PUBLIC PROVISION IN AN ECONOMIC AND MONETARY UNION: NEW FUNCTIONS FOR THE BUDGET OF THE EUROPEAN COMMUNITY

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The European Community is currently evolving into an economic and monetary union, but one of a kind that is most unfamiliar. Whether or not it will have a common currency, the union as envisaged will be without a government competent for external security and it will have only very restricted power to get and spend money of its own. Moreover, the present Community has only a makeshift system of political institutions and this must be partly explained by the fact that it also lacks competence for security and has such a limited responsibility for public finance. The history of representative government in Europe and elsewhere suggests that the Community's weakness in public finance is probably the more significant of these reasons for its failure to develop parliamentary institutions.

An economic and monetary union on the scale and with the complexity of that now intended cannot be usefully compared with organisations like the Benelux Union. But one that does not have significant responsibility for security and public finance is difficult to compare with both existing federations and unitary states. It is true, nevertheless, that the differences from past experience are relative. We cannot say absolutely that a viable economic and monetary union must also be a political union or how much it should have access to other common uses of public power. These conditions can vary according both to the prevailing circumstances in which economic integration is occurring and to the contingent principles and objectives, general or specific policies, of the union itself. However, they clearly raise political issues of the greatest importance. Comparatively, what the Community now seems to be doing has far-reaching consequences for the use of public power and the question must arise whether what it intends, if only by implication, is a radically new relationship between state and society.

In fact, the member states' governments, with the assistance of the Community's Commission, are currently engaged in a standing conference on political union, which runs concurrently with the similar standing conference that is preparing a treaty for economic and monetary union (EMU). The political implications of public finance do not seem, however, to be on the agenda of the conference on political union. The parallel conference on EMU is concerned with public finance but chiefly with the need to provide for efficient co-ordination of member states' macro-economic policies. The subject has also been raised (mainly by the Spanish and Irish governments) as an aspect of 'regional policy', or, in the less precise and possibly more inclusive term made regular by the 1986 Single European Act, 'economic and social cohesion'. However, some states (mainly the economically weaker ones) are much more anxious about this aspect than others.

My aim here is to raise some political issues that arise from the implications of EMU for public finance that seem to have been neglected in the current, highly important inter-governmental negotiations and not addressed fully by the Commission or the Parliament. I shall suggest that there are significant consequences for the further development of political institutions but I have not yet considered fully what these might be, concentrating here on the case for assigning new functions to the Community's budget. My conclusions and suggestions in many respects contradict those reached by other scholars and official advisers and diverge so much from what appears to be the orthodox view Community's own approach) that they may seem extravagant. But they might provoke more constructive discussion of the issue. [1]

The limitations of the Community's budget

One of the more obvious reasons why public finance does not have a very significant role in the Community so far or in current proposals for EMU is that only restricted functions of public management have been assigned to the Community or envisaged for EMU. The restricted nature of the Community's budget up to now does not have quite the same implications as an EMU without major competence in public finance, because the proposal for a common market, on which the Community is so far chiefly founded, leaves most ordinary functions of public management with the member states. Indeed, to the extent that it affects those functions, and it essentially does, it tends to replace them with a common legal order designed to prohibit rather than prescribe the use of public power and to substitute common regulation, with limited direct consequences for public finance, for separate regulation by state authorities.

At least, that is so in theory. In practice, as we well know, the new legal order is replete with exceptions, while special arrangements have been in practice for some groups who claim that they simply could not gain a livelihood without special public provision. In the past those groups have been possibly much more significant politically and socially in Europe than in other advanced, industrialised parts of the world, including the USA. Even so, not all exceptions to the Community's fundamental principles of free movement of goods, services, persons and capital have been treated by methods requiring the direct transfer of financial responsibilities to the Community.

In the beginning the EEC's budget contained little more than the normal administrative costs of the institutions and resembled the budget of an ordinary international organisation both in that respect and in being financed from fixed proportional contributions by the member states. The earlier Treaty establishing the European Coal and Steel Community provided for specific items of expenditure (financed by direct levies on producers), as well as borrowing and lending operations, with considerable importance for the industrial sectors concerned. However, these financial operations are still not wholly incorporated in the common budget of today (which also excludes the self-contained activities of the European Investment Bank or EIB). The otherwise amalgamated budget acquired significance as an instrument of public finance only when it was finally agreed (in the late 1960s) to provide a common financial regime for the common agricultural policy (CAP), including the purchase of surplus stocks when necessary to support prices within the Community, the payment of export restitutions to farmers and charging levies on imports to the Community. In fact, as we well know, the costs of the CAP not only regularly consumed between two-thirds and three-quarters of the annual budget (reduced to 61 per cent in 1990) but were a growing cause of conflict, inequity and inefficiency.

1.One of several current studies salient to the issue is being made by the Irish Association of European Studies for the Trans European Policy Studies Association with financial and other support from the Commission of the EC.

Neither outcome was presumably intended but the Community's pre-occupation with agricultural expenditure inhibited it in various ways. Among other things it meant that the budget remained very inflexible as an instrument of public policy, though this was also because of the Community's confined powers to raise revenue or to borrow. Although from 1971 the Community was legally entitled to its 'own resources', consisting of the whole receipts from the common customs tariff and agricultural import levies and a share of receipts from value-added taxation (VAT), the member states were still responsible for collecting and transferring these revenues. More importantly, the Community could not raise new forms of revenue without a cumbersome procedure similar to making a new treaty. By the 1980s the receipts from 'own resources' were insufficient to finance even existing legal commitments to expenditure and the budget was in severe crisis.

Nevertheless, by that time the Community had significantly increased its expenditure on other functions, most notably by repeatedly enlarging the original European Social Fund (ESF, for supporting public interventions in the labour market mainly by vocational training) and by establishing the European Regional Development Fund (ERDF, mainly for supporting public works but increasingly also direct grants to private entrepreneurs), and also by a number of lesser recurrent spending programmes (for overseas aid, research and technology, energy, transport and fisheries). The ESF and the ERDF now constitute, along with the small Guidance section of the European Agricultural Guidance and Guarantee Fund (EAGGF), what are officially called the 'structural funds'; these are now regulated and managed according to common objectives and principles. (In addition, outside the budget, there are the special borrowing and lending powers used for similar purposes under the so-called 'new Community instrument' introduced in 1979 and the operations of the EIB.) The problem of inadequate revenues was temporarily resolved when the prolonged financial crisis was settled in June 1988, by increasing the Community's share of VAT and adding a new category of variable state contributions. At the same time, a novel long-term agreement between the institutions enabled the Community to double its expenditure from the structural funds by the end of 1992 (partly to take account of the accession of Portugal and Spain), while imposing new spending limits on agricultural market intervention.

Most of these expenditures may be freely appropriated in the annual budget up to the limits and for the specific purposes provided by the relevant legislation, unlike expenditure on the Guarantee section of the EAGGF, which is determined by a prior commitment to meet the costs of interventions required to deal with unpredictable market fluctuations. They mostly take the form of conditional matching grants paid to public authorities and agencies in the states at the Commission's discretion. The relevant legislation makes them highly selective both among recipient states and among types of economic activity. Indeed, the overriding motive for expanding the Community's competence in public finance in these ways, like the 1988 decisions on revenue, has been the re-distribution of income. The structural funds are strictly-speaking derivative from the Community's various social, regional and other sectoral 'policies', which are designed to influence the allocation of resources. In fact, they are mainly used, at least in aggregate, as a 'side payment' to those states for which economic integration is considered likely to be especially problematical, not least because the common market's rules on competition restrict state aids along with other methods of protecting domestic occupational groups.

The Community's budget, therefore, is in both form and content still at best a typically confederal instrument. It cannot as it stands be compared very usefully with the management of public finance by previous federations, let alone by unitary national states. Many prominent modern functions of public policy are excluded from its scope altogether, while its later development into re-distributive functions remains miniscule in amount and very restrictive in competence. The Community's own financial operations are in total far too dimunitive to be used for purposes of macro-economic counter-cyclical policy, though they can make a considerable difference to the fiscal capacity of some individual states, especially following the 1988 reform. Because the Community's budget is so truncated, it cannot even serve adequately the function of 'public housekeeping' , either evaluating the overall performance of public administration or selecting new objectives. If public finance has been such a politically contentious and decisive issue as it has for the Community, this is primarily because certain states have chosen to make it an issue (not always with sound empirical reason) and also because the budget became one of the few opportunities for the directly-elected members of European Parliament to assert themselves. On the other hand, as has been fully discussed elsewhere, [2] both the structure of the budget and the procedures for its approval leave much to be desired in terms of public management as well as in those of conventional parliamentary accountability. In both respects, the cause is not just the institutional procedures but also the impotence of the budget itself as an instrument of public policy.

The Role of Public Finance in an Economic and Monetary Union

The Community, chiefly at the initiative of its Commission or Parliament, has occasionally considered the possibility of expanding its competence in public finance beyond the existing confederal stage. The most substantial contribution on the subject so far is the so-called 'MacDougall Report' published in April 1977 as the result of two years' work by a group of mainly economic consultants appointed by the Commission. [3] The question of public finance was also addressed in the context of earlier proposals for EMU and the current revival of those proposals has brought it up again, prompting some new research and consultancy by both Commission and Parliament. In spite of the limitations of the Community's existing budget, these reviews have not hesitated to use comparisons with the role of public finance in mature federations and in unitary states or to draw on the substantial body of theoretical and applied studies of the economics of public finance and, in particular, of 'fiscal federalism'. Both past and current proposals for EMU cannot evade at least some reference to the role of public finance. In any event the issue is bound to arise, when the standing inter-institutional agreement on the budget expires at the end of 1992.

The MacDougall Report was not directly concerned with the prospects of EMU, which were remote at the time. However, after considering a wide range of

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2.For a more extensive and authoritative account of the subject-matter of this section see M. Shackleton Financing the European Community RIIA/Pinter 1990.

3.Commission of the EC, Report of the study group on the role of public finance European integration, Volumes 1 and 2, Brussels, 1977.

empirical comparisons and different hypothetical stages of development for the Community itself, the Report proposed a modest but relatively substantial increase in the Community's competence in public finance in conditions of an EMU as foreseeable at the time. In what the Report describes as a 'small public sector federation', with EMU but without federal responsibility for defence, a level of central expenditure amounting to between 5 and 7 per cent of GNP was envisaged, compared to the contemporary level of 0.7 per cent in the Community. The Report recommended in any event some expansion of the Community's financial competences on both economic and political grounds adding new functions for marginally assisting counter-cyclical management and for income re-distribution. It expressed a clear preference in the case of re-distributive expenditure for the use of specific-purpose grants with matching ratios varying between richer and poorer states. This suggestion has been followed in practice in the reform of the structural funds. However, total Community expenditure, including that on the Guarantee section of EAGGF, will in the period 1988-92 still not exceed annually a half of the 2 to 2.5 per cent of GNP that the MacDougall group envisaged for a 'pre-federal stage'.

Circumstances have altered significantly since the MacDougall Report in a number of respects. The Community has enlarged its membership in a way that exacerbates the problem of spatial disparities in economic performance and economic structures. However, the richer member states are, if anything, more reluctant than before to countenance on general principles an increase in public expenditure by the Community. All states have favoured policies of financial retrenchment in the face of renewed world recession, and have tended to restrict fiscal instruments of intervention for both counter-cyclical and re-distributive purposes in favour of monetary instruments of stabilisation. The same trend helps to account for the new popularity of monetary integration, based on an independent centralised mechanism (the Eurofed) for controlling the supply and the nominal exchange rates of money. Another significant development, indeed, has been the success of the European Monetary System (EMS), while flexible exchange rates have lost much of their former appeal as a means of economic adjustment between creditor and debtor states. Above all, perhaps, the further removal of non-tariff barriers by the 1992 programme has made centralised management of monetary policy a much more attractive, even necessary, method of realising stability in view of the effects of fluctuations in trade between states, especially following agreement to free the movement of capital.

Nevertheless, the very logic of this argument for monetary integration demonstrates that EMU must restrict the competence of member states to pursue independent macro-economic policies, so that the question must arise: what happens in the likely event that the economic performance of those states continues to diverge to a significant extent ? That it has so diverged since the early 1970s cannot be denied. The divergence has already been increased by successive enlargements of membership, while the prospect of accession by formerly communist states threatens to add to it. Indeed, there are reasons for supposing that economic performance might diverge more, other things being equal, as economic and monetary integration proceeds in the direction now intended.[4]

4.See Commission of the European Communities, European Economy, No. 44 October 1990 p. 24-9.

The MacDougall Report already gave reasons why economic integration may increase inter-regional disparities, drawing on both economic theory and a wide range of practical experience of economically integrated political unions, including both federations and unitary states. It also showed that it is a normal function of public finance in political unions to correct inter-regional disparities by a wide range of fiscal mechanisms involving both revenue and expenditure. Without countervailing measures of a similar kind the sovereign state is much more exposed to the effects of economic integration. The Report's technical explanation is worth quoting at length:

> The difficulty for a country which joins with others in a common market and common monetary system without a developed central system of public finance . . . is that, like a region or federal state within a developed economy, it cannot use trade-barriers or currency-devaluation to help it to adjust to, for instance, a fall in demand for its exports or a rise in the price of its imports, nor does the built-in stabilisation produced by its public finance system carry with it a built-in financing of the import surpluses which stabilisation of income may cause. If internal activity is to be in some degree stabilised, pending either a structural adjustment of the economy to its changed circumstances or an autonomous reversal of the original cause of the trouble, then the country, unless it started with a sufficient export surplus, must be able to borrow from abroad or draw on reserves. If it cannot do so, then employment cannot be maintained . . . (pp.34-5)

The report explained why states within federations are in effect protected against these and other effects of economic imbalance as a result of the federal government's substantial, though still restricted, competence in public finance; it pointed out that at the time public expenditure by central government in most mature federations varied between 19 and 25 per cent.

The problems of economic divergence and of spatial disparities have been recognised in current proposals for EMU. In a recent comprehensive study of the foreseeable benefits and costs of further economic and monetary integration the Commission admits that monetary union on its own would increase the need for both autonomy and discipline in states' own fiscal policies. Since the need to co-ordinate those policies would also increase, the same study considers possible methods of common action in public finance, but recognises that, short of a full economic union and depending on the policies such a union would adopt, the member states would experience on aggregate increased pressures to manage their budgets more restrictively by their own efforts. Optimistically, the Commission seems to assume that the pressures would not persist beyond the 'medium term', after which the general benefits of increased economic efficiency and greater monetary stability would make counter-cyclical measures less necessary. The main solution proposed, therefore, here as in other orthodox prospectives of monetary integration is to improve co-ordination of member states' own economic policies without transferring significant new functions to the Community.[5]

However, the Commission's study, like the earlier Delors Report, also recognises the need for special measures to take account of persistent

5.Ibid. pp. 100-30

inter-regional disparities.[6] The extent and the nature of these within the Community of 12 are such as to suggest to all concerned that the real cause is, indeed, structural: hence the tendency to treat them as a separate problem, demanding separate remedies, from that of economic divergence. Whatever the political reasons may be, there is also, therefore, an economic and a social justification for common action by the Community to deal with spatial disparities. This much is established by the SEA, which provides the Community with corresponding powers under the heading of 'economic and social cohesion'. As we have seen, those powers include an enlarged competence in public finance and it is actually in this perspective that the currently orthodox view of EMU defines a role for the Community budget. Before examining more closely the issue of economic divergence, therefore, let us consider the reasons for this view and their possible justification.

Regional policy and the structural funds

Inter-regional disparities, measured in terms of GDP, rates of unemployment and other relevant variables, are much greater in the Community of 12 than they are in most economic unions, including the USA.[7] They appear when comparing either the economic performance of member states or that of regions within states, though in the latter case the definition of what constitutes a region is arbitrarily derived from the states' own administrative systems, which vary enormously. In order to correct the more extreme measurable spatial disparities, the Community's expenditure on its structural funds was multiplied in gross by a factor of 14 between 1975 and 1985 and will double between 1989 and 1993. Over the past fifteen years the funds, along with other 'structural instruments' (mainly of lending at favourable rates), have been increasingly used for purposes of regional policy and, following the SEA and the reform of the funds in 1988, are now employed in accordance with common objectives and methods based on the fundamental treaty principle of economic and social cohesion.[8]

The nature of this quantum growth in structural intervention by the Community might suggest that the orthodox doctrine of economic integration in the original treaties has been radically modified. Indeed, the way in which spatial disparities have arisen in the common market supports the neo-Marxist view that the market principles of advanced capitalism inevitably lead to spatial economic domination of the periphery by the centre, thereby intensifying

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6.Ibid. pp. 212-32. See also Commission of the European Communities, Report of t Committee on Economic and Monetary Union, April 1989.

7.The main economic theories are discussed in D. Pinder Regional Economic Development and Policy, London 1983, and in H. Armstrong and J.Taylor Regional Economics and Policy, Oxford 1985; see also D. Keeble et. al. Peripheral Regions in a Community of 12 Member States, Brussels 1988, T. Padoa-S EC European Economy No. 44 (op.cit.) pp. 212-6.

8.The total volume of financial assistance available from the Community for thos common objectives (most of it not included in the budget) amounted to approximately 20 billion ECU in 1988.) For a detailed account of the nature of the funds and the results of the most recent reform, see Commission of the European Communities, Guide to the Reform of the Structural Funds, Luxembourg 1989.

problems of both inefficiency and inequity. The fact that enlargement of the Community's membership is a major contingent explanation of the growth in its spatial disparity does not, of course, undermine this argument, since the enlargement has been from centre to periphery in terms of economic geography.

The Community's orthodoxy has not, however, been that radically modified; the way the 1992 programme of further market integration was so enthusiastically adopted shows that it not only still prevails but is in some ways stronger than ever. A mixture of economic, social and political factors explain why and how the Community has been able to expand and re-inforce its powers of structural intervention, involving some new functions of public management. Broadly: the Community has been greatly influenced by the technocratic view of regional development favoured in the mixed economies of its member states; it has also felt the effects of the pressures on its member states from organised occupational groups to sustain employment in declining economic activities; and it has needed to find means of compensating individual states (especially the new members from the periphery) for the costs of joining the common market. In addition, both the Community's Commission and - though to a much greater extent- its Parliament have had their own institutional reasons for encouraging the growth of structural-fund expenditure (which forms a non-compulsory element of the budget open to annual variation within the budgetary procedure itself).

The largely technical issues of why and how public policy can and should endeavour to correct spatial disparities within a given sovereign jurisdiction in which free market principles otherwise prevail have been exhaustively discussed by economists (though usually by way of sociological and political presumptions that are inadequately understood). With the prevalence of monetarism in the 1980s much of the resulting theory and corresponding practice were subsequently discredited. Regional policy, though dislodged from its pre-eminence during the 1970s, continues, however, to appeal as a possible means of treating the problem of allocating public goods in conditions of free market capitalism, of complementing in the short term supply-side adjustments required by market forces, and of minimising the short-term social costs of unemployment. It does, moreover, seem to offer a way of doing all or any of these things without committing the state to a permanent or comprehensive responsibility for public management of economic activity (and the corresponding fiscal responsibility): in theory at least, interventions for purposes of regional policy should be temporary, specific as to function and de-centralised, leaving a wide measure of administrative responsibility to local communities.

In fact, mainly for social and political reasons, regional policy operates in entirely different ways: the selected localities tend to become permanently dependent on state support; they use that support for functions other than those intended (often corruptly); and both for these reasons and for those of equity a higher than usual degree of centralised management becomes necessary, if the policy is to be at all effective in conformity with its goals. Advocates of regional policy on technical grounds have, therefore, struggled in recent years to evolve new techniques of implementation to correct these and other deviations; the results of those efforts are clearly reflected in the recent reform of the Community's structural funds (which actually extended over several years during the 1980s). Subsidies from the Community budget now have to be approved according to multi-annual regional 'framework programmes' designed to realise genuine economic improvement over time and to identify specific types of subsidised activity that are viable for this purpose, while the programmes themselves are drawn up and implemented by means of a 'partnership' involving both national and local authorities directly as well as regular consultation of sectional private interests. Moreover, so that Community intervention will be seen to be both efficient and equitable, it has to give a clear preference to categories of recipient selected according to strictly ordered criteria, expressed in terms of five prior Community-wide objectives.

The chief orthodox economic rationale for concentrating expenditure from the structural funds on regional policy objectives is that the more backward areas of the Community will not be able to share in the benefits of economic integration unless they are assisted to 'catch up' economically with the more advanced areas. Although the present statutory objectives of the structural funds include particular social categories (the unemployed and those employed in agriculture), the overriding priority is geographical: peripheral, 'less-developed' regions; areas sufferring from industrial decline; and predominantly rural areas. The emphasis is clearly on aid to the geographical periphery, including three 'regions' that constitute member states in their entirety: Greece, Ireland and Portugal. The functions for which the funds may be used are specified (according to the different fund regulations) mainly as public works, direct grants to start up or adapt economic undertakings and vocational training. The funds are administered by the Commission, which does not normally allocate them directly but makes them available in previously agreed amounts to be used by the states' own public authorities, which also have to guarantee to provide (from domestic sources) a fixed share of the total expenditure in any single project. By their nature the functions specified for support from the funds normally engage local authorities and state agencies of whatever kind. The fact that public authorities (and established procedures of public accountability) are consequently almost always involved both greatly facilitates the administration of the funds and ensures a large measure of de-centralisation from the Community level.

There are good reasons of both economic theory and administrative convenience for using financial aids to develop infrastructure as an instrument of the Community's regional policy and also for restricting those aids to a form of specific-purpose and selective matching grants to member states. In fact, the Community's regional policy seems to have been influenced by the view that spatial disparities in a common market arise in large part from differences in location, agglomeration, capacity for sectoral diversification and infrastructure between regions. To the extent that a common market endows certain regions with special advantages in these respects there are economic reasons (of allocative efficiency) for employing fiscal measures of re-distribution to develop infrastructure in the least advantaged regions. Infrastructure is here defined as a set of public goods that are not provided efficiently by the market and that cannot be provided efficiently by the unaided efforts of the economically less advantaged regions (especially when these are also geographically peripheral and sparsely populated). Moreover, if infrastructure is defined as public capital, it provides relatively specific and visible items of Community expenditure that are susceptible both to regular procedures of public accountability and to devolved public administration, while not normally being substitutable by goods supplied more efficiently in the market. [9]

However, the limitations of this method have been less well ventilated. At a technical level economic geographers and public administrators may have had a disproportionate influence in this respect, leading policy makers to neglect other causes both of spatial disparity and of under-employment of human and physical resources. Geographical explanations may be less revealing than is usually supposed, especially when they rely on comparative measurement of GDP rather than on qualitative evaluations of living and working conditions. In fact, the Community has a general and persistent problem of long-term unemployment, local circumstances of extreme poverty and economic distress scattered throughout its territory, many industrial sectors with a potentially chronic failure to adapt to technological and other changes in production and demand, and a tendency to misallocate and misuse basic resources such as energy, transport and food. Indeed, the allocative arguments for regional policy can be all too easily subverted by purely re-distributive motives (which cannot be blamed entirely on those who make those arguments). Moreover, partly as a consequence of this defect, it is not always safe to rely on the prudence and wisdom of national public authorities to ensure that financial aids to infrastructure are employed for the most efficient uses in practice. Even if it were, the functions specified at a Community or a national level may not always be the most appropriate to any given local situation; and there must be a limit to the number of useful projects for road-building, sewage disposal, tourist amenities, training schemes and industrial sites that public authorities can find or invent to justify matching grants. Possibly the most important reason of all for questioning the inherent value of aids to infrastructure is, in fact, the growing realisation that it is different kinds of <u>market failure</u> and of <u>managerial incapacity</u> that mostly account for the misallocation of resources, perhaps especially in less advantaged regions. If this is so, then reliance on the structural funds may be positively wasteful in certain circumstances.

However, the main reasons why the Community has given such priority to regional policy as an end and structural funds as a means are probably social and political rather than economic. On the one hand, the central governments of the member states have been tempted to pass on the onus of responding to group demands for protective measures of a re-distributive nature to other levels, such as local authorities or the Community budget, though they have not at the same time lifted restrictions on the fiscal capacity of either local authorities or the Community. Meanwhile the Community continues to experience extreme social disparities with economic causes that are not confined to peripheral or even depressed regions, crudely defined as these geographical categories are whether as states or as administrative units within states. On the other hand, by disbursing financial support to national public authorities the Community budget serves as an expedient means of compensating those states more reluctant to face

9.See D. Biehl (ed.) <u>The Contribution of Infrastructure to Regional Development</u>, Luxembourg 1986, and D. Biehl, The Role of Infrastructure in Regional Development, paper presented to the conference, <u>Regional Policy in the Europe of the Nineties</u>, Madrid, May-June 1989.

the consequences of market integration.[10]

In spite of the reform of the structural funds and although the aim may be to facilitate the process of economic integration in the interests of economic efficiency, the Community's budget is still chiefly used to re-distribute income between member states. Since the CAP already has a re-distributive effect of its own, but one tending to favour the wealthier regions and social groups (both in terms of prices to the consumer and the incomes of producers) and since the Community's revenue is largely derived from regressive forms of taxation (especially in the case of VAT), the net contribution of the structural funds to equalising real incomes is probably insignificant, especially in view of its miniscule proportions in relation to the Community's overall GDP. Even so, any additional real effects that contribution might have on efficiency and stability are, to say the least, arguable. No less than the CAP, the Community's actions in the name of regional policy are determined as much by each member states' calculations of short-term net financial return from the Community budget as they are by the indirect claims of organised sectional economic interests, in this case investors expecting to gain from public works contracts and entrepreneurs saved from the cost of industrial training and of compensating redundant labour.

Indeed, if regional policy retains its appeal as a means of public economic intervention, this is to a large extent because it does not admit fundamental flaws in the economic system itself and does not, in fact, threaten to disturb established structures of economic, social or political relationships. The kinds of intervention to which it leads are called 'structural' possibly because that is precisely what they are not. The Community's regional policy does not seek to undermine the doctrine that the national state is still a unique source of authority for determining the material welfare of its people. Nor does it challenge, at a higher level of reasoning, the related doctrine that both social injustice and economic inefficiency tend to arise not from the way the factors of production are organised but from geographical location and even cultural identity. If I am unemployed and indigent in Manchester, I can blame the economic system or at least those who mismanage it; if I am in the same condition in Limerick, it is more likely to be because I am probably Irish.

New functions for the Community's budget

Unlike the budget of most economic and monetary unions that we already know, the Community's budget is not an instrument of macro-economic policy nor does it provide for a coherent re-distribution of income. It is not even a viable mechanism for co-ordinating and controlling the use of public power at a Community level, especially since its contents are largely an accident of political bargaining, not the result of a considered assignment of public functions. This outcome must be largely explained by the idiosyncratic approach to integration on which the Community is still founded: the member states see economic integration as a desirable and practicable undertaking without the

10.This reason for using the Community's budget for re-distributive purposes is often justified by economists as a necessary means of maintaining 'solidarity', see, for example, MacDougall Report, op.cit., pp. 59-60; Padoa-Schioppa, op.cit. p.90.

concomitant need to develop common political institutions. Indeed, it is difficult to believe that the budget could have remained so restricted, if what are supposed to be conventional doctrines of political representation and accountability in the states had been applied. We might infer from this that those doctrines are not, in fact, so prevalent in Western Europe as might be otherwise supposed; it would, therefore, be interesting to re-examine in another context how far they are genuinely supported and followed within the states themselves.

There seems, indeed, to be little if any intention to extend the Community's powers in public finance in the prospects of monetary and even political union. Both the Commission and the member states seem to be satisfied that the budgetary reforms already instigated with respect to the CAP and the structural funds will serve as much for the transition to EMU as for that to a more fully integrated internal market. The prevailing orthodoxy is contained in the conclusions of the influential report of the group chaired by Padoa-Schioppa[11]: the best available policy for efficiency is a genuine common market, for stability a common monetary authority and for equity a reform of the CAP and structural funds. While some suitable technique of financial adjustment between states' budgets might be appropriate as a common safeguard mechanism, the Community's economic policy should continue to be that of a 'co-operative growth strategy' to be implemented directly by the member states themselves with suitable inter-governmental organisation.

The Padoa-Schioppa report does make the tanatalisingly vague qualification that: 'If monetary integration were to move to a qualitatively more advanced level, budgetary policy at the Community level might have to extend beyond the limited potential of co-ordination'(p.86). Both the Delors report on EMU and the Commission's own subsequent analyses are even less forward-looking, except that they imply a more rigorous and comprehensive institutional procedure for 'surveillance' of states' budgetary policies, since embodied in official proposals for the first and second stages of EMU. The institutional arrangements for economic policy in the third and final stage have yet to be decided and member states seem currently far from agreement. Some of the implications for public finance can, however, be read in the Commission's study of October 1990,[12] in particular:

> The mere creation of a monetary union requires . . . long-term consistency between the common monetary policy and the fiscal policies of the Member States. Unsustainable budgetary positions in a Member State, ultimately leading to either default or debt monetization, would be a major threat to the overall monetary stability. . . Fiscal discipline is . . a vital component of EMU. Since the present fiscal position of some Member States cannot be considered as sustainable, this is a serious matter of concern. (p.100).

Even in the medium term, 'surveillance will have to correct possible tendencies for budget deficits to become too large as their interest rate cost is spread throughout the Union'. Nevertheless, neither here nor elsewhere has any overall harmonisation of national taxation systems been envisaged and the transfer to

11.T. Padoa-Schioppa, op.cit.

12.European Economy No. 44, op.cit.

the Community of fiscal competence with macro-economic significance is not normally considered a condition of EMU, though future political options remain open. The Commission's own current perspective assumes that the Community will continue to lack a fiscal regime of its own 'and therefore that any fiscal policy measure belongs to the autonomous or coordinated action of the Member States' (Ibid. p. 101).

The Community's current position conforms to a prevalent political as well as technical view of the use of public power in economic affairs, and the relevant circumstances may change. But it also reflects a continuing lack of conviction in federalism as a model for European integration. In both respects it has put the Community's policy makers into an ominous dilemma. On the one hand, further economic and monetary integration seems essential, if the limited confederation is to survive with anything like its original objectives of shared material security and prosperity. On the other hand, no more than partial and temporary arrangements for the government of an economically integrated union are open to discussion. One way out of this dilemma may be to assume optimistically that further integration will by itself or with minor institutional adapatations produce a sufficient measure of convergence in economic performance to make major institutional changes unnecessary. This is the currently orthodox view. But it is one that is not only optimistic but also arrogant, in view of the present and foreseeable prospects of the Community's economic growth and the measure of its social and spatial disparities. The dilemma persists.

The case for the confederation rests fundamentally on the belief that there is already a sufficient convergence of economic preferences, of interdependent interests and of common social and political values to justify removing from its member states the legitimate use of a wide range of public powers, including in some circumstances fiscal instruments of counter-cyclical policy, for protecting the material welfare of their people. But, at the same time, it is believed that there is an insufficient convergence of preferences, interests and values to trust the confederation with significant competences in public finance of its own. One ideal solution, which would greatly expedite the currently orthodox view, would be to assume that preferences, interests and values, in fact, diverge and to such a degree as to make social and spatial disparities a perfectly acceptable fact of European life. This may well be the inevitable condition of the present real balance of power in Europe, but it is a pessimistic and submissive one for many of those involved and one hardly compatible with the Community's aim of 'harmonious development'.

The issue of the Community's role in public finance is not, therefore, likely to remain uncontroversial for long. How might the Community budget develop in the light of such controversy ? In the first place, the controversy can be expected to frustrate any continued attempt to separate treatment of the macro-economic function of public finance from that of its re-distributive function. When individual states find that existing policies at a Community or a national level do not in fact lead to 'convergence', they will sooner or later seek to change them. It is, therefore, prudent from any point of view to consider what measures might be taken at either level in such a likely eventuality beyond the customary resort to specific and temporary derogations from Community law backed by financial assistance for the individual states concerned. Any such lasting measures must have re-distributive implications. But in turn macro-economic and re-distributive functions of public finance cannot be fully separated from its consequences for economic efficiency.

My own main conclusion is, indeed, that official and other studies, including the present one, have not adequately examined the reasons why, in spite of the degree of convergence already achieved, some people in the Community fare economically so much worse than others. The answer cannot be found entirely in a continuing divergence of preferences, interests and values nor, as has already been explained, in different regional endowments of infrastructure. Even relative advantages of location, agglomeration and economic diversification can alter significantly with new technology and changing consumer preferences. In fact, the influence of these and other factors can all be affected by another independent variable: the effects of the use of public power on the general economic environment. This factor can, of course, take myriad forms, some of them impinging directly on the other variables more usually considered apart. But one aspect that deserves further attention in its own right is the impact of national policies on the capacity for developing entrepreneurial and related skills. Even when considerations of stability and equity have been taken into account, economic and monetary integration may still make it more difficult for public authorities to pursue appropriate policies for growth, which increased expenditure on infrastructure cannot adequately compensate. The additional constraints can result both in the form of penal taxation and in the inadequacy of public provision.

It has so far been assumed that both tax systems and public services can and should vary to a large degree among the Community's member states, especially in view of the expected absence of a significant mobility of labour and of what is described loosely as 'political homogeneity'. It is also admitted, however, that in an EMU they cannot be permitted to vary in such a way that the rules of 'fiscal discipline' are breached. Nevertheless, even in existing conditions of convergence, let alone given what can be implied from the fundamental principle of 'economic and social cohesion', the Community will have a hard task to get all states consistently to observe those rules. More important for the present argument, if it does succeed, then it can only be because some states, especially those with a recent history of capital indebtedness, continue to adopt highly restrictive fiscal policies. Whether these policies lead to high levels of personal taxation or to low levels of public provision, and in most of the less-advantaged states they lead to both, the prospects for genuine, long-term economic improvement will be poor. Since it cannot be assumed that the more talented and adventurous are discouraged only by high levels of personal taxation and interest rates but also by the adequacy of public provision in education, health and other amenities, those prospects will be further worsened by emigration (with a consequent spillover benefit to other states from the public provision the emigrants have already enjoyed).

New functions for the Community's budget should be assigned with three combined aims: supplementing monetary safeguards of stability; compensating re-distributive effects of integration (including those arising from the CAP and the presently regressive forms of Community revenue); and maintaining an adequate level of public provision throughout the Community. In combination, these aims, it should be stressed, match preferences, interests and values in all parts of the Community and would be as universal in their possible impact as are the social ills of unemployment and economic deprivation. Various schemes that have been previously examined are available for further scrutiny. Probably the most premature is the proposal for a regular system of fiscal equalisation between richer and poorer states (similar to the landerfinanzausgleich adopted in the Federal Republic of Germany), which would be difficult to operate consistently with stability without at least a common system of political parties.[13] Proposals to give the Community some direct revenue-raising power, however, as by means of the phased introduction of a progressive surcharge on personal or corporate incomes might serve both to enhance the 'political homogeneity' many consider to be so important and to improve the public accountability for Community expenditure.[14] Most attractive of all are the possibilities of transferring to the Community part of the direct costs of specific social services: either education (as a natural extension of the Community's present indirect fiscal competence for vocational training) or unemployment benefit and possibly both.

The creation of a Community unemployment fund, possibly financed from a special employment levy, would provide the Community with some direct competence for both counter-cyclical and re-distributive functions, while it would greatly relieve the fiscal constraints on economic activity that are likely to increase most in precisely those places where they can be most destructive of the potential for growth. It would also serve this purpose with possibly greater gains in both economic efficiency and administrative convenience, as well as in supporting fiscal discipline and meeting genuine social need, than a further expansion of matching grants for infrastructure projects.[15] Indeed, the remarkable thing about such a proposal is that it has not already been the subject of a concerted political programme of opposition to EMU as currently envisaged.[16] But that observation also brings me back to the fundamental reasons why the Community's budget, like the rest of its institutional apparatus, is different in kind from anything we have heretofore assumed about the use of public power in an economic and monetary union.

I have not here taken account of the possible outcome of current moves towards political union. If the Community were to evolve in the near future into a union with its own competence for internal and external security, then something much more like a typical federal system of public finance might be expected to result. On the other hand, the net gains of centralisation in these spheres of public policy would have less positive impact on economic efficiency and equity than the proposals for a social budget considered above. If the result were to reduce total spending on security functions, the gains for efficiency might be considerable throughout the Community but those for equity

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13.See MacDougall Report, op.cit., Vol. 1 p. 40 and Vol 2 pp. 65-100 and 400-30.

14.See, for example, D. Biehl, Deficiencies and reform possibilities opf the EC fiscal constitution, in C. Crouch & D. Marquand (eds.) The Politicsof 1992, Oxford 1990.

15.Such a proposal was first made in the so-called 'Marjolin Report': Commission the EC, Report of the Study Group 'Economic and Monetary Union 1980 [sic]' Brussels March 1975. See also MacDougall Report, op.cit., Vol. 1 p. 16 and Vol.2 p. 287 and the references given in European Economy No. 44 pp. 168-9.

16.See, however, ARCA, Policies for Balanced Development in an Integrating Community, a report for the Socialist Group of the European Parliament, Brussels, July 1990.

mixed: some states and regions would face increased unemployment, while others would experience little or no immediate fiscal advantage. If total spending were to remain the same, then some member states and many people in all member states would need to be persuaded who the enemies were. Nevertheless, the moral seems to be that without a sufficient external or internal threat to peace, the people of the Community are no longer of a mind to change the way they are governed for the sake of common welfare. It remains to be seen whether an infusion of new Europeans will make any difference.