

Linking Institutions with Outcomes An Institutionalist Assessment of the EU Budgetary Procedure

Debates over the future of the European Union presently loom large and leading European politicians seem to feel an obligation to present their individual political visions and opinions on this issue. The German Chancellor, Gerhard Schröder, recently did so in a keynote proposal for the next national conference of his Social Democratic Party (SPD). One aspect of his very broad proposal sparked particular interest within the media and the public. Mr. Schröder suggested giving the European Parliament exclusive authority over the budget, and developing the Commission into a full government of the EU. With this, the Chancellor seeks to improve the transparency of the EU's decision-making procedure and to induce budgetary reforms, in particular a reduction of the expenditure for the Common Agriculture Policy, that appear unfeasible under the current system.¹

In this paper, I wish to take up Mr Schröder's proposal and to place it within a thorough analysis of EU budgetary politics. I share the two key assumptions of the proposal: (i) the current *EU budget faces sectoral problems of fiscal discipline*, which make a policy change desirable; (ii) *institutions influence policy outcomes* and thus reforms of the budgetary decision-making procedure will result in changes in the EU budget. Taking these assumptions as claims, I will try to point out which institutional features are responsible for existing sectoral problems of fiscal discipline.

For this purpose, I define 'sectoral problems of fiscal discipline' as the dominance of selective spending interests in those policy sectors in which the EU plays a distributive role. This definition is based on four arguments: First, it is difficult to judge the overall size of the EU budget. Such a judgement would imply a normative framework to answer the question of which tasks should be handled at the EU level.² Therefore, the overall size of the budget as such does not constitute a useful indicator for fiscal discipline, especially as existing institutional rules prevent the EU from running a budget deficit and sudden fiscal expansion. Second, given the current set of tasks, I assume that the existing allocation of resources favours special interests in certain sectors, most notably agricultural spending. Here, the level of expenditure exceeds the level of spending that is demanded by the collective of taxpayers. Third, given these priorities and political objectives, the way of pursuing them, e.g. the design of expenditure programmes, entails inefficiencies and is equally dominated by special interests. Fourth, the problem of fiscal discipline gains additional weight from a dynamic perspective. Even if these special interests do not succeed in further increasing expenditure they are successful in preserving the status quo and in preventing changes in budgetary prioritisation.

* This paper is still work in progress. Please do not cite it without my permission.

¹ This Mr Schröder experienced when he held the presidency in the first half of 1999 and tried to find an agreement on a new seven year-budgetary framework.

² Fiscal federalism constitutes such a framework. However, it is at questionable whether it is applicable to the European Union.

While the problem of fiscal discipline is the focus of this paper, the key instrument for addressing this problem is an institutionalist model developed by the economist Jürgen von Hagen developed and his collaborator, Ian J. Harden, in 1994 for the assessment of national budgetary procedures. Motivated by the Maastricht convergence criteria for national fiscal performance, they try to develop a set of prescriptions for institutional reform through which national governments can commit themselves to a reduction of the budget deficit and of public spending. They argue that a strong finance minister, a parliament with limited amending powers, and a restricted implementation process ensure a lower overall size of the budget and more restricted use of credits as a way of financing public expenditure. As their model focuses on the Maastricht convergence criteria, it carries a clear normative bias: lower levels of public spending and low budget deficits in the EU member are preferable. Other purposes of the budget and the budgetary procedure, i.e. the legitimisation of distributive policies and the generation of information on spending preferences, are consciously neglected.

At first sight, the clear normative focus of the model and its concentration on national budgetary procedures in mainly parliamentary systems seem to undermine its usefulness for an assessment of the EU budgetary procedure. Certainly, the EU does not have a deficit problem and it lacks a clear and accepted normative benchmark for an upper limit of the EU budget, as given for national budgets by the convergence criteria and the stability pact. Moreover, in a complex political system like the EU, the political reality will inevitably diverge from the first-best solution of economic models.

However, the problem of fiscal discipline, defined as the dominance of special interests, is similar in national and EU budgetary politics even if it occurs in the EU as a sectoral phenomenon. Both also share the dynamic characteristic of the discipline problem, i.e. the difficulty in demolishing existing strongholds of special interests. Following Hix's plea for the application comparative instruments in EU studies (1994), I therefore assume that similar problems warrant the use of the same analytical tools. Moreover, I acknowledge that my focus on fiscal discipline is a narrow view, and that an encompassing institutional reform proposal would necessarily include other purposes of the budgetary process, as well as a political feasibility assessment.

Overall, this paper is part of a more general debate over the problem-solving capacity of the EU. I argue with Scharpf (1988) much of EU decision-making is still dominated by a self-interest-oriented bargaining style. It seems to me that in an ever-expanding Union, problem-solving will only be achieved when more hierarchical elements are introduced in the decision-making process.

The paper is organised as follows: first, I will introduce the model of von Hagen und Harden; second, I apply this model to the EU budgetary procedure and subsequently develop a set of institutional reforms. Finally, I will point out avenues for further research in EU budgetary politics.

1. Assessing budgetary procedure: von Hagen/Harden's model

The budget is at the core of government. It allocates resources and enables state action. The budget contains the plan for how much money government wants to spend and for what purposes in a given period of time. Budgetary choices are made between expenditure for different potential objectives and between different sources of revenue, including the decision to balance the budget or to borrow additional resources. Budgetary outcomes affect all areas of government policy and have direct impact on society.

Despite the importance the budget and the politics surrounding it, political scientists largely ignore this area of research. They leave it to the economists, who in turn have developed sophisticated analytical approaches over the last decades. Originally, the public finance branch of economics focused on the question of what the state ought to do. It thus assumed that once definitive answers to this question were found government would take them up and benevolently implement them. The public choice school of the 1960s and 1970s shifted the focus towards the question of how does the state do what it ought to do. Under the umbrella of this new stream of research in (positive) political economy, economists started to apply assumptions of rational and benefit maximizing behaviour to the political process, and thus undermined the belief in a benevolent state. They also began using econometric tools for quantitative analyses of the factors that influence governments' performance. In the field of budgets, this resulted in public choice models of the rise of government spending (through 'rent-seeking', 'budget-maximizing' and electoral cycles; Tullock 1959, Niskanen 1971 and Nordhaus 1975) and a series of quantitative tests of the causes of budget deficits (see review in: De Haan/Sturm 1994).

The approach of von Hagen/Harden (1994) combines elements of the public choice literature with the rigour of econometric methodology. In contrast to the existing quantitative accounts, which test fairly straightforward hypotheses, such as the impact of ideology and the political stability on governments' spending attitudes, it derives its hypotheses from a focus on the institutional design of the budgetary decision-making process. Similar to institutionalist approaches in political science, von Hagen and Harden assume that 'institutions shape the outcome of the political processes' (von Hagen 1992: 2). Budgetary procedures, i.e. 'the rules according to which budgets are drafted by a government, amended and passed by parliament, and implemented by the government' (ibid.) have a decisive impact on the government's fiscal performance. Following this presumption, von Hagen/Harden (1994) compare the various budgetary procedures of EC member states. They test their institutionalist hypotheses and find significant evidence for their claims.

Overall, their empirical analysis enables von Hagen and Harden to return to the original purpose of economics: to advise governments. Although, of course, the prerequisite remains that self-interested governments have to be willing to take advice, procedural reform offers them a previously unknown instrument for committing themselves before voters to achieving certain budgetary outcomes. Before presenting von Hagen/Harden's institutionalist arguments and recommendations, the following paragraph introduces their (normative) definition and interpretation of 'fiscal performance'.

1.1 The normative benchmark

Von Hagen/Harden follow Wildavsky's view of the budgetary process as a mechanism through which political interest groups 'bargain over conflicting goals, make side payments, and try to motivate one another to accomplish their objectives' (Wildavsky 1975: 4, quoted in

von Hagen/Harden 1995: 772). The process is the locus of conflict-resolution, which involves solving three central questions: first, how large should the government be relative to the private sector and to what extent it should be involved in economic activities? Second, which specific activities should government be engaged in and which groups in society should receive special attention and financial benefits from government? And third, who carries the burden of financing government activities and when?

On a normative level, von Hagen/Harden (1994: 322-323) emphasize that the budgetary process should achieve four major objectives.

- It should lead to *stable agreements* among all participants as a basis for consistent and predictable planning of public activity during the budget period. The budget can only be effective as an administrative instrument when it is introduced in time, at the beginning of the financial year, and it is then honoured by all participants as the exclusive spending plan during that period.
- All interests of society, as well as those of future generations, should be represented in budgetary decision-making (*interest representation*). It should be ensured that there is no bias towards those interest groups that have privileged access to decision-makers.
- The budgetary process should ensure that public resources are used efficiently, which means that they should generate the maximum volume of outputs from a given volume of inputs (*efficiency*).
- It should lead to effective budgeting decisions and programmes, in the sense that they constitute the best possible way to achieve given political objectives (*effectiveness*).

From these four objectives, von Hagen/Harden's key concern applies to the dominance of private interests over the collective interest and its effect on *fiscal discipline*. They evade a clear definition or operationalization of the collective interest, but follow rather narrowly the imperative of the Maastricht convergence criteria, which set out upper limits for public spending and the budget deficit. Judging from the developments of public finances in European countries over the last three decades, von Hagen/Harden detect a strong spending bias and deficit bias in budgetary processes. The first stems from the fact that politicians weigh the (concentrated) benefits of a spending decision higher than its actual (spread) costs for the taxpayers ('fiscal illusion'). Similarly, the second relates to the fact that budgetary actors, when financing expenditure through public debts, tend to under-represent the costs, which they leave to future taxpayers. Identifying an institutional design that reduces these two biases and thus ensures fiscal discipline is the main objective of von Hagen/Harden's work. As indicators for fiscal discipline, they take the level of public expenditure as a percentage of GDP and net government lending as a percentage of GDP.

1.2 The typology of the budgetary procedures and institutional prescriptions

Von Hagen/Harden divide the budgetary procedure into three stages (see figure I): the *government stage*, the *parliamentary stage* and the *implementation stage*. The government stage and the parliamentary stage take place before the beginning of the financial year (t_{1-x}) and entail the process of drawing up and deciding the budget plan. The implementation stage, as defined by von Hagen/Harden, encompasses the execution and the audit of the budget plan. It takes places during and after the financial year.³

³ In their model von Hagen/Harden do not discuss the institutional details of the micro-execution of budget-lines and subsequent auditing methods, but focus exclusively on the budgetary decision-making process and the ability of actors to reverse budgetary decisions in the implementation stage.

Figure I: The three stages of the budgetary procedure

Stages	Government Stage		Parliamentary Stage		Implementation Stage	
Tasks	Preparation	→	Review and Approval	→	Execution	→ Audit and Discharge
Main Budgetary Actors	Executive		Legislature		Executive	Legislature (+ independent agency)
Time	t_{1-x}				t_1	t_{1+x}

Source: by the author.

a) Government stage

During the government stage of the budgetary procedure, the executive draws up the budget plan. This is a five-step process, which begins with the setting of budget targets and ends in Cabinet where the budget plan is finalised and adopted. Von Hagen and Harden describe the process as a co-ordination procedure between the Ministry of Finance (FM) supported by the Prime Minister (PM) on the one side and the spending ministries on the other. Depending on the institutional position of the ministry of finance in each step of the process, the procedure is either a strategically centralised, decentralised guided or a fully decentralised one (see figure II).

The UK and France provide clear examples of a strategically centralised procedure. In both countries the finance minister has a dominant position and controls the drafting process through bilateral negotiations and a senior cabinet committee.⁴ Equally, in Denmark the budgetary process is strategically centralised. Yet, it is not based on the direct predominance of the finance minister, but on a firm commitment to numerical budget targets, which are prepared under the control of the finance minister. While the Dutch budgetary process is example of a decentralised guided one, where bilateral negotiations are mixed with multilateral discussions in the Cabinet, the Irish government draws up its budget plan almost without prior targets and guidance by the finance minister. Binding multiannual budget plans exist in no European country, although Luxembourg and Denmark have a firm political commitment to multiannual fiscal programmes. In Germany, the Netherlands and the UK, annual budget must be presented as parts of detailed multiannual fiscal projections.

Judging the effects of different institutional procedures on fiscal performance, von Hagen/Harden argue that the more dominant the ministry of finance, the less likely the occurrence of fiscal illusion and of deficit bias. Their argument is based on the assumption that the dominance of spending ministers leads to 'universalism', i.e. proposals that contain something for everyone, and 'reciprocity', i.e. deals between spending ministers. The dominance of the finance minister, on the other hand, strengthens the collective interest. Budget deficit and variation in public expenditure is lower in those countries in which the finance minister imposes clear numerical targets (preferably on the basis of multi-annual expenditure plans) or has the role of directing the procedure, monopolizing information across departments, and who had authority to reach bilateral agreements with individual spending ministers and to prepare the agenda for cabinet decisions.

⁴ All empirical examples are taken from von Hagen/Harden (1994) and von Hagen (1992). Additional material can be found in European Parliament(1997).

Figure II: Structure of the government stage

		Type of Procedure		
		1. strategically centralized	2. decentralised guided	3. decentralised
Step	Event	Participants		
G 1	Budget Targets and guidelines	Prime minister (PM) or finance minister (MF)	Cabinet or proposal by MF	Cabinet
G 2	Budget bids	Spending ministries		
G 3	Compilation of draft	MF, in bilateral negotiations	MF, serving as intermediary between spending ministries and cabinet	MF, simple collection of bids
G 4	Reconciliation	PM or senior cabinet committee	Senior cabinet committee or cabinet	Cabinet
G 5	Finalisation	Cabinet		

Source: Von Hagen/Harden (1994:336)

b) Parliamentary stage

During the parliamentary stage of the budgetary procedure, the legislature reviews and approves the budget plan. Key parameters of the process are the scope of amendments and changes that the parliament can enact, the internal division of power within Parliament and the degree of its independence from government. Depending on these key parameters, von Hagen and Harden describe the process as open, restricted or intermediate (see figure III).

The French process is an example of a restricted one. Here, parliament can only make amendments that reduce expenditure or create a new source of revenue. The Government can pressure Parliament by connecting the budget vote to a vote of confidence; it can further force Parliament by calling a block vote on entire passages of the budget. Only the veto power of the French Senate brings a limited intermediate element into the French process. On the other end of the scale stands the Belgian process, where there are no limits on amendments. Both houses enjoy equal rights in budgetary matters and continue to negotiate until a consensus is reached. Government can interfere only on an informal basis outside the parliamentary procedure. In all countries, party discipline plays an important role in connecting the government with parliament.

Similar to their judgement of the government stage, von Hagen/Harden argue that the parliamentary stage is dominated by a conflict between the collective interest and the interests of individual constituencies. While a strong government in a restricted procedure ensures the representation of the former, a powerful parliament in an open procedure leads to dominance of the latter. Thus, von Hagen/Harden recommend a strengthening of the agenda-setting position for the government and creation of a 'closed amendment rule' for parliament that significantly restrains Parliament's amendment power. Moreover, they regard a bicameral system with a strong upper house as conducive to fiscal expansion, following the assumption that members of the upper house generally represent regional constituencies or certain groups on society, and are most likely to induce fiscal illusion.

Figure III: Structure of the parliamentary stage

	Type of Procedure		
	<i>Restrictive</i>	<i>Intermediate</i>	<i>Open</i>
Scope of amendments	Amendments cannot increase spending or reduce revenues, or certain amendments are not receivable	Amendments cannot change overall balance	No limits on amendments
Relation of upper and lower house	Upper house has no budgetary powers	Lower house has prerogative over upper house	Lower and upper house have equal rights
Relation of government and parliament	Government can call vote of confidence or can impose voting procedure on parliament; amendment require consent	Amendments may cause fall of government	No special stipulations

Source: Von Hagen/Harden (1994:338).

c) Implementation stage

During the implementation stage, the executive carries out the budget plan. A key parameter of the process is the ability of the implementing bodies to diverge from the budget plan, as it has been adopted at the end of the parliamentary stage. Von Hagen and Harden describe the process as open, intermediate or restricted depending on the independence of spending departments from the ministry of finance, and on the procedure for substantial revisions of the budget plan (see figure IV).

Figure IV: Structure of the implementation stage

	Type of Procedure		
	<i>Restrictive</i>	<i>Intermediate</i>	<i>Open</i>
Expenditure management	Disbursement approval required and/or spending departments subject to cash limits, MF can block expenditure	Disbursement approval required, and/or spending departments subject to cash limits	Disbursement approval required or full authority of spending departments
Transfers of appropriations	Within chapters only	Within chapters unrestricted, between chapters upon approval by MF	Unrestricted
Substantive revisions	By new law and rarely used	By new law, commonly used	By approval of MF

Source: Von Hagen/Harden (1994:339).

In Germany and France, restricted procedures demand that spending ministers generally have to obtain authorization for actual disbursement from finance controllers or from the finance minister. In other countries, like the Netherlands, this may be the case only occasionally. The system of transfers is very open in Greece, where finance ministers can enact considerable

changes through transfers. Supplementary budgets are subject to a new budget law in all EC countries. Yet, the frequency of their use varies across Europe. Belgium and Italy are examples of countries in which supplementary budgets are a common feature of the implementation process.

Although von Hagen and Harden acknowledge that a certain degree of flexibility is needed to respond to unforeseen events, they stress the danger that the spending bias and deficit bias may be re-introduced, if the budget needs modification at this stage. The anticipation that budgets can and will be revised during the fiscal year strongly reduces the incentive to make hard choices and to solve political controversies during the government- and parliamentary stage.

Overall, the prescriptions developed by Hagen/Harden for each stage have to be taken as a interlinked approach for reform. Successful institutional reform of the budget process must consider all three stages of the procedure together. For example, far-reaching agenda-setting powers for the government alone cannot improve fiscal discipline, if spending ministers still dominate the drafting and implementation process. Similarly, a strategically centralised government is toothless against a strong parliament and it is likely to water down its own budget plan in anticipation of the open parliamentary stage.

d) Additional features of the budgetary procedure

Von Hagen and Harden introduce two additional features of the budgetary process that are linked to all three stages: the informativeness of the budget (von Hagen 1992: 40) and the accountability of conflict resolution (von Hagen/Harden 1994: 330) (see figure V). Both features affect the ability of spending ministers to pursue their spending interests. The first relates to the extent to which the budget plan makes all budgetary actions transparent and limits off-budget activities. Von Hagen/Harden argue that a lack of transparency allows spending ministers and parliament to 'secretly' expand the budget.

The second denotes the degrees to which the budgetary decision-making process encompasses and reviews all budgetary commitments. Von Hagen/Harden (1994:330) identify two main ways in which a budget process may fail to ensure accountable conflict resolution: first, 'if the process leads to "non-decisions"; that is, if it operates under rules which do not ensure that conflicting claims, and decisions between them, are clearly identified and made'; and second, 'if the conflict-resolution function is removed from the budget process. This happens if either the budget process is bypassed entirely, or if the budget becomes merely a record of prior commitment.' In Italy, where nearly all expenditure is mandatory and the actual discretion of the budgetary process is minimal. In contrast, in Denmark numerical expenditure ceilings limit the pre-committing effect of open-ended entitlements. Essentially, von Hagen/Harden make the point that through legislative pre-commitment, spending ministers and legislative committees in Parliament acquire budgetary authority and exploit it for spending purposes. Rules of procedure should therefore ensure that the budgetary decision-making process is the forum for all budgetary choices.

Figure V: Additional features of the budgetary procedure

Feature	High	Intermediate	Low
Informativeness of the budget plan	High transparency and specification in the break down of expenditure and revenue, as well as very limited off-budget activities.	Some off-budget activities and unclear grouping of accounts	Hardly transparent at all and large off-budget activities and special funds.
Accountability of conflict resolution	A clear separation of laws creating the legal foundations for a specific public activity and the budget decision; a mechanism for the re-evaluation of the purposes and achievements of established spending programmes to weighing these claims against the other conflicting ones.	The budgetary decision-making faces some legislative acts with financial implications and entitlements.	Large parts of the budgets are pre-committed by legislative decisions with financial implications, fixed spending programmes and carry-overs; open-ended entitlements leave overall expenditure unspecified.

Source: adaptation of von Hagen/Harden (1994) and von Hagen (1992) by the author.

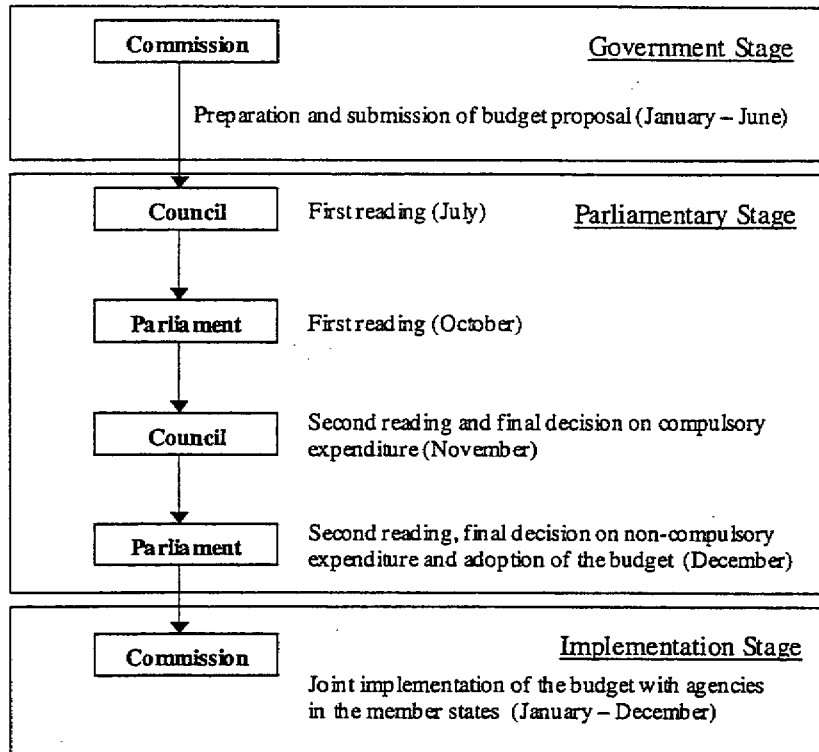
In the following part of this paper, I will apply von Hagen/Harden's approach to the budgetary procedure of the EU. On the basis of the three stage-typology, I will assess the institutional design of EU budgetary decision-making and identify areas for institutional reforms. In doing so, I am aware that von Hagen/Harden's model carries a clear normative and narrow focus on the reduction of public spending and the budget deficit, and is developed for national budgetary processes following the setting of Maastricht convergence criteria. As certain aspects of the EU's problem of fiscal discipline resemble the situation in national budgeting, the application of von Hagen/Harden's model seems justified to address this problem.

2. The EU budgetary procedure

The budgetary treaties of 1970 and 1975, which introduced the system of 'own resources' and incorporated the European Parliament into the budgetary decision-making process, laid the legal framework for the current EU budgetary procedure. As with national budgetary procedures, it can be divided into a government stage, a parliamentary stage and an implementation stage (see figure VI). First, the Commission prepares the budget proposal. Then, the two arms of the budgetary authority, the European Parliament and the Council, decide the budget in a four step process, which distinguishes between two types of expenditure: compulsory expenditure, where the Council makes the final decision with qualified majority voting, and non-compulsory expenditure, which is determined by a

majority vote in the EP with a fixed maximum rate of increase. After the two readings in each institution, the EP finally adopts the budget. Subsequently, the Commission takes over again and overviews the implementation process.⁵

Figure VI: Stages of the EU budgetary procedure



Source: by the author.

2.1 Applying the typology⁶

a) Government stage

The government stage combines a centralised procedure with a multiannual numerical commitment device (see figure VII). However, the internally strong Budget Commissioner has little impact on the setting of numerical targets, and legislative pre-commitment significantly undermines the accountability of the budgetary process (see figure VIII)

⁵ Key features and developments of the EU budget can be summarized as follows: (1) The EU budget massively increased over the last 40 years, not only in totals but also as share of the Community's GDP and as expenditure by capita. (2) The EU budget (as expenditure per capita and as % of GDP) is still very small compared to national budgets. (3) The EU is not engaged in (large scale) defence, education or classic welfare policies. 80% of the budget is spent on the structural funds operations and the Common Agricultural Policy. (4) The EU budget is financed mainly by a uniform percentage rate of the VAT assessment base and the 'fourth resource', which is calculated on the basis of member states' Gross National Product in market prices. (5) The EU budget does not have a budget deficit.

⁶ The following description is based on the following sources: Laffan (1997), Nugent (1999 and 2001), Strasser (1990) and Commission (1995), as well as numerous interviews with budget officials in the European Commission, the European Parliament and the Council by the author.

- G1: Budget targets and guidelines

The annual budgetary decision-making procedure starts in January, twelve months before the financial year begins, with preparatory work in the Commission. The different units of the Directorate General Budget prepare forecasts and calculations on the basis of a multiannual budget plan, the 'financial perspective'. This financial framework sets out binding ceilings for seven comprehensive expenditure categories and the total budget for a period of seven years. It constitutes a numerical commitment device, which is stricter than any of the existing multiannual frameworks in national procedures. However, in contrast to von Hagen/Harden's recommendations, the Budget Commissioner has little say during the negotiation process in which numerical targets are set. This takes place every seven years at a summit meeting of the European Council. The Commission's and European Parliament's powers are limited to approval or rejection of these negotiations.

In February, the Budget Commissioner presents the technical adjustments of the financial perspectives, the revenue forecasts, and some key spending objectives for the coming financial year to her colleagues in the College of Commissioners, and to the two arms of the budgetary authority, the EP and the Council. While the spending Commissioners start to produce their spending proposals, the EP and Council have first debates on their spending objectives for the coming budget negotiations.

- G2: Budget bids / G3: Compilation of draft

In the early months of spring, the spending DGs present their spending proposals in 'hearings', which the DG Budget organises in its building. These bilateral negotiations allow the officials of the DG Budget to focus on the different claims and to decide upon them. The binding ceilings of the financial perspective are strong instruments for the DG Budget to discipline the different spending interests. The ability of the DGs to sustain their claims against the dominant position of the DG Budget depends on their means to substantiate them. Thus, DGs, like the DG Agriculture or the DG Research, that are able to refer to existing financial legislation or entitlements, are in a better position than others.⁷

- G4: Reconciliation / G5: Finalisation

Cases and issues on which tensions between a spending DG and the DG Budget cannot be resolved on the head of unit-level, are delegated to a higher level within the DG and result eventually in bilateral negotiations between the Budget Commissioner and the spending Commissioner. Once major tensions are resolved, the Budget Commissioner presents the final proposal for the 'preliminary draft budget' to the College of Commissioners, which subsequently adopts it and forwards it to the Council.

⁷ DG Regional policy can even use the financial perspective for its own spending purposes, as the sums indicated in the financial perspective for structural expenditure constitute spending objectives rather than maximum limits.

Figure VII: The government stage in the EU budgetary procedure

Step	Event	Participants
G 1	Budget targets and guidelines	Budget Commissioner on the basis of a multiannual numerical commitment device, the 'financial perspective' (centralised)
G 2	Budget bids	Spending DGs
G 3	Compilation of draft	DG Budget, in bilateral negotiations (centralised)
G 4	Reconciliation	Budget Commissioner in bilateral negotiations (centralised)
G 5	Finalisation	College of Commissioners

b) Parliamentary stage

The parliamentary stage in the EU budgetary procedure can be characterised as open, similar to that of Belgium. However, the numerical commitment device of the financial perspective, which is an example of a successful institutional reform, and two procedural limits, i.e. the balance budget rule and strict revenue ceilings, limit the budgetary authority considerably (see figure VIII).

- Scope of amendments

The two arms of the budgetary authority, the European Parliament and the Council, enjoy nearly unlimited amending power, as long as they act together. They can completely change the Commission's preliminary draft budget and adopt a final budget with a massively increased total amount. Their power is limited only by two – albeit significant – procedural commitment devices: (i) the balance budget rule, which prohibits borrowing as a means for covering additional expenditure, and (ii) the fixed revenue ceiling, which can be altered only with the consent of national parliaments. The financial perspective does not set formal limits against a united budgetary authority; a revision of its expenditure ceilings is possible. However, all revisions must be initiated by the Commission and – when in excess of 0.03% of the GDP – supported by a unanimous vote in Council, in addition to a qualified majority in the EP. These high prerequisites for internal unity make revisions very difficult to achieve.⁸ Thus, the numerical targets of the financial perspective do in fact limit the scope of amendments considerably.⁹ Additionally, existing legislative pre-commitments restrict the scope of amendments for the budgetary authority (see below: accountability of the budgetary process).

- Relations between government and parliament

The Treaty foresees only a marginal role for the Commission in the parliamentary stage. Formally, the Commission's active involvement in the budgetary procedure finishes with the submission of the preliminary draft budget. It has no power to reject the budget proposal, as is the case in EU legislative politics. In practice, the interinstitutional agreement nevertheless involves the Commission in the decision-making process as a moderator between the two arms of the budgetary authority and as co-decider over the enactment and revisions of the multi-annual budget plan. This weak position of the Commission and the Budget

⁸ While between 1988 and 1992 seven revisions were adopted, in 1993-1999 the budgetary authority agreed on only one revision and since 1999 no revision has been adopted despite strong demands for it from the EP.

⁹ This is especially the case when the ceilings of the financial perspective are very tight, like they are at the moment.

Commissioner significantly undermines the positive effect of the centralised government stage. The anticipation of a strong budgetary authority reduces the incentives for the Budgetary Commissioner to resist spending Commissioners, and to issue radical budget proposals. The openness of the parliamentary stage diverts the tensions and focus away from the Commission versus budgetary authority dichotomy towards a dichotomy of EP versus Council.

- Relation of upper and lower house

Today, the two arms of the budgetary authority are nearly equal partners in the annual process of determining expenditure allocation. Interinstitutional relations have undergone considerable changes since the introduction of the current treaty provisions in 1975.

In the 1980s, budgetary politics was synonymous with severe institutional fights within the budgetary authority, constant deadlock and lack of budgetary discipline. The Council was unable to reform the system of open-ended (agricultural) expenditure and at the same time reluctant to agree on increasing the revenue side. The Council tried to circumvent the balanced budget rule by adopting a budget only partly covered by revenue, assuming that a supplementary budget and repayable direct transfers from member states would temporarily resolve the budget crisis. The situation was intensified by the EP, which pressed for a higher budget and an extension of its budgetary power.

The introduction of the financial perspective in 1988 signified a breakthrough. It increased the expenditure and resources considerably, while at the same time introduced stability and predictability into EC budgetary politics. The multiannual framework was accompanied by an interinstitutional agreement between the Council, the Commission and the European Parliament, in which all three institutions committed themselves to respect the ceilings when adopting the annual budget.

However, the financial perspective has not completely eradicated interinstitutional struggle. The EP is still eager to expand its institutional hold on the budget and regards each annual budget as an occasion for institutional and political battles. Tensions over very small sums thus become surrogates for a larger institutional conflict and go often far beyond the economic relevance of the individual budget line.

On the revenue side¹⁰, the procedural commitments of the treaty sets clear limits on expansionist spending approach. The European Parliament has no influence on the revenue and the balanced budget rule. Furthermore, requiring the consent of national parliaments for changes to overall revenue ceilings produce strong procedural commitments to fiscal discipline. The current system of 'own resources' also sets incentives for the Council to keep actual expenditure low. As almost 99% of the 'own resources' comes directly from the national budgets and is largely calculated on the basis of national GDPs, national governments, especially net contributors, are keen to reduce financial strains on the national budgets by adopting a tight budget.¹¹ In contrast, the EP experience an incentive that works in the opposite direction. Having no responsibilities over the revenue side, MEPs are not judged against the dispersed costs they induce on national budgets, but rather on the concentrated benefits.

¹⁰ The EU budget is essentially an 'expenditure budget' which means that the sum of expenditure decisions determines the revenue.

¹¹ Although this applies mostly for the net contributors, even net beneficiaries are seldom lobbying for an overall increase and concentrate on the expansion of 'their' policies, in order to prevent a possible 'crowding out effect', which would mean the expansion of certain policies at the expense of 'their' policies.

This means that von Hagen and Harden's assumption that the upper house, as the representation of the regions, is likely have a strong preference for fiscal expansion is as such not fully adequate for the case of the EU budgetary procedure. The situation is more complex. Finance minister in the Budget Council have an incentive and with the revenue ceiling the instrument to keep the budget low. At the same time, the Councils of spending ministers, most prominently the agricultural ministers, push for an increase of the budget either during the budget negotiations or through legislative pre-commitment. In the negotiations between Parliament and Council, the two institutions represent different interests. Despite the Budget Council's pressure for reduction, an agreement will between the two institutions is most likely to be higher than if just one institution adopted it.

Figure VIII: The parliamentary stage in the EU budgetary procedure

Parliamentary stage	Type of Procedure
Scope of amendments	No limits on amendments, except for two procedural commitment devices, i.e. the balance budget rule and strict revenue ceilings, and a numerical one, the 'financial perspective' (= open)
Relation of upper and lower house	Lower and upper house have (nearly) equal rights (= open)
Relation of government and parliament	The Commission has no formal power to interfere (= open)

c) Implementation stage

The implementation stage combines an open system of expenditure management with a restrictive, but insufficient, procedure for the authorisation of transfers and intermediate constraints on substantial revisions (see figure IX).

- Expenditure management

The Commission is fully responsible for overseeing the implementation and management of expenditure, although up to 80% of the budget is in fact implemented by national and regional agencies in the member states.¹² The authorisation of expenditure is done jointly by spending DGs and member states agencies.¹³ This means that the procedure for expenditure management is fairly open leaving the Budget Commissioner with very limited powers to control actual spending. Moreover, current expenditure management has found it difficult to tackle the large implementation gap in the EU budget, which is exploited by spending interest through transfers and supplementary and amending budgets.¹⁴

¹² And up to 99% of the revenue is collected by the member state agencies.

¹³ Disbursement approvals by the DG Financial Control used to be required; but this is changed in 2001 with abolishment of the DG Financial Control Nugent 2001: 289). The function is now allocated as separate units within the DGs.

¹⁴ On the one hand side, implementation gaps seem to underscore the assertion of a parliamentary stage that leads to a strong spending bias. On the other hand, implementation gaps can also result from poor implementation management.

- Transfers of appropriations

Transfers are an instrument through which spending Commissioners reemploy large amounts of expenditure that have not been implemented. The procedure for transfers between chapters¹⁵ is fairly restrictive, i.e. the Budget Commissioner proposes them and at least one arm of the budgetary authority can always veto them.¹⁶ Given the sheer amount of transfers¹⁷ and the Commission's information advantage, the discretionary power is considerable. As the DG Budget seems simply to forward the demands of the spending DGs, transfers occur mostly at the end of the year when spending departments realise that they will not be able to spend 'their' money and try to 'save' it by transferring it into another chapter.

- Substantive revisions

A further instrument in adapting the budget plan during the implementation is the supplementary and amending budget. These undergo the same stages as the annual budget plan and initiate substantial changes in the budgetary plan. Although the Treaty strictly limits their use to very exceptional case, one to two supplementary and amending budgets have been the average since 1975.

Figure IX: The implementation stage in the EU budgetary procedure

Implementation stage	Type of Procedure
Expenditure management	Budgetary Commissioner has little control over on the actual spending; disbursement decisions are now taken by separate units in the spending DGs (= <i>open</i>)
Transfers of appropriations	Within chapters only (= <i>restrictive</i>)
Substantive revisions	By new law, but commonly used (= <i>intermediate</i>)

d) Additional features of the budgetary procedure

- Informativeness of the budget

About 5 - 7% of the EU's financial activities are not covered by the general budget. These are: the operational budget of the European Coal and Steel Community, the budgets of the decentralised bodies, the European Development Fund, borrowing and lending operations, and intergovernmental expenditure for the Common Foreign and Security Policy and for Justice and Home Affairs. Despite these large-scale off-budget activities and special funds, there is still an intermediate level of overall transparency.

- Accountability of the budgetary authority

Large parts of the EU budget are pre-committed by legislative decisions with financial implications. For legislative acts that are adopted through the co-decision procedure, the responsible legislative committee in the EP and the respective sectoral Council can agree on a financial 'amount deemed necessary'. They thus take on budgetary functions outside the

¹⁵ Commission has full autonomy in transferring sums between articles in its own section.

¹⁶ Depending on its classification as non-compulsory or compulsory expenditure, either the Council or the EP has a veto power – although no decision equals a adoption of the transfers.

¹⁷ Transfers amounted for the 1999 budget to over 10% of the initial expenditure in the two largest headings (agriculture and structural policy).

annual budgetary procedure.¹⁸ Similarly, the ceilings for structural operations in the financial perspective constitute spending targets. The European Council thus 'removes' one third of the budget from the annual budgetary decision-making. Furthermore, international agreements often have financial implications. Although the amounts are indicative, the budgetary authority is politically pre-committed to them.

In the agricultural sector, open-ended entitlements leave overall expenditure unspecified. The budgetary authority thus makes itself dependent on the developments of the markets and the rate of currencies.¹⁹ Carry-overs are an additional factor, which is very frequent, especially in structural operations, and pre-commits parts of the budget for the next annual round. These are both signs of decision avoidance.

Figure X: Additional features of the EU budgetary procedure

Feature	Characterisation
Informativeness of the budget plan	Large scale off-budget activities; but seemingly fairly transparent (= <i>intermediate</i>)
Accountability of conflict resolution	Large parts of the budgets are pre-committed by legislative decisions with financial implications, international agreements, spending targets in the financial perspective and carry-overs; open-ended entitlements leave the overall expenditure unspecified. (= <i>low</i>)

2.2 Evaluation and institutional reforms

The application of the typology shows that the EU budgetary procedure deviates in four essential respects from von Hagen/Harden's institutional prescriptions for achieving fiscal discipline.

1. The openness of the parliamentary stage leads to institutional games and budgetary deals between and within the two arms of the budgetary authority. These accommodate the different special interests at the expense of those of the collective of taxpayers. The fact that the Commission has no power to force its budget proposal through the parliamentary stage feeds back into the government stage: despite the Budget Commissioner's dominant position during the preparation process, the Commission's incentives to present a rigorous budget proposal are greatly diminished by the prospect of a powerful budgetary authority in the subsequent parliamentary stage.
2. Legislative pre-commitment, open-ended entitlements, spending targets of the financial perspective and international agreements expand the power of spending Commissioners, sectoral Councils and legislative committees into the budgetary realm. Therefore, large parts of the budget escape the authority of the budgetary decision-makers; conflicting budgetary claims are not made sufficiently explicit in the budgetary procedure.
3. The existent off-budget activities blur the informativeness of the budget plan and allow for expansive spending policies in areas outside the budgetary procedure.

¹⁸ Frequently, the legislative acts are multi-annual programme with overall amount for the whole period leaving the budgetary authority at least the power to determine the annual amount.

¹⁹ Although, the introduction of the financial perspective and the attached agricultural guideline have marked an important change and reduced the impact of open-ended expenditure through setting overall ceilings.

4. The existing restrictions during the implementation stage are insufficient to prevent spending bias from sneaking back into the budget through large-scale transfers, carry-overs and supplementary budgets. Expenditure, which has not been used for the designated purpose during the financial year, is redeployed for different purposes or tacitly carried over into the following year.

Two forceful procedural commitment devices, which are set out in the budget treaty (i.e. the balanced budget rule and the strict procedure for altering the revenue ceiling) play an important role in ensuring that these problematic characteristics of the budgetary procedure do not lead to a budgetary deficit and uncontrolled explosion of the expenditure: the EU's 'own-resources' comes straight out of national coffers and national parliaments need to consent to an increase of the revenues ceilings. Member states experience clear fiscal limits. However, the developments of the 1980s demonstrated that the procedural devices alone are insufficient.

The numerical commitment device of the financial perspective with its binding expenditure ceilings has been an important and necessary innovation, which brought the open-ended agricultural expenditure under control and settled the distributive and institutional conflicts between the EP and the Council, as well as among member states. Although it led to a significant increase in expenditure, it did so in an orderly fashion and at a lower rate than demanded by the EP in the annual budgetary battles of the 1980s. The introduction of the financial perspective illustrates the positive impact that an institutional reform can have. Its attachment to a soft-law interinstitutional agreement paved the way for policy change that was acceptable to all three institutions.

However, the financial perspective has also introduced new problems and partly intensified existing ones. Most importantly, it shifted a significant part of budgetary decision-making away from the Budget Commissioner and the budgetary authority to the European Council. Although a strengthening of the role of prime ministers is in line with von Hagen/Harden's prescriptions (as prime ministers are believed to represent the collective rather than special interests), in the setting of the European Council prime ministers present their country rather than the European Union as a whole. The negotiations between these national aggregations can lead to an outcome that is very different from negotiations dominated by an actor representing the European collective interest. Taking the common agricultural policy as an example, it is sufficient for milk-producing farmers to be pivotal players within national politics of a few key European countries in order to dominate the budgetary negotiations, although in comparison with the European population as a whole they are marginal.

The fact that decisions in the European Council on the financial perspective are taken unanimously rather than by qualified majority (as done in the Budget Council) reduces the likelihood of a poorer majority systematically exploiting the rich minority. Yet, each country gains a blocking power. This strengthens the status quo and makes deviation from the existing distribution unlikely. Given that the financial perspective is adopted for a period of seven years, certain allocation of expenditure and sectoral inefficiencies are thus frozen with no chance for change. This is especially problematic when, as in structural operations, the budgetary ceilings represent expenditure targets rather than spending limits where the budgetary authority can fall below. Significant implementation gaps result, which intensifies problems at the implementation stage, as they open up the possibility for large scale transfers and create a considerable amount of carry-overs. Overall, the financial perspective has brought a high degree of stability and predictability into EU budgetary politics. However, it did so at the expense of flexibility and (paradoxically) fiscal discipline.

Institutional reforms

Having assessed the budgetary procedure, it is now possible to develop a series of institutional reform proposals, which are aimed at increasing the fiscal discipline in the EU budget by reweighing the balance between collective and special interests:

1. The openness of the parliamentary stage should be reduced and the role of the Budget Commissioner strengthened.²⁰ This could be achieved by (i) limiting the scope of amendments the budgetary authority is allowed to make, i.e. only within a certain rate of deviation from the budget proposal or (ii) by making the Commission proposal the default position if the EP and the Council fail to agree.²¹ Chancellor Gerhard Schröder's proposal for giving the EP full budgetary authority over expenditure²² fits into this as it reduces the budgetary authority to one player and therefore diminishes the prevalence of interinstitutional budget deals. However, his proposal should be accompanied by a strengthening of the Budget Commissioner, which would match his suggestion to develop the Commission into a full government.
2. Rules should be enacted which set clear limits for transfers, carry-overs and amending and supplementary budgets. The current, already fairly restrictive, system seems to be insufficient. Furthermore, the role of the Budgetary Commissioner as a monitoring institution should be strengthened.
3. The budgetary decision-making procedure should cover all financial decisions. Legislative decisions should only set indicative figures. The decision to allow legislative committees and sectoral Councils to set 'amounts deemed necessary' should be reversed.²³
4. In a stricter application of the existing rule of budgetary unity in the treaty, off-budget activities should be integrated into the budget to increase the informativeness.
5. The financial perspective should return to a five year-cycle and the ceiling for structural expenditure should lose the status of a spending target.²⁴ Furthermore, assigning more explicit agenda-setting power to the Budget Commissioner should strengthen her role during the negotiation process.

²⁰ The assertion that the Budget Commissioner has an interest similar to the collective interest rests on the assumption that she is appointed for this task. In contrast to spending Commissioners, she has an incentive to achieve stable agreements, to see all parts of society represented and to achieve effective and efficient budget outcomes, because she is judged on her ability to deliver on this task.

²¹ The abolishment of the first reading of the Council is an additional constructive proposal. Although this would increase the effectiveness of the decision-making process rather than have a considerable effect on fiscal discipline.

²² Frequently, it is argued that the EP should have powers over the revenue because this would entail a responsibility and hence set incentives to reduce the expenditure. Yet, on the basis of von Hagen/Harden's model this does not seem to be a convincing argument.

²³ The decision is part of the 1999 interinstitutional agreement. The budgetary committee's new right to submit its opinion of legislative acts with financial implications directly to Plenary is certainly a step in the right direction.

²⁴ Alternatively, one could admit that regional operations are essentially interregional and interstate redistribution and which are five-annually reviewed and are not attached to any conditions.

3. Conclusion

In this paper, I assessed the budgetary procedure of the European Union and identified areas, in which institutional reform could enhance fiscal discipline. I used the institutional model developed by von Hagen/Harden (1994) for national budgetary procedures, and applied it to the European Union. Following the key presumption of the model, that a strong finance minister, a parliament with limited amending powers, and a restricted implementation process ensure fiscal discipline, the paper recommended five institutional changes: first, the openness of the parliamentary stage should be reduced and the role of the Budget Commissioner strengthened. Second, rules should be enacted that set clear limits for transfers and carry-overs, as well as strengthen the role of the Budget Commissioner. Third, the budgetary decision-making procedure should cover all financial decisions and prohibit legislative pre-commitment and open-ended expenditure. Fourth, off-budget activities should be integrated into the budget. Finally, the financial perspective should return to a five year-cycle, the ceiling for structural expenditure should lose the status of a spending target, and the position of the Budget Commissioner during the negotiations of the financial perspective should be strengthened.

This assessment supports Gerhard Schröder's proposal to give the EP exclusive budgetary powers over expenditure. Such a move would reduce the budgetary authority to one player and therefore diminishes the prevalence of interinstitutional budget deals. This should however be accompanied by a strengthening of the Budget Commissioner, which would match Mr. Schröder's suggestion to develop the Commission into a full government.

Not considering the interesting question of how these institutional reforms could be adopted and implemented, the paper raises two methodological questions that demand further research. First, how can 'fiscal discipline' be measured in the context of the EU budget? In my paper, I reject von Hagen and Harden's operationalization of fiscal discipline as the overall size of the budget and the level of budget deficit. However, my notion of 'sectoral problems of fiscal discipline' is itself not yet sufficiently defined that it would allow for the collection of quantitative data. Second, how can purposes other than fiscal discipline be incorporated into this institutional approach? Von Hagen/Harden's approach focuses exclusively on fiscal discipline and leaves out other functions and objectives that budgetary procedures may need to fulfil, such as legitimising fiscal policy or expanding state involvement. Even von Hagen and Harden acknowledge this. In an article they published in 1995 as an extension of their model, they argue that in situations in which uncertainty over political targets is prevalent, collective cabinet negotiations leading to numerical targets are superior to bilateral negotiations between spending ministers and a strong finance minister. Thus, it is important to emphasise that I do not want to underestimate the benefits of the current budgetary system of the EU. In particular since the 1988 reform, the EU has achieved a high degree of political stability in budget politics. In my analysis, I focused on one aspect of the budget, i.e. sectoral problems of fiscal discipline, and explored an institutional avenue for tackling it.

Overall, there are large areas in EU budget politics in which further research would be very interesting. Political scientists should therefore overcome their disinterest in budgetary matters and be encouraged by the economics literature in this field. This paper made a step in this direction and offered a tool kit for the assessment of political proposals, such as the one by Mr. Schröder.

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