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The Multiannual Financial Framework of the European Union: A Political Power Game

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The Multiannual Financial Framework of the European Union: A Political Power Game

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Abstract

The present multiannual financial framework (MFF) 2014-2020 of the European Union (EU) is the first long-term budgetary framework for the Union under the Treaty of Lisbon. The MFF has been called a political power game among the institutions of the Union; the paper looks at the financial results of the changing financial powers under the new Treaty. The two guiding questions are: (1) How does the MFF, or more general a fiscal rule, look like?; and (2) Does the MFF really constrain the EU budget? The paper states the results of the constitutional/political power game inside the new framework. In general it can be said that flexibility is the key to understanding the outcome of the negotiations: increased flexibility of the existing budget and new flexible off-budget expenses. Accounting, disguised as flexibility measures, has become a form of transparent budget gimmickry.

Keywords: the multiannual financial framework of the European Union, constitutional economics, creative accounting

Introduction

The current Multiannual Financial Framework (MFF) (formerly "financial perspective") (European Commission, 2013) is the first one that is based on the Treaty of Lisbon that entered into force on December 1, 2009. Article 312(1) of the Lisbon Treaty, as the Treaty on the Functioning of the European Union (TFEU) is known, states that "[t]he "annual budget of the Union shall comply with the multiannual financial framework". The MFF is the long-term budgetary framework within whose limits annual budgets for the EU must be agreed. As the European Commission (Commission) (2011), the EU's executive arm, says, the MFF "is not the budget of the EU for seven years. It is a mechanism for ensuring that EU spending is predictable and at the same time subject to strict budgetary discipline". On the basis of political priorities it defines the maximum amounts available for each major spending. It is also a political as well as budgetary framework. Within the framework, the European Parliament (EP) and the Council of the European Union (Council of Ministers or Council) (representing the governments of the 28 Member States), which are the budgetary authorities of the Union, have to agree each year on the budget for the subsequent year.

Before 2009 the MFF's had no legal basis in the Treaties.[1] The first framework for the period 1988-1992 was based on an Inter-Institutional Agreement (IIA) between the Council, Commission and EP.

The MFF has been called a political power game among the EU institutions (Dhéret et al., 2012, p. 6). The paper states the results of the constitutional/political power game inside the new framework: the so-called MFF package.[2] What are the budgetary results of the changing financial powers of the new Treaty? The two guiding questions are: (1) How does the MFF, or more general a fiscal rule, look like?; and (2) Does the MFF really constrain the EU budget?[3] In other words, is there sufficient political commitment to pursue a disciplined policy or is creative accounting the name of the game?

The paper first looks at the reason of fiscal rules, their history and gives taxonomy of fiscal rules and their outcome on the performance of governments. Next we do state the history and general constitutional rules of the MFF. Subsequently we look at the changing political powers before and

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[1]Their legal significance, however, was considered to be more than a simple political commitment. This since financial perspectives had been concluded by institutions that can enter into legal obligations under the powers conferred on them by the Treaties. The agreements were therefore consistent with the provisions of the Treaties. The Lisbon Treaty requires that the MFF be set out in a regulation. A regulation is a law that is applicable and binding in all Member States directly, whereas inter-institutional agreements are binding only for the contracting parties.

[2]For an overview of the political power game itself and the political horse trading that went with it see European Parliament, 2013, Focus.

[3]At present the budget is 959 billion euro in spending commitments (1.03% of total GNI of the Member States) and 908 billion euro in actual payments (0.98% of GNI)..

after the Lisbon Treaty. The paper concludes with stating and assessing the budgetary results of the new MFF package.

Fiscal Rules

The IMF defines a fiscal rule as a "permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates" (IMF, 2009, p. 4). A fiscal rule delineates a numerical target with a view to guiding fiscal policy, it specifies a summary operational fiscal indicator and it can be readily operationalized, communicated and monitored. In short, fiscal rules should be simple and well-defined (cp. Schuknecht, 2004 and Debrun et al., 2008). Fiscal (budget) rules, however, do also refer to a wide range of fiscal institutions. "Even the institutions that legislatures use to prepare budgets, and the structure of committees through which budget deliberations must proceed, can be viewed as budget rules" (Poterba, 1996, p. 4). For this reason we do also consider the MFF as a fiscal rule. In general, fiscal rules or, more general, rules-based fiscal responsibility frameworks can be looked at as a form of incomplete constitutional contracts (Buchanan, 2000). We are looking at rules that are designed at the contractual/constitutional level which will be executed later at the post-constitutional contractual level. The MFF package does show both levels.

The Reason of Fiscal Rules

But first, why are fiscal rules or, more general, rules-based fiscal responsibility frameworks necessary? It is to guard against the deficit bias and excessive spending of governments. The reasons given are firstly governments' supposed shortsightedness (IMF, 2009). Concerns about electoral prospects do lead potentially to insufficient attention to longer-term requirements: governments opportunistically raise spending or cut taxes to increase reelection chances. In short, public debt and spending do become instrumental for obtaining political power or for remaining in power. Secondly, the "common pool problem" is mentioned. The problem occurs since special interest group or constituencies do not internalize the overall budgetary impact of their computing financial demands. Debt and spending take the role of political mollifiers. Besides that, the larger the group that has direct access to political decision-making, the more the goals will diverge and the more debt and/or spending is needed to form a common government policy (Blankart, 1996, p. 264). In general in can also be said that authoritarian institutions that centralize power in the hands of a small group, are more likely to pursue tight fiscal policies than collegial institutions that disperse power and do require consensus for budget enactment (Poterba, 1996, pp. 44-46). Obviously, the Union belongs to the last group of institutions.

For those, of course, who do not perceive a government as selfish and prone to misuse public debt, the situation is different. For them a benevolent government acts as an authority that uses its instruments in general to the best.

The negative view, however, seems particularly fit for the Union. For what to think of a budget decision where, e.g., a member of the EP (MEP) from Romania decides over money coming from the Netherlands to be spent for someone living in Italy? Can it not safely be stated that the incentives for a MEP to look for the common good, as compared to, e.g., a member of a national parliament, is weaker? (Cp. Friedman, 1980, p. 146). And more than that, the present situation is characterized by a lack of trust and fears of free riding between Member States themselves and between Member States and EU institutions. The budgetary process of the Union, as far as the policies of the Member States go, can probably be best described as a vetocracy: “as a war of ‘red lines’, leaving all responsibility for achieving a coherent outcome to selected ‘brokers’ ” (Benedetto, 2012, p. 172).

As a consequence a strong commitment to fiscal sustainability is needed. The introduction of the MFF, subsequent to the already existing explicit fiscal rules, does complement the Union’s fiscal constitution. The philosophy behind the introduction of subsequent fiscal rules shows the necessity of the different steps in the evolution of Europe’s fiscal constitution.[1]

Fiscal Rules in History

The virtue of fiscal rules was already heralded by the Romans:

“The budget should be balanced, the treasury should be refilled, public debt should be reduced” (Cicero 63 BC, Kopits, 2001, p. 3).

Formal attempts, however, span over the last century and a half. Three waves of fiscal rules can be distinguished (Kopits, 2001, pp. 4-5). In the first wave, as of the 20s of the last century, the so-called golden rule was prescribed. Subnational governments in federal systems, e.g., in the U.S. and Switzerland, had to maintain a current budget balance that is net of investment. In the second wave, after World War II, industrial countries, e.g., Germany, Italy and The Netherlands, introduced balanced-budget rules. Most of them were of the golden rule type. In the third and current wave, in contrast to the previous waves, fiscal rules are supported by transparency standards and appropriate accounting conventions. In general these elements are enshrined in broad legislation or international treaty, e.g., in New Zealand, Brazil, and EU’s Member States[2].

To be specific, the most important rules that promote fiscal sustainability are: (1) Budget balance rules (e.g., overall, structural, cyclically adjusted, or primary balance). None of the rules, however, have any influence on government size but only on debt sustainability and/or economic stabilization. (2) Debt rules which do set an explicit limit or target for public debt in percent

[1]The question, however, if a government really wants to be constrained, since self-binding is the essence of constitution-making, is an open question. Maybe it is just the other way around: “[i]n politics, people never try to bind themselves, only to bind others” (Elster, 2000, p. ix).

[2]For the EU the goal of transparency is still a long way to go. Recently it has been said that “the EU’s budget and budgetary procedures are beyond Byzantine” (King, 2014). King also states that the “opaque” and “unintelligible” budget is beyond the control of the political process but in the hands of EU civil servants.

of GDP. These rules are effective in terms of ensuring convergence to a debt target but have no influence on the size of the government either. (3) Expenditure rules set limits on spending in absolute terms or growth rates in percent of GDP. They do constrain the size of the government; however, they do not constrain the revenue side. (4) Revenue rules set ceilings or floors on revenue.

The Results of Fiscal Rules

As said, over time, an increasing number of countries have moved away from a single rule toward a combination of rules closely linked to debt sustainability and, more recently, also curtailing the size of the government.[1] In many cases the rules have been introduced as part of broader reforms aimed at strengthening the framework for fiscal policy: strong transparency requirements and public oversight (mandatory publication of regular reports that must contain multiyear fiscal projections and other pre-determined disclosures), effective budget mechanisms, legislated broad principles that guide the formulation of fiscal policy, and independent fiscal agencies (IMF (2009).

These broader reforms are important in view of the effects of fiscal rules on creative accounting. At one extreme, the "institutional irrelevance view" holds "that budget rules can be circumvented by modifying accounting practices and changing the nominal timing or other classification of taxes and expenditures" (Poterba, 1996). As we will see for the EU the stated effects are not imaginary.

On the other hand, empirical studies (Hagen and Harden, 1995; Debrun et al, 2008; IMF, 2009) suggest that fiscal rules do lead to improved fiscal performance: a stronger cyclically adjusted primary balance (however there is a weaker relation in terms of public debt-to-GDP ratios); budget balance and debt rules are better than expenditure rules; higher levels of government have been associated with more fiscal discipline; a strong legal basis of rules and strict enforcement are important.

Fiscal rules also do increase the probability of accurate budget projections (Luechinger and Schaltegger, 2013, p. 785). Before projections by finance ministers were generally over-pessimistic. Fiscal rules, however, could also create incentives to be overly optimistic in projections in order to postpone politically disputed budget cuts. As far as creative accounting, window-dressing or other ways to circumvent fiscal rules go, it, however, appears that fiscal rules significantly lower the probability of projected and realized deficits.

[1]Intergenerational equity, e.g., requires the buildup of public assets form the proceeds of exhaustible natural resources.

The MFF: History and Content

During the eighties of the last century the yearly negotiations on the budget were plagued by continues stalwart between the Council and the European Parliament. Several times, in 1980 and 1985, the Parliament rejected the proposed budget. A fundamental reform of the Community's budgetary procedure was required.1 In 1988 an inter-institutional agreement between the Council, Commission and the EP, enabled the two wings of the budgetary authority to make decisions in advance for a period covering a number of years.2 Financial perspectives, as they were called, the predecessors of the current MFF, setting out the priorities for five to seven years, were subsequently made for the years: 1988-1992 (the "Delors I Package"); 1993-1999 (the "Delors II package"); 2000-2006 (Agenda 2000); 2007-2013, and the present framework for the years 2014-2021. The existing seven-year budget is for a total of Euro 959 billion in spending commitments, the so-called ceilings on commitment appropriations, and 908 in actual payments, the so-called ceilings on payment appropriations (both are in 2011 prices).

The MFF fixes the amount and composition of the EU expenditure over the following years. It ensures adequate financing for projects extending over several years, improves financial discipline, and establishes objectives from the outset. The annual budgetary procedure then determines the exact level of expenditure and breakdown of expenditure between headings for the year in question (Nello, 2012).

Article 312 of the TFEU (Part Six, Title II, Chapter 2) on the MFF states (paraphrased) the following five points:

1. The MFF shall ensure that the Union expenditure develops in an orderly manner and within the limits of its own resources. It shall be established for a period of at least five years. The annual budget shall comply with the MFF.
2. The Council shall adopt a regulation laying down the MFF. The Council shall act unanimously after obtaining the consent of the EP which shall be given by a majority of its component members. However, unanimously the Council can adopt a decision to act by qualified majority when adopting the regulation.
3. The MFF determines the amounts of the annual ceilings by category and lays down any other provision required for the annual budgetary process.
4. Where no Council regulation has been adopted, last year's framework shall apply.
5. The EP, Council and Commission shall work together to facilitate the adoption of the MFF.

[1]For the change in the power to the annual budgetary procedure under the Lisbon Treaty see Benedetto and Milio, 2012, pp. 47-48.
[2]Notwithstanding, the EP rejected the annual budget for 2011

The MFF is also the constitutional framework next to the already existing fiscal rules on a balanced budget (Art. 310)[1] and the limitations on the own resources (Art. 311). It is, to be specific, the so-called MFF package that has to be decided on: the MFF regulation (MFFR) (European Council 2013a) and an Inter-institutional Agreement (IIA) (European Council, 2013b).[2] Next there are, in the new MFF package some declarations on, e.g., own resources, youth unemployment and review/revision of the MFF (European Commission, 2013). In sum, in the package the expenditure side (the MFF) as well as the revenue side (the Own Resources decision) has to be decided. The national governments, however, are still fully responsible for raising the revenue.

The MFF: Political Enforcement before and after the Lisbon Treaty

As is said, the MFF "is a real 'political power game' where each institution tries to make final agreements, as much as possible, in line with its own views" (Dhéret, 2012). How did the procedures change for the MFF before and after the Lisbon Treaty?

Before the Treaty, the Commission and the Council would agree on the long-term budget. Member States would reach accord unanimously. The EP had the right of veto. The three institutions could set an amendable ceiling for expenditure to allow some flexibility in case of need, i.e., in a recession or natural disaster. EU revenue was capped at a maximum level. Article 312 (3) of the new treaty, however, sets an absolute ceiling on spending. This constrains the flexibility of the annual budget.

Before the new Treaty there was allowed for a maximum and actual rate of increase in the budget to be agreed annually by the Commission, Council and EP. After Lisbon, the MFF sets the maximum rate of increase and the treaty does not foresee increases.

As far as decision-making for the own resources go, the EP gained the power of consent over the implementation measures of any change to the own resources (Art. 311 TFEU). The Council, on the basis of a proposal of the commission, still unanimously decides, after consulting the EP, on changes of the own resources. To be approved by the Member States in accordance with their respective constitutional requirements.

Can the fiscal rules be enforced? In general it can be said that fiscal rules invite abuse by creative accounting practices to circumvent the rules. One of the most effective ways, however, to guarantee the enforcement of fiscal rules is strict transparency as an integral part. There should be transparency in institutional structure and transparency in fiscal reporting. In general, as is said,

[1]At the moment, EU budget has no discretionary role in economic policy. If that should be the case, to balance the budget, as is presently required, would be much harder to do: a zero-structural-deficit rule, as is already required for the Member States by the new stability and growth pact, would be necessary. Reliable data, however, would be hard to get.

[2]That IIA contains some residual aspects that were originally in the financial perspectives (the old IIA), but were not included in the MFF.

the Commission, Council and EP benefit from a "collective efficiency and legitimacy gain" (Benedetto, 2012, p. 41) by the simplified and easier to understand budgetary procedures of the Lisbon Treaty. If so, creative accounting should be diminished.

Assessment of the MFF Package

The positive or negative assessment of the new MFF package is of course related to the point of view one takes. If, e.g., a government is anxious to avoid criticism for their acceptance of EU empowerment, it will downplay the changes in the new Treaty. Important, as well, is how one sees the effects and purpose of the EU budget. Is it purely redistributory or does it delivers side-payments to secure European integration. Does it have benevolent objectives, e.g., spending for regional development, or has the budget to be increased because of substantial new tasks, e.g., foreign policy, R&D and the improvement of infrastructure.

Whatsoever, the question becomes: Has the very real rebalancing of the budgetary powers of the EU institutions in terms of agenda-setting and vetoes changed the outcomes of the MFF package decision process (cp. Benedetto, 2012, pp. 55-56).[1]

The Constitutionalisation of the MFF

The constitutionalisation of the MFF is one of the major changes introduced by the Lisbon Treaty. It is about the strongest commitment one can make about fiscal sustainability. Since it requires a Treaty change, the MFF can hardly be changed under tempting situations. There is a real loss of flexibility; after the Lisbon treaty, the MFF became more difficult to amend. The new MFF also maximizes the reputational costs for those institutions of the Union that do not respect it. In short, budget flexibility, e.g., for higher spending ceilings or ad hoc policies, will be diminished for the Commission, the Council and European Parliament. At first sight, it also looks that the MFF means a real loss of power for those in favor of budget flexibility.

The Abolishment of National Retification and a Ceiling on Spending

The abolishment of the cumbersome and time-consuming national ratification of the MFF by the Member States, however, clearly increases the reform possibilities of the parties. However, as just-said, the ceiling on spending is a counterforce. Article 312 (1) says that the Union expenditure develops within the limits of its own resources and since there is a clear ceiling on the revenues of the Union, of 1.23 % of GNI, expenses too are under control. As a consequence, the MFF is the envy, almost the ideal, for those who

[1]As far as the constraining powers of the formal rules of the MFF go, it is also of importance to look at how Member States are constrained (checks and balances) by internal decision-making processes prior to presentations in country positions at the EU level (Benedetto, 2012, pp. 24-28). These constraints, however, are no part of this paper.

want to balance the budget and curtail the growth of the budget of governments.

Flexibility

The MFF, as said, ensurer stability in EU spending over time and avoids annual interinstitutional battles and battles amongst the Member States (European Parliament, 2013). At the same time, however, flexibility is needed to cope with unforeseen budgetary needs. In general, this can be done, e.g., by increasing the flexibility instruments in number and/or in terms of amount allocated, or to create more flexibility in terms of easiness of procedures (Molino and Zuleeg, 2011, p.15). Flexibility, also, became an issue in the negotiations over the new MFF. Several routes were taken.

As said the MFF package contains an IIA on budgetary discipline, cooperation in budgetary matters and on sound financial management (Art. 259 TFEU). It contains provisions related to the special flexibility instruments not included in the financial framework.

To be specific, the new MFF allows unused margins (differences between the expenditure ceilings and the money actually spent) as well as unused funds (unused payment appropriations) to be transferred onto the following year or into different areas of the budget. In the new MFF, also, it is possible to move available funds from one part of it to the other. The new IIA ensures that available funds are fully used rather than returned, as was previously the case, to the Member States. In short, flexibility is both on budgeted commitments and actual payments.

Next to these general instruments some specific flexibility measures have been introduced. For instance there is more flexibility for commitments in growth and research: the leftovers can be transferred to a later date. There is also a special flexibility for youth employment and research. Without being limited by the annual expenditure ceilings set by the MFF funds, money can be brought forward (frontloading). Finally there is a last resort instrument to react to unforeseen circumstances: a general contingency margin which amounts to 0.03% of the EU's GNI.[1]

Part of what can be called "the flexibility deal" in the new MFF package is also a revision clause of the existing MFF 2014-2020. Half way through this time period, the Council, EP and Commission can check whether the political priorities and figures allocated to expenditure ceilings should be revised. This review would take place in 2016 at the latest. It also allows the newly in 2014 elected EP and Commission to reassess the priorities for the remaining years of the MFF.[2]

[1]It is to be noted that the overall margin available under the own resources ceiling for payment appropriations is already "used" as collateral for the outstanding amount of loans or credit lines granted to Member States under the European financial stability mechanism (Marzinotto, 2012, p. 6)

[2]In this midterm review the Commission also has to present a proposal aligning the MFF with the political cycles of the institutions.

Off Budget[1]

Just as a government, e.g., state governments in the U.S., can use public authorities to circumvent constitutional debt limits (Bunch, 1991, p. 57), the Union can, e.g., use the European Investment Bank (EIB) as a sort of financial intermediary. In the U.S. the introduction of fiscal restraints induced the engagement in off-budget activities and authorities (Hagen, 1991, p. 202; cp. Bennett and Dilorenzo, 1983).

To be specific, for the Union this means that some funds or projects are left outside the MFF. These instruments are also available outside expenditure ceilings agreed in the MFF. They are the Emergency Aid Reserve, European Globalization Fund, Solidarity Fund, Flexibility Instrument and the European Development Fund (EDF).2 In short, though debt and/or an increase in expenditures are prohibited in the budget, it is not necessarily prohibited off-budget (Blankart, 1996, p. 258).

And last, another off-budget payment is coming. Though for the first time the MFF was cut in real terms, the actual result probably will be different. In general, commitments (undertakings to pay) were cut by 3.4% and payments with 3.7%, that is 0.3% of EU-wide GNI.3 This gives an unusually large gap between these two amounts. This of course can potentially cause problems down the line. Probably the EP and the Commission do think there will be a future bail-out. This just as there were, retroactively, so-called top-up funds necessary for the 2013 budget: there was extra money needed to indeed pay for the commitments with the Council had agreed to supply.

Conclusion

The MFF is the necessary and logical complement to a development of a Union focused on personal freedom: the freedom of trade in goods and services, on the freedom of choosing one's residence, and on the freedom of capital movement, to a Union that is devoted also to finance the redistributive programs of the Union at worst or, at best, to provide public goods (Blankart, 1996, p. 257; Blankart and Kirchner, 2003, p. 3). Hence, the original Treaty only needed a few budgetary rules (Articles 310 to 325). After these loose fiscal rules, however, a transparent financial framework became necessary. In other words, just fixing the existing budgetary rules was no longer sufficient:

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[1]According to Art. 310 of the Treaty all items of revenue and expenditures have to be entered into the budget. This, however, is still a far cry. The EU budget acts as "collateral" in a number of financial instruments, e.g. the European Stability Mechanism, loan guarantees to small and medium enterprises, trust funds in development aid. It was the wish of the EP that those post were to be included in the new MFF.

[2]The EDF gives assistance to African, Caribbean and Pacific countries. It is also outside the MFF because Member States contribute differently to it compared to their financing of the EU budget.

[3]In general the budget went down, (the first net reduction to the EU budget in the Union's history), to 1% from 1.12% of the EU GNI.

institutional-constitutional reform was needed (Buchanan, 2000, p. 213). The MFF was the result.

With the new MFF the EP got more power. That power, in step with the desire of the Commission, has been used to increase the EU budget. This notwithstanding a by some Member States much heralded reduction. The EP and Commission were an effective countervailing power to the wish of the European Council to curtail the budget. As a result, because of creative bookkeeping, the budget was curtailed in name only.

The result was more of less to be expected. As history teaches: when an “outside” agent forces a reduction in the expenses of the government, the government will respond by increasing hidden liabilities (Easterly, 1999). Specifically, flexibility, that is more money to spend, was achieved by the introduction of the possibility of carry-over budget surpluses from one sector to another one, commitment appropriations to become actual payment appropriations, a half term revision, and creating off-budget programs.

Notwithstanding the just-said, the new MFF is a logical and necessary addition to the existing fiscal rules. It is fully in step with the Union’s growing emphasis on spending. The result of the new MFF package is, as was to be expected given the experiences else where, all but perfect: it is fraught with transparent budget gimmickry.

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