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Economics of Policy Errors and Learning in the European Union

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Abstract

Policy errors occur regularly in EU Member States. Learning from these errors can be beneficial. This paper explains how the European Union can facilitate this learning. At present, much attention is given to “best practices”. But learning from mistakes is also valuable. The paper develops the concept of “avoidable error” and examines evidence from infringement proceedings and special reports of the European Court of Auditors which indicate that Member States do indeed commit avoidable errors. The paper considers how Member States may take measures not to repeat avoidable or predictable errors and makes appropriate proposals.

Keywords: European Integration, Policy Implementation, Avoidable Errors, Best Practice, Mutual Learning

JEL codes: D73, F15, H11, O52, P11

“Experience is the name everyone gives to their mistakes”
Oscar Wilde

Introduction

It is now “trendy” for policy initiatives in Brussels to seek to identify “best practices”. The intention is that by finding what appears to work well in one country, other countries will be tempted to copy it. This is a fairly cheap way of improving policy effectiveness. It is in the interests of those who apply good practices to disseminate them and of others to imitate them.

Numerous books and articles in scientific literature and popular psychology claim that we also learn from our own mistakes and those of others.¹ After all, this is what we apparently call “experience” which we value. Yet, as far as I know, no one in the EU has attempted to identify “bad practices” or policy errors and disseminate them so that others do not commit similar errors.

The purpose of this paper is to examine the nature of incentives for dissemination of information on bad as well as good practices in the EU and to consider how mutual learning can be facilitated. In principle, Member States can gain both from the successes and failures of others. Policy practices that work better than others can be replicated while those that work worse than others can be avoided.

But here there is a problem. In principle, one country’s failure, can be another country’s gain because the latter learns what not to do. Yet, although everybody learns from others’ mistakes, it is unlikely that those who commit the mistakes would be willing to reveal them. As shown later on, this is a situation akin to prisoner’s dilemma. Similarly to the resolution of prisoner’s dilemma, in a situation where individually we are worse off, but collectively better off, then there is a need for coordination. The EU is the natural candidate for the role of coordinator whose task is to spread useful information for the benefit of all Member States.

There is ample and convincing evidence that Member States get things wrong, persistently. According to the latest Annual Report on Monitoring the Application of EU Law, the highest number of infringements of EU law occur in the fields of the environment and transport.² But this is the same pattern that is revealed by previous Annual Reports. It is puzzling why year after year Member States encounter so much difficulty in complying with environmental and transport rules. It is not so much that there may be some degree of natural difficulty in implementing rules in these two fields. Rather, it is the persistence of problems which is puzzling.

¹ See J. Hallinan, *Why We Make Mistakes* (New York: Broadway Books, 2009); and K. Schulz, *Being Wrong* (New York: Harper Collins, 2010) and the references therein. For a more detailed analysis of why policy errors occur and how they may be avoided see P. Nicolaides, *Microfoundations of Policy Implementation*, (London: Routledge, 2013).

² See European Commission, 30th Annual Report on Monitoring the Application of EU Law, COM(2013) 726 final, 22 October 2013. It can be accessed at:
http://ec.europa.eu/eu_law/docs/docs_infringements/annual_report_30/com_2013_726_en.pdf

The Commission, of course, examines only legal infringements. But a “bad” practice can be bad and a policy error can be an error without breaking any law. Later on it will be shown that many policy errors are not necessarily contrary to EU law. But they are certainly contrary to the interests of Member States. So benefits from mutual learning can be had both in relation to legal and non-legal mistakes.

The paper presents a number of findings and makes several recommendations. Its first finding is that, in a game-theoretic framework, Member States are understandably more likely to trumpet and, perhaps, exaggerate their policy successes than their policy errors. Second, even though all Member States gain from learning from each other’s mistakes, their dominant strategy is to avoid revealing their policy errors. Third, the paper makes a distinction between avoidable and unavoidable errors and suggests that certain errors can be avoided precisely because they are fairly predictable *ex ante*. Fourth, the paper presents empirical evidence that shows that Member States do commit avoidable errors. Fifth, with a notable exception (please see below), existing mechanisms for detecting errors are limited to legal infringements and do not aim to compare national performance and help Member States adopt good practices and avoid bad ones.

The recommendations of the paper are, first, that the EU has a natural role to play in the collection, assessment and dissemination of information on policy successes and mistakes. Second, the EU should assist Member States to avoid predictable errors. Such errors can be avoided through improved policy and institutional design. Third, the collection and dissemination of information on policy performance can itself lead to improvement.

The paper is structured as follows. It begins by considering the issue of policy successes or “best practices”. Then it turns its attention to policy failures or “bad practices” and the incentives for hiding policy errors. It defines avoidable errors and considers how their recurrence can be prevented in practice. It then reviews evidence from reports of the European Court of Auditors on how Member States have implemented certain policies. It argues that the evidence lends support to one of the main theses of this paper, that indeed certain policy errors can be avoided. It concludes by drawing several recommendations for EU action.

Before proceeding to the main part of the paper it is important at this point to make two important clarifications on the scope of the analysis. First, the paper does not cover national macroeconomic policy and fiscal instruments which are subject to peer review by the EU such as that in the framework of the “European Semester”. This kind of review is explicitly intended to prevent policy errors and contribute to mutual learning. Similar reviews, however, are not carried out systematically or on the basis of explicitly agreed criteria in relation to sectoral policies. Therefore, the paper should be understood to refer to those sectors for which regular and institutionalised peer reviews do not exist.³

³ “Regular” means that the reviews are carried at predetermined intervals. “Institutionalised” means that someone has been assigned the task of carrying out the reviews according to pre-defined criteria. See, for example, the latest publication of the scoreboard of the Macroeconomic Imbalance Procedure, which is based on eleven headline indicators (13 November 2013). It can be accessed at: http://epp.eurostat.ec.europa.eu/portal/page/portal/macroeconomic_imbalance_procedure/indicators

Second, standard economic theory is based on the assumption that individuals are rational in the sense that they know what they want and that they allocate their income so as to maximise the utility they derive from consumption or leisure activities. They do not make intentional mistakes. What appears *ex post* as a mistake is the result of *ex ante* wrong information, not wrong computation. In other words, an individual makes choices X_i, \dots, X_j , subject to an income constraint, I , so as to maximise utility U . In this setting, a mistake or error occurs when the expected or desired outcome, U^* , is different from actual outcome, U' . Once the individual obtains new information, the error is corrected immediately, provided that the correction itself is not costly.

The situation is vastly more complex in the case of policy errors. First, it is not always clear what governments maximise. The standard assumption is that they maximise the sum of individual utilities, which in practice are measured by income. This may or may not be a good approximation. Second, governments are also expected to seek to achieve things that individuals cannot. For example, governments are tasked with the provision of public goods such as security, laws, education, roads, etc. The list varies depending on one's political preferences. Third, the income constraint of a government is hardly binding. Governments can tax, print money or even borrow in perpetuity [e.g. British "consols"]. Given the complexity of policy making, the concept of policy error in this paper does not refer to what ideal policies should be or what governments ought to do. It is more narrowly defined to mean a deviation of actual from expected policy outcome. It does not imply attribution of importance or moral significance. Certainly, it does not assess overall policy objectives. An objective that is acceptable to one person may be rejected by another. The concept of policy error in this paper takes as granted initial policy objectives or preferences.

Policy successes or "best" practices

The EU has been described as a system of "multi-level governance networks". In every policy area, there are networks of Member State ministries, departments, agencies and all sorts of public authorities which meet regularly in Brussels or in the Member State that holds the rotating presidency of the Council. The typical tasks of these meetings of national authorities are to consider the need for EU action, appraise legislative proposals and review the implementation of already adopted EU rules. There is also a trend to use the gatherings of national officials to identify on an informal basis "best practices".⁴

But there are at least two problems with this informal approach. First, it may not be easy to identify best practices. What is good in the short-term may be off the mark in the long-term. Second, best practices may not be replicable. They may be the product of country-specific influences and traditions. Best practices which are truly useful to others must be first subject to rigorous assessment.

⁴ This trend is visible at all levels of the functioning of the EU. The Conclusions of the European Council of 24-25 October 2013, invites Member States to "take full account of best practices" in the application of the Services Directive. At a different level, the Lithuanian Presidency's press release on the Joint Meeting of the Human Resources Working Group (HRWG) and Innovative Public Services Working Group (IPSG) of the European Public Administration Network (EUPAN), 28 October 2013, stated, among others things, that one of its objectives was to "share best experience of public management improvement".

But even when assuming such problems away, the question is why the EU should be involved in the identification and dissemination of best practices. What is that which gives it an advantage over its Member States? This is not a trivial question because if a country obtains benefits from publicising its best practices [e.g. prestige, attraction of foreign investors, higher credit rating, etc], it should have a strong incentive to do so itself. After all, this is what most national investment agencies routinely do. They extol their business-friendly policies and efficient regulatory systems to attract foreign investors.

The advantage of the involvement of the EU may be twofold. First, it can assess alleged best practices more objectively. National agencies may make claims which can be exaggerated or even false. The EU can presumably inject objectivity in the process of identifying best practices. Second, the EU is likely to enjoy economies of scale in the collection and dissemination of information on best practices.

Therefore, even if each Member State has an incentive to spread its own policy and regulatory practices, the EU may be more effective and more efficient in the task of disseminating best practices in the sense of being able to identify truly good and replicable practices and to do it less costly.

Assume that the gains a country “i” obtains from publicising its best practices, “bi”, can be denoted by function $G > 0$. The benefits, in terms of learning, it derives from best practices in other countries are given by $L(b_j) > 0$.

Consider the following possible ranking of pay-offs from the spreading of best practices:

All countries publicise their best practices:	$3 = G(b_i) + L(b_j)$
Only other countries publicise their best practices:	$2 = L(b_j)$
Only country “i” publicises its best practices:	$1 = G(b_i)$
No country publicises anything:	$0 = G = L = 0$

Country i	Other countries (j)	
	Publicise	Not publicise
Publicise	3, 3	1, 2
Not publicise	2, 1	0, 0

The shaded cell indicates the dominant strategy. With these pay-offs and ranking, all countries have an incentive to publicise their best practices.

The problem in this situation is not to incentivise countries to reveal information but to prevent them from exaggerating claims of best practices. Hence, there is a need for an independent assessor.

Policy errors or “bad” practices

Policy errors are costly for those who commit them. However, we also learn from our mistakes and in some sense benefit from them because they generate useful information. In ideal conditions, a policy is implemented only when the ex ante benefits outweigh the ex ante expected costs. In an ex ante situation we want to avoid errors.

Nonetheless, *ex post*, even if a policy turns out to be wrong, we still derive a benefit from learning what does not work.

While those who commit the errors may nevertheless experience net benefits if the errors are not too costly, others derive pure benefits because, normally, they do not have to suffer the consequences of wrong policies. Let's assume that $G(e_i)$ are the benefits from learning from our own mistakes and $L(e_j)$ are the benefits from learning from others' mistakes.

The fact that one learns from one's own mistakes does not mean that a country would rush to tell the world of the policy errors it has committed. First, there is what may be called an embarrassment factor. This factor may be denoted by function $M(e_i)$. Justifiably a country does not want to acquire a reputation of being sloppy.

Second, there may be penalties imposed on the persons who commit the errors, irrespective of the fact that others learn from those errors. In this paper we ignore personal consequences and focus instead on the national embarrassment factor.

Now, the following pay-offs and ranking can be derived:

Only other countries publicise their errors:	$4 = G(e_i) + L(e_j)$
All countries publicise their errors:	$3 = G(e_i) + L(e_j) - M(e_i)$
No country publicises anything:	$2 = G(e_i)$
Only country "i" publicises its errors:	$1 = G(e_i) - M(e_i)$

Please note that in all options country i gains because it learns itself from its own errors. This differs from the case of best practices in the previous section because the gain for country i was derived from the prestige it enjoyed from publicising its good policies. If now there is no publicity, it follows that there is no gain from extra prestige.

The ranking above is derived on the assumption that $L(e_j) - M(e_i) > 0$. In fact, it is an assumption that does not affect the robustness of the results. The outcome does not change if the opposite assumption is made, i.e. $L(e_j) - M(e_i) < 0$. In this case, the ranking of the second and third option is simply reversed. That is,

Only other countries publicise their errors:	$4 = G(e_i) + L(e_j)$
No country publicises anything:	$3 = G(e_i)$
All countries publicise their errors:	$2 = G(e_i) + L(e_j) - M(e_i)$
Only country "i" publicises its errors:	$1 = G(e_i) - M(e_i)$

Possibility I [$L(e_j) - M(e_i) > 0$]

		Other countries (j)	
		Publicise	Not publicise
Country i	Publicise	3, 3	1, 4
	Not publicise	4, 1	2, 2

Possibility II [$L(e_j) - M(e_i) < 0$]

		Other countries (j)	
		Publicise	Not publicise
Country i	Publicise	2, 2	1, 4
	Not publicise	4, 1	3, 3

Now the dominant strategy for each country is to hide policy errors, irrespective of whether the embarrassment factor exceeds or not the benefits of learning from others' mistakes.

The two possibilities, I and II, can also be interpreted from a different and more interesting perspective. It is reasonable to assume that the value of $L(e_j)$ depends on the number of countries. The higher the number of countries from which we can learn, the larger the benefits. That is, $dL/dn > 0$. Correspondingly, the higher the number of countries, the lower the embarrassment factor because if many countries make policy mistakes, the less embarrassing they are for each individual country. That is, $dM/dn < 0$.

In other words, we can surmise that there is a number, n , for which $L(ne_j) > M(ne_i)$ and, consequently, $L(ne_j) - M(ne_i) > 0$. In a European Union with many Member States, everybody gains yet each one individually does not reveal its errors voluntarily.

The following preliminary conclusions can be reached:

1. Even though all countries benefit from learning about policy errors, the dominant strategy for each country is not to reveal its policy errors. This strategy is invariant to the number of countries in the EU, even though the higher the number of Member States, the larger the collective gains of learning from each other.
2. The natural role for the EU is to identify and collect both good and bad practices. In the case of good practices it will have to filter them and choose the genuinely good ones. In the case of bad practices or policy errors it will have to identify them in the first place. It is also better for the EU as a whole when policy errors are identified from a large enough sample of Member States so that a sufficiently high number of n can ensure that $L(ne_j) - M(e_i) > 0$.

The next section examines the difference and implications of avoidable and unavoidable errors.

Avoidable errors

Since errors are always costly to a certain extent, why are they committed? One answer is that they are *ex ante* unpredictable.⁵ Suppose that a policy maker is in charge of defining optimum policy by determining the correct value of policy variable, x . The optimum outcome, W^* , is given by $W(x^*)$ where $dW/dx = 0$. If the actual outcome W' is different from the expected outcome W^* , i.e. $W' \neq W^*$, then it can be concluded that a policy error occurs. But if the error is a result of a random factor, the error is unavoidable and there is nothing we can do about it.

But suppose that on the basis of past experience, our policy maker learns that if he applies x_1 , then the policy outcome W_1 occurs with a probability of p_1 . If he applies x_2 , then policy outcome W_2 occurs with probability of p_2 . Therefore, the expected value of each policy outcome is $E_1 = p_1W_1$ and $E_2 = p_2W_2$.

⁵ Charles Perrow, in a seminal book published in 1999, referred to "normal" errors or accidents. These accidents are bound to occur because of the complexity of systems and despite their built-in safeguards. See C. Perrow, *Normal Accidents: Living with High Risk Technologies*, (Princeton: Princeton University Press, 1999).

If we assume that $W1$ is preferred to $W2$ [i.e. $W1 > W2$], we can define as “avoidable” error that policy choice that fulfils the following two conditions:

- i) its outcome has a higher probability of occurrence [i.e. $p2 > p1$] and
- ii) its expected outcome is less desirable than alternative outcomes [i.e. $E2 < E1$].

The policy maker should not choose $x2$ because not only is $W2$ less preferred to $W1$, but also because the worse outcome is more likely to materialise!

Given that according to this definition, it is fairly daft to commit an error that can be predictably avoided, it is reasonable to surmise that Member States would be averse at revealing avoidable errors. Indeed, the embarrassment factor is likely to be higher. Not only would they not be inclined to reveal them, but they may in fact try to hide them. This is precisely because this kind of error could have been avoided. Member States should not have committed them because they generate outcomes which are valued less than other feasible outcomes.

In this situation the role of the European Union is not only to uncover them and disseminate them but also to help Member States to avoid them in the first place. Member States should be prevented from committing errors which, by definition, are harmful to themselves.

The question that arises at this point is why do Member States do something they can avoid and which is not ostensibly in their own interest? As always, a standard economic answer is that what is in the collective interest of a country may not be in the narrow interest of the person or institution responsible for designing or implementing a particular policy. Correct design and implementation requires personal/institutional effort whose costs are borne largely by that person/institution. By contrast, if public money is wasted or if social welfare is not maximised, that person/institution hardly suffers. Collective and individual interests are not aligned. Such non-alignment is an institutional or organisational fault.

The evidence presented later on reveals the existence of institutional design faults. If EU Member States are indeed afflicted by such institutional weaknesses, then the EU can assist them to strengthen their policy systems. It is in their collective interest to do so. The next section considers how the incidence of avoidable errors can be reduced.

Reducing the incidence of avoidable errors

The enlightened policy maker who populates textbooks seems to spare no personal effort in order to maximise policy function $W(x)$ by choosing the appropriate value of policy instrument x . But reality is different. The policy maker may in fact minimise effort, which is presumably costly. Let E be the cost of personal effort. Further assume that it is determined by x and the function $E(x)$ is convex. This policy maker will put effort in implementing policy instrument x up to the point where $dE/dx' = 0$. Here x' denotes the “personal” optimum.

Now, assume that the system changes and the policy maker becomes accountable. Let A denote this accountability mechanism. Assume that A is structured in such a way so that it creates costs borne by the policy maker as follows: $A = 0$ if $x' = x^*$ and $A > 0$ if $x' \neq x^*$ or $dA/d(x - x^*) > 0$. In other words, a deviation from the socially optimum level of x is costly to

the policy maker. Under these conditions, the policy maker will minimise the sum of E and A up to the point where $dE/dx'' = -dA/dx''$. On the basis of our assumptions, in the new equilibrium, $x' \neq x''$ and $(x'' - x^*) < (x' - x^*)$. The latter means that, although the socially optimum value of x^* is not reached, the difference between the socially optimum and the personal optimum value of x is smaller after the accountability mechanism is introduced.

The problem in this situation is of course the same as with that in the typical principal-agent dilemma. The principal does not know the true optimum. Whether it can be reached depends on the efforts of the agent. Notice, however, an importance difference between the principal-agent situation and the subject-matter of this paper. The fact that the desired optimum cannot be defined ex ante does not necessarily mean that certain frequently errors in policy formulation and implementation cannot be avoided. In other words, just because we cannot see the top of the mountain because it is obscured by thick clouds, it does not mean that we do not know which way is up. If we just start going up we may reach the top of a low hill rather than the mountain summit [mathematically, the solution is a local optimum rather than global optimum] but we will have left the plains where errors occur.

Perhaps surprisingly, EU law also makes a distinction between avoidable and unavoidable errors. Directives 93/38 and 2004/17 on public procurement in utilities allows modification of contracts after they are awarded in case of “unforeseen circumstances”. What is “unforeseen” is often contested in court. A landmark case on this issue is Spain v Commission, T-540/10. The General Court, in its judgment of 31 January 2013, rejected the arguments of Spain that it could not have foreseen the changes to a contract, which became necessary after it was awarded [paragraph 77] because it found that mistakes in the original specification of the tender were caused by i) lack of “due diligence” [paragraph 100] and ii) “errors and omissions” resulting from “lack of knowledge” [paragraph 107]. It also stated that “unforeseeable circumstances” are those that are revealed only after the start of work. In other words, Spain should have known but it failed to do what it normally would have been done in a similar situation.

Therefore, the question that arises is what kind of accountability mechanism can influence individual behaviour in a way that minimises avoidable or predictable errors by inducing policy makers and public authorities to exercise “due diligence” – i.e. what needs to be done before an action is taken or a policy is implemented. Consider how this is done in other fields where complex operations take place.

Before an aeroplane takes off, the pilots go through a checklist. The purpose of the checklist is to prevent the pilots from making mistakes in the preparation of aeroplane that can endanger its airworthiness. These checklists were introduced in the 1950s and reduced accidents dramatically. Checklists are now applied in many diverse environments. For example, in 2008 the World Health Organisation together with the Harvard School of Public Health came up with a simple method for reducing “avoidable deaths” in operating rooms. Surprisingly, that method was a one-page checklist. Its success in reducing avoidable errors has been phenomenal in any country that has adopted it.⁶

⁶ See A Simple Checklist that Saves Lives, Harvard Public Health Review, Fall 2008, p. 25. It can be accessed at: http://www.hsph.harvard.edu/news/files/2012/12/HSPHfall08_checklistfinal.pdf

As is evident from these examples, a checklist is another word to denote a prescribed process where experience shows that certain errors occur with high frequency. It is not necessary to define the socially optimum in order to avoid certain mistakes. It is very important to appreciate that checklists or accountability mechanisms do not solve all problems. But they can solve some easily foreseeable problems.

We will see in the next section that Member States commit avoidable errors where they do not have “checklists” or their “checklists” are incomplete. Their procedures for policy formulation and implementation are faulty. This is proven by two facts. First, it is rather easy to predict *ex ante* that problems will occur at the implementation stage, as happens, for example, when policy objectives at the formulation stage are not clearly defined. This may appear as an exaggeration but the European Court of Auditors routinely uncovers such failings. Second, some Member States perform better and manage to avoid many such errors by following good practices [e.g. checklists]. This implies that adopting such good practices is practically feasible.

Those responsible for formulation and implementation of public policies and public measures are less accountable if there are no explicit and detailed enough requirements they should meet. Accountability at its barest minimum is an obligation to explain or justify one’s own actions. If there is no protocol, say, on project assessment, or if such a protocol is too broad and vague, then they cannot be held accountable because their performance cannot be measured and therefore whatever justification is put forth cannot be rejected.

By gathering information on simple but avoidable errors and by helping Member States on how to avoid them, the Commission will be both spreading good practices and contributing to making national officials more accountable. If everybody else is adopting such good practices, it can soon become very difficult for them to justify why they do not follow them too. But the first step in this process is the definition of what does not work and how it can be fixed.

The next section serves two purposes. First, it reviews recent Special Reports of the European Court of Auditors to show that Member States do commit avoidable errors. Second, it indicates what the solutions can be. If, for example, Member States waste public money by supporting projects that would have been viable without assistance, such waste can be avoided simply by checking whether the assistance is necessary. This is a suitable candidate for a policy or project checklist: the rule would be something like “check the

See also Harvard School of Public Health, press release, 16 January 2013: “In an airplane crisis—an engine failure, a fire—pilots pull out a checklist to help with their decision-making. But in an operating room crisis—massive bleeding, a patient’s heart stops—surgical teams don’t. Given the complexity of judgment and circumstances, standard practice is for teams to use memory alone. In a new study published in the January 17 issue of the *New England Journal of Medicine*, however, researchers at Ariadne Labs, a joint center for health system innovation at Brigham and Women’s Hospital and Harvard School of Public Health, have found that teams using checklists have markedly better safety performance. Specifically, the research shows that clinicians provided with checklists in a novel study using advanced simulation of surgical crises were three-fourths less likely to miss key life-saving steps in care.”

It can be accessed at:

<http://www.hsph.harvard.edu/news/press-releases/checklists-in-operating-rooms-improve-performance-during-crises/>

expected profitability of the candidate project before granting financial assistance". It does not require complex assessment or calculation of the policy impact on the wider economy. It focuses exclusively on the aid recipient.

Do Member States commit avoidable errors? Some empirical evidence

That all countries make policy mistakes is a truism. But is there any evidence that countries commit avoidable errors? The purpose of this section is to present evidence that avoidable errors do indeed occur. The evidence is extracted from three Special Reports of the European Court of Auditors (ECA). These Reports have been selected for four reasons. First, they are in the same policy area – agriculture and rural development – so their results are fairly comparable. Second, the Reports are based on the same methodology. Third, they are in a policy area where the EU has legislated extensively. If Member States can make avoidable mistakes in that area, then the likelihood that they can make avoidable mistakes in other policy areas must be higher. And lastly, their results allow us to draw conclusions as to how the EU should react. Making policies more detailed will not necessarily improve their implementation. The right solution is for the EU to help Member States build their institutional capacity by identifying the policy processes of successful Member States.

It is sufficient for the purpose of this paper, and also in order to avoid duplication, to review just one Report. The other two Reports are "Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?" ECA Special Report 6, 17 September 2013 and "Support for the Improvement of the Economic Value of Forests from the European Agricultural Fund for Rural Development", ECA Special Report 8, 19 September 2013. They can be accessed on the ECA's website. The rest of this section reviews the Report "Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?" Special Report 1, 10 April 2013.

Background

As part of the aid given for rural development under pillar 2 of the common agricultural policy (CAP), provision is made for a specific measure "adding value to agricultural and forestry products" ("measure 123"). Measure 123 contributes to the objective of improving the competitiveness of agriculture and forestry.

Through measure 123, public money is made available to enterprises with fewer than 750 employees or turnover of less than EUR 200 million that process and market agricultural and forestry products. Support is given to fund investments that can add value to those products. EU aid is co-financed with national public money and the total public expenditure on the measure is some EUR 9 billion. The measure is used principally to give grants towards the beneficiaries' investment costs. Member States may determine the aid rate, within limits. Most grants are for between 20% and 50% of the companies' total eligible investments. The EU budget for the period 2007–13, for measure 123, totals EUR 5.6 billion.

Assessment methodology

The main assessment questions asked by the ECA were:

- i) Has the measure been designed in a way that provides for the efficient funding of projects addressing clearly identified needs?
- ii) Have Member States implemented the measure with due regard to value for money?
- iii) Have the Commission and the Member States appropriately monitored and evaluated the results of the measure?

i) Design of measure

The legislation itself does not specify what the added value is intended to be (purely financial, from an environmental or a quality standpoint, etc.) nor to whom such added value should accrue. Consequently, the onus is on Member States to ensure that the measure results in improved added value and achieves benefits for the competitiveness of agriculture.

However, the RDPs did not identify specific needs for intervention in the food-processing sector, such as instances where the possibilities to add value to agricultural products were hindered by inadequate processing capacity. Where needs were identified, they were of a very general nature. The RDPs did not show why public support was necessary and how it could achieve the desired change. [Paragraph 21 of the Report]

ii) Value for money?

A common weakness was that Member States relied on the projections made by the applicants without checking that the figures and the underlying assumptions were well-founded and plausible. [Paragraph 31]

Member States did not have information to show if the projects to which they had given financial support were financially sustainable and effective, i.e. that they had achieved specific RDP objectives for the measure and added value to agricultural products. [Paragraph 42]

Deadweight refers to the extent to which a beneficiary would have undertaken the investment even in the absence of public financial support. To give a grant in such cases is an inefficient use of the EU and national budgets as it is not needed to achieve the desired effect (i.e. the investment). However, the Member States audited did not set specific objectives so the measures were open to all investment projects whether public support was needed or not. [Paragraph 53]

Member States could also check whether the applicant needed a grant for the project to be viable and whether the applicant had sufficient capital or access to capital to finance the entire project. None of the Member States audited did so. [Paragraph 54]

In certain Member States the authorities accepted project costs retroactively up to two years before the submission of the support application or allowed project costs to be financed even if incurred before applying for EU support. [Paragraphs 57-58]

The ECA assessed 24 projects and found that indications of deadweight were strong in eight of the 24 projects with indications of some deadweight in a further 11. [Paragraph 60]

Displacement is the degree to which an activity promoted by public support is offset by reductions in activity elsewhere. A subsidy that enables one company to increase its market share at the expense of a competitor may have no net effect on policy objectives such as creating employment or adding value to agricultural produce, and is therefore a priori not an efficient use of the EU funds. Of the 24 companies visited in this audit only three traded predominantly in local markets, the others all competed nationally and 10 of the companies, internationally. Giving a grant of up to 50% of a company's investment costs puts it at a competitive advantage in relation to unsubsidised companies and therefore carries a strong risk of displacement. [Paragraph 63]

As with deadweight, the primary means of mitigating the risk of unjustified displacement lies in programme design. This requires identifying needs that are sufficiently strong to justify any displacement that may occur, and setting objectives and eligibility conditions specific to those needs. In the Member States audited this was not done [e.g. in sectors where there is overcapacity, there is also a high likelihood of displacement].

Because of the displacement risks, Member States' authorities should assess project proposals for the likelihood of displacement risk during project approval. Where displacement is likely, they should ensure that the project makes a sufficiently high contribution to the measure's objectives to justify the grant. However, none of the Member States audited did so. None gave any consideration to the risk of displacement or to the efficiency of the measure in this respect. [Paragraph 65]

The ECA assessed the 24 projects for the risk of displacement based on documentation and discussions with the beneficiary on the company's products, markets and competitors and the effects of the investment on these. In particular, where the investment resulted in increased capacity, the ECA considered whether this was responding to an expanding market or was aimed at capturing market share from competitors. The analysis showed that displacement was likely in 13 of the projects, which was most evident where the project aimed at increasing market share by increasing capacity or reducing costs. The ECA also found displacement effects within the food-processing chain. [Paragraph 66]

The effectiveness and efficiency of the measure would be demonstrated if the projects selected are financially sustainable, result in an improvement in added value, are not affected by deadweight and do not cause unjustified displacement. Only two of the 24 projects met all four of these criteria. Ten were classed as medium and represent satisfactory value for money. Effective projects should also contribute to specific RDP objectives — but this could not be assessed as the RDPs set only very general objectives. [Paragraph 67] The remaining 12 projects selected by the same Member States were classed as low or very low in the ECA's analysis. [Paragraph 68]

These case studies illustrate the consequences of a lack of effective programming and selection: the failure in the first instance to identify needs, set specific objectives and design

the measure in a way to best achieve those objectives; and in the second instance to have an effective selection process. [Paragraph 69]

iii) Monitoring and evaluation of results

Member States should not only collect data from the applications for support and payments but also on the results achieved at beneficiary level.

The two common result indicators for measure 123 focus on the effects on the food processing companies. They provide little information on the achievement of added value or the effects on producers. None of the Member States audited has introduced additional result indicators that would serve this purpose. [Paragraph 73]

Only two Member States monitored project results declared by the beneficiary after the grant payment and this concerned only the companies' financial results and employment. [Paragraph 74]

The review of 23 mid-term evaluation (MTE) reports conducted as part of this audit revealed that the information needed to answer the evaluation questions is, in most cases, lacking and the assessment of project effectiveness is mainly based on theoretical arguments rather than on evidence from completed projects. [Paragraph 75]

Eight of the 23 MTE reports reviewed by the ECA gave no conclusions on the evaluation question 'To what extent have supported investments contributed to improving the competitiveness of the agricultural and forestry sector?' despite this being the EU objective for which the aid is given. The other reports mostly gave a positive assessment that agricultural competitiveness had been improved, while recognising that their conclusions were based on assumptions and expectations. These evaluations were of little use for demonstrating the effectiveness or efficiency of the measure as they failed to assess the 'extent' of any improvement. [Paragraph 76]

Lessons to be drawn

If indeed the findings of the ECA Report are correct, then it is not difficult to conclude that Member States have committed serious errors in the design and implementation of their policies for adding value to agricultural products. Were these errors avoidable. The answer, unfortunately, is in the affirmative.

These errors were avoidable because they would not have occurred had the Member States used a standard policy formulation and implementation methodology. Member States cannot claim in their defence that they pursued other policy objectives. After all, the avowed objective was to add value to agricultural products. Of course, there may have been many different instruments they could have chosen in order to achieve that objective, but no instrument would have been successful because, due to the defective design of their policies, it was largely impossible to measure the effects of any instrument. Moreover, Member States failed to ensure that public money was utilised only in those situations where it added value by stimulating further private investment.

In the subsequent Special Report “Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?” [Special Report 6 of 17 September 2013], the ECA, in addition to assessing the measures of Member States, it also identified a Member State which had applied good practices. That Member State was the UK. Only UK required beneficiaries to demonstrate the need for public subsidies. It used the following criteria: Selected projects had to specify the market failures they addressed; requests for grants had to be justified with proof of the existence of a funding gap (e.g. comparing alternative cash-flow projections between ‘borrowing scenario’ and ‘public intervention scenario’); selected projects had to demonstrate the value of outputs to their region by estimating the proportion of outputs that would have been delivered without the requested grant.

Furthermore, only the UK assessed and mitigated displacement of economic activity from one region to another [if displacement occurred, then the public policy objective of diversifying the rural economy would not achieve its target of increasing the overall output of rural areas]. The UK used the following criteria to mitigate displacement: Exclusion of proposals in saturated sectors; beneficiaries had to prove that there was demand for their products and describe the impact on possible competitors; the relevant authorities had to assess the potential of displacement risk as part of project appraisal and selection or rejection of applications.

None of the good practices identified by the ECA and summarised above is unique to the UK. They can all be replicated in other countries. This evidence suggests that weaknesses in ex ante policy design can be remedied. The EU can help Member States improve their institutional capacity, through dissemination of information, training, and ex ante monitoring. After all, it is in the interests of the EU that Member States use EU resources effectively and efficiently. When it comes to preventing avoidable errors, action by the EU must be ex ante. When it comes to learning from successes and unavoidable errors, action by the EU can only be ex post.

Other mechanisms for monitoring the performance of Member States⁷

As the Commission itself states, the EU “has a wide array of tools to assess whether EU policies are properly implemented”.⁸ It appears, however, that, with the notable exception of the European Semester and macroeconomic surveillance, none of these tools are either

⁷ The EU, in general, and the Commission, in particular, also self-assess their own performance. See, for example, the efforts during the past decade or so to reduce unnecessary regulation through the SMART programme and the withdrawal of costly or ineffective regulation. More recently, the Commission launched the Regulatory Fitness and Performance Programme (REFIT) to ensure that the “body of EU legislation remains fit for purpose”. See Commission Communication on EU Regulatory Fitness, COM (2012) 746 final, 12 December 2012; Commission Communication on Regulatory Fitness and Performance, COM (2013) 685 final, 2 October 2013. See also Commission Communication on Better Governance for the Single Market, COM(2012) 259 final, 8 June 2012.

There are also findings of “learning” effects generated by impact assessment studies. See in this respect the European Court of Auditors, Special Report no 3, Impact Assessment in the EU Institutions: Do they Support Decision Making, 2010; O. Fritsch et al, Regulatory Quality in the European Commission and the UK, paper no 362, CEPS, January 2012.

⁸ European Commission, 30th Annual Report on Monitoring the Application of EU Law, COM(2013) 726 final, 22 October 2013, p. 2.

intended or capable of identifying the reasons for improper implementation and sub-standard performance.⁹

The main tool at the disposal of the Commission is the detection of infringements which is embedded in the formal infringement procedure in Articles 258 & 260 TFEU. As its name indicates, this procedure aims to detect and correct non-application or faulty application of EU law. The latest Commission report which was published only a few weeks ago reveals that at the end of 2012, there were 1343 infringement procedures open.¹⁰ In 2012, the Court of Justice delivered its judgment in 46 cases brought by the Commission against Member States. In 91% of the cases, the judgment was in favour of the Commission [i.e. finding of infringement].

For the past five or so years, the infringement procedure is supplemented with the so-called “EU Pilot” initiative. The EU Pilot project is a collaborative attempt by the Commission and Member States to remove obstacles in the internal market and facilitate the proper application of EU law through dialogue.¹¹ In addition, there is the EU-wide network of SOLVIT centres which respond to complaints brought by citizens and businesses. The EU Pilot is essentially a bilateral communication channel between the Commission and each Member State, while the SOLVIT network also concentrates on bilateral contacts, this time between two and occasionally more Member States. The infringement procedure and the EU Pilot are largely driven by complaints. SOLVIT is entirely driven by complaints.

The infringement procedure and the rulings of the Court are indispensable for ensuring compliance with EU law. Whenever, the Court finds that a particular national measure is incompatible with EU law, we learn immediately what may not be done. If other Member States engage in similar practices, then they do benefit from this knowledge [and they have removed the incompatible measures]. But there are three limitations to this legal process.

First, it does not identify what works well. It cannot determine good or best practices, nor is its purpose to do so. Second, it naturally applies to the legal obligations of Member States. But as the Special Reports of the European Court of Auditors have demonstrated, many faulty instruments and weaknesses at the implementation stage are not per se illegal. If a Member State, for example, fails to maximise the value which is added to agricultural products it does not necessarily break EU law, especially if EU law does allow a certain degree of leeway to Member States. But this is precisely the area where mutual learning can be most beneficial. While the legal errors committed by the Member States can be identified by the Commission and confirmed by the Court, there is no corresponding mechanism for non-legal errors. Third, the assessments carried out by the European Court of Auditors go a long way towards explaining the causes of the policy or implementation errors precisely because they also identify underlying structural faults in the design of

⁹ For a detailed and extensive analysis of compliance with EU rules see the recent study by P. Pelkmans and A. Correia de Brito, *Enforcement in the EU Single Market*, (Brussels: CEPS, 2012). The authors make a distinction between infringement procedures and preventive procedures such as the procedure of Directive 98/34 on technical regulations.

¹⁰ 30th Annual Report on Monitoring the Application of EU Law, p. 8.

¹¹ See European Commission, *EU Pilot Evaluation Report*, COM(2010) 70 final, 3 March 2010; European Commission, *Second Evaluation Report on EU Pilot*, SEC(2011) 1629/2, 21 December 2011.

policies and implementing instruments. They do not limit themselves to judging the outcomes of policies.

As mentioned earlier, a notable exception is the macroeconomic surveillance in the form of the European Semester, the strengthened Stability and Growth Pact and the adoption of additional rules that cover national debt as well as government budget. In the framework of the surveillance of Member States' macroeconomic conditions and policies, the Commission and the Council do assess policies, identify good and bad practices and make appropriate recommendations. For those Member States which have received financial assistance from the EU and IMF – the so-called programme countries – the supervision by the “troika” of Commission, IMF and European Central Bank is indeed extensive and intrusive. There is no doubt that as far as macroeconomic and fiscal policies are concerned, the EU does examine and assess what works and what does not. There is no doubt either that the surveillance and peer reviews carried out in the Council do produce learning effects for all Member States.

Another notable exception, which however, is not as systematic or regular as the macroeconomic surveillance is the recent and innovative peer review or “mutual assessment” in the framework of the Services Directive [Directive 2006/123]. Member States were divided into smaller groups and reviewed each other's rules concerning the establishment of services providers and the cross-border provisions of services. The objective was to “make it possible for Member States, together with the Commission, to better understand and compare the existing national requirements and their justification”.¹² This mutual assessment revealed that Member States have very diverse practices. Surprisingly, practices vary even when they ostensibly have the same objective [e.g. protection of consumers]. The Commission has concluded that even when restrictions are justified in principle, Member States may not be applying disproportionately onerous obligations on service providers. It intends, therefore, to issue guidance on the application of the concept of proportionality. This is indeed a very good example of how learning from experience can lead to policy improvement. However, it requires, first, a central gathering of relevant information and, then, dissemination of such information in a comprehensible and useful format.¹³

The next section brings together the different strands of the paper and identifies options for the EU.

What can be done to improve policy implementation in the Member States

This paper is predicated on the premise that we learn from the successes and failures of others as well as from our own. The paper began by exploring incentives for dissemination

¹² Commission Staff Working Document on the Peer Review under the Services Directive, SWD(2013) 402 final, 2 October 2013, p. 3.

¹³ See Commission Communication on the Implementation of the Services Directive, COM(2012) 261 final, 8, June 2012; Commission Staff Working Document on the Peer Review under the Services Directive, SWD(2013) 402 final, 2 October 2013.

of information on good and bad practices. While Member States may be willing to showcase their successes, they would be reluctant to admit their failures.

The Commission can facilitate the flow of information between Member States, but more information in itself will not bring about improvement in policy implementation. Information is useful when it can be utilised. Therefore, what is also needed is not just more information of the right kind, but also institutional capacity to utilise it.

When, in the context of the services directive, the Commission delved specifically in how Member States assess the proportionality of the obligations they impose on service providers it found the following. First, restrictions appear to have a legitimate objective. They aim to raise the quality of services. However, restrictions are imposed without appropriate consideration as to whether the risks they prevent are worth the costs which are caused by the restrictions. Second, although public policy concerns such as the protection of consumers may justify some or certain restrictions, it is not clear how all existing restrictions may be justified by those concerns. Third, Member States do not seem to examine the possibility of alternative but less restrictive measures that can ensure the same level of quality of services.

Once more, we see that the root of the problem uncovered by the Commission in relation to legal restrictions appears to be very similar to the root of the problem uncovered by the reports of the ECA in relation to implementation of policies and funding programmes. Broad policy objectives are not linked and ranked *ex ante* to specific instruments, alternative options are not explored and the effectiveness and efficiency of adopted instruments are not reviewed and assessed *ex post*. These are avoidable errors simply because they can be addressed at the stage where policy is formulated and laws are drafted.

In a recent study, Pelkmans and Correia de Brito examine in detail the enforcement of EU rules and make a distinction between legal (infringement) and non-legal (preventive) approaches. They argue convincingly in favour of preventive measures. Legal procedures take too long and address only a very small proportion of possible infringements. They observe “a slow but steady learning process in national administrations” concerning the correct application of technical regulations.¹⁴ One of the reasons they are in favour of preventive approaches is because they “aim to reduce the likelihood that infringement might occur later”.¹⁵

Although they study the performance of Member States from the more technical angle of compliance and enforcement, whereas this paper looks at the broader issue of avoidance of typical policy errors even when they do not constitute infringement, they arrive at a largely similar conclusion: *Ex ante* cooperation between the Commission and Member States prevents future problems. This requires that the Commission acts as coordinator and facilitator of the flow of information from and to Member States. However, this is a necessary but not sufficient condition. The “learning process in national administrations” has to be institutionalised and the capacity for policy formulation and implementation has to be strengthened.

¹⁴ P. Pelkmans and A. Correia de Brito, *Enforcement in the EU Single Market*, (Brussels: CEPS, 2012), p. 129.

¹⁵ *Op. cit.* p.128.

It is noteworthy that Annex V of the still draft “common provisions regulation” for structural funds in the 2014-20 period defines “general ex ante conditionalities” that have to be satisfied by the Member States. With respect to environmental legislation, where many problems occur, the regulation requires Member States to demonstrate the “existence of a mechanism which ensures the effective implementation and application of Union environmental legislation”. It then elaborates the components of such mechanism by stating that:

“Effective implementation and application of Union environmental legislation is ensured through:

- complete and correct transposition of EIA and SEA directives;
- institutional arrangements for the implementation, application and supervision of EIA and SEA Directives;
- a strategy for training and dissemination of information for staff involved in the implementation of EIA and SEA Directives;
- measures to ensure sufficient administrative capacity.¹⁶ [emphasis added]

The draft regulation does not explain how Member States can improve their institutional arrangements and administrative capacity. Presumably, the Commission will issue guidelines later on.

At any rate, this is progress in the right direction. The Commission, in its proposals for new EU rules, should not just be assessing the need for such rules according to the principle of subsidiarity, but should also consider the capacity of Member States to apply the rules. In this respect, it should identify the minimum institutional capacity that Member States should put in place to avoid predictable errors when they implement the new rules. Uniform and consistent implementation of common rules is in the common interest.

Conclusions

Policy errors do occur in EU Member States. The ECA Reports provide ample proof. In addition, the thousands of complaints submitted to the Commission and SOLVIT each year and the hundreds of infringement cases also demonstrate that Member States fail to a certain extent to fulfil their legal obligations. The problem is real.

Will the European Union benefit from solving this problem? The answer is yes. This paper has argued that policy makers, like the rest of us, learn from both successes and mistakes. While successes are naturally trumpeted, failures are hidden. Yet, there is a collective benefit to be had from the possibility to learn from others’ failures. Because this type of learning is a public good, a case can be made for it to be provided at EU level.

Successes can be exaggerated. Before best practices can be disseminated they should be assessed for their veracity, relevance and extent to which they can be duplicated by other Member States. Again, this is a natural role for a central institution such as the Commission. It is also in the collective European interest that all Member States improve their policies.

¹⁶ See p.157. The draft regulation can be accessed at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0246:FIN:EN:pdf>

Certain policy errors are avoidable because they are easily predictable. They are caused by institutional and policy design faults. Because they can be remedied ex ante, the EU is well placed to assist Member States to improve the capacity of their institutions and the design of their policies.

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