AT A GLANCE

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European Parliament

Net operating balances indicator:

A distorted indicator of a Member State's benefit from the EU budget

Operating budgetary balance (OBB) calculations **imply that EU spending is a zero-sum game**. This feature is inconsistent with the main argument that **EU spending creates European added value**. Thus, taking simple net operating balances as an indicator of a Member State's 'net benefit' from the Union's fiscal activities can **lead to misleading results**, as demonstrated in the following points of argument.

Firstly, spending at the EU level can have more added value relative to spending at the Member State level due to **economies of scale** (i.e. cheaper provision of a public good at the central level) and **threshold effects** (i.e. failure to provide a desired public good at the Member State level due to budget constraints). Similarly, added value for the Union can be created from **cross-border effects** of EU funds. Such **positive externalities** arise due to (knowledge) spillovers and second-order effects of higher cross-border trade, or investment stemming from the original beneficiary Member State.

Secondly, certain types of EU spending, such as **external spending**, are not allocated to Member States directly and are therefore completely absent from Operating budgetary balance calculations. **External spending** can potentially benefit all Member States (through e.g. increased trade, reduced migration costs).

Thirdly, even if funds can be allocated with reasonable certainty to a recipient that is situated in a Member State, it is not obvious **which Member State bears the full economic rents from these funds in practice**. For example, a significant amount of Cohesion funds flowing to economically lagging regions proceed to multinational enterprises with headquarters in other Member States, and within these firms the rents are further shared between capital and labour originating from different Member States. Thus, the benefits of a fund do not necessarily remain in the assigned country fully; yet Operating budgetary balances subscribe all fund benefits to the Member State to which the payments are made.

Fourthly, EU transfers have historically helped the European community reach important integration bargains. For example, the Cohesion Fund was used as an important tool to reach unanimity on the Maastricht Treaty. **Deep integration steps**, made possible by EU spending, **benefit the Union as a whole** but are not reflected in Operating budgetary balances.

Finally, although Operating budgetary balances are based on (parts of) the core EU budget, **the EU has several additional instruments** (e.g. European Investment Bank, European Stability Mechanism). These additional instruments are **economically significant** but are in no way reflected in Operating budgetary balances.

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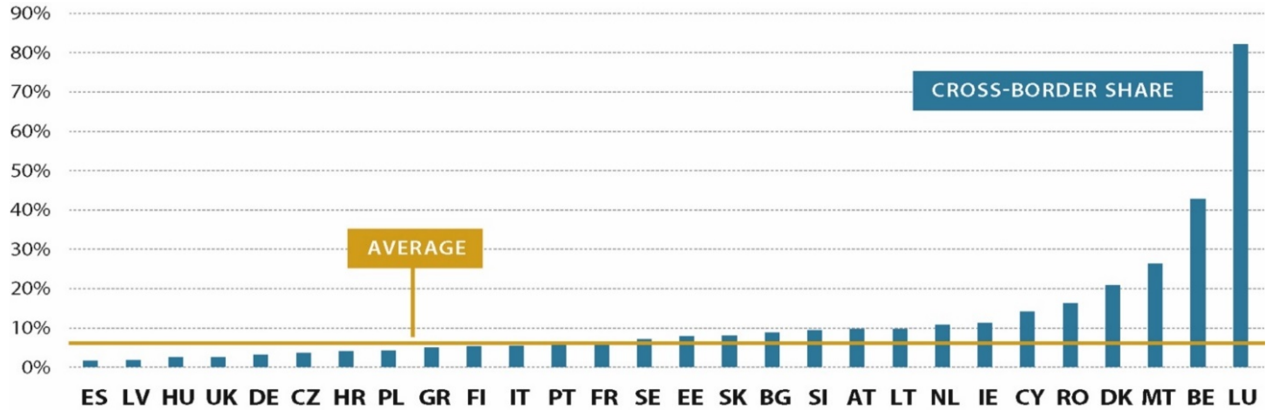
Example: The incidence of structural funds

An enterprise implementing a large infrastructural project financed by European Structural and Investment Funds may hire both local and foreign workers. This enterprise may be owned by other firms located in EU Members other than the Cohesion region. **The large infrastructural project would surely benefits the economic growth of the targeted region, but the profits and wages generated during the implementation of the project would also flow to the foreign employees and owners of the implementing firm, who might reside abroad.** The questions of whether the firm owners would benefit from transfers to firms through higher profits, or whether international workers benefit from transfers through higher wages are not obvious and have to do with relative forces of demand and supply. Similarly, market conditions will at least partly dictate whether local or foreign firms win the transfers.

In general, because of the relatively less developed capacities of the Cohesion regions, **a significant share of their EU funds are likely to be used by firms owned by other Member States**. As shown in Figure 1, the share of contract awards won by firms residing in other Member States is the lowest in Spain (1.5%), followed by the UK (2.4%), Germany (3%) and Italy (5.4%). This share is highest in the small country of Luxemburg (82%), followed by Belgium (43%), which hosts many EU institutions. The poorer Member States of Romania and Bulgaria rank average (16.3% and 8.7% respectively). Thus, the incidence of EU funds spent in poorer and smaller Member States tend to partly flow to larger and richer Member States. Although the magnitude of this effect is sizeable (e.g. **16.3% of EU funds procured in Romania flows to non-Romanian firms, a rate that is three times larger than that of Germany**), the calculations might even underestimate this effect since subsidiaries of multinationals registered locally are not counted as cross-border firms. On the other hand, the more developed regions of Europe, with capacity-constrained firms and expensive workforce, are likely to hire employees from less developed regions to carry out these projects. Therefore, they will shift some of the rents of Cohesion spending to these regions through labour effects. **Overall, this type of cross-border effect is significant, but – apart from a few countries – it does not seem to be huge.**

Figure 1. EU co-funded public procurement contract values won by firms other than the procuring Member State (%, 2006-2017)



Source: Authors' calculations based on *European Union*, "Tenders Electronic Daily" (accessed 01 June 2018). Data includes 20,695 EU co-funded contracts, of which 684 are awarded to cross-border firms. These contracts total over €13 billion, of which €842 million are awarded to cross-border firms.

Source: Extracts from the Briefing *Why net operating balalnces are a distorded indicator of a Member States benefi from the EU budget*, February 2020

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