EU Regional Policies and European Fiscal Equalisation

Dr. Michael Thöne
Managing Director & CEO, FiFo Köln

Presented at the
1st Speyer Conference on European Finances
FÖV-BMF-Conference, 16 May 2017
I. Fiscal Equalisation in Europe?

EU Regional Policies and European Fiscal Equalisation
Motivation

- Do the Own Resources need reform in face of dominant “Juste retour”-thinking?
- Fiscal Union: Does it necessitate more European fiscal equalisation – the “Europäischen Länderfinanzausgleich”? 

Two debates on the Future of EU Finances

Naturally, these two debates are interconnect. But how?
Current EU fiscal equalisation debate

- **Economic and fiscal crisis** lead – *inter alia* – to calls for a **EU Fiscal Union**.
- **Dominant question here:**
  - Can a **fiscal equalisation** mechanism, e.g. a **common unemployment insurance**, help to **stabilise** in the face of **macroeconomic shocks**?
- **Answers:**
  1. Yes. To a some degree and when faced with asymmetric shocks. \(^1\)
  2. But: A common EU unemployment scheme might weaken incentives and increase moral-hazard among Member States. \(^2\)
  3. Already, the Own Resources-system stabilises in case of asymmetric macro-shocks. \(^3\)

- **My topic** today:
  - Stabilisation? Okay, we see the point.
  - But mainly, **fiscal equalisation is about redistribution**.

---

Redistribution within EU is not unpopular

My question in this talk

- How much 'classic' fiscal equalisation is already hidden in the current structure of revenues and spending of the EU?

- I focus on gross national income (GNI) per inhabitant, the most likely variable on which a fiscal equalisation system in the EU would be based – at least partly, maybe even fully.

- The following calculations and simple regressions only serve to formulate hypotheses. I do not claim to present anything other than an empirical first shot.
EU Regional Policies and European Fiscal Equalisation

II. REVENUE SIDE
Composition of EU Revenue (2015)

- VAT-based own resource: 18.087 EUR million
- Traditional own resources (TOR): 18.730 EUR million
- GNI-based own resource: 100.967 EUR million
- UK correction: -443 EUR million
- Surplus previous year: 1.434 EUR million
- Other revenue: 7.258 EUR million
- TOTAL REVENUE: 146.027 EUR million

Source: Own Calculations; based on COM-Data.
Correlation: GNI-based OR and GNI (2015)

- GNI-based OR and GNI are closely correlated.
- $R^2 = 98.7\%$ (2015)
- Unsurprisingly.

Source: Own Calculations; based on COM-Data.
Fun fact:
- Total OR and GNI are correlated even closer than GNI-based OR and GNI.
- \( R^2 = 99.4\% \)
- Surprisingly (but only true in 2015).

Financing of EU:
- Almost immaculate proportional financing rate
- Based on a straightforward (\& simple) ability-to-pay principle

Correlation: **Total OR and GNI (2015)**

Source: Own Calculations; based on COM-Data.
III. EXPENDITURE SIDE

EU Regional Policies and European Fiscal Equalisation
Composition of EU Expenditures (2015)

- Competitiveness for growth and jobs 13,033
- Economic, social and territorial cohesion 50,873
- Sustainable Growth: Natural Resources (i.e. Agriculture) 56,486
- Security and Citizenship 1,935
- Administration 7,452
- Global Europe and outside EU 15,273
- Other 192,2

Total Expenditure 145,243 (EUR million)

Source: Own Calculations; based on COM-Data.
Agriculture spending and GNI (both per head; 2015)

- 39% of the budget
- No interconnection with GNI per head
- Agriculture spending does not serve an obvious fiscal equalisation purpose.
“Competitiveness for growth & jobs” and GNI (both per head; 2015)

- Structural, but „non-regional spending“ (9% of 2015 budget)
- Little to no interconnection with GNI
- Here, one or several other “non-equalisation”-rationales reign.
- The same is true for the remaining EU expenses.

![Graph showing the relationship between EU expenses on competitiveness for growth and jobs and GNI per head.](image)

Source: Own Calculations; based on COM-Data.
35% of the budget

Regional policy spending per head follows a downward slop with increasing GNI per head. (Logarithmic specification.)

$R^2 = 67.8\%$ may seem moderate. Yet, in the “business” of calculating fiscal equalisation systems, this correlation is actually quite good.

Combined with revenue, this slope produces a clear redistribution rate of an (implicit) fiscal equalisation system.

Source: Own Calculations; based on COM-Data.
Areas of Cohesion spending in 2014-2020

- Cohesion spending **spatially focused** on less developed EU-regions
- **But little thematic focus**; cohesion funding supports virtually all tasks of potential relevance for regional development.
- **The lack of sufficient funds** in the regions is obviously a stronger rationale for cohesion spending than any unique “European value” rationales (externalities, public goods, other added value).
- Additional evidence for our “fiscal equalisation hypothesis”

EU Regional Policies and European Fiscal Equalisation

IV. FISCAL EQUALISATION?
Conclusions

• With GNI-based revenues and mainly GNI per head-based regional spending, a fairly strong, yet implicit fiscal equalisation mechanism (> one third of EU budget) is already in force. (Actually, we knew that.)

• Two consequences for the current debate:
  1. With this clear regional redistribution from rich to poor, clearly there is no room for “juste retour”-thinking.
  2. Fiscal union: Don’t ask whether we need an EU fiscal equalisation. Ask whether the existing equalisation conforms with our needs.

• A possible answer / a “new narrative”:
  – With the calls for more “European added value” in expenditures and with the - at best - mixed evidence for “additionality” of EU regional spending, an explicit fiscal equalisation with more applied subsidiarity might be discussed as a (partial/full?) replacement for the current implicit practise.
Thank you

Continuing the dialogue:

thoene@ fifo-koeln.de

www.fifo-koeln.de