National Budgeting for European Convergence

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Introduction

Current financial turbulence and uncertainty in Europe reinforce arguments in favour of encouraging economic and monetary cooperation but, at the same time, make such cooperation more difficult. Since the rejection by Denmark of the Maastricht Treaty, five Community currencies (those of Ireland, Italy, Portugal, Spain and United Kingdom) have devalued, two of them have left the system (United Kingdom and Italy) and others have come under serious pressure (Denmark and France). The difficulties cannot be ignored. An important component of the problem is the management and control of public expenditure. Adjustments to monetary parameters are necessary to solve urgent problems, but they are not sufficient to build a solid EMU. Excessive use of monetary instruments, with persistent budgetary deficits, is one of the main reasons for the current crisis. Long-lasting financial-market stability requires budgetary discipline. Serious movement towards EMU cannot take place successfully until the budgetary performance of Member States has converged.

The European Monetary Union will function properly when Member States accept and work under nominal convergence requirements, among other things, conditions on inflation, interest rates, etc., which means having similar levels of budget deficits. Externalities and interdependence form the basis of the following important arguments identified in support of fiscal cohesion in the European Community: the need for a global European fiscal policy beyond the aggregation of 12 individually decided budgetary positions; the need to avoid the disproportionate use of Community savings by one Member State; a possible bias towards lack of fiscal restraint'; and the need for convergence in budgetary positions during the transition period (A. Lamfalussy, 1989, p. 91). Although the need for fiscal coordination and for controlling national spending in particular have been widely justified, relatively little attention has been paid to identifying and analyzing concrete measures to make this feasible. Most studies on these aspects of the Economic Monetary Union have been concerned with questions as to why the need exist for fiscal convergence and to what degree is it desirable. Attention has only recently been focused on examining what budgetary measures (rules, procedures, structures) can be taken by the Commission or finance ministries for European convergence.

This last question was EIPA's main global concern when organizing the workshop Can Norms and Rules enable EC Member States to Secure Budgetary Convergence?' in December 1992. In this workshop, a mixed group of academics and experienced practitioners from the 12 Member States and the Commission met to analyze and discuss the above question and also the general consequences on national budgeting as a result of the conditions put forward by a future European Monetary Union. Presentations and discussions were multidisciplinary. Most of the relevant scientific approaches were represented: public economics, political science, public management and law. A special participant in this workshop was Professor Wildavsky, a visiting professor at EIPA at that time. The objective of the workshop was to analyze, discuss and suggest alternative policy-option initiatives at EC and national levels encouraging convergent financial management behaviour. Discussions were based on the following important questions: What is the current capacity of EC and national governments to manage public spending?'; What budgetary strategies are available to reduce deficits?'; How do social values and political culture affect spending patterns?'; What should the role of the Commission be under these circumstances?'; What is the Member States' responsibility for managing national budgets?'; What budgetary norms and rules should be proposed and negotiated to guarantee convergence of integration?'; What other orders of control should be applied and by whom?' and What strategic and structural arrangements could facilitate integration?'.

A Legally Binding Treaty: Enough for Convergence?

As is well known, if the Treaty of Maastricht or a similar agreement is finally approved by the Member States, the Economic and Monetary Union will be one of the main courses to be taken for the future development of the EC. The EMU aims to create and implement a single currency area in which a central institution will manage monetary policy in order to achieve common macroeconomic objectives. Successful steps towards the EMU require convergence of the economic performances of Member States. One of the key criteria for convergence is the reduction in fiscal deficits and public debt. The Treaty specifies two conditions: government deficit should not exceed 3% of GDP and public-debt stock should not exceed 60% of GDP. Most Member States have to make great efforts to keep their fiscal position in alignment and adjustments will require tight fiscal policy. In a transitional period a specific multilateral surveillance procedure will focus on budgetary performance. Avoiding excessive deficits will become a binding obligation and a criterion for deciding whether a country may be allowed to pass to the final stage.

Although legally binding, the Treaty of Maastricht has its limitations. The procedure is not automatic (Alexander Italianer, 1993, p 1). The final decision is reserved for judgment by the Council of Ministers. This means that the Maastricht norm alone is not sufficient to guarantee convergence. There is a need for further accompanying' rules and other positive measures, not only to monitor convergent budgetary behaviour in Member States but also to encourage voluntary strategic budgetary adaptations.

It is expected that the EMU will make the European economy more efficient and subject to less variability of prices and production. However, important benefits from the EMU will depend on how national budgeting adapts to a more demanding situation: solving domestic problems (budgetary autonomy), avoiding excessive deficit (budgetary discipline) and responding to overall EC macroeconomic policy (coordination). Budgetary discipline and policy coordination are vital for the EMU. Although the framework for both of these can be agred and set at EC level, the Community is still faced with the problem as to how appropriate budgetary behaviour for convergence can be encouraged at national level, assuming that this field should not be under specific European central control, according to the principle of subsidiarity. Budgetary autonomy is especially necessary, given the postulated loss of monetary and exchange-rate policy, as key policy instruments at national level.

Concerned countries have recently presented to the Commission convergence programmes with drastic reductions in public expenditures for the next few years. However, it is not enough merely to formulate tight budgets if there is insufficient capacity in the budgetary system to meet objectives. Encouraging Member States to fulfil conditions of convergence requires actions from the Commission establishing a general framework of budgetary discipline. Ensuring that norms and rules are properly negotiated and accepted at all levels of government is a first order of control for convergence. These parameters for budgetary discipline represent a preventive framework within which national governments can manage their own expenditure. National discretion for short-term budgetary adjustment to domestic needs also requires capacity from the Commission and Member States for the *ex-post* monitoring of budgetary performance (second order of control). Furthermore, the Community and each Member State can promote positive strategic action to encourage voluntary convergence and design appropriate inter-organizational mechanisms for cooperation (third order of control).

Options for Convergent Budgeting in Member States

The Maastricht Treaty proposes norms to control fiscal performance of EC Member States. These norms are either criteria of substantive discipline (such as overall limits for government deficit and debt), procedural (i.e. EC multilateral surveillance) or institutional (decision-making and monitoring bodies). The focus here is on complementary budgetary norms (specific rules, national procedures and roles of institutions) at all stages of the budgetary cycle and from the perspective of the role to be played both at EC and national levels.

Governmental commitment and capacity for fiscal discipline is important at all phases of the budgetary process: budget negotiations to allocate resources, parliamentary approval of the budget law and budget execution. As von Hagen's study suggests, a budgetary process under a dominant position of the Prime Minister or Finance Minister, with subordinated spending ministers, limited parliamentary amendment power and limiting changes during budget execution, contributes significantly to fiscal discipline. The results of his study propose a possible need for institutional adaptation in the budgetary process of some Member States to guarantee long-lasting fiscal discipline (von Hagen, 1992, pp. 37 et seq.). Strong budgetary leadership is a necessary complement to fiscal norms and rules for convergence.

Pointing in the same direction, Aaron Wildavsky suggests a set of norms and procedures (in the general sense of both words) that would facilitate strong leadership for long-lasting convergence within the EC (A. Wildavsky, 1992, pp. 3 et seq.). They were presented as being complementary to the Maastricht Treaty:

1) outlays not to grow faster than GDP;

2) overall ceiling determined by previous year's spending multiplied by the percentage increases (or decrease in GDP);

3) subceilings on the above principle established on major traditional spending accounts;

4) PAYASUGO: no increase in subceilings unless accompanied by agreed cuts in outlays in other accounts or revenue increase;

5) no inflation premium; subceilings for coming year established by prior year's outlays;

6) quasi-entitlements; governments given authority to vary entitlement spending from 95% to 100%;

7) governmental responsibility; (budget voted up or down as a whole).

A connected issue addressed at the workshop was the assessment of the capacity to reduce budgetary deficit. Is there budget flexibility in the Member States? If so, where and how? What is the room for manoeuvre for the finance ministries? What budgetary policy alternatives are available which comply with the Maastricht criteria? Two different approaches were chosen to discuss the answers to these questions. The first one analyzed the potential contribution of increasing main revenue sources and/or reducing spending categories (J. de Haan and C. de Kam, 1992, pp. 4 et seq). Taking into account political factors, institutional arrangements, budgetary procedures, etc., De Haan and De Kam suggest that there are tax and spending options available to each of the five countries studied. According to their research, some countries (The Netherlands and Denmark) have hardly any options to increase tax revenues. Broadening the base and eliminating reduced rates of corporate tax are open options for Belgium, Italy and Ireland. On the expenditure side, their research identified transfers to family and industry as the main target for further reductions in public outlays. For most of the countries studied, social security and welfare outlays showed some flexibility for reduction. Reducing volume or benefit rates is an important opportunity for reducing spending, although demographic trends, economic growth and general wage trends may influence the effectiveness of this policy.

The second approach focused on suggesting changes in budget behaviour and restructuring the relations between the finance ministry and other budgetary actors (E. Zapico, 1992, pp. 25 et seq.). The Maastricht Treaty mainly focuses on correcting divergent budgetary behaviour by enforcing fiscal rules and norms. Main budgetary centres at national and Community levels do not provide positive strategic guidance for convergence except for the projection of budget figures and fiscal scenarios. As in other European initiatives, part of the problem of budgetary convergence is the lack of leadership for innovation. Strong central institutions are expected to play a traditional role of guardianship and arbitration.

Rejecting Non-Discipline but also Guiding Convergence

The Maastricht Treaty proposes strong legal commitment for convergence, but the credibility of future compliance is still low. The enforcement procedure is based on surveillance of multilateral peer groups. Most programmes of convergence are based on spending cuts in budget preparation. However, the capacity to adapt budget behaviour to the convergence context remains low. Although the general framework and procedure set out in the Maastricht Treaty for budgetary convergence are useful to avoid voluntary budgetary non-discipline, the hidden face of budgeting as a strategic tool should at least be considered as a complementary approach. Merely tightening constraints does not guarantee progress towards budgetary convergence. Central budget institutions have to provide guidance to adapt financial management behaviour to the budget context.

The Commission and national governments need to take into account the budgetary context within which they work in order to facilitate the appropriate adjustments. Budgetary deficits are not isolated from the economic, political and cultural context. Budgeting and auditing systems in the Member States reflect national values and preferences. Patterns of relationships between political values/culture and budgeting are highly useful for explaining public deficits. If there is no capacity for managing public spending, it will be impossible to establish the self-control of national and Community budgetary deficits.

Declining resources and uncertainty have provoked what Professor Wildavsky has identified as repetitive budgeting. Frequent and erratic adjustments of budgetary figures, interdepartmental struggles, interdependence and difficult communication necessitate theactive intervention of central budget units at all levels of government. The finance ministry has to take responsibility for budget flexibility (Les Metcalfe, Sue Richards, pp. 177 et seq.). This means the adaptation of the whole budgetary system. It implies not only applying budget rules, norms and hierarchy but also leading the inter-organizational development of budget networks. Under these circumstances, the main budget centres have to play a new role, which is quite different to the traditional one. Some important components of this new role have been identified as (1) encouraging the coherence of budgeting with strategic management, (2) building trust through multilateral integrative bargaining in the budget procedure, (3) redesigning accountability systems for organizational learning and (4) redefining budget effectiveness as a capacity for adapting financial management behaviour to the budget context. All these components of this new role apply to EC, national and subnational budgeting for European convergence. These and other policy options mentioned before are further elaborated in the papers presented at the workshop mentioned above. They, along with the discussions held during the colloquium, will be published by EIPA in the next few months.

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