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Roger Bowles and Philip Jones*

Fairness and the EC Budget: Is Spain Tilting at Windmills?

The poorer member states of the EC are often disappointed at what they see as a very limited degree of redistribution of resources away from the richer members towards the less well off. In a recent paper to the intergovernmental conference (IGC) on political union, for example, Spain calls for a number of measures, including explicit inter-state budget transfers, in order to increase the rate of convergence of income levels across member states. The purpose of this paper is to review the degree of redistribution entailed by the EC budget system as it works at present and to make some conjectures about the implications of pursuing the Spanish argument.

We begin with an outline of the main trends in the EC budget. Table 1 gives the basic set of data on expenditure by (or total payments to) member states in 1985 and 1989. These figures are calculated by expressing raw data (taken from *European Economy* and *Official Journal of European Community*) in ECUs and adjusting by a GDP deflator computed for each member state for each year. The resulting figures are divided by the country's population at the time to get data in per capita terms. Adjustment in this way enables direct comparisons to be made both between member states and also between years.

There are two issues in particular arising from the data in Table 1. The first concerns the degree of variation in expenditure levels when expressed in per capita terms as they are here. The pattern of variation across countries is broadly stable through time: those member states receiving relatively heavy expenditure per capita in 1985 tended also to be receiving a relatively high level in 1989. The most obvious exceptions to this generalisation are the deterioration in Belgium's receipts under the agriculture head and the gains of the Netherlands under the same head. These variations through time are nevertheless much smaller than the variation across member states within any particular year.

The second issue relates to the proportion of total

expenditure represented under the different budget heads. In 1985 agriculture and fisheries expenditure accounted for just over 83% of the total. The decline by 1989 to 79% is significant, but not very large. It is certainly a smaller decline than some of the member states have been urging and agriculture remains much the largest single target of EC spending. As we will see later, it is not the more "agricultural", low income states which derive greatest benefit from this expenditure so much as those with the highest productivity in agriculture and those concentrating on certain kinds of agricultural produce. This is probably the greatest single source of tension within the EC at present and is a matter which needs to be resolved.

Own Resources

We consider next the basic data describing the extent of contributions (own resources) to the EC budget by member states. Table 2 sets out own resources per capita measured in ECUs at constant prices. These data are set alongside data on expenditure taken from Table 1. Net own resources (which correspond with what one might term "net contributions") are calculated by subtracting these expenditure levels from (gross) own resources.

Gross own resources contributed by member states increased in real per capita terms in all cases between 1985 and 1989, although the increase was larger in some cases than others. The other feature immediately obvious

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from Table 2 is that there is less variation in own resources across member states than there is in expenditure levels.

When own resources are considered net of expenditure there is, as one might imagine, a higher degree of variation both across countries and over time. Although there is very little change in the set of member states which are positive net contributors as between 1985 and 1989 there is considerable variation in the size of the net contribution.

Redistributive Impact

One very obvious question to ask of any fiscal system which collects revenue and allocates spending is: how are contributions and receipts determined and what relation do they bear to income? Member states making large net payments into the EC and those making contributions they judge to be high in relation to the benefits they receive may well take the view that they would like to see a reform of the budgetary arrangements. One thinks immediately of the UK's efforts to reduce its contributions in the mid-eighties, of the complaints by some of the Mediterranean member states about the structure of agricultural price support and of the current efforts by Spain to increase the share of expenditure going through the regional sector of the budget.

The identification of the redistributive impact of fiscal systems is, of course, a complex matter. We take a very crude approach here, ignoring most of the possible complications such as the impact of the EC budget on the structure of a member state's economic activity. There are good grounds for assuming that the agricultural sector in particular will adjust itself to the system of price support so that the composition of agricultural output will depend in an

important way on the pattern of price support. The approach we use here is to focus on comparisons between member states in terms of the expenditure they receive and the resources they contribute per capita of their own population, relating both to the country's GDP per capita.

It is well also to keep the EC budget in perspective. Although the total amounts of expenditure appear quite large they represent only a very small fraction of EC activity. In very rough terms the budget is of the order of 1% of GDP for most member states, and this obviously puts a very low ceiling on the degree to which income redistribution can be achieved through the EC.

The results of the analysis are documented in Table 3. Emphasizing that the data are expressed in per capita terms, it can be seen that there is limited evidence of the expected (negative) relationship between total expenditure and GDP. The member states with lowest incomes, at least to some extent, benefit from high expenditure. Greece and Ireland, two low income members, for example benefit significantly whilst high income members such as France and Germany benefit to a much smaller degree. There are counterexamples however, most notably Denmark and the Netherlands who both receive high levels of expenditure although they are high income economies. The reason, of course, for the latter is that both do very well under the agricultural policy.

In net terms, when contributions are adjusted for expenditure levels, we find that Denmark and the Netherlands remain among the net beneficiaries in both 1985 and 1989 despite having amongst the highest levels of GDP in the Community. At the other end of the spectrum meanwhile we find that Spain is a net contributor despite having one of the lower levels of GDP. It is perhaps not

Table 1
Expenditure per Capita in Real Terms,
1985 and 1989

(Million ECU, 1985 prices)

Country	Expenditure on Agriculture & Fisheries		Expenditure on Regional & Social Fund		Total Expenditure	
	1985	1989	1985	1989	1985	1989
Belgium	94.52	48.73	6.26	6.15	108.54	57.26
Denmark	165.27	161.48	8.06	5.48	178.43	169.05
Germany	60.78	51.34	2.81	4.23	68.58	61.46
France	86.42	72.32	8.86	9.08	98.18	84.23
Greece	128.65	158.79	39.06	52.73	171.41	212.66
Netherlands	142.73	195.65	4.31	4.81	154.05	214.65
Ireland	351.16	277.09	81.86	89.71	437.49	403.21
Italy	62.87	69.48	13.38	18.01	78.41	89.36
Luxembourg	17.99	12.24	3.55	6.23	23.18	18.25
UK	35.62	27.39	13.56	16.71	54.88	46.74
Portugal	—	28.27	—	52.04	—	80.33
Spain	—	43.71	—	30.85	—	75.42
Total excl. Spain and Portugal	1146.01	1074.51	181.71	213.14	1373.2	1356.9
%	83.46	79.19	13.23	15.7	100.0	100.0

Table 2
Expenditure and Own Resources per Capita
(in real terms) 1985 and 1989

(Million ECU, 1985 prices)

Country	Total expenditure		Own resources (gross)		Own resources (net)	
	1985	1989	1985	1989	1985	1989
Belgium	108.54	57.26	131.12	151.44	22.58	94.18
Denmark	178.43	169.05	121.31	140.87	-57.12	-28.18
Germany	68.58	61.46	122.97	149.09	54.39	87.63
France	98.18	84.23	96.42	127.95	-1.76	43.72
Greece	171.41	212.66	39.06	46.96	-132.35	-165.70
Netherlands	154.05	214.65	130.41	151.32	-23.64	-63.33
Ireland	437.49	403.21	83.73	87.37	-353.76	-315.84
Italy	78.41	89.36	78.41	110.03	0.00	20.67
Luxembourg	23.18	18.25	138.26	161.99	115.08	143.74
UK	54.88	46.74	89.91	95.51	35.03	48.77
Portugal	—	80.33	—	38.94	—	-41.39
Spain	—	75.42	—	76.07	—	0.65

surprising therefore that Spain should be seeking relatively radical reforms which would promote redistribution from richer to poorer members.

Regression Analysis

A more precise method of examining the relationships between expenditure, own resources and the GDP levels of member states is to apply techniques of regression analysis. This enables one to assign a quantitative estimate as to how progressive the schedules relating expenditure and own resources to GDP are. From an analysis discussed in more detail elsewhere¹ we have estimated each of the schedules in question. Our principal findings can be summarised as follows.

First, there is a close relationship, as one would expect, between own resources and a member country's GDP per capita for the period 1985-89. The correlation coefficient exceeds 80% and the equation indicates that a 1% increase in GDP will raise a member country's own resources by almost exactly the same amount.

Secondly, and rather surprisingly, there is little sign of the expected negative relationship between total payments and GDP. Instead of finding that the low income states receive high payments and vice versa we find virtually no relationship between the two. To put the matter more bluntly, a 1% increase in GDP will not tend to depress a member state's receipts under the EC budget at all.

The reason for this is, primarily, the structure of agricultural price support. As income levels in an economy rise one will generally observe a rise in productivity. As productivity rises in one sector so it will tend to rise in all

sectors in an economy, including the agricultural sector. In the context of price guarantees for agricultural products, output in such economies will rise as will the cost to the EC of buying up the extra production. The consequence of increasing incomes could thus, at least in theory, be a rise in receipts under the agricultural support head.

Closer analysis of the data, however, fails to confirm any positive association between farm price support expenditure and GDP. Equally, an analysis of structural support spending finds that also to be largely independent of GDP, although quite sensitive (positively) to the fraction of the labour force employed in agriculture.

The overall impact of the EC budget can be summarised by looking at the relationship of own resources, net of total payments received, to GDP. Having already illustrated that own resources in gross terms increase with GDP whilst there is little systematic link between total payments and GDP it comes as no surprise to find that net own resources appear to bear a mildly positive relationship to GDP. The relationship is depicted in Figure 1, on which we have superimposed the "line of best fit" estimated from a simple regression of net own resources on GDP.

This relationship is a relatively weak one, but it is of particular interest to the extent that it can be used to identify clusters of observations lying significantly out of line with others. It is evident from the graph that Greece, Italy and Denmark are doing better than they might expect whilst Spain, Portugal and Luxemburg appear to be doing relatively poorly in net terms. The other point which comes across clearly from the graph is that the picture changes only slowly through time: a member state faring well one year can expect to do likewise another.

A point which does not come across quite as forcibly from the graph but which nonetheless needs to be taken

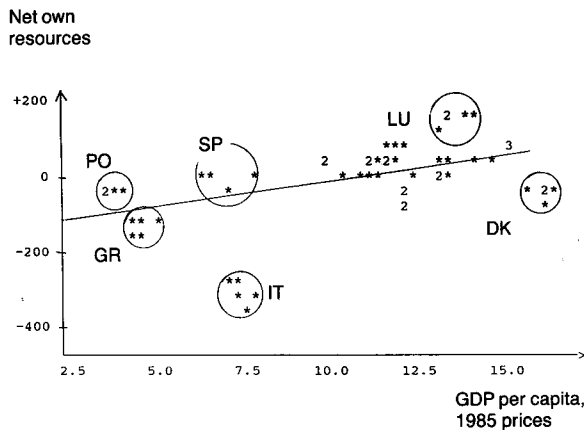
¹ R. Bowles, P.R. Jones: The EC Budget 1985-89: a pooled cross-section time series analysis, mimeo, Centre for Fiscal Studies, University of Bath, 1991.

Table 3
Expenditure, Own Resources and GDP, 1985 and 1989
(Million ECU, 1985 prices)

Country	1985				1989			
	Total expenditure	Own resources (gross)	Own resources (net)	GDP	Total expenditure	Own resources (gross)	Own resources (net)	GDP
Belgium	108.54	131.12	22.58	10.67	57.26	151.44	94.18	11.59
Denmark	178.43	121.31	-57.12	15.12	169.05	140.87	-28.18	15.40
Germany	68.58	122.97	54.39	13.47	61.46	149.09	87.63	14.49
France	98.18	96.42	-1.76	12.52	84.23	127.95	43.72	12.81
Greece	171.41	39.06	-132.35	4.39	212.66	46.96	-165.70	4.09
Netherlands	154.05	130.41	-23.64	11.49	214.65	151.32	-63.33	11.43
Ireland	437.49	83.73	-353.76	6.95	403.21	87.37	-315.84	7.18
Italy	78.41	78.41	0	9.86	89.36	110.03	20.67	11.33
Luxemburg	23.18	138.26	115.08	12.54	18.25	161.99	143.74	13.57
UK	54.88	89.91	35.03	10.57	46.74	95.51	48.77	10.92
Portugal	-	-	-	-	80.33	38.94	-41.39	3.48
Spain	-	-	-	-	75.42	76.07	0.65	7.25

seriously is the question of whether the line of best fit is "sufficiently steep". For the line (best) describes the position as it is, not as one would necessarily want it to be. Argument has of course long raged about how much redistribution there should be through national budgets, and it would be surprising if the budgets of supranational federations were not subject to similar tensions. Low income members of the EC might well argue that the EC budget ought to be more effective in redistributing resources than it is at present. The problem they have is finding a means of persuading their richer confederates to change the rules.

Figure 1
Net Own Resources and GDP per capita,
1985-89



Note: Where numbers 2 and 3 appear, there are 2 or 3 observations respectively lying very close to one another.

Table 4
Expenditure and Own Resources per Capita,
in Real Terms, 1989
(Million ECU, 1985 prices)

Country	Expenditure		Own resources	
	Actual	Simulation	Actual	Simulation
Belgium	57.261	65.549	151.444	179.507
Denmark	169.048	176.779	140.876	166.980
Germany	61.455	67.341	149.086	176.712
France	84.230	96.092	127.948	151.657
Greece	212.658	282.737	46.960	55.662
Netherlands	214.650	220.462	151.352	179.398
Ireland	403.203	516.341	87.368	103.557
Italy	89.362	111.418	110.032	130.421
Luxembourg	18.247	32.710	161.994	192.011
UK	46.737	64.497	95.502	113.199
Portugal	80.325	145.155	38.935	46.150
Spain	75.416	109.785	76.069	90.165

Note: Actual figures as in Table 2. Simulation figures derived by doubling the size of structural expenditure and financing the spending with a proportionate increase (common to all member states) in own resources.

Some efforts have been made in this direction in the past of course. In February 1988 at the Brussels European Council it was agreed that the size of the structural component of the budget should be doubled over the five year period 1987-1993. In order to illustrate the potential effects of such policies we simulate here what might have happened over the period 1985-89 had such a doubling been introduced at a stroke in 1985. In other words we are examining the likely effects of a more radical effort to redistribute income than the EC has actually pursued.

The results of this simulation are presented in Table 4. This allows direct comparison between actual budget outcomes 1985-89 and our simulation based on a doubling of structural spending accompanied by a proportional increase in contributions sufficient to cover the increase in spending. The outcome is reported only for 1989, but the picture is similar for the earlier years.

The principal finding from this exercise is the expected one, namely that the lower income countries do rather better under the policy simulation than they did in the event. Further analysis of the resulting distribution of expenditure and contribution levels shows that such policy would have at least eliminated the regressive element in the budget. It indicates that the increased spending through the structural funds would have ensured that an increase in GDP on the part of a member state would add more to its EC tax bill than it could expect to recover by way of additional spending from Brussels. Nevertheless the difference between the two increases would be very small and would incline one to describe the policy as "broadly neutral" in distributive terms.

It is therefore not surprising to find countries like Spain becoming very impatient over the slow movement on redistribution. The policy we simulated is being phased in over a period of five years, but even after this has happened it seems unlikely that any significant degree of redistribution will be taking place. At best it will prevent the movement of resources from the lower income states to the higher income members.

The 1988 EC budget agreement expires at the end of 1992 and it is certain that some of the issues raised in this paper will assume growing significance as the renewal date approaches. The low income members, particularly the recent joiners Spain and Portugal, seem to be doing rather badly under the current arrangements. With pressure on German finances from the integration of Germany one possible source of additional funding no longer looks very potent. Considerable imagination and analytical effort will be needed in devising a new set of budgetary arrangements if the mounting pressures to remedy regional wealth gaps are to be contained.