



EUROPEAN CENTRAL BANK

**OCCASIONAL PAPER SERIES**

**NO. 27 / APRIL 2005**

**THE EU BUDGET**

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FOR INSTITUTIONAL  
REFORM?**

by Henrik Enderlein,  
Johannes Lindner,  
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and Raymond Ritter



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## ABSTRACT

This paper reviews current discussions on reforming the European Union (EU) budgetary procedure and assesses the main reform proposals that have been suggested thus far. It argues that prospects for reforms are presently hampered by the complex interplay between supranational and intergovernmental decision modes and the requirement of any budgetary procedure to strike a balance between efficiency and legitimacy. The paper reviews

the main criticisms of the present budgetary procedure and the related reform proposals, which are assessed on the basis of relevant theoretical literature as well as brief comparisons with the federal budget of the United States. The paper argues that the current EU budgetary procedure maximises efficiency and legitimacy, given the present state of political integration in the EU. Significant modifications to the budgetary procedure would depart from that equilibrium.

*“Now that the European Council has decided to give us the mandate to simplify the system, to make it more functional and visibly democratic, are we supposed to hold onto all the procedures which history has laid down in succession, or are there some which can we do away with?”*

Giuliano Amato, Vice-President of the European Convention,  
on budgetary decision-making in the EU (12 September 2002)

## I INTRODUCTION

Calls for reform of the procedures governing the finances of the EU have enjoyed some prominence in recent discussions on the future institutional framework of the EU. Both in academic and policy-making circles, it has become commonplace to refer to the “problem” deriving from the present EU budgetary framework at both the multi-annual and annual levels. The Chairman of the European Convention, President Giscard d’Estaing, commented on the present budgetary procedure by claiming that “there is indeed a real problem in that area” (Plenary Session of the Convention on 12 September 2002). The representative of the United Kingdom in the Convention, Peter Hain, was equally bold on this issue and called upon his colleagues to “simplify where we can”. The Sapir Report prepared at the request of Commission President Prodi calls upon Member States to “refocus the EU budget” (Sapir 2003); while the special report of the European Parliament on the budgetary procedure stressed the “need for reforming, updating and simplifying” (European Parliament 2003).

These demands for an institutional overhaul of the EU budgetary procedure contrast with the results achieved in the recent round of discussions on changes to the EU legal framework, in particular in the context of the European Convention and the Intergovernmental Conference (IGC). While the Constitutional Treaty for Europe (which was adopted by the IGC on 17-18 June 2004 but still needs to be ratified by the Member States) introduces a few minor changes to the

budgetary procedure, many fundamental issues have either not been raised or have rapidly disappeared from the agenda.

The goal of this paper is threefold. It intends

- to provide an assessment of the EU budgetary procedure based on theoretical considerations and brief comparisons with the budgetary procedure of the United States;
- to present an overview of the various reform proposals presently or recently under discussion, assessing their potential implications for the balance between efficiency and legitimacy in the EU budgetary procedure; and
- to suggest an explanation of the nature of the reform discussions on the EU budgetary procedure and their (limited) impact on the outcome of the recent constitutional negotiations within the EU.

Although due to its limited size the EU budget does not bear major economic and fiscal importance for the EU economies, a close analysis of the rules and procedure that govern budgetary decision-making at the EU level is nevertheless of considerable interest for the European Central Bank (ECB). First, in identifying the factors that determine the shape and the design of the budgetary procedure this paper provides indications of why the EU budget has remained limited in size compared to the national budgets. The small size of the EU budget and the requirement that it must always be in balance or in surplus have clear

implications for the conduct of macroeconomic policy in the euro area: it makes the coordination of decentralised fiscal policies all the more crucial. The dominance of national budgets reflects the current state of the integration process, but it is not necessarily a steady state. Understanding why the EU budget remains small in comparison to national budgets, how it has developed over time and the debate about its future development is therefore of great interest to those who, like the ECB, are involved in policy formulation with a euro area-wide perspective. Second, modifications to the EU budgetary procedure are a particularly intriguing example of institutional reform in the EU. The reform discussions concerning the EU budgetary procedure reveal that individual policy areas are embedded in the overall state of political integration and that this embeddedness can significantly constrain the scope of institutional reform. The assessment of the reform discussions and their outcome therefore contributes to a better understanding of the impediments to launching area-specific reforms.

The paper is structured as follows. Section 2 outlines the main theoretical considerations. Section 3 presents the main criticisms of the current EU budgetary procedure and reform proposals and assesses them on the basis of comparisons with the budgetary process in the United States and with reference to the relevant theoretical literature. Section 4 reviews the actual changes contained in the European Constitution and Section 5 concludes.

## 2 SOME THEORETICAL CONSIDERATIONS

The assessment of the EU budgetary procedure has to be placed into two sets of wider theoretical analyses. On one hand, focusing on the particular political and institutional context of the EU, which is based on the pooling of national sovereignties in a supranational framework, seems warranted in order to understand the implications of that particular

context for the budgetary procedure. On the other hand, an overview of the theoretical literature is necessary for identifying the main features that should be provided by any budgetary procedure.

Three main concepts are used to assess the current EU budgetary procedure: efficiency, legitimacy and political integration. These will be considered in more detail later in this section, but it is worth mentioning them briefly at this point. We consider that any budgetary procedure has to strike a balance between the considerations of efficiency and legitimacy under the constraint of political integration. The efficiency of a budgetary procedure can be described as the timely and flexible allocation of resources in order to ensure the appropriate provision of the main public goods required. The legitimacy of a budgetary procedure derives from the degree of democratic control by citizens so that resources are allocated according to the will of the people and that any kind of “rent-seeking” is minimised. It follows that from a purely institutional perspective there is a conflict between the basic requirements of efficiency and legitimacy, with large units enhancing the former and small units the latter (Scharpf 1988). We believe, however, that beyond that simple institutional relationship, the compatibility of efficiency and legitimacy is largely conditioned by a political dimension related to the willingness of citizens to accept the redistributive implications of a common budgetary authority. The legitimacy of a large budgetary unit (e.g. in a large nation state) increases in line with the citizens’ sense of belonging to that unit, and thus their willingness to be part of a pooled system of income redistribution also grows. We use the term “political integration” to refer to this willingness.<sup>1</sup>

<sup>1</sup> This definition of political integration obviously relates to the two large bodies of literature on fiscal federalism (see Oates 1999 for an overview) and on the appropriate size of nations (see Alesina and Spolaore 1997).

### THE EU'S INSTITUTIONAL FRAMEWORK BETWEEN SUPRANATIONAL AND INTERGOVERNMENTAL DECISION MODES

The origins of the EU's present institutional set-up can be assessed in terms of a principal-agent analogy. This starting point benefits from the use of constitutional choice literature (e.g. Buchanan/Tullock 1962) which gives normative and positive accounts of the origins of constitutional orders and their legitimacy and efficiency. The focal point of the constitutional choice literature is the pooling of individual citizens' sovereignty and the delegating of functions and powers to elected representatives. Citizens, as principals, allow elected representatives, as their agents, to be in charge of public institutions and to take political decisions.

While the principal-agent analogy allows the constitutional choice literature to explain the rationale behind the existence of states, the analogy can also be used to analyse institution building at the international level and, in the specific European context, at the supranational level (Pollack 2003). Here, states are regarded as the principals. Under certain circumstances, cooperation among states is beneficial and states may decide to pool their political sovereignty in selected areas. A key example of such an institution based on a certain degree of pooling of sovereignty among states is the United Nations (UN). Other examples include the UN specialist bodies such as the International Monetary Fund and the World Trade Organisation.

In the context of pooled sovereignties at the supranational level, there are, however, two types of decision-making procedure:

- *Intergovernmental cooperation.* States agree to take decisions in the relevant policy area by unanimity, thus preserving a considerable degree of “ultimate” sovereignty stemming from the power of each individual member state to veto decisions. These decisions are legitimised

by the direct link between citizens and their national governments and the fact that these governments cannot be outvoted. At the same time, the unanimity rule renders negotiations difficult, as decision-making is clearly hampered by national vetoes.

- *Supranational governance.* States might realise that it is beneficial to take some decisions by majority and to delegate, as principals, certain functions to an (independent) agent helping them to overcome collective action problems. This move towards majority voting and delegation is motivated by an interest in increasing the efficiency of international decision-making. The states sacrifice their veto power and assign political tasks, such as overseeing implementation and mediating between states, to a supranational agent. However, supranational governance may, in the view of citizens, be regarded as less legitimate, because national governments can be outvoted and supranational agents exercise power without a direct mandate from the citizens.<sup>2</sup> In order to counteract this lack of direct legitimisation, supranational actors may be directly elected by the citizens, thus circumventing national governments as the sole source of legitimacy. However, this increase in legitimacy may again come at the cost of efficiency. The involvement of an additional directly elected agent may increase the complexity of decision-making.

Applying these theoretical considerations to the EU, we can see a political system that has reached an advanced but still limited state of integration. Important areas of national sovereignty, such as competition and trade policy and the four freedoms that underpin the single market, are pooled at the EU level and a certain degree of political identification and

<sup>2</sup> However, it is also argued that efficient decision-making procedures yielding effective policy outcomes can also create a high degree of legitimacy (see the distinction between input and output legitimacy in Scharpf 1999).



acceptance has been achieved. However, the nation state still provides an important reference point for political identity and national institutions continue to determine the day-to-day life of citizens in a vast number of areas.

With regard to the institutional set-up, the EU level is governed by a combination of supranational and intergovernmental forms of decision-making. In the intergovernmental sphere, Heads of State or Government set the broad policy guidelines in the European Council by consensus. Moreover, they adopt Treaty changes, which are subsequently ratified according to national domestic procedures. In the Council of Ministers, representatives of national governments make detailed policy decisions on the basis of legislative initiatives from the supranational Commission. Voting rules vary depending on the policy field. Where unanimous voting still applies, the Council acts as an intergovernmental body, while in the case of qualified majority voting ministers switch to supranational mode. The directly elected European Parliament provides a link between the supranational decision-making process and the citizens. Its involvement as a strong veto-player is largely connected to qualified majority voting in the Council, where, in terms of legitimacy, it compensates for the loss of Member States' veto power. Moreover, it fulfils control functions vis-à-vis the Commission and thus contributes to an appropriate level of accountability. The present institutional set-up of the EU thus combines elements of intergovernmental cooperation and supranational governance and strikes a balance between legitimacy and efficiency.

This overall balance lays the foundation for the specific rules and procedures in the different policy fields of the EU. The involvement of the Commission, the European Parliament and the Council is a common feature of most policy domains. It caters for similar legitimacy and efficiency concerns regardless of the particular

characteristics of the specific policy field. This does not mean that there is no variation in the degree to which political authority is delegated to supranational agents in the different domains. Indeed, in certain policy fields, such as competition policy, the Commission exercises significant decision-making powers, while in others, such as the Common Foreign and Security Policy, decisions are taken by unanimity in the Council. However, policy fields evolve as part of the overall institutional framework. Moreover, they reflect the general scope of pooled sovereignty and the degree of political integration and acceptance.

Therefore, calls to reform the decision-making procedure in a particular policy field should not be assessed independently of the general state of integration. On the contrary, their contents should be put under scrutiny with a view to the “meta-level” that the state of integration constitutes. This meta-level not only overarches but also determines decision-making in the different policy fields of the EU. Therefore the complexity or alleged inefficiency of a decision-making procedure cannot be exclusively attributed to the institutional provisions governing the specific policy field but need to be linked to the characteristics of the meta-level. Moreover, the degree of embeddedness in the meta-level constrains the scope of institutional reform in a policy field. In other words, while far-reaching reform proposals could increase the efficiency and legitimacy of the procedure, they would indeed require a higher degree of political integration than is currently the case.

#### **BUDGETARY PROCEDURES – A BALANCE BETWEEN EFFICIENCY AND LEGITIMACY**

Shifting the analysis from the general reflections on the institutional set-up of the EU to the procedural features of the budgetary field, it becomes clear that the complex interplay between the concerns of legitimacy and efficiency is even further accentuated in that particular area. Decisions on the

utilisation of public finances need to be subjected to tight control by citizens so that resources are allocated according to the will of the people and any kind of rent-seeking is minimised. At the same time, such decisions need to ensure an efficient resource allocation and ought to guarantee the provision of the main public goods required.

There is a solid body of academic literature linking these fundamental requirements of a budgetary procedure to the underlying institutional framework.

In relation to the effectiveness and efficiency of the budgetary procedure, influential literature has emerged from a number of cross-country analyses comparing different types of institutional framework. Mainly developed by von Hagen (1992), von Hagen and Harden (1994), and Hallerberg and von Hagen (1999), this literature establishes theoretically grounded and empirically detectable links between institutional components of the budgetary procedure and its success in achieving specific policy goals (in this literature mainly fiscal discipline). The starting point for these analyses is the assumption that an optimal allocation of public resources is unlikely to be achieved within a complex interplay of numerous actors pursuing different interests. They show that a strong political authority at the top of the process (e.g. a strong finance minister), a parliament with limited amending powers, and a strict implementation process ensure a lower overall size of the budget and more restricted use of debt as a way of financing public expenditure. What stems from this literature is the claim that budgetary procedures need to be capable of yielding swift and effective decisions on fiscal measures, even if such measures seem unpopular in the short run.

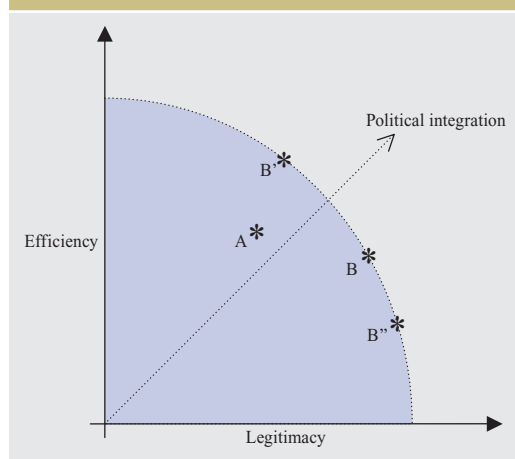
The delegation of powers to a strong political authority for efficiency reasons, however, needs to be embedded in an effective democratic control mechanism, ensuring that voters' legitimacy concerns are met. As a

number of stylised analyses in political economy convincingly demonstrate, for voter utility to be maximised in a system of delegated authority, an effective separation of powers needs to be enacted (Persson, Roland and Tabellini 1997; Persson and Tabellini 2003). The analyses are based on the key distinction between presidential and parliamentary constitutional regimes, arguing that direct accountability is more effective in presidential than in parliamentary democracies. Persson, Roland and Tabellini (1997, 2000) give two reasons for this. First, the chain of delegation is shorter under the presidential system, since the executive is directly accountable to the voters. In a parliamentary system, where the executive is directly accountable not to the voters but to the legislature, the scope for collusion at the voters' expense is greater. Second, the degree of separation of powers tends to be larger and the system of checks and balances tends to function more effectively in presidential systems. Persson, Roland, and Tabellini generally argue that checks and balances in a presidential system improve accountability and strengthen the incentives for good behaviour among politicians, since voters can exploit diverging interests among the bodies involved in decision-making to prevent abuse of power or to reduce information asymmetries between themselves and the policymakers (see also Persson and Tabellini 2003).

#### THE EU BUDGETARY PROCEDURE AND THE CONSTRAINT OF LIMITED POLITICAL INTEGRATION

Looking at the EU budgetary procedure from the twin perspectives of "efficiency" and "legitimacy", it becomes clear that the institutional complexities arising from the articulation of supranational and intergovernmental decision modes are even greater in the budgetary sphere. While it is straightforward to argue that an appropriate budgetary procedure for the EU would seek to strike a balance between citizens' legitimacy concerns and procedural efficiency concerns, it

Figure 1 The efficiency-legitimacy trade-off



has to be taken into account that such balance has to be determined under the constraint of still limited political integration. Indeed, as a large number of studies and surveys indicate (see overview in Marx and Hooghe 2003), the delegation of sovereignty from European citizens to the EU is to a large extent still grounded in a strong national identity rather than a European identity. The mechanism of democratic control by European citizens of decision-making bodies of the EU still seems largely perceived as requiring the intervention of national governments rather than being exercised directly through the European Parliament.

In this context, options for reforms of the budgetary procedure need to be considered within the scope granted by the present degree of political integration. The EU budget basically reflects the range of those areas in which sovereignty is pooled at the EU level. Such pooling is often legitimised on the basis of efficiency. However, taking into account the varying degree of European citizens' political identification with supranational decision-making at the EU level and also the very tangible financial component of budgetary decisions, possible legitimacy concerns need to be carefully addressed. The involvement of Member States' representatives serves to

redress such concerns, as budgetary decisions are usually regarded as an issue close to national sovereignty. However, such intergovernmental elements may come at the expense of efficiency.

This paper thus argues that the exogenously given state of political integration is key to understanding the current debate – and its outcome – on the reform of the EU budgetary procedure. Proponents of far-reaching reforms seem to underestimate, first, the scope for change allowed by the general state of integration and, second, the high degree to which the current procedure is already in tune with the present degree of integration.

To illustrate this assessment, Figure 1 (which should be viewed as a metaphorical depiction rather than a formula-based curve) indicates possible solutions to the identified trade-off between legitimacy and efficiency. These solutions are limited by a “Pareto frontier” determined by the state of integration – i.e. outward/inward shifts of the frontier can only be triggered by increases/decreases in political integration.

Proponents of reform seem to assume that the budgetary procedure is currently situated at the suboptimal point A. This paper, by contrast, argues that point B is probably an accurate description of the current procedure. While the proponents of reform take the view that reforms would significantly and simultaneously increase efficiency and legitimacy, this paper argues that improvements could only be marginal and would have to concentrate on enhancing either efficiency (leading to B') or legitimacy (leading to B'').

### 3 REFORMING THE EU BUDGETARY PROCEDURE: AN ASSESSMENT

This section assesses the main proposals for reform of the EU budgetary procedure and argues that simultaneous increases in legitimacy and efficiency are highly unlikely

without major advances in political integration.

In the current political discussions an array of different reform proposals have been presented by various actors. The European Parliament set out its ideas in a report that was initiated by the Committee on Budgets (European Parliament 2003). The European Convention focused extensively on the budgetary procedure in a special discussion circle (European Convention 2003a) during the preparatory phase leading to the issue of its draft Treaty establishing a Constitution in June 2003 (European Constitution 2003b). Finally, an independent, high-level study group, which was established at the initiative of the President of the Commission, also covered the budgetary procedure in its report on the

economic governance of the EU (Sapir et al. 2003). Table 1 gives an overview of these different proposals.

These reform proposals can be assessed in the context of a comparison of the EU budgetary procedure with the decision-making process of the US federal budget.<sup>3</sup> Obviously, comparing the United States and the EU is limited in its legitimacy. The United States is already a fully-fledged federal system where “intergovernmental” cooperation has made way for “supranational” governance and states

3 The description of the US budgetary process is based on the seminal treatment of the matter by Schick (2000), as well as Office of Management and the Budget (2003) and Congressional Budget Office (2003). For the EU budgetary procedure, Laffan (1997), Nava (2000), European Commission (2002) and Lindner (2005) serve as the main references.

Table 1 Overview of reform proposals

| Reform proposals  | European Parliament <sup>1)</sup> | The Convention's discussion circle on the budgetary procedure <sup>2)</sup> | Sapir Group <sup>3)</sup> | European Convention <sup>4)</sup>        |
|---|-----------------------------------|---|---------------------------|--|
| <b>Content of the budget</b>  |                                   |   |                           |  |
| a) Re-focussing the expenditure side of the EU budget   | –                                 | –   | Yes                       | –  |
| b) Modifying the revenue base of the EU budget  | Yes                               | –   | Yes                       | –  |
| <b>Financial Perspective</b>  |                                   |   |                           |  |
| a) Adopting the Financial Perspective and/or the revenue side by qualified majority among Member States               | Yes                               | Yes (preferably with a “super majority”)                                    | Yes                       | Yes for the FP, but no for later revenue |
| b) Institutionalising the Financial Perspective   | Yes                               | Yes   | –                         | Yes                                      |
| c) Adopting the Financial Perspective in the Council of Ministers instead of the European Council                     | –                                 | No  | –                         | Yes <sup>6)</sup>                        |
| d) Taking the veto power from the European Parliament   | No                                | No  | –                         | No                                       |
| e) Shortening the time frame of the Financial Perspective and synchronising it with the European Parliament elections | Yes                               | No (at least five years)  | –                         | No (at least five years)                 |
| f) Increasing the flexibility of the expenditure headings   | Yes                               | No (but with provisions for flexibility reserve)                            | Yes                       | No                                       |
| <b>Annual budgetary procedure</b>   |                                   |   |                           |  |
| a) Eliminating the distinction between compulsory and non-compulsory expenditure                                      | Yes                               | Yes   | –                         | Yes                                      |
| b) Giving either the Council or the European Parliament the last word   | Yes (EP <sup>5)</sup> )           | Yes (EP <sup>5)</sup> )   | –                         | Yes (EP <sup>5)</sup> )                  |

1) European Parliament (2003): *Report on the reform of the budgetary procedure: possible options in view of the revision of the treaties*, 20 February, A5-0046/2003.

2) European Convention (2003a): *Final report of the discussion circle on the budgetary procedure*, 14 April, CONV 679/03.

3) André Sapir et al. (2003): *An Agenda for a Growing Europe. Making the EU Economic System Deliver*, July.

4) European Convention (2003b): *Draft Treaty establishing a Constitution for Europe*, 18 July, CONV 820/1/03 REV 1, CONV 847/03, CONV 848/03.

5) Within certain limitations.

6) But possibly allowing for the Council of Ministers to meet at the level of the Heads of State or Government.

have pooled much of their sovereignty, as is also reflected in the actual contents of the federal budget (see Table 2). In the United States, political decision-making takes place in a context of dominant federal actors. The executive power enshrined in the Presidency largely depends on agreements with the House of Representatives, representing the interests of electoral districts, and the Senate, representing those of individual states. Imposing an analogy with the EU, the role of the European Commission can be compared with that of the US President, the role of the European Parliament with that of the House of Representatives and the role of the Council of Ministers with that of the Senate. From this analogy one clear difference between the broader political systems of the United States and the EU becomes immediately apparent: the degree of representation of the citizens. In the United States, Senators are directly elected by their constituents, rather than being representatives of state governments. Similarly, although the President of the United States and the European Commission could be characterised as the executive power respectively in the two systems, there is a clear difference in terms of how they are appointed. In other words, there is a direct link between the electorate and all three players in the US budgetary process, which is further enhanced by a national identity that attaches US citizens to the federal level. In terms of the criteria

outlined above, this difference matters most in checks and balances but also plays a role when it comes to effectiveness of decision-making and to transparency. This brief and broad-brush comparison between EU and US procedures is nonetheless a worthwhile exercise as it illustrates areas for possible reform of the EU procedure, while also showing that even the fully integrated political system of the United States still functions on the basis of a budgetary procedure based on a complex interplay between legitimacy and efficiency concerns within a multi-level polity.

#### PROPOSALS FOR REFORM AT THE GENERAL LEVEL

One main criticism voiced with regard to the general level of the EU budget relates to the expenditure structure of the EU budget and implicitly also raises the issue of the size of the EU budget.

In this context, it should be noted that at present the size of the EU budget is almost negligible in economic terms (around 1% of EU GNI),<sup>4</sup> whereas the US budget amounts to roughly one third of US GDP, of which the federal level accounts for approximately twice as much as

4 At present the size of the EU budget is formally capped at 1.24% of combined national GNIs.

**Table 2 The content of the EU and US budgets in 2003**

| EU budget                                 |  | US federal budget                             |  |
|---|--|---|--|
| <b>Total expenditure amount</b>           | EUR 99.7 billion                             | <b>Total expenditure amount</b>               | USD 2,158 billion                            |
| as a percentage of GNI                    | 1.0%   | as a percentage of GDP                        | 19.8%  |
| <b>Selected expenditure</b>               | as a percentage of total expenditure in 2003 | <b>Selected expenditure</b>                   | as a percentage of total expenditure in 2003 |
| Agricultural policy and rural development | 45%  | Social security                               | 22%  |
| Structural and Cohesion Funds             | 34%  | Health (including Medicare)                   | 22%  |
| Internal policies                         | 7%   | National defence                              | 19%  |
| External actions                          | 5%   | Income security (e.g., unemployment benefits) | 15%  |
| Pre-accession aid                         | 3%   | Education                                     | 4%   |

Sources: European Union Financial Report 2003 and Office of Management and Budget.

expenditure by the states. The large difference in size between the EU and US budgets reflects the very different compositions of the respective expenditures and sources of revenue. While in the United States the federal budget contributes to the financing of state and local government through annual federal grants amounting to around 3.5% of GDP, the relationship in the EU is the opposite. Moreover, large parts of the US budget are concentrated on welfare, military spending, education and servicing federal debt. In contrast, in the EU spending on welfare, defence and education is done at the national level. The EU budget focuses mainly on a small number of policies with a strong redistributive bent, namely agricultural and regional policies, which alone account for more than 80% of expenditure in the EU budget. While agricultural spending provides European farmers with subsidies, regional spending redistributes funds to less wealthy regions. Although often presented as such (e.g. Leonardi 1999), these policies may only to a limited extent be regarded as public goods benefiting the Union as a whole. Together with a revenue side that de facto is based largely on national contributions, these policies result in a system in which Member States are under pressure to demand “*juste retour*” for the payments into the budget.

The present EU budget is expenditure-led within a limit set in an “Interinstitutional Agreement” with a multi-annual horizon (see below). Resources are raised to match what is needed to carry out the EU policies. This creates very different incentives for the European Parliament and the Council as the two arms of the budgetary authority. For Member States there is an incentive to reduce expenditure to achieve a reduction in their direct contributions, while for the European Parliament there is an incentive to propose expenditure programmes, since the matching financing will be furnished automatically by the Member States up to the overall ceiling.

Members of the European Parliament (MEPs) thus enjoy a unique position – they gain credit for expenditure agreed by the European Parliament, but are not associated with the related costs. This is not the case for US politicians, who also set the tax levels necessary to finance expenditure. In practice, however, differences in the incentives for Member States and MEPs have been reduced, on one hand, by a growing acceptance among MEPs of an austerity approach towards budgetary decisions and, on the other hand, by the interests of individual Member States in expenditure in areas in which they gain more from the budget than they contribute.

While one of the main rationales for the existence of a public budget is the financing of the provision of public goods which would otherwise be under-provided, the fact that current expenditure at the EU level is for the most part redistributive in nature shows that equity rather than efficiency criteria play a dominant role in guiding the expenditure side of the EU budget. Although it does not question the existence of a redistributive element in the budget, the Sapir report favours a “change in the current mix of equity and efficiency considerations” when deciding upon expenditure financed by the EU budget as well as an increase in the provision of public goods, which do not prompt a calculation of *juste retour* among contributors. The Sapir report suggests that the EU budget should promote growth through expenditure on R&D, education and training, and infrastructure. Other proposals have included internal and external security, foreign policy, research, immigration, and single market-related issues (see e.g. Tabellini 2002).

The key problem related to changes on the expenditure side is obviously one of allocating more legitimacy for decision-making at the European level. It has to be borne in mind that the present structure of EU expenditure reflects the current institutional set-up of the EU and

the political consensus on the policy tasks assigned to the EU and national levels respectively.<sup>5</sup>

Any changes to be made on the expenditure side of the EU budget would thus necessitate an agreement among policymakers on the modification of the present assignment of policy tasks at the EU level. Reforms of the spending programmes depend on the willingness of citizens to allocate additional tasks to the EU and thus may only be realised as a consequence of changes in the degree of political integration (see also Strauss-Kahn et al. 2004).

A related field of criticism with regard to the present general features of the EU budget is its revenue base. At present, the EU is funded predominantly by direct transfers from the Member States, although the current system is called a system of “own resources”. Direct transfers obviously facilitate the computation of net positions and do little to curb Member States’ pursuit of *juste retour*.

The system of own resources has become less and less autonomous since its creation in the 1970s when it was intended to give resources to the Community that would “belong” to it and would not depend on decisions by national governments. This, together with the granting of the “power of the purse” to the European Parliament in the 1970s, was a development of a federal nature, aimed at enhancing the supranational element of the Community. However, as Community expenditure increased, the traditional own resources, namely customs duties, agricultural levies and VAT contributions, proved insufficient and a fourth resource – in form of a set percentage of national GNP – was established as part of the Delors-I package in 1988 which also introduced the multi-annual Financial Perspective (see below). This fourth resource, which now accounts for approximately two-thirds of total EU budget revenues, can be regarded as similar to the pre-1970 period in which the Community was financed by

contributions from the Member States (Begg and Grimwade 1998). In line with the notion of an expenditure-led budget and in consideration of the sovereignty concerns of Member States, changes in the revenue structure of the EU have to be taken by unanimity following a procedure that is completely separate from the annual budgetary procedure.

In the United States around one-half of current revenues are raised by personal income tax, a third by social insurance receipts and a further 10% by corporate income tax. Almost all of these sources of income are referred to in the US federal budget as general funds. Decisions over the level and structure of taxes are often directly linked with expenditure decisions. The US budget is allowed to run deficits, but, in line with the current state of integration, the Treaty clearly forecloses this option in the EU and obliges the budgetary authority to adopt balanced budgets.<sup>6</sup>

In the light of the decreasingly autonomous character of the EU’s “own resources”, a

5 As Padoa-Schioppa (2002: 200) puts it: “There can be no doubt that it would be a good thing, for the Union, to have more room for manoeuvre in the area of budgetary policy. But it is also my belief that this can only come as a natural consequence of political union. No country has ever adopted a large budget just in an effort to obtain more instruments for economic policy. Historically, the size of the budgets grew because the functions attributed to the Union grew.”

6 In a sense, the situation with regard to the EU budget resembles more closely the one that characterised the US federal budget during the nineteenth century. In fact, up until 1921 the budgetary process in the United States can be characterised as one of legislative dominance (Schick, 2000), in which the Congress effectively constrained the executive not only over total expenditure but also over individual items of expenditure (see description of the EU budgetary procedure below). The size of the US federal budget was very limited and stable at around 2% of GDP up until the Civil War in the 1860s, and mainly devoted to financing public works projects, defence and the operations of government agencies. In addition, in the absence of a federal income tax, the US budget lacked true own resources to commit itself to making major investments in transportation and finance. The major source of US federal revenues throughout the nineteenth century remained the tariff, which accounted for around 80 to 90% of federal revenues (Wallis 2000). Moreover, and despite the lack of a formal constraint on budgetary outcomes, the norm of balanced budgets was broadly maintained. It was not until the 1930s that the US federal budget gained the prominence that it currently enjoys in the allocation of fiscal activity between the different levels of government.

number of proposals have been made. For example, the Sapir report proposes the introduction of a new revenue source with a clear EU dimension, such as a tax with a very mobile tax base within the EU. This could be capital income taxes or stock exchanges taxes. While such a tax would arguably convey a strong and positive symbolic message and enhance the transparency of citizens' contributions to the EU, it is doubtful that such a proposal would be acceptable given the present state of political integration. On one hand, Member States seem very reluctant to move the current set-up on the revenue side in a more supranational direction which would ultimately give the EU resources that cannot be redirected to Member States when they exceed the level of expenditure. On the other hand, the creation of an "EU tax" would certainly require a well-functioning system of checks and balances at the EU level. As Persson, Roland and Tabellini (1997) and Persson and Tabellini (2003) argue, rents from power and incomplete information at the expense of voters are accentuated in a common pool situation in which the bodies participating in the budgetary procedure are "residual claimants" over the budget (i.e. they can keep the benefits of spending within the majority, putting part of the costs on the excluded minority). Put in the context of the EU institutional set-up, this argument is certainly far too simple. There are no clear lines of divide between majorities and minorities in the EU context. Alliances tend to vary greatly between different groups of actors in both the European Parliament and the Council. The fundamental demand of "no taxation without representation" is still likely to be voiced as an argument against an EU tax. This argument would be technically wrong, since representation could be ensured by the European Parliament, but in the perception of most EU citizens the time does not seem ripe for introducing an EU tax.

Overall, looking at general aspects of the budgets in the United States and the EU, it is evident that the role of the EU budget is commensurate with the much lower degree of

political integration in the EU: the size of the budget is small, its content is not geared towards the provision of basic public goods but has a very limited focus and it is redistributive. This combination of a budget which is funded by direct transfers from Member States and which is spent largely on regional or agricultural programmes, which are easily tracked to regional or national recipients, rather than on European-wide public goods creates a situation particularly prone to bargaining.

#### PROPOSALS FOR REFORM AT THE LEVEL OF MULTI-ANNUAL PLANNING

The Financial Perspective is the EU's multi-annual budgetary framework (7 years) which lays down the maximum amounts of both total annual expenditure and annual expenditure in specific policy areas.<sup>7</sup>

The Financial Perspective was a welcome development when it was first introduced in 1988 (Lindner 2003). In the late 1970s and early 1980s EU budgetary negotiations was characterised by confrontations between the European Parliament and the Council which eventually led to the rejection of entire draft budgets by the European Parliament (Läufer 1990). The early 1980s also saw complaints from the United Kingdom and a lack of sufficient resources. The latter was prompted mainly by the increase in Common Agriculture Policy (CAP) spending and aggravated when the UK rebate was agreed. In this context, the Financial Perspective was intended to significantly restrict the scope for political choice during the annual budgetary procedure. By linking revenue and expenditure sides, it

7 While the Financial Perspective sets an upper limit on the annual EU budget, there is some limited leeway for revisions in response to unforeseen circumstances. However, any revision has to remain within the margin for unforeseen expenditure as specified in the Financial Perspective. Moreover, revisions amounting to more than 0.03% of Community GNI require the agreement of both the European Parliament and the Council, whereby the Council has to act unanimously (in the case of revisions below 0.03% of Community GNI, the Council can act by qualified majority).



ensured that expenditure-led budgets would no longer exceed existing resources (Shackleton 1990).

The Financial Perspective combines intergovernmental and supranational elements. After a proposal by the Commission, it is discussed in the European Council, where it requires unanimous agreement among Member States. The involvement of Heads of State or Government ensures that differences and stalemates between EU ministers are overcome. The Financial Perspective is finally adopted as an “Interinstitutional Agreement” between the European Parliament, the Council and the Commission. In contrast to indicative financial programming, the ceilings of the Financial Perspective are binding on the three parties. While the revenue ceilings are codified in legal acts adopted unanimously by Member States in the Council, the expenditure ceilings gain their binding character from the political willingness of actors to adhere to the “Interinstitutional Agreement”, which by itself does not have the status of an enforceable legal act (Monar 1994). The semi-voluntary character of the Financial Perspective obliges actors to cooperate, as the multi-annual framework would otherwise break down.

Planning stability and a reduction in conflict comes at a price: the Financial Perspective clearly limits the flexibility of budgetary actors and introduces a strong status-quo bias. Annual expenditure ceilings for regional spending, for example, have the status of spending targets and thus commit annual budgetary decisions over a period of seven years. Moreover, when the Financial Perspective is renegotiated in the European Council, national governments use their veto power in order to maximise budgetary gains. Although the Financial Perspective is not automatically renewed at the end of the seven year period, the use of veto power and the resulting bargaining dynamics lead to a largely incremental revision of the ceilings, thus respecting the key spending interests of Member States, such as the rebate for the United Kingdom, regional spending for

the countries benefiting from the Cohesion Fund, and unaltered CAP spending.<sup>8</sup> In such a setting, major changes and far-reaching reforms are very unlikely to occur (Begg 1999) unless there is significant progress in political integration.<sup>9</sup>

In the United States there is no true multi-annual planning, as there are no binding multi-annual constraints. The President’s budget, which is transmitted to Congress each February, pertains exclusively to the following fiscal year, while the horizon envisaged in the congressional budget resolution has no statutory implications. The only multi-annual budgetary implications stem from the mandatory spending implied by past acts providing for entitlements such as social security, but then again, the President and Congress can change the law in order to change the spending on entitlements and other mandatory programmes in any given year.

Overall, in the EU a binding multi-annual budget plan adopted by Heads of State or Government plays a key role in reducing the conflict between budgetary actors and ensuring planning stability. This comes at a price: the flexibility of the annual procedure is seriously curtailed and major shifts between the main spending blocs are de facto almost impossible. The intergovernmental level, at which legitimacy concerns clearly dominate over efficiency concerns, thus uses multi-annual planning to strictly limit the scope for supranational decision-taking in the annual procedure. Although lengthening the budgetary cycle is discussed, decision-making

8 Renegotiations in the European Council take place in conjunction with other political issues. Hence, bargaining among Member States combines budgetary issues with non-budgetary issues. In this context, it has been argued that the EU budget fulfils an important “compensation function”. It compensates those Member States that might incur costs from the integration process and thus, facilitates a consensus for further integration among Member States (Folkers 1997).

9 Although the Commission and the European Parliament have, as signatories of the International Agreement, a veto power over the ceilings of the Financial Perspective, they rarely exercise it. Usually, the European Parliament grants its consent to the ceilings in exchange for informal extensions of its budgetary powers.

in the United States proceeds almost exclusively within the remit of the annual procedure.

A number of proposals have been made to reform the Financial Perspective.

One set of proposals for reform relates to the suggestion of the European Parliament, the Convention's discussion circle on the budgetary procedure and the Sapir report that the Financial Perspective be adopted by qualified majority voting among Member States.

Such reform would address the key bottleneck of the veto power by Member States. It would probably reduce the tendency for the negotiations on a new Financial Perspective by-and-large to confirm the existing spending structure. It may also help to curtail the inclusion in the Financial Perspective of amounts earmarked for specific spending projects in individual Member States without a direct link to existing expenditure programmes, as has arguably been the case with the expenditure for "particular situations" detailing specific amounts of structural funds for certain regions (Begg 1999). Combined with the introduction of qualified majority voting on the revenue side, this may enable Member States to revisit the rules that govern own resources.

While these arguments may look very appealing from the perspective of increasing the efficiency of the EU budgetary procedure, it is rather doubtful, given the present state of political integration, that such reform would indeed yield the desired increases in efficiency. Moreover, it probably lacks the necessary basis in terms of transfers of legitimacy.

It is indeed not certain that an abolition of the unanimity requirements would eradicate the "pork-barrel" character of the Financial Perspective. Experience from areas in which qualified majority voting has been adopted show that bargaining still figures prominently

in the discussions, as Member States generally try not to outvote each other.

Even more importantly, as the decisions regarding the Financial Perspective and the revenue side are ultimately redistributive in nature (Member States will probably always try to work out whether they are net contributors or net recipients), it could be difficult to legitimise the contributions to the EU budget of Member States that are outvoted in the decision on the Financial Perspective (imagine, for example, a decision taken by majority that significantly increases the budget contribution of one of the large net contributors).<sup>10</sup> The unanimity requirement in the area of the Financial Perspective and in particular on the revenue side serves, at the moment, as an important element in addressing the sovereignty concerns of Member States.

Although, at first glance, the introduction of qualified majority voting seems conducive to further reducing conflict by limiting the veto power of Member States, it might actually have the opposite effect. Currently, Member States are assured that their distributive interests will be taken into account in the negotiations for the renewal of the Financial Perspective. Potential conflict is channelled into these negotiations. If this were no longer the case, outvoted Member States may altogether question the advantage of having a Financial Perspective and may carry their discontent into the annual procedure. As long as the binding nature of the Financial Perspective is dependent on the political will and acceptance of all actors involved, the introduction of qualified majority voting might seriously threaten the functioning of the Financial Perspective.

A second set of proposals for reform relates to including the Financial Perspective in the Treaty and making its ceiling legally binding,

<sup>10</sup> Legitimacy concerns could to some extent be diminished by involving the European Parliament in the decision-making procedure on the revenue side.

as proposed by the European Parliament and the Convention's discussion circle. Budgetary actors would be obliged to adopt a multi-annual budget plan and to adhere to its ceilings during the annual budgetary procedure. Such an institutionalisation of the Financial Perspective would give recognition to the special relevance of the Financial Perspective for budgetary decision-making and would thus close the gap between the Treaty provisions and current practices.

At the same time, depriving the Financial Perspective of its voluntary nature could undermine its conflict-reducing nature. At present, negotiations take place in the shadow of the qualified majority voting prescribed by the Treaty for the annual procedure. The Financial Perspective is not renewed automatically and its existence hinges on the ability of Member States and subsequently of the Commission and the European Parliament to agree on a new multi-annual budget plan (although the Interinstitutional Agreement stipulates that the ceilings of the old Financial Perspective continue to apply until a new one is adopted, the Council and the European Parliament can veto such automatic continuation). If the Financial Perspective were to be institutionalised and such a veto did not exist, the tendency for negotiations over a new Financial Perspective to confirm the existing spending structure might increase further. Budgetary actors could simply prevent change by relying on the automatic prolongation of the status quo. Also, the threat to exit the Financial Perspective (and the Interinstitutional Agreement) or to veto its renewal has so far served as a healthy warning to all actors involved, thereby forcing them to cooperate.

A third set of proposals on the Financial Perspective relates to its adoption in the Council of Ministers instead of the European Council. This proposal is included in the EU Constitution, with the possibility, however, that the Council of Ministers could meet at the level of Heads of State or Government. The adoption by the Budget Council would indeed bring the multi-annual budget plan more in line

with the annual budgetary procedure and would place it on the same level as other EU policy areas.

Having said this, the involvement of the European Council ensures that differences between the spending ministers are transcended. The Budget Council may not be powerful enough to free itself from the grip of the spending Councils (the influential role of the Agriculture Council is often cited in this respect). Moreover, Heads of State or Government in the European Council are able to broker an agreement on the Financial Perspective by linking financial negotiations with non-budgetary issues, as has so far been the case every time the Financial Perspective has been renewed.

A fourth set of proposals on the Financial Perspective relates to synchronising the time-frame with the term of office of the European Parliament, as has been proposed by the European Parliament. This would shorten the time frame from seven to five years and thus (slightly) reduce the high degree of pre-commitment that the current seven-year cycle entails. Moreover, synchronising the Financial Perspective with the European Parliament elections would politicise the multi-annual budget plan. MEPs could put their budgetary ideas before the electorate and thus gain strength vis-à-vis the Council. European voters would become more aware of the EU budget and may exercise pressure for a more effective use of EU funds. There are thus clear arguments in terms of legitimacy and checks and balances in favour of this proposal.

That said, a shorter time frame would be likely to increase the number of budgetary negotiations, thus reducing the degree of efficiency of the procedure. Indeed, a politicisation would only be feasible if the European Parliament were fully involved in the negotiations on the Financial Perspective. As long as the ceilings of the Financial Perspective are set by Member States in the European Council and the European Parliament

is presented with a take-it-or-leave-it choice at the end of the negotiations, voters will not see the relevance of European elections for the setting-up of the Financial Perspective.

The last proposal on the Financial Perspective relates to increasing the flexibility of the expenditure headings, as proposed by the European Parliament and the Sapir report. The ceilings imposed on specific expenditure headings under the current Financial Perspective may indeed be regarded as questionable. By setting rigid limits on expenditure for specific purposes for a rather long period of time, a potentially useful degree of flexibility is lost. It appears that the preference for detailed bargaining at the multi-annual or annual level may be driven by the voting mechanism through which the multi-annual framework and annual budgets are approved. In the current situation the unanimity requirement renders agreement on the Financial Perspective particularly difficult and the costs in terms of lost flexibility may not outweigh the benefits in terms of predictability and stability over a relatively long period of time. However, if voting requirements for approval of the Financial Perspective and the annual budgets were to be relaxed, the benefits of greater flexibility than is currently the case could perhaps be reaped without running the risk of a protracted stalemate.

However, loosening the headings and facilitating regular revisions may turn the Financial Perspective into a mere “financial planning” exercise, largely re-shifting the decision-making on budgetary matters back to the annual budgetary procedure and thereby reducing the efficiency of the procedure. In consequence, the high levels of conflict that dominated the 1970s and 1980s may creep back into budgetary decision-making, thereby seriously threatening the timely adoption of annual budgets. Moreover, with its flexibility and emergency reserves the Financial Perspective already provides buffers to allow for unexpected developments.

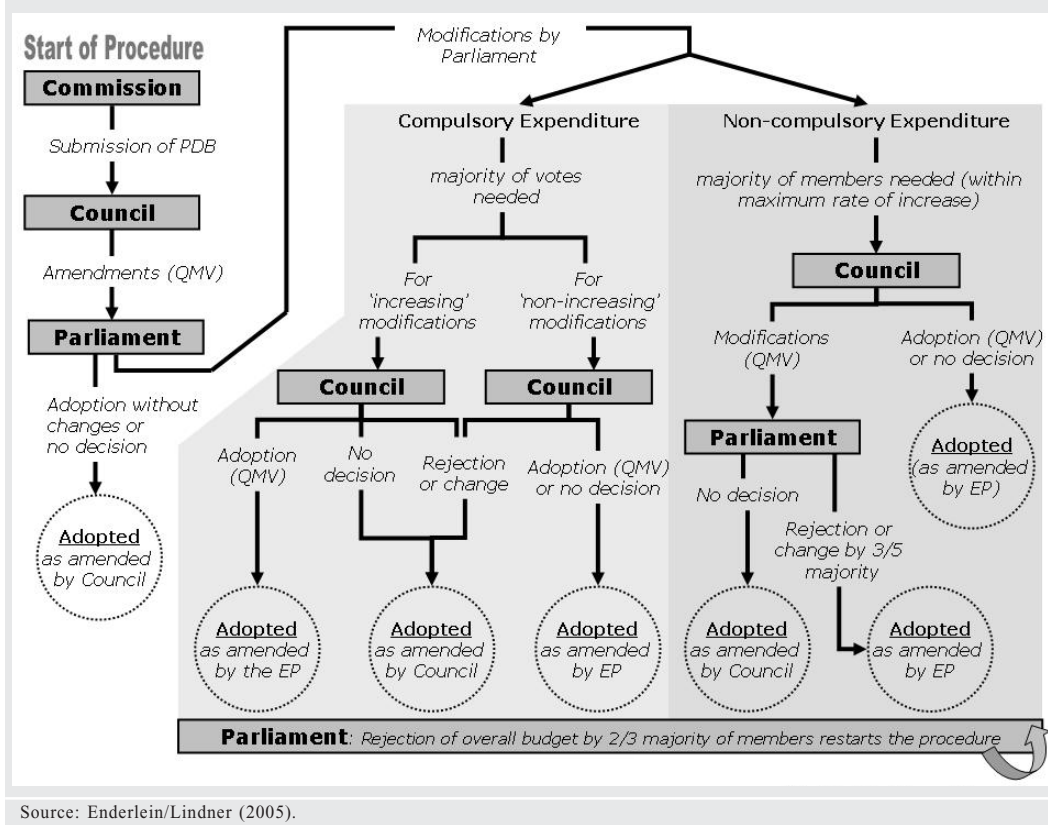
Theoretical approaches support this point. As mentioned above, voter utility increases in a two-stage system based on separate allocations of responsibilities for the size of the budget and its composition (Persson, Roland and Tabellini 1997). Increasing the flexibility of the Financial Perspective (which is de facto set by the European Council) may run the risk of creating a “common pool” bargaining environment, leading to increased rent-seeking activity by office-holders and a decrease in utility for voters.

#### PROPOSALS FOR REFORM AT THE LEVEL OF THE ANNUAL PROCEDURE

The annual budgetary procedure for the EU budget, set out in detail in Article 272 of the Treaty, appears to conform to the division of labour between an executive branch that proposes the budget and a legislative branch that adopts it (see Figure 2). The Commission prepares a “preliminary draft budget” (PDB), which is amended by the Council; this version of the budget, which at this stage of the procedure is called the “draft budget” (DB), is forwarded to the European Parliament for proposals for amendments or modifications. Following two readings by each of the two institutions, the European Parliament adopts the final budget. However, the role of the Commission is much more limited than this division of labour suggests. Although the Commission is present at all stages of the budgetary process, its main function is over once the preliminary draft budget is submitted.

The Treaty bestows each of the two arms of the EU budgetary authority, i.e. the European Parliament and the Council, with specific powers which largely rest on a distinction between compulsory expenditure (that results directly from Treaty application or from acts adopted on the basis of the Treaty) and non-compulsory expenditure. Compulsory expenditure accounts for around 45% of the EU budget and is mainly used for the CAP. While

Figure 2 The current budgetary procedure (Article 272 of the Treaty)



the European Parliament can – within the limits set by the Financial Perspective<sup>11</sup> – overrule the Council’s amendments on non-compulsory expenditure, it has to accept the Council’s prerogative in the domain of compulsory expenditure. Moreover, the European Parliament has the exclusive power to reject the overall budget.

For years, the distinction between compulsory and non-compulsory expenditure has been a bone of contention between the European Parliament and the Council (Lindner and Rittberger 2003). It was introduced in 1970 in order to limit the budgetary powers of the European Parliament and to ensure the exclusive control of Member States in the Council over legislative decisions with financial implications. With that distinction, the Council was able to continue its practice of

introducing legally binding entitlements. As the definition of compulsory expenditure in the Treaty left scope for interpretation, the European Parliament and Council fought intense battles over the classification of certain expenditure lines.

Since the introduction of the Financial Perspective and the extension of the European Parliament’s legislative powers, the distinction has gradually lost relevance. Close cooperation and a series of formal and informal meetings during the course of the annual procedure give the two arms of the budgetary authority the opportunity to confer over both types of expenditure. Often a compromise is found at

<sup>11</sup> The Treaty provides for a maximum rate of increase as a limit on non-compulsory expenditure. Under the Interinstitutional Agreement, the ceilings of the Financial Perspective replace the maximum rate of increase.

the conciliation meeting shortly before the second reading in the Council, which is then endorsed by both institutions in their respective readings.

As mentioned above, in the United States the President, as the executive, plays a much stronger role, and the main dividing line in the budgetary process runs between the President and the two chambers of Congress – the Senate and the House of Representatives. Unsurprisingly, the current annual budgetary process of the US federal budget has been shaped by a number of swings in the relative strengths of the Presidency and the Congress which have resulted in a rather complex budgetary procedure.<sup>12</sup> The first step in the US federal budgetary cycle involves the submission by the President of the budget for the following fiscal year. Once the President's budget has reached the legislature, Congress passes its own "budget resolution", which provides a framework within which the different congressional committees will work and includes targets for total spending and revenues.

Once Congress has passed its budget resolution, it turns its attention to passing the legal instruments which will, subject to the signature of the President (who retains the power of veto), allow the disbursement of funds. The procedure for such approval depends on the type of expenditure in question.

Formally, the US federal budget contains two types of spending categories – discretionary and mandatory – which have some resemblance to the distinction between compulsory and non-compulsory expenditure in the EU budgetary procedure. Discretionary spending for the following fiscal year is decided on an annual basis by the President and Congress. Discretionary spending, which currently accounts for around a third of all federal outlays, covers items such as agency budgets, defence programmes, education, foreign aid, etc.

Mandatory spending, which accounts for two-thirds of all spending, is authorised by permanent laws. It includes entitlements, such as social security, through which individuals receive benefits because they are eligible on the basis of certain criteria. It also includes interest on the national debt, which the Government pays to individuals and institutions that hold Treasury bonds and other government securities. The President and Congress can change the law in order to change the spending on entitlements and other mandatory programmes – but they do not have to. For discretionary programmes, Congress and the President must act each year to provide spending authority. For mandatory programmes, they may act in order to change the spending that current laws require.

On an annual basis, Congress prepares thirteen bills to appropriate funds for discretionary expenditure and, if it so chooses, modifies or enacts new authorising bills governing mandatory spending and revenues. In each case, for any authorisation or appropriation to be enacted, ratification by the President is required. If the President vetoes a bill, it will be returned to Congress where a two-thirds vote by a quorum of members in each chamber is necessary to override the veto of the executive branch.

Conflict between the President and Congress can be pervasive from the moment the President's budget reaches the Congress in February up until the beginning of the fiscal year in October. The very nature and the high profile of the budget resolution makes it prone to conflict between the President and Congress. Congress can pass any resolution but ultimately must gain the President's approval to enact its proposals. As a result, since 1974 the process

<sup>12</sup> Most notably the 1921 Budget and Accounting Act, by which the President gained a formal role in the federal budget prior to Congress action, and the 1964 Congressional Budget and Impounding Control Act, which provided for Congress to adopt an annual budget resolution setting revenues and spending and also established the Congressional Budget Office.

and timing of the congressional budget resolution has been widely different depending on the year. The veto power enjoyed by the President is over entire bills. In other words, the President cannot pick and choose from among the provisions of a particular act. Congress can also combine several appropriation bills with other legislation into one single omnibus measure, thus forcing the President to sign it or veto it as a whole. This tactic can put significant pressure on the President, particularly if, as it is sometimes the case, spending bills are presented after the new fiscal year has already started and a presidential veto would risk shutting down the Government. Partial shut-downs of federal government have in fact occurred in the not too distant past (e.g. 1981, 1984, 1986, 1990 and 1995).

Conflicts between the executive and legislative branches are aggravated by pork-barrel spending, in particular earmarking, contained in bills forwarded by Congress to the President. By incorporating earmarks into the 13 annual spending bills that it passes each year, Congress specifies in law how a certain amount of money be spent, rather than giving the executive branch discretion. In so doing, provided the President signs the respective bill, Congress manages to keep a tight grip on an important element of government expenditure.

Overall, both annual budgetary procedures display a high degree of complexity which stems from the involvement of a wide range of institutions and actors representing different constituencies. In tune with the political system of the United States, the US budgetary procedure seeks to strike a balance between the powers of the directly elected President, who heads the executive branch, and the role of Congress, the legislative branch, which represents the interests of voters in the districts and states. In the EU the largely supranational annual budgetary procedure involves delegates of national governments in the Council and directly elected MEPs. The Commission, as a representative of the executive branch, is a bureaucratic actor that plays a limited role in

the final stages of the procedure. The ceilings of the Financial Perspective provide a largely intergovernmental framework around the annual procedure that limits the conflict between the different actors.

A number of proposals for reform have been made with regard to the annual budgetary procedure in the EU.

One set of proposals relates to eliminating the distinction between compulsory and non-compulsory expenditure (proposals made by the European Parliament and the Convention's discussion circle). Such reform would address one of the complexities of the annual budgetary procedure and would acknowledge not only that there is no real difference in nature between the two types of expenditure, but also that in practice the European Parliament and the Council have developed a system of close cooperation which has significantly reduced the relevance of the distinction. Moreover, the rationale that originally lay behind the distinction, namely to accommodate the asymmetry in the distribution of budgetary and legislative powers between the Council and the European Parliament, has largely ceased to apply, as the European Parliament has become an important co-legislator.

However, it should be kept in mind that abolishing the distinction is closely linked to the question of whether one of the two arms of the budgetary authority should dominate the annual procedure. At the moment, the distinction serves as an instrument for dividing the power to adopt the annual budget equally between the European Parliament and the Council. Should non-compulsory expenditure become the single, all-encompassing expenditure classification, the European Parliament would be able to reject the Council's amendments and would thus gain the last word on the annual budget.

A second set of proposals for reform relates to giving either the Council or the European Parliament the last word on the annual budget

(proposals made by the European Parliament, the Convention's discussion circle and the Constitution – all three proposals favour giving the last word to the European Parliament).

The current system with two arms of the budgetary authority having two readings of the annual budget could indeed be streamlined by reducing the number of readings to one and giving one of the two branches of the budgetary authority the last word on the annual budget. Such a reform would help increase the efficiency of the annual budgetary procedure, in particular as the Council's first readings seem to serve mainly presentational purposes. Moreover, the reform might also increase the coherence of annual budgets, as one arm of the budgetary authority would assume responsibility for the budgets as a whole and would be freed from finding detailed compromises with the other institution. For reasons of democracy,<sup>13</sup> the European Parliament would seem to be more suited than the Council to take over this position, in particular as the European Parliament already has the right to reject the overall budget.

However, it is important to bear in mind that, taking into account legitimacy concerns, the current balance between the Council and the European Parliament helps to ensure the acceptance of annual budgets among MEPs, as well as among Member States, whose contributions form the EU budget. Therefore, proposals to grant the European Parliament (or the Council) the last word over the annual budget may need to be embedded in a structure of close cooperation, building on the existing channels between the European Parliament and the Council. In particular, the conciliation committee should play a prominent role, thereby ensuring that the position of the Council (or the European Parliament) is duly taken into account.

The theoretical literature on efficiency and legitimacy provides no clear answers to the question of the final decision-taking authority in the annual budgetary procedure. The specific

set-up of the EU institutions makes it difficult to attribute the traditional roles of “executive” and “legislature” to the various players involved in the annual budgetary procedure. It is clear, however, that a joint decision mode, bringing together two or more actors in the budgetary procedure, would face the “common pool problem”. In this context, a two-stage approach with either the European Parliament or the Council taking the final decision on the annual budgetary procedure would appear theoretically more desirable. This point also derives from the efficiency literature, which clearly favours a streamlined process with a clear allocation of power resources.

#### 4 THE STATE OF PLAY FOLLOWING THE INTERGOVERNMENTAL CONFERENCE<sup>14</sup>

Against the background of these different proposals and on the basis of the draft Constitution of the Convention, representatives at the IGC negotiated on the possible institutional reforms in the budgetary field. The European Constitution, which was finally adopted by Heads of State or Government in June 2004 and formally signed in Rome on 29 October 2004, introduces a budgetary procedure that remains de facto close to the current budgetary decision-making process – even though de jure the two procedures may appear very different. In fact, the main innovations that the “new” budgetary procedure entails are taken from the rules and procedures that are currently laid down in the Interinstitutional Agreement. Thus, it simply institutionalises existing informal arrangements and does not enact institutional change.

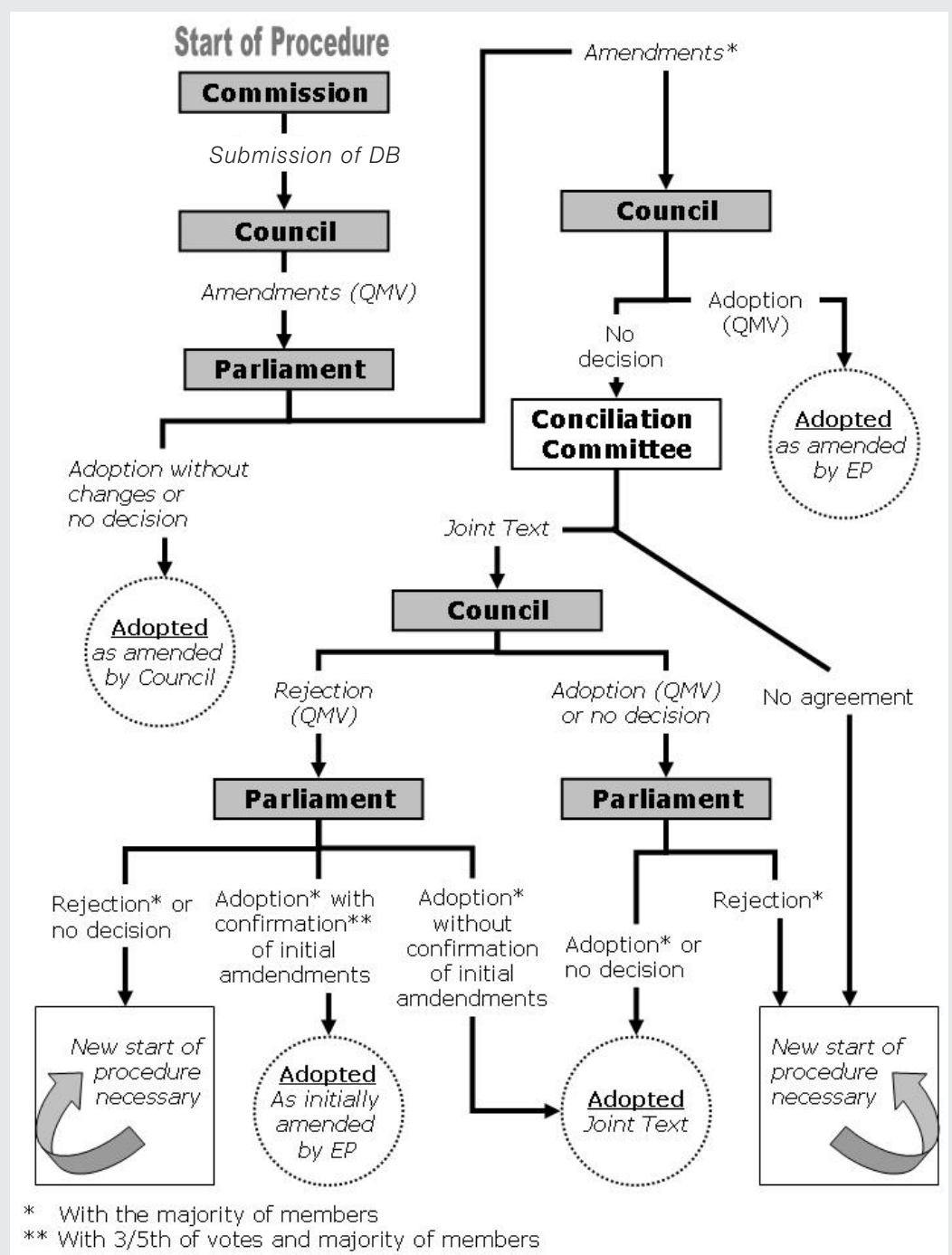
For the annual procedure, three innovations are introduced (see Figure 3): (i) the abolition of the

<sup>13</sup> As MEPs campaign on European platforms and are directly elected to decide on European issues, it may be argued that their democratic legitimacy is stronger than that of national governments, which are chosen (in most Member States) by national parliamentarians who are elected largely on the basis of national issues.

<sup>14</sup> This section is based on Laffan/Lindner (2005).



Figure 3 The amended annual budgetary procedure in the Constitutional Treaty (Article III-404)



Source: Enderlein/Lindner (2005).

distinction between compulsory and non-compulsory expenditure, (ii) the introduction of a Conciliation Committee into the Constitution, and (iii) the granting of the right of rejection to the Council. All three correspond closely to current practice. In the first case, over time the distinction between the compulsory and non-compulsory expenditure has lost its relevance. The Interinstitutional Agreement already gives the European Parliament some say over compulsory expenditure through the ad hoc conciliation procedure. Second, the equivalent to a Conciliation Committee is already in place. Most of the time, the annual budget is de facto adopted in a conciliation meeting between the Council and the European Parliament shortly before the second reading in Council. Third, given that negotiations at the conciliation meeting cover all areas of the budget, the exclusive budgetary powers over the non-compulsory expenditure for the European Parliament and over the compulsory expenditure for the Council have de facto amounted to a right of rejection for both arms of the budgetary authority. Both the Council and the European Parliament use their budgetary powers as bargaining chips to strike deals over the different parts of the budget. Under the new procedure, the Council will be able to prevent an agreement in the Conciliation Committee and thus trigger a new budget proposal by the Commission. The granting of the right of rejection to the Council simply maintains the current balance.

With regard to the Financial Perspective, the new provisions largely institutionalise the current procedures for the multi-annual budget plan. From the outset, it was clear that the institutionalisation of the Financial Perspective would probably be a minimum result of the constitutional negotiations. Given the objectives of the constitutional process (i.e. to update and streamline the Treaty), the contrast between the Treaty provisions and current practice was simply too pronounced in this area of budgetary decision-making for the drafters of the Constitution to ignore it. However, any attempts to go beyond institutionalising the current Interinstitutional

Agreement were strongly opposed. Although the Convention settled on the introduction of qualified majority voting for the Financial Perspective after 2013, the Heads of State or Government adopted a provision that allows for the introduction of qualified majority voting only on the basis of a unanimous decision by the European Council. Similarly, the Constitution's provisions concerning the revenue side do not alter the unanimity requirement for own-resources decisions.

Overall, the IGC settled on reforming the current budgetary procedure only to the extent that proven rules and procedures from outside the Treaty are brought into the Constitution. Taking into account the close link between the overall state of integration in the EU and procedural issues related to budgetary matters, it is not surprising that constitutional negotiators were risk-averse with regard to changes to the budgetary procedures that would have entailed significant consequences for the general set-up of the EU.

## 5 CONCLUSION

This paper has discussed the question why, despite widespread calls for reforms of the EU budgetary procedure, the European Convention and, even more importantly, the Intergovernmental Conference seem to have generated only minor institutional adjustments in the area of the EU budgetary procedure.

The analysis of the EU budgetary procedure and various reform proposals reveals that the current institutional design corresponds by-and-large to an equilibrium between all the actors involved. Altering that equilibrium would require a shift in the level of integration. The "embeddedness" of the budgetary field in the overall state of European integration thus constrains the scope of reform. Given that neither the European Convention nor the IGC focused on questions related to the general state of political integration, it is not surprising that the calls for far-reaching reforms of the EU

budgetary procedure did not result in the desired institutional change.

While it is beyond the scope of this paper to consider the pros and cons of changes in the state of political integration, a number of elements are crucial in demarcating the room for manoeuvre for the EU budgetary procedure. Such key elements, which we call dimensions of political integration, are (i) the assignment of tasks to the different levels of government, (ii) the balance of power between the various EU actors and the corresponding voting modalities, and (iii) the degree to which citizens identify themselves with the EU and with the politicians who are supposed to represent them at that level.

These conclusions should not be read as a panglossian view of current EU budgetary procedures but rather as a cautionary tale about the limited impact that may be expected from a simplification of budgetary procedures that leaves unaltered the broader EU institutional and political set-up. To fundamentally change current EU budgetary outcomes would require the modification of the current set of broader constraints in which any EU budgetary procedure is necessarily embedded.

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