D can have an impact on innovation across borders (Coe and Helpman, 1995).

Chu (2009) argues that the centralisation of R&D spending can lead to the opposite problem – overprovision of research funding – due to the common pool problem (national governments have the incentive to free-ride on the central government budget). However, it is argued that, given the very small size of the EU budget for R&D, this is not currently a problem. It would only become a problem if the EU budget for R&D was very significantly increased.

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?

It can be argued that heterogeneity is not a problem as EU countries have relatively similar levels of economic development, and therefore similar needs in terms of research. (Although there are clearly differences in the level of development of Member States, they are all developed countries).

However, it can also be argued that, despite their similar levels of development, EU countries have very different industrial structures, which makes it difficult to have an integrated policy (van Pottelsberghe, 2008).

Step 7: Are there more political failures at the EU level or at the national level?

Persson, Rolland and Tabellinni (1996) argue that, since research institutions are inefficient and badly organised in European countries, harmonization, by increasing the competition between the countries, could increase efficiency. Although national research institutions have improved significantly since then, the argument remains that the centralisation of research policy increases the competitive pressure between countries, forcing them to become more efficient.

In addition, several countries still allocate funding for research on the basis of criteria other than the quality of the projects, and not in an impartial way – this makes them more prone to political failure. At EU level, this is less of a problem, because apart from a concern to ensure that all countries benefit from the funding (including the poorer Member States), funding is allocated on the basis of efficiency.

Step 8: Can this spending programme at EU level be cost-efficient?

To be cost-efficient, EU research should meet its objectives as efficiently as possible, at a cost lower than the benefits it brings. The objective of EU research policy is to solve the market failures described above, where this can be done better at EU level than at national level. The previous steps have shown that this means both to lead to an increase in investment in research and, importantly at EU level, to improve the productivity of research. The policy is currently correctly targeted at that objective: funding is being allocated to the areas where provision of research is suboptimal, and where the EU can have most value added. In particular, funding is tied to the obligation to partner with researchers in other EU countries. I will now assess whether this is being done cost-efficiently.

The impact of EU R&D funding on the economic growth or on the productivity of EU countries is best measured by qualitative than quantitative methods. The main reason for this is that EU funding for research is mainly aimed at complementing national spending, and at making it more efficient (for example, by leading to more cross-border cooperation) so it is difficult to isolate the effect of EU funding from the effect of national funding. In addition, due to the small size of the EU budget for research (less than 5% of total government expenditure on research in the EU) it is difficult to measure the impact it has on research by itself.

These difficulties are added to the fact that it is very difficult to measure how R&D impacts on the economy, since the channels through which different types of R&D affect innovation and technical change are multiple and highly complex (Guellec and Van Pottelsberge, 2001).

For those reasons, the impact of the EU R&D policy has generally been assessed using other evaluation methods, based on case-studies, interviews

and assessments on the ground. Using these methods, a recent mid-term evaluation of MFF7 for the European Commission, by an independent expert group, found that EU funding was having a positive effect, in particular due to its leverage effects (European Commission, 2010).

A first leverage effect is that the existence of funding programmes at EU level is an important incentive for the mobility and cooperation of researchers; this leads to the creation of a Europe-wide research area, since research in Europe becomes cross-borders, instead of compartmented by countries. A larger research area will be more productive, as there will be less duplication of efforts, and there will be effects of competition and comparative advantage. Therefore, even small scale funding at EU level can have a substantial impact.

Another leverage effect of EU research policy is related to the fact that the main problem with research policy at the national level is not a lack of public funding, but inappropriate legislation (Botazzi, 2002). As argued above, the countries' regulatory environments often discourage investment in research. So the right funding programmes can provide incentives to make national policies more efficient. For example, some research programmes involve the cooperation of national governments to promote the dissemination of a new technology throughout Europe. This gives governments a powerful incentive to look into improving their regulatory environments, partly by looking at best practice in other countries.

However, the evaluation also found problems with EU research funding, and it is clear that the policy could be made more efficient. Above all, despite successive attempts to simplify procedures, the administrative burden is still excessive. This confirms the findings of a recent report of the European Parliament, known as the "Carvalho report" from the name of the MEP who led it (European Parliament, 2010). This discourages the participation of the private sector and particularly of small firms.

The European Parliament report also found that MFF7 was excessively risk-averse, in that it was unwilling to provide funding to risky projects – however as seen above, one of the reasons why government intervention is needed in research is that it can be difficult for the private sector to find funding for riskier R&D investments.

As a conclusion, funding of R&D at EU level can be very cost-efficient, particularly as, due to leverage effects, a small amount of funding can have a large positive effect. The current level of cost-efficiency is already high, but could be made higher by improving the policy in the ways indicated above.

Step 9: Is having this policy at EU level supported by public opinion?

There is very wide support for EU action on "scientific and technologic research", with 73% of the population thinking that the EU should be active in this field. This may be due to the fact that people support transferring to the EU level policies where they feel that cooperation between the Member States can lead to more efficient results.

There is not a great disparity in results between the Member States in this area, as they vary only between 61% (UK) and 92% (Cyprus), and most countries' results are between 70% and 85%.

However, it is possible that support would be lower if funding for research was significantly increased, because if funding is allocated on the basis of excellence, it will be mainly given to the wealthier countries which have more established research institutions. This could be resented by the poorer Member States, and lead to problems of redistributive fairness, because funding for research should be distributed on the basis of excellence, and this may lead to some countries benefiting more than others. At present, funding is not being distributed on the basis of merit only, precisely to ensure that each country gets its fair share. However, this makes the policy considerably less efficient.

Although research networks across countries help to limit this problem (funding is always allocated to a group of countries, rather than to a single country) they do not eliminate it completely, because, if funding is distributed on the basis of merit, naturally the best performing countries will be able to participate in a larger number of projects.

Part of the justification for a EU-level policy is the fact that it leads to competition for the funding, forcing researchers to become more efficient, and also that it allows for specialisation of countries in the areas where they

can be more efficient. However, this will not take place if funding is distributed on a country basis.

This problem is aggravated by the fact that if funding is allocated on the basis of excellence, it will be mainly given to the wealthier countries which have more established research institutions. This will make the distribution even more unfair, as poorer countries will be subsidizing research in richer countries.

A way of tackling this problem would be to have a compensation system, whereby funding would be allocated according to excellence, but countries would afterwards be compensated for any net balance losses. This type of scheme has been proposed by several authors (see, for example, Heinemann, Mohl and Osterloh, 2008).

However, this would not solve the problem entirely, because if funding for research was substancially increased at EU level, and therefore decreased at national level, this would make poorer countries less able to fund their research. It could be argued that research is a core aspect of national industrial structure, and to lose it would be damaging. However, the same can be said of several types of economic restructuring at EU level due to the Single Market, as they can also lead to a restructuring of the industry throughout Europe, and to a concentration of certain industries in certain countries rather than others.

It should also be noted that poorer countries obtain funding for research – namely, for the creation of research infrastructures - via cohesion funding. This could be seen as compensation for obtaining less funding for research projects from the research budget.

Therefore, a balance needs to be found between reaping the benefits of a common research area and ensuring that countries can keep their R&D infrastructure. While funding for research is kept at the current very low level, this is unlikely to prove problematic. However, if it was to become a significantly larger percentage of the EU budget, it would be necessary to ensure that poorer countries are not excessively penalised.

Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?

Concerning research policy, this is an area where governments often delegate part of the decision-making to an independent agency, as decisions on which research to support can be made more efficiently if they are impartial and independent. When that is the case, having an independent agency at EU level or at national level should lead to the same degree of procedural legitimacy. When that is not the case, it is possible that accountability is lower at the EU level, and there is a risk that this policy could fall prey to vested interests.

As was the case for the previous two policies analysed, the political process behind EU funding for research begins at intergovernmental level, with the decisions on how much of the EU budget should be spent on research, and how much is going to each main heading of spending (cooperation, ideas, people, capacities) However, differently to the two previous cases, the EU budget negotiations do not set by how much each country will benefit. That is because the funding under each heading is then allocated via calls for tender, so that the best research proposals benefit from funding, irrespective of their country.

The reason for this is, firstly, that research funding should always be allocated to the most efficient projects (Nunez-Ferrer and Figueira, 2011), and secondly, that, as research funding represents a much smaller share of the EU budget, Member States accept that it is redistributed according to efficiency criteria rather than at an intergovernmental level.

In practice, approximately 15% of the funding is allocated by an independent "council" and is therefore distributed entirely according to efficiency criteria. The majority of the funding is allocated via calls for tender, where European Commission officials are in charge of selecting the best projects. Commission officials select the projects based on efficiency criteria, although they also take into account other concerns, such as territorial equity. For example, officials will seek to ensure that poorer EU countries, namely those from the more recent Member States, also benefit from the funding, and that it does not always go to the same countries.

Therefore, in this case, Majone's argument that the EU is being used as an independent agency actually applies fully. Public funding for R&D is an area where decisions on which research to support can be made more efficiently if they are impartial and independent, leading several countries, such as the UK, Ireland and Portugal, to allocate it to an independent agency. Therefore, having an independent agency at EU level or at national level should lead to the same degree of procedural legitimacy.

Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?

As seen above, only the decisions on how much to allocate to research from the EU budget, and how much goes to each main heading, are taken at intergovernmental level, while the rest is decided based on effectiveness criteria. Therefore, indirect legitimacy applies to those two decisions, but is not relevant for the rest of the procedure. Since, as explained in the previous step, this is a policy area where decisions should be taking impartially, it is argued that this degree of indirect legitimacy is optimal, as it gives governments a direct say on the (subjective) question of how much funding should be allocated to the EU level, but not on the (objective) question of which projects should benefit.

In the case of agriculture, it was argued that political failures meant that governments were not able to negotiate spending on agriculture in a way that was beneficial, either to the EU as a whole, or even to each country individually. In the case of research, that problem does not apply, as countries cannot set how much is benefiting each country individually, since that is done by Commission officials.

Detailed Results

The following table shows how this policy scored in terms of each of the criteria proposed in the previous chapter.

Table 5: Criteria for EU Funding applied to Research Policy

Steps	Criteria	Result
EU Law		
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	1.1 Does Part Three of the EU Treaty mention specifically that this spending programme should be at EU level?	++ Part Three mentions specifically funding programmes at EU level
	1.2 Does Part Three of the EU Treaty specify which aspects of this funding policy should be at EU level?	+ The current programmes are in accordance with the Treaty's emphasis on promoting cross-border research
Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	2.1 Does this spending programme respect the condition of subsidiarity defined in article 5?	++ This policy can clearly be more efficient at EU level, due to important economies of scale
	2.2 Does this spending programme respect the condition of proportionality defined in article 5?	++ It can be argued that, to achieve the objective of creating a ERA, funding is not yet sufficient and should be increased
	2.3 Does the remainder of the Treaty indicate that this spending programme can/should be at EU level?	+ The other references to this policy in the Treaty confirm its place at EU level. They add that EU policies should not limit the powers of national governments; indicating that there should not be an

		excessive increase in EU powers in this area
Public economics		
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	3.1 Is this spending programme helping to address one/several market failure(s)?	++ R&D has several market failures justifying public intervention, such as positive externalities and economies of scale
	3.2 Is this spending programme helping to address one/several equity goal(s)?	- This policy is not directly targeted towards any equity goals
Step 4: Should the government intervention be in terms of funding or in terms of regulation?	4.1 Is government intervention of the funding type the best way to tackle the goals identified in step 3?	+ This policy requires both funding and regulatory intervention.
Fiscal Federalism		
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	5.1 Are there economies of scale to be gained from undertaking this spending programme at EU level?	++ This policy benefits from very significant economies of scale at EU level
	5.2 Are there externalities to be addressed by undertaking this spending programme at EU level?	+ R&D is one of the main drivers of growth in EU countries, and EU economies are interconnected

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?	6.1 Are heterogeneities in tastes across EU countries low in this area?	- It is argued that the similarities between the R&D needs of EU countries are sufficiently large to justify a common R&D policy, and that heterogeneity is not a problem as long as the policy focuses on the areas where there is similarity
Step 7: Are there more political failures at EU level or at the national level?	7.1 Is/would this spending programme suffer(ing) from political failures at national level, that can/could be remedied by moving it to the EU level?	+ Spending at national level is currently too low, so the additional spending at EU level helps to mitigate that problem.
	7.2 Is this spending programme exempt from political failures at the EU level, that could be remedied by moving it to (or keeping it at) the national level?	- EU funding involves heavy administrative burdens, making it difficult for small firms to benefit
Public Economics		
Step 8: Can this spending programme at EU level be cost-efficient?	8.1 Is current spending at EU level cost-effective?	+ Although it is nearly impossible to measure this effect empirically, theoretical analyses agree that this policy is very effective, particularly due to its leverage effects

	8.2 Can intervention be potentially cost-effective?	++ Analysts agree that this policy is cost-effective and has the potential to become ever more so if the funding is increased
Political Science		
Step 9: Is having this policy at EU level supported by public opinion?	9.1 Does the Eurobarometer survey show that a majority of the population support having this policy area at EU level?	+ 73% of EU citizens support this policy. It is argued that these high levels of support could not be maintained if the funding was excessively increased, but given the currently low levels there is still room for an increase
Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?	10.1 Is this spending programme aimed at redistributive rather than allocative goals? (in which case, according to Majone (1998), there is less need for procedural legitimacy and more need for indirect legitimacy)	+ This policy is allocative, so it can be decided at EU level, as long as it benefits from procedural legitimacy
	10.2 To what extent are the political procedures associated with this spending programme controlled by the European Parliament?	- The decisions on which countries benefit from funding are made impartially by Commission officials

Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	11.1 To what extent is this spending programme controlled by nationally elected representatives, either via the Council or via the national governments?	+ The total level of spending is decided at intergovernmental level (high indirect legitimacy), while the decision on which programmes benefit is taken by officials and an independent Council (no indirect legitimacy, but it is argued that at this level it is not needed)
	11.2 To what extent are the political procedures associated with this spending programme controlled by the national parliaments?	- The national Parliaments are not involved
	11.3 Is this spending programme aimed at allocative rather than redistributive goals? (in which case, according to Majone (1998), there is less need for indirect legitimacy)	++ This spending programme is directed at allocative goals, and is, even at national level, often delegated to an independent agency, so that decisions can be made on the basis of efficiency only

Main results

Fiscal federalism and public economics make a very strong case for EU research funding at EU level, due to economies of scale and political failures at the national level (Hoeller et al., 1996), although the small scale of the

funding makes it difficult to obtain direct empirical evidence. Leverage effects are also by nature very difficult to measure. The political analysis shows that transferring a small amount of EU funding for research to the EU level does not present major problems of legitimacy, since this funding should be distributed according to criteria of efficiency, and not according to political choices. However, if the funding was to be increased on an extremely large scale, there would be problems, as EU citizens and governments oppose more spending at EU level, and if funding is distributed according to excellence this could be seen as distributionally unfair.

The legal analysis reinforces this conclusion. While the Treaty clearly offers a legal basis for spending on research at EU level, it also emphasises that the EU competences in this area should not lead to any reduction of the national sovereignty. This implies that EU funding should be additional to national funding, rather than replacing the national programmes.

The conclusion from this analysis is therefore that there should be research funding at EU level, but it should be maintained below a certain level, as to avoid the potential problems highlighted by the political analysis. However, the current level of spending on R&D at EU level is so low that it would still be advisable to increase it, since that would increase the economic benefits of integration in this area, without causing legitimacy problems. This is particularly true in the light of the fact that the EU spends relatively less on research than several other OECD countries such as the US and Japan, and this is one of the reasons why its R%D productivity is lagging behind (Botazzi, 2002).

This analysis has helped to explain the discrepancy between the fiscal federalism recommendations and the reality. While fiscal federalism would suggest that funding for research should be entirely at EU level, because it can be considerably more efficient, EU funding for research is currently very low. The other academic lenses help to explain this, as they show that there would be political and legal problems associated with transferring great part of the national spending programmes to the EU level.

5. Conclusion

The question of how the EU budget should be spent is not only an economic one – it is also inextricably linked with politics and law. This thesis has attempted to offer a set of fiscal principles that can be applied to all areas of spending, to give guidance to policymakers and academics on how the EU budget should be spent.

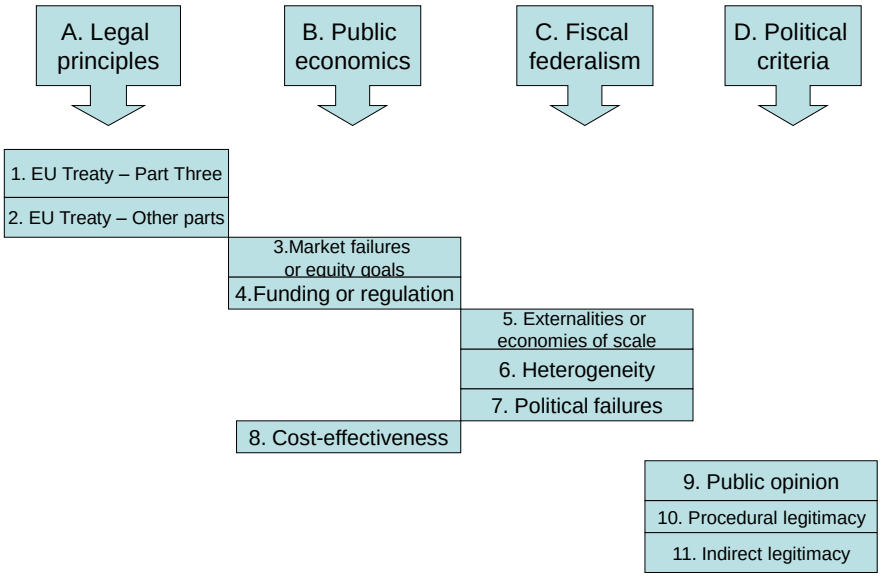
The research question tackled by this thesis was "what set of fiscal principles should guide the allocation of spending programmes to the EU budget?". The main findings of the thesis can therefore be divided into two types: firstly, the set of principles proposed by the thesis; secondly, the results obtained by applying that set of principles to three areas of the EU budget. Section 5.1 addresses the first question, by explaining the set of fiscal principles proposed, and the added value that these provide. Section 5.2 then summarizes the main results for cohesion, agriculture and research. Section 5.3 analyses how the methodology proposed helps to solve the flaws that scholars have identified in the discipline of fiscal federalism, when it is applied to the EU. Section 5.4 suggests areas for future research. Section 5.5 concludes by relating the proposals made in this thesis with the current policy context.

5.1 A Set of Fiscal Principles for the EU Budget

The main goal of this thesis was to propose a set of fiscal principles that could be used to find how the EU budget should be spent. This was achieved by deriving, from four different academic fields, the conditions that need to be met for a spending programme to be necessary, to be more efficient at EU level, and to be legitimate from both a political and a legal perspective at EU level.

Those insights were translated into conditions – a policy should be funded by the budget if it passes those conditions. The following scheme shows the eleven conditions that should be met for there to be a case for a certain policy area or spending programme to be funded by the EU budget.

Figure 1: Methodology



The first two, legal, steps, assess whether the EU Treaty supports the existence of a certain spending programme at the EU level. The third and fourth, economic, steps, assess whether the spending programme is needed and requires public funding. The following three steps are based on fiscal federalism, and analyse whether the spending programme is more efficient if it is handled by the EU budget or by the national budgets. The eighth step looks at whether the spending programme can, in practice, be delivered efficiently by the EU budget. Finally, the last three steps assess whether it is politically legitimate to transfer the sovereignty and control over the spending programme from the hands of the national government to the EU political system.

This graph shows the steps that a policy should pass to be funded by the EU budget. These steps can also be associated with concrete criteria, which need to be met by a programme to pass a certain step. In some cases, those criteria can provide a straightforward answer on whether a programme passes the step (for example, 1.1 Does Part Three of the EU Treaty mention that this

spending programme should be at EU level?). In other cases, the answer will be more subjective (for example, 8.2 Can intervention be potentially cost-effective?

Table 2 shows the criteria that can be associated with each step, as well as the sources from where an answer to each criteria can be derived:

Table 2: Criteria for EU Funding

Steps	Criteria	Sources
EU Law		
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	1.1 Does Part Three of the EU Treaty mention specifically that this spending programme should be at EU level?	EU Treaty
	1.2 Does Part Three of the EU Treaty specify which aspects of this funding policy should be at EU level?	EU Treaty; Literature on EU law
Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	2.1 Does this spending programme respect the condition of subsidiarity defined in article 5?	EU Treaty; Literature on EU law; Literature on fiscal federalism
	2.2 Does this spending programme respect the condition of proportionality defined in article 5?	EU Treaty; Literature on EU law
	2.3 Does the remainder of the Treaty indicate that this spending programme can/should be at EU level?	EU Treaty; Literature on EU law

Public economics		
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	3.1 Is this spending programme helping to address one/several market failure(s)?	Literature from public economics on policy area
	3.2 Is this spending programme helping to address one/several equity goal(s)?	Literature from public economics on policy area
Step 4: Should the government intervention be in terms of funding or in terms of regulation?	4.1 Is government intervention of the funding type the best way to tackle the goals identified in step 3?	Literature from public economics on policy area
Fiscal Federalism		
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	5.1 Are there economies of scale to be gained from undertaking this spending programme at EU level?	Literature on fiscal federalism
	5.2 Are there externalities to be addressed by undertaking this spending programme at EU level?	Literature on fiscal federalism
Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?	6.1 Are heterogeneities in tastes across EU countries low in this area?	Literature on fiscal federalism

Step 7: Are there more political failures at EU level or at the national level?	7.1 Is/would this spending programme suffer(ing) from political failures at national level, that can/could be remedied y moving it to the EU level?	Literature on second generation fiscal federalism
	7.2 Is/would this spending programme suffer(ing) from political failures at the EU level, that can be remedied by moving it to (or keeping it at) the national level?	Literature on second generation fiscal federalism
Public Economics		
Step 8: Can this spending programme at EU level be cost-efficient?	8.1 Is current spending at EU level cost-effective?	Data on current cost-effectiveness of programmes; Literature on cost-effectiveness
	8.2 Can intervention be potentially cost-effective?	Literature on current and potential cost-effectiveness
Political Science		
Step 9: Is having this policy at EU level supported by public opinion?	9.1 Does the Eurobarometer survey show that a majority of the population support having this policy area at EU level?	Eurobarometer survey
Step 10: Does having this area of spending at EU level lead to problems in terms of	10.1 Is this spending programme aimed at allocative rather than redistributive goals? (in	Political procedures underpinning the policy;

procedural legitimacy?	which case, according to Majone (1998), there is less need for procedural legitimacy)	Majone (1998)
	10.2 To what extent are the political procedures associated with this spending programme controlled by the European Parliament?	Political procedures underpinning the policy
Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	11.1 To what extent is this spending programme controlled by nationally elected representatives, either via the Council or via the national governments?	Political procedures underpinning the policy
	11.2 To what extent are the political procedures associated with this spending programme controlled by the national parliaments?	Political procedures underpinning the policy
	11.3 Is this spending programme aimed at allocative rather than redistributive goals? (in which case, according to Majone (1998), there is less need for indirect legitimacy)	Political procedures underpinning the policy; Majone, 1998

The aim of this set of principles is, not to provide concrete objective answers, but to allow policymakers to make decisions based on a complete and sound knowledge of the advantages and disadvantages of funding a certain area at EU level. Indeed, the analysis highlighted that, for most areas of spending,

there is no straightforward answer on whether they should be handled at EU level – instead, there are often trade-offs. For example, it may be economically efficient to fund a certain area at EU level, but not politically legitimate.

This is because there is no straightforward answer on what the (spending or other) competences of the EU should be. The answer depends on a large number of subjective factors, such as one's liking or disliking of the EU, and whether they stand towards the left or towards the right of the political spectrum. Robustness of results can therefore not be provided, as different assumptions, or a different weighting of the criteria, would lead to different results.

Nonetheless, this methodology aims to provide a clear picture of the advantages and disadvantages of funding each area at EU level, so that an informed choice can then be made by policymakers and, insofar as the EU's democratic setup allows, voters.

5.2 How Should the EU Budget be spent? Results for cohesion, agriculture and research

The thesis applied the proposed set of fiscal principles to three areas of spending: cohesion funding, agriculture and research funding. This sub-section reviews the main results, and presents them in a table format.

For cohesion funding, most aspects of the analysis support the continuation of EU cohesion funding for poor regions *within poor EU Member States*. The analysis found that this funding can potentially be very efficient in helping those regions (Hoeller, 1996, Nunez-Ferrer, 2007), that it is fully backed by EU law, and that a mix of supranational and community method ensures the legitimacy of the political process currently in place. Some aspects of the analysis were less supportive of this type of funding, namely the fact that the evidence on the effectiveness of cohesion funding is mixed, and the policy appears to be successful only in some countries (Ederveen, 2003, OECD, 2007, Farole, 2011). But it was suggested that those problems could be solved if the EU ensures that the funding is spent appropriately, and has the desired leverage effects.

However, for the other parts of the funding, the analysis has exposed trade-offs that should be openly addressed. The economic analysis would suggest to renationalise both the funding for poorer regions within wealthier Member States and employment funding, because it is not efficient at EU level (Hoeller, 1996, Bureau and Champsaur, 1992). However, the political analysis showed that there can be advantages in providing cohesion funding to all Member States, as there could be a higher public acceptance of the policy if all citizens feel that they are benefiting directly from the EU budget. The legal analysis was ambiguous; while the Treaty provides a clear basis for all types of funding, the subsidiarity condition is clearly not met in these cases.

There is therefore a trade-off between the fact that these policies cannot be performed efficiently at EU level, and the fact that they are meeting a political objective. This requires a political choice to be made.

Concerning agriculture, the picture is more straightforward. All sections of the analysis have shown that this spending policy should not be at EU level,

except EU law, which is ambiguous on the subject. It has shown that this policy is inefficient and even in some respects harmful for the economy and at the same time also decreases political legitimacy (Breuss and Eller 2004, Hoeller et al., 1996, Kay, 1998, Kaditi and Nunez Ferrer, 2006, OECD, 2005). This applies both to Pillar II of the CAP (those spending measures are justified, but should be undertaken at the national level) and to Pillar I of the CAP (those measures are not necessary, even at national level).

Although there is consensus in the literature that the CAP should be reformed, some analysts shy away from advising its complete renationalisation, as they believe that it is not politically realistic to expect that it will ever happen. However this study argues that the first step in the reform of the EU budget is to assess how it should be spent, and only in a second phase there should be an assessment of what reforms are possible at this stage.

Moreover, by not advising the complete renationalization of this policy, analysts give the mistaken impression that there is actually a need for some elements of this policy to be retained at EU level. As a result, the work that the European Commission is currently undertaking to reform the CAP (known as the Ciolos Proposals, from the name of the Commissioner for Agriculture) is focusing on making the CAP more environmentally friendly, rather than focusing on renationalising it. In addition, Szemlér and Eriksson (2008) show that policymakers in all EU countries now expect that there will be a significant reform of the CAP. Therefore the political climate may be ripe to achieve changes in this area, and it is useful to make clear that changes should be as much as possible in the direction of renationalizing the CAP.

Finally, for research policy, the analysis has shown that, while economic criteria would advise a significant or even total transfer of funding programmes from the national to the EU level (Hoeller et al, 1996), this could lead to political and legal problems. Therefore, the conclusion is that there should be an increase in research funding from the current (very low) levels (Botazzi, 2002), but that this should not go beyond a certain level. Here again, there is a trade-off between economic objectives (increasing the productivity of research in Europe) and political objectives (maintaining the legitimacy of the EU).

In conclusion, the analysis has shown that the EU budget should no longer finance agriculture, and that the share for research should be increased, but research funding is being spent appropriately so no significant changes are needed regarding the types of programmes in place. As for cohesion, the analysis has shown that the EU budget should continue to fund help for the poorest regions within the poorest Member States. The decision on whether to continue the funding for poorer regions within wealthier Member States is a political one, that should be made based on the trade-offs highlighted by the analysis.

Although the other areas of the EU budget have not been analysed, the results obtained already point to a very different EU budget from the one that is currently in place. Eliminating spending on agriculture would free up half of the budget, which could then be used to increase spending on research, and to fund other policy areas.

Table 6: Main Results for the three Policy Areas analysed

	Cohesion	**Agriculture**	**Research**
Step 1: According to the EU Treaty's Part Three, what should be the competences of the EU in this area?	The EU Treaty backs both cohesion funding and employment funding. It emphasizes that funding is for the regions (not countries) (EU Treaty, Title XVIII (Articles 174 to 178) and Title XI (Articles 162 to164))	The Treaty supports a high level of EU intervention in agriculture. However, the objectives specified in the Treaty do not correspond to the policies currently in place, so the policy should be significantly modified. (EU Treaty, Title III, Articles 38 to 44)	Part Three foresees EU funding of research, and mentions that EU activities in this area should all involve stimulating cooperation between the Member States. (EU Treaty, Title XIX, Articles 179-190)

Step 2: According to all other sections of the EU Treaty, what should be the competences of the EU in this area?	The remainder of the Treaty also backs this policy, without adding further guidance. (EU Treaty, Articles 3 and 5, and Title 1)	The subsidiarity condition is not met by this policy. It can also be argued that this policy runs counter to the objectives of Article 3 (EU Treaty, Articles 3 and 5, and Title 1)	The remainder of the Treaty implies that the funding should be increased, but stay below a certain level (EU Treaty, Articles 3 and 5, and Title 1)
Step 3: Is the government intervention necessary, either to address a market failure or to meet an equity goal?	There are several market failures and equity goals justifying intervention. Market failures: Internal market requires homogeneity between countries; positive externalities; compensating for agglomeration forces. Equity goals: redistribution between EU regions (European Commission, 2010b)	Government intervention in agriculture is justified by the existence of several market failures. In particular, positive and negative externalities, as agricultural activity produces not just food, but also other outputs that can bring a positive value to society (such as the preservation of the countryside and food security) or a negative value (such as pollution) (OECD, 2008)	Public intervention in research is justified by the existence of several market failures. For example, positive externalities: research by one company leads to new technologies that can be used by the rest of the companies, which did not have to invest in that research (Mansfield et al., 1977)

Step 4: Should the government intervention be in terms of funding or in terms of regulation?	Funding (although conditionality ensures impact on regulation) (Nunez-Ferrer, 2007)	Government funding is justified in the case of a public good such as the preservation of the rural areas, to subsidise the production of a good from which the whole society benefits (OECD, 2008)	Funding of research is justified both by the existence of externalities and by the public good characteristics because, as was discussed, these two market failures lead to suboptimal provision of research by the market (OECD, 2005)
Step 5: Are there externalities or economies of scale that can be best addressed at EU level?	Fiscal federalism justifies redistribution to poorer regions within poorer countries, but not within wealthier countries. (Hoeller et al., 1996)	There is wide agreement in the literature on fiscal federalism that EU policies for agriculture should be scaled back, or even completely handed back to the national level (Breuss and Eller, 2004)	The literature on traditional fiscal federalism generally concludes that these policies should be at EU level, due to the existence of economies of scale, as Member States can pool their research capacities and human capital, and avoid the duplication of research (Hoeller et al, 1996)

Step 6: Is there a significant heterogeneity of preferences, which makes EU level action problematic?	Heterogeneity is not a problem, because the programmes funded by the regional funds are designed and managed at the national level. However, in the case of ESF the programmes are designed at EU level, and therefore do not take into account heterogeneity of preferences, which is very high in this area (Alesina and Wacziarg, 1999)	Heterogeneity is very high. The nature of rural areas differs widely between countries. In addition, while in some countries there is a strong willingness to maintain the rural areas, even if at a high cost, in others this concern is less important. (European Commission, 2008b)	It can be argued that heterogeneity is not a problem as EU countries have relatively similar levels of economic development, and therefore similar needs in terms of research. However, it can also be argued that, despite their similar levels of development, EU countries have very different industrial structures, which makes it difficult to have an integrated policy (van Pottelsberghe, 2008)
Step 7: Are there more political failures at EU level or at the national level?	Cohesion funds decrease political failures at national level, as, with their requirement of being co-funded by the national budgets, they provide an incentive for national	There is a significant case of political failure involved in EU level agricultural policy (Kay, 1998). It is very likely that these problems would be lower at national level, as	Persson, Rolland and Tabellinni (1996) argue that, since research institutions are inefficient and badly organised in European countries, harmonization, by increasing the

	governments to put money into creating the right infrastructures for growth	many of its causes are EU-specific (inertia, common pool problem, problems with EU policymaking procedures)	competition between the countries, could increase efficiency
Step 8: Can this spending programme at EU level be cost-efficient?	Mixed results. The effectiveness of cohesion funding depends on whether the funding is put to good use, which itself depends on the quality of the recipient country's institutions (Ederveen at al., 2006)	The CAP is highly inefficient at meeting its stated goals. Firstly, the policy is not actually targeted towards its main stated goals. Secondly, even if the policy was targeted towards the right objectives, the other steps in this analysis show that those objectives would be best achieved at the national level. This applies both to pillar I and to pillar II (Kaditi and Nunez Ferrer, 2006)	Difficult to measure empirically, as small funding and main impact is through leverage effects. Majority of scholars agrees it has a positive effect (Hoeller et al., 1996, Botazzi, 2002)
Step 9: Is having this policy at EU	According to Eurobarometer, 61% of EU	Opinions on whether agricultural	There is very wide support for EU action on

level supported by public opinion?	citizens support the existence of this policy at EU level. So the majority supports it, even though this is by a small margin (European Commission, 2010). It is likely that the level of support would fall if funding was no longer allocated to any of the wealthier countries – this can be seen as an argument to maintain that type of funding (Millio, 2012)	spending should be at EU level are divided, almost in half, among EU citizens (European Commission, 2010)	"scientific and technologic research", with 73% of the population thinking that the EU should be active in this field (European Commission, 2010)
Step 10: Does having this area of spending at EU level lead to problems in terms of procedural legitimacy?	Most aspects of this policy are decided at an intergovernmental level, without direct democratic control. However, it can be argued that, as this is a redistributive policy, the emphasis should be, not on procedural	Here also, most aspects of this policy are decided at an intergovernmental level, so there is no direct democratic control	Public funding for R&D is an area where decisions on which research to support can be made more efficiently if they are impartial and independent. Therefore, having an independent agency at EU level or at national level should lead to the

	legitimacy, but on indirect legitimacy (Majone, 1998)		same degree of procedural legitimacy
Step 11: Does having this area of spending at EU level lead to problems in terms of indirect legitimacy?	Most aspects of this policy are decided at an intergovernmental or national level. Indirect legitimacy is therefore high	This policy is mainly decided at an intergovernmental level. However, it is argued that, since this policy is a case of political failure, the decisions made by Member States do not reflect what national policymakers want, hampering indirect legitimacy	The decisions on how much to allocate to research from the EU budget, and how much goes to each main heading, are taken at intergovernmental level. Therefore, indirect legitimacy applies to those two phases of policymaking
Main Results	The funding given to poor regions in poor Member States is justified by most aspects of the analysis. Conversely, the funding given to poorer regions within wealthier countries, and to the remaining regions in the form of employment funds, is not	All spending programmes within this policy fail the majority of the steps. Pillar I measures are not justified, either at EU or at national level. Pillar II measures are justified, but should be made more efficient and should be undertaken at the	While fiscal federalism would suggest that funding for research should be entirely at EU level, because it can be considerably more efficient, EU funding for research is currently very low. The other academic lenses

	justified by the economic analysis. However, the political and legal analyses point to some advantages. A trade-off was therefore identified	national level rather than at the EU level	help to explain this, as they show that there would be political and legal problems associated with transferring great part of the national spending programmes to the EU level

5.3 Towards a European Version of Fiscal Federalism

One of the main goals of this thesis was to contribute towards improving how the methodology of fiscal federalism can be applied to the EU. In particular, this thesis has sought to solve the problems of applying fiscal federalism to the EU (described in section 3.1), by completing the insights of that discipline with those of three other fields. This has addressed the main limitations as pointed out by scholars in this field, in the following ways.

Oates (2002) pointed out that fiscal federalism was designed for countries and not for “emerging confederations”, which led to problems when it was applied to the EU. Including considerations of legitimacy into the analysis helps to solve this problem, because it makes it possible to take into account the fact that it is not sufficient to ascertain that a certain policy can be achieved more efficiently at EU level, for it to be justifiable to reduce national sovereignty on it. The legal analysis also helps to address this question, as it makes it possible to consider what EU countries agreed would be the role of the EU in each area.

Ackrill (2003) noted that when fiscal federalism is applied to a single country, the "central" level of government is the higher level of government, while, in the EU, the national governments are more powerful than the EU level. Therefore, the highest level of government is also the “broadest” in fiscal terms. This methodology addressed that problem, by considering, within the political analysis, the general reluctance to increase funding at EU level.

Until recently, to the knowledge of this author no attempts had been made to solve the problems connected specifically with the application of fiscal federalism to the EU. A very recent paper, published while this thesis was in the editing stages (Jamet 2011), has just made a first attempt by considering heterogeneity of preferences, not as an exogenous factor, but instead as a factor that can be altered by deliberation. Therefore, he adds to the fiscal federalism criteria, an additional criterion: that the allocation of a certain policy at EU level should be accompanied by the creation of a political system that ensures that the design and implementation of the policy are done in accordance with the preferences of the citizens affected by them.

That paper therefore has similar objectives to this thesis concerning the adaptation of fiscal federalism to the EU. However, it stops short of providing an adapted version of fiscal federalism that can be used, in practice, to allocate competences to the EU level. The methodology proposed in this thesis attempts to do that.

Looking ahead, the methodology proposed in this thesis could also be modified into a “European version” of fiscal federalism. While this thesis has taken a multidisciplinary approach, by keeping each discipline separate, it would also be possible to take an interdisciplinary approach, by inserting elements from other disciplines into fiscal federalism. Just as “second generation” fiscal federalism has incorporated certain aspects of political economy into the theory, thereby making it more realistic, It would also be possible to incorporate some of the steps of this methodology into the theory. Namely, it would be possible to incorporate the concept of legitimacy into the theory, either just from a political perspective, or including also the related legal considerations.

This would effectively result in a novel use of political economy within fiscal federalism – instead of focusing just on political failures, it would bring in the political literature on the concept of legitimacy.

The literature on fiscal federalism has so far not taken centre stage in the debate on the future of the EU. This is partly due to the fact that these theories had so far appeared to be out of touch with the reality of the EU, as they ignored political considerations. It is argued that the "European version" of fiscal federalism proposed in this paper can contribute towards bridging the gap between the academic work and the policy debate on EU competences.

5.4 Areas for Future Research

This thesis focused only on the EU budget, but the methodology proposed could also be used to analyse the competences of the EU in general. One of the main questions facing EU scholars at the moment is what the competences of the EU should be, and what should be their limits. It is particularly difficult to answer that question because it is subjective, and depends on one's views.

This thesis has provided a methodology that makes it possible to assess, in an objective way, the advantages and disadvantages of having a certain competence at EU level. While political choices still need to be made, by highlighting clearly the different trade-offs, this methodology makes it possible to make those choices based on the correct economic, political and legal considerations. An area for future research would therefore be to apply this methodology to the other aspects of EU policymaking, such as its regulatory powers.

This thesis also only looked into three areas of EU spending, so a logical extension of the research would be to analyse all areas of spending using this methodology. In this thesis, it was thought best to focus only on three areas of expenditure, so that the analysis could be done in more depth. Agriculture and cohesion policy were selected because they are the two main areas of EU spending at present, while R&D was selected because it is one of the areas under most intense debate in relation to the EU budget. This is particularly the case given the European Union's "2020 strategy" for economic growth, as improving Europe's productivity if research would be one of the main ways to lead to increased economic growth (Botazzi, 2002). However, it would also be useful to look what role the EU budget should play in other areas of policymaking.

This thesis went into greater detail into each of the policy areas than the existing literature. However further work is still needed to look at each spending programme in even greater detail, as to define specifically how much should be spent on each, taking this proposal as a starting point.

Further research is also needed into the political economy of the EU budget negotiations. This thesis has focused only on the analysis of how the EU

budget should be spent. However, as seen above, the reasons blocking a reform of the EU budget are not only the lack of fiscal principles (which this thesis attempted to provide), but also the problems surrounding the negotiations of the EU budget.

Although there already exists an extensive literature in this area, that literature has so far focused on identifying the reasons why the EU budget is a case of political failure, rather than on how that political failure can be solved. For example, a great part of the literature assesses whether the CAP spending is due to capture by lobbies or to problems with the EU institutional design. However, there is a lack of research on how those flaws can be remedied. In particular, it would be useful to explore whether the negotiation procedures could be modified, as to make them less prone to political failures such as inertia and capture by vested interests.

5.5 A better Budget for a better Union

The current negotiations for the 2014-2020 budgetary package offer an opportunity to rethink how the EU budget should be spent. It is clear that policymakers in practice do not focus only on what they believe is the optimal way to spend the EU budget, as they also take into account their country's net contribution to the budget, the view of the press and their electorate, and difficulties related to reaching agreements in this area, as highlighted in the political economy section.

However, policymakers are generally aware that it is in their long-term national interest to use in the EU budget in a way that is optimal for the EU as a whole, since the advantages from a better functioning EU are much larger than their relatively very small yearly contribution to the EU budget. For that reason, the outcomes of past negotiations have shown that the EU budget can slowly be improved, and incremental reforms are possible. It is therefore essential to provide policymakers with the tools and knowledge necessary to be aware of how the EU budget should be spent.

While studies based only on fiscal federalism consideration may have seemed too "out of touch" with reality, the set of fiscal principles proposed in this thesis aims to take into account all the different aspects that are important when deciding which spending policies to allocate to the EU level. It is

therefore hoped that it can provide policymakers with a more realistic and complete tool.

Of course, this tool does not give a single objective answer to such a complex question, but it does make it possible to identify clearly the advantages and disadvantages of having a certain policy or spending programme at EU level. Once this first step has been done, a decision can be made, openly and democratically, on whether to transfer a certain policy area or spending programme to the EU level.

The EU budget may be small in size, but it plays a very important role in supporting the activities of the EU – so it is essential that it is spent correctly. The political reality of the procedures and negotiations at EU level makes it impossible to radically change the way in which the budget is spent in the immediate future. For example, it would be impossible to have no spending on agriculture in the next MFF, which is currently being debated by the EU Member States and EU institutions. However, incremental reforms are possible, and the ongoing debates can, and should, be a large and important step in the long road that will hopefully bring the EU budget to an optimal structure.

Samenvatting

Met minder dan twee jaar te gaan totdat het Europese begrotingspakket van de 2007-2013 verloopt, bereiden de lidstaten van de Europese Unie zich voor op de gebruikelijke moeizame onderhandelingen over “wie wat krijgt” van het EU budget. In juni 2011 kwam de Europese Commissie met een voorstel voor het zevenjarige begrotingspakket, waarover nu in de Lidstaten en in het Europese Parlement zal worden gedebatteerd. Voor onderzoekers van het EU budget is een onontkoombaar “déjà-vu” gevoel merkbaar: Grootste verklaringen over de bereidheid om het EU budget te hervormen vanuit zowel instituties van de EU als vanuit de lidstaten, maar het eindresultaat wordt naar verwachting een overeenkomst over een begrotingspakket, bijna identiek aan de vorige.

De EU begroting is lang bekritiseerd en zou de contact met de realiteit van de huidige EU hebben verloren (Sapir et al., 2003, Begg, 1999, Buti and Nava, 2003). Bijna de helft van de fondsen komen toe aan de landbouw, een sector welke op zijn teruggang is in Europe. Dit staat in schril contrast met terreinen waarin de EU in toenemende mate een belangrijke speler begint te worden, zoals Binnenlandse Zaken of economisch groeibeleid, welke bijna niet worden ondersteund vanuit het EU budget.

De structuur van het budget is problematisch, omdat het niet is ontwikkeld volgens een samenhangende reeks van beginselen. Uitgaven zijn door de jaren heen ad hoc toegevoegd aan de begroting, zonder enige beoordeling van de vraag of het noodzaak is deze op Europees niveau te financieren of zonder de vraag of het toegewezen bedrag overeenkomstig is met het belang van de post (Buti and Nava, 2003).

Alhoewel er de afgelopen dertig jaar een toename van literatuur over het EU budget is waar te nemen, beslaat deze bijna exclusief beleidsanalyse en niet een diepgaand wetenschappelijk onderzoek en steunt de literatuur bijna enkel op theorieën over fiscaal federalisme. Fiscaal federalisme is een tak van de economische wetenschap die analyseert welke functies van de overheid het beste uitgevoerd worden op een gecentraliseerd (of Europees) niveau en

welke het beste uitgevoerd worden op een gedecentraliseerd (of nationaal) niveau (Musgrave, 1959; Oates, 1972).

Alhoewel fiscaal federalisme waardevolle inzichten biedt op hoe het EU budget zou moeten worden uitgegeven, heeft deze theorie ook ernstige beperkingen wanneer toegepast op de EU (Oates, 2002, Ackrill, 2003). Ik betoog dat deze beperkingen helpen verklaren waarom de inzichten van de literatuur tot dusverre zijn genegeerd door beleidsmakers. Dit proefschrift vult deze leemte, en stelt een methodologie voor die het fiscaal federalisme combineert met andere theorieën, daarbij ook in beschouwing nemende de specifieke kenmerken van de EU.

Dit proefschrift geeft een multidisciplinaire benadering van hervorming van de begroting van de Europese Unie. Het combineert fiscaal federalisme met een tweede tak van de economische wetenschap (economie van de publieke sector), met politicologie en met Europees Recht. Vanuit deze vier disciplines worden elf stappen afgeleid welke toegepast worden op drie belangrijke gebieden van de Europese begroting—cohesie, landbouw en onderzoeksbeleid—om na te gaan welke van deze gebieden op Europees niveau gefinancierd zou moeten worden.

De onderzoeksvraag van dit proefschrift is derhalve: Welke reeks beginselen zou de allocatie van een Europese begroting moeten leiden? Specifieker, is het mogelijk vanuit een multidisciplinaire benadering een reeks beginselen af te leiden welke niet enkel overwegingen vanuit het oogpunt van efficiency, maar ook andere relevante factoren meenemen in de analyse?

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Curriculum Vitae

Filipa Figueira, born on 21 December 1980 in Lisbon (Portugal), holds a degree in economics from the London School of Economics (LSE) and a Masters in European Economic Studies from the College of Europe in Bruges (Belgium).

Filipa Figueira currently works as an independent researcher in European economics and politics. She undertakes research for universities, research centers and public organizations on the European Union policies and institutions, the EU budget and the economics of the EU. She has participated in a large number of projects for the EU institutions, and is the author of several publications on the EU budget.

Filipa Figueira is also currently working as a tutor in economics for university students, at undergraduate and postgraduate level. In addition, her teaching experience includes delivering lectures on the EU finances to postgraduate students at the College of Europe.

Previously, she was a researcher at the Brussels-based think-tank Centre for European Policy Studies (CEPS). She also worked as a consultant in EU affairs at the Centre for Strategy and Evaluation Services in London, and at GPlus Europe in Brussels, where she advised clients on a large number of EU policy areas, including EU funding, cohesion policy and EU economic policies.

She is fluent in English, French and Portuguese (written and spoken). She also has an advanced knowledge of Spanish, and a basic knowledge of Dutch, German and Italian.