Budgetary discipline in Brussels

Numerical targets or procedural rules?

by

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Abstract

With the coming enlargement of the EU, and with the ongoing dispute over the national incidence of the EU-budget, budgetary discipline with respect to the general EU-budget will become of increasing importance. Budgetary discipline can be achieved by commitment to numerical targets, or by procedural strategic dominance of a party that is sympathetic to the efficient use of public resources (like a Minister of Finance on the national level).
As for the EU-budget, at this moment a range of numerical targets is used, such as the VAT-call-up-rate and -ceiling, the own resources ceiling, and the agricultural guideline. As a result of Agenda 2000 these targets have been supplemented by rules concerning the structural policies, and regarding pre-accession and accession expenditure. In addition to these numerical rules, various procedural rules are used, mostly relating to the division of budgetary competence between Commission, Council, and Parliament, in stead of rules that institute strategic dominance of one of these parties.
In this paper these rules as well as their application are critically assessed, focusing on the period 1977-1999. It is concluded that both Commission and Council have wrongfully stayed clear of introducing new procedural budgetary rules. Instead of that, they rely heavily on new numerical targets, that give cause to rigidity and creative budgeting.

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1. Introduction

This paper deals with budgetary institutions (principles, rules) and their application to the finances of the European Union (EU), to ensure budgetary discipline.

Why is budgetary discipline becoming more and more relevant to the EU?

In general, economists are concerned with the fiscal performance of governments because of the unrestricted possibilities of governments to raise revenue, by using their power to tax. Although the EU's own power to tax is limited, and shared with and decided upon by its member states, some sort of restraint is required. The considerable growth of the EU's budget over the years (especially in the field of the Common Agricultural Policy, and in the field of the Structural Policies) gives rise to doubts as far as the effectiveness of fiscal restraints in the past is concerned. Moreover, some member states, like Germany and The Netherlands, complain about the impact the growth of the EU-budget has on their own budgetary latitude.

Secondly, the coming enlargement of the EU will probably draw heavily on the EU-budget. Fiscal discipline[1] is necessary at the present time to facilitate enlargement, but will also be highly relevant after the EU has been enlarged. At the Berlin Summit in March 1999 it has been concluded that "... the Union's expenditure must respect both the imperative of budgetary discipline [...], and the need to ensure that the Union has sufficient resources at its disposal [...] to cope effectively with the process of enlargement"[2].

Thirdly, there is the Economic and Monetary Union (EMU). Although the EU-budget is small compared to, for example, the federal budget in the United States, it is about as large as the central government budget of EU member states like Spain and The Netherlands. If monetary union requires fiscal prudence on the part of these member states, the same should go for the EU itself.

Budgetary discipline and the need for budgetary reform within the EU are often analysed from the perspective of power politics. The evolution of the EU-budget is then explained by focusing on the balance of power within the EU, or on the behaviour of member states' representatives at European summits, or on the struggle for budgetary power between Council and Parliament. That approach is not used in this paper. Here we will focus on the role

[1] In this paper the terms budgetary discipline and fiscal discipline are used as synonyms.

budgetary institutions play as far as ensuring budgetary discipline is concerned. Moreover, we will suggest some improvements in the budgetary institutions used in the EU at present.

Following Alesina and Perotti (1996: 401) we can define *budgetary institutions* as all rules and regulations according to which budgets are drafted, approved and implemented. These rules can be numerical targets on the budget (like the balanced budget rule), but also procedural rules which regulate the preparation, the legislative approval, and the implementation of the budget, or rules regarding the transparency of the budget. Budgetary rules thus is a generic term referring to rules concerning the way government budgets are prepared and arranged, as well as to rules guiding budgetary behaviour.
Von Hagen and Harden (1994, 1995), Alesina and Perotti (1996), Corsetti and Roubini (1996), and Milesi-Ferretti (1997) have dealt with the question what sort of rules should be used. Is setting numerical fiscal targets a better instrument to ensure fiscal discipline than the use of procedural rules? Using numerical targets obviously has some drawbacks, like the lack of flexibility they impose on budgetary policy, and the ineffectiveness due to the systematic resort to creative budgeting these targets give cause to. In principle, reforms of institutions and procedural budget rules could provide effective fiscal discipline at lower costs, while enhancing the transparency and the democratic nature of the budget process (Corsetti and Roubini, 1996: 412). As Von Hagen en Harden (1994: 353/354) point out, there seems to be a systematic link between the size of an economy and the most adequate commitment technology:

- commitment to a procedure that gives special authority to participants in the budget process representing the collective interest in efficiency of public finances seems to be the common strategy for large EU member states with relatively successful fiscal performance;
- firm commitment to numerical budget targets adopted early in the budget process seems to be the key to success for smaller EU member states;
- a mixture of both commitment systems is successfully used in medium size member states like The Netherlands.

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[2] Point 4, Presidency Conclusions, Berlin European Council, 24-25 March 1999.

To keep a grip on the general EU's budget, on which this paper focuses, both numerical fiscal rules and procedural fiscal rules are used. Since 1990, the Financial Perspectives are used as the relevant medium-term financial framework. Next to that set of numerical rules, there are various procedural rules, regarding the adoption of the budget, concerning the approval of the own resources of the EU, et cetera. It is interesting to see whether this mix of numerical and procedural rules is sufficient to ensure budgetary discipline in the EU. If not, should the EU set out for more numerical rules, or should it rely more heavily on procedural rules in which one of the budgetary authorities has strategic dominance[3]?

In the next section, *section two*, an overview is given of the actual budgetary performance of the EU in the period 1977-1999. This performance touches on three different parts of the budgetary cycle. First there is the preparation of the budget. How has the (preliminary) draft budget evolved over the years? How does it compare to the Financial Perspectives? Secondly, there is the adoption of the budget. What changes does the budget undergo, from the early stage of the preliminary draft budget to the stage of the final budget? Finally, there is the implementation of the budget. How do the actual expenditures and revenues compare to the budget?

Next, in *section three*, the budgetary rules that are used in the EU are briefly discussed. From this discussion it follows that the EU's budgetary framework consists of a variety of rules which have been piled one on another over the years.

In section *four*, this budgetary patchwork is critically assessed, focusing on the issue of numerical rules versus procedural rules.

The *fifth section*, finally, contains some conclusions.

[3] Von Hagen and Harden (1994: 354) suggest that if the EU should become more and more of a fiscal union, with a relatively large fiscal administration, it would be desirable to create new procedural constraints, in stead of more numerical rules.

2. An empirical analysis of budgetary discipline in the EU, 1977-1999

As was mentioned in the introductory section, the EU's budgetary performance touches on three different parts of the budgetary cycle: the preparation of the budget, the adoption of the budget, and the implementation of the budget.

{figure 1 about here}

{figure 2 about here}

In figures 1 and 2 the evolution of the *expenditure side* of the EU-budget is shown for the period 1977-1999. For each year the size of the budget is shown, through eight different stages of the budgetary procedure[4]:

1. the Financial Perspectives (FP). These Financial Perspectives have come into effect in 1990, which is why they are part of figure 2 and not of figure 1;
2. the preliminary draft budget by the Commission (PDBCOMM). The preliminary draft budget for 1977, which totalled 10.1 billion EUA[5], has been set at 100;
3. the draft budget by the Council (DBCOUNC), in other words: the budget after the first reading by the Council;
4. the budget after the first reading by Parliament (1RPARL);
5. the budget after the second reading by the Council (2RCOUNC);
6. the budget as it has been adopted in Parliament (BUDGET);
7. the budget after it has been amended and supplemented during the budgetary year (SUPPLAMB);
8. the budget as it has been executed (EXECBUDG): the actual expenditure.

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[4] The data sources are the general reports of the European Commission and the European Court of Auditors. The data for the Financial Perspectives concern the updated perspectives for that year. The budgets for 1980, 1982, 1985 and 1986 have been adopted after complicated proceedings, with new draft budgets, third readings and so on. For these years the adjusted budget data have been used (second draft in stead of first draft, third reading in stead of second reading, et cetera).

[5] European Unit of Account, the predecessor of the European Currency Unit (ECU). 1EUA = 1 ECU.

FIGURE 1 Evolution of the EU-budget, 1977-1989
(appropriations for commitments, current prices, PDB1977=100)

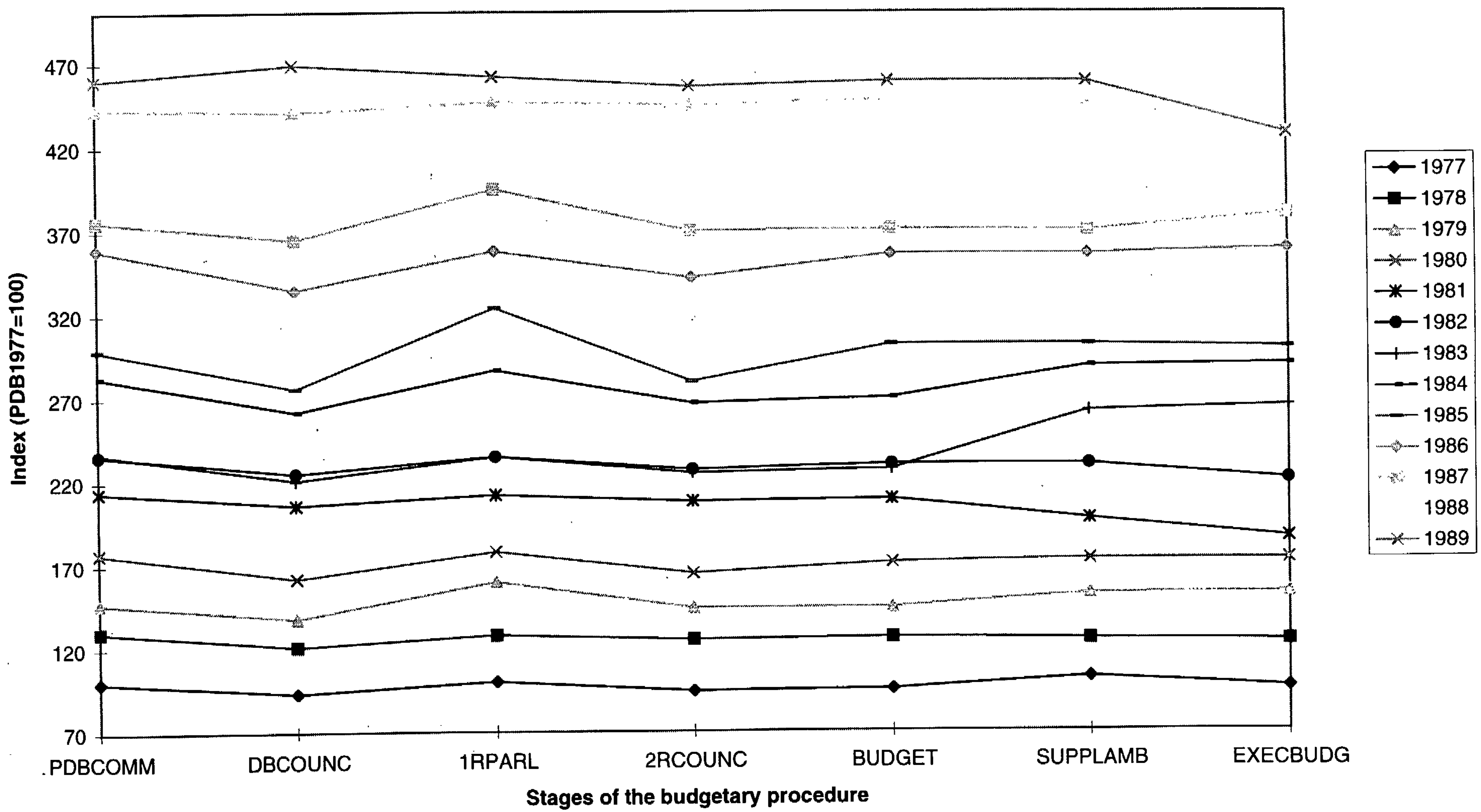

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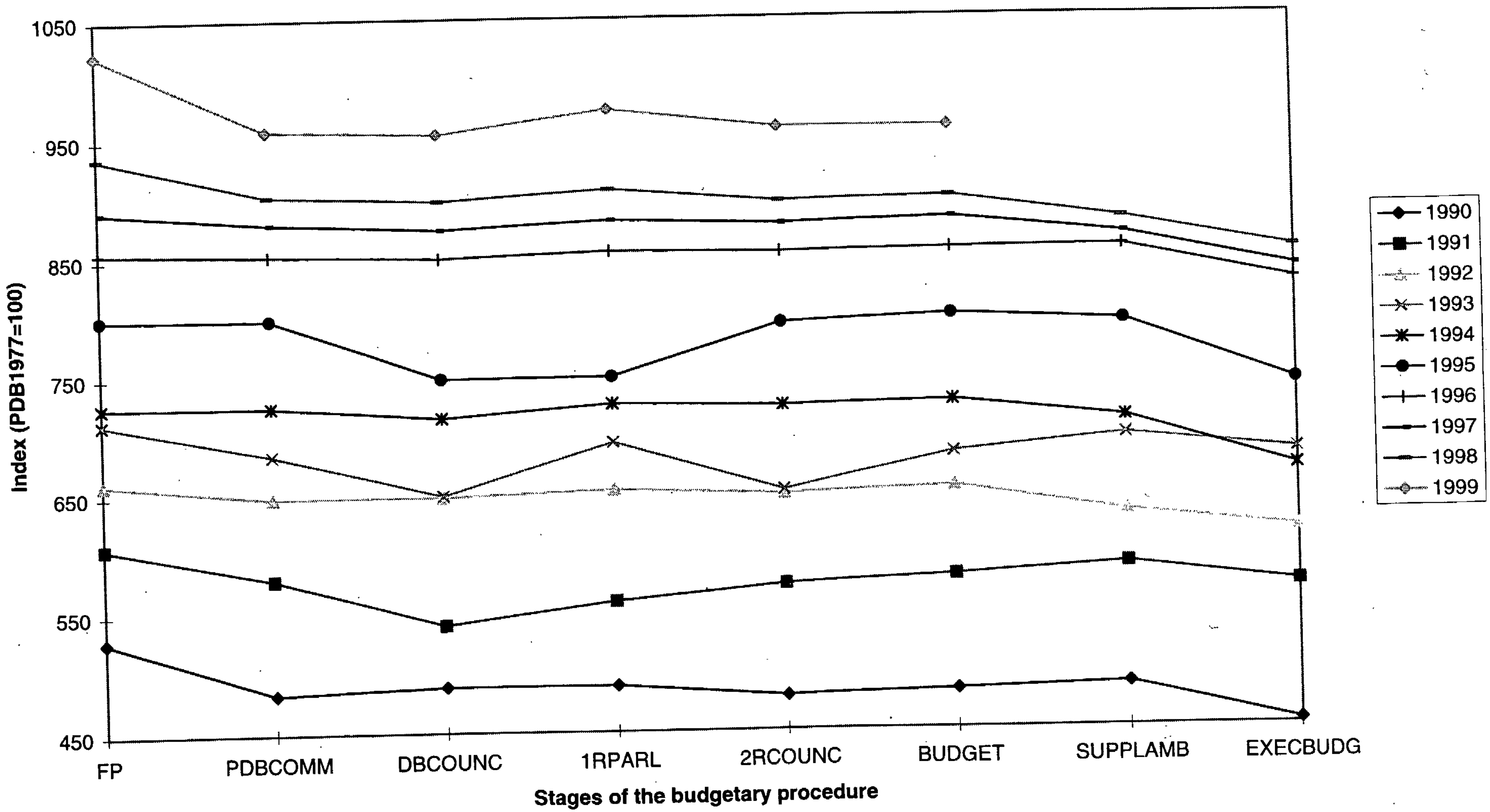
FIGURE 2 Evolution of the EU-budget, 1990-1999
(appropriations for commitments, current prices, PDB1977=100)



Firstly, it follows from figures 1 and 2 that the budget has grown considerably over the years, even when we take into account that we deal with current prices. With a starting point of 100 in 1977 (10.1 billion EUA), and a fictitious annual nominal inflation of 6%, the size of the budget in 1999 would be somewhere around 360 (36.3 billion EUR). In reality it is 1.022 (according to the Financial Perspectives for 1999, or: 103.4 billion EUR). Put differently: the EU-budget has known an annual nominal growth of more than 11% in the period 1977-1999.

Secondly, it is clear that there is no growth whatsoever of the budget throughout the budgetary procedure. That goes for the period 1977-1989 as well as for the period 1990-1999. However, the evolution of the budget throughout the budgetary procedure displays a number of characteristics:

- the Financial Perspectives enable the budgetary authorities to set the level of expenditure much higher than is actually done. With the exception of the period from 1994 to 1996, all preliminary draft budgets and draft budgets are well within the framework of the Financial Perspectives. In other words: there seems to be a lot of slack in the Financial Perspectives;
- the Council almost always adjusts the preliminary draft budget in a downward way. Next, Parliament in its first reading increases the budget, and then the Council in its second reading cuts the budget back again, followed by a small increase by Parliament in its second reading. This pattern is dominant throughout the period 1977-1989[6]. The procedures in the period 1990-1999 exhibit more variation. In the years 1996-1998 the budget remains at the same level throughout the stage of adoption;
- in the stage of implementation of the budget, it stands out that the executed budget is almost always well within the level of the amended and supplemented budget[7]. There is no real pattern as far as these amended and supplemented budgets is concerned, when we compare them to the initially adopted budget.

[6] Nicoll (1986, relating to the year 1985) and Strasser (1990) portray the annual budgetary power struggles between the Council and Parliament in this period.

[7] It should be pointed out that the data on the executed budget used in figure 1 and 2 are only concerned with commitments made during the budgetary year, that are covered by appropriations for commitments out of the budget for that particular year. Additional commitments can be made using appropriations for commitments carried over from the previous budgetary year. These are not taken into account in figures 1 and 2.

FIGURE 3 Evolution of EU-revenues, 1977-1989
(current prices, BUDGET1977=100)

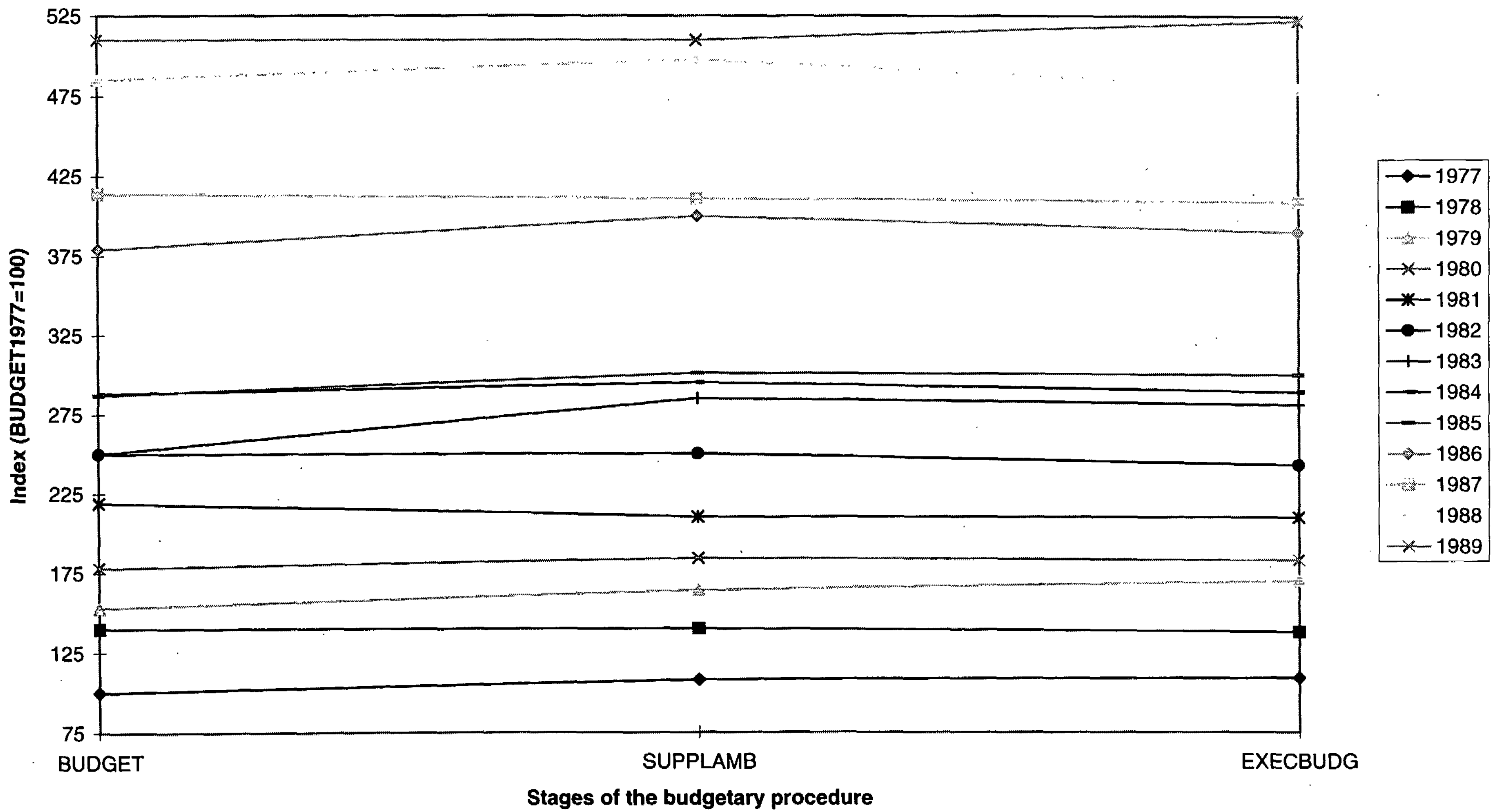
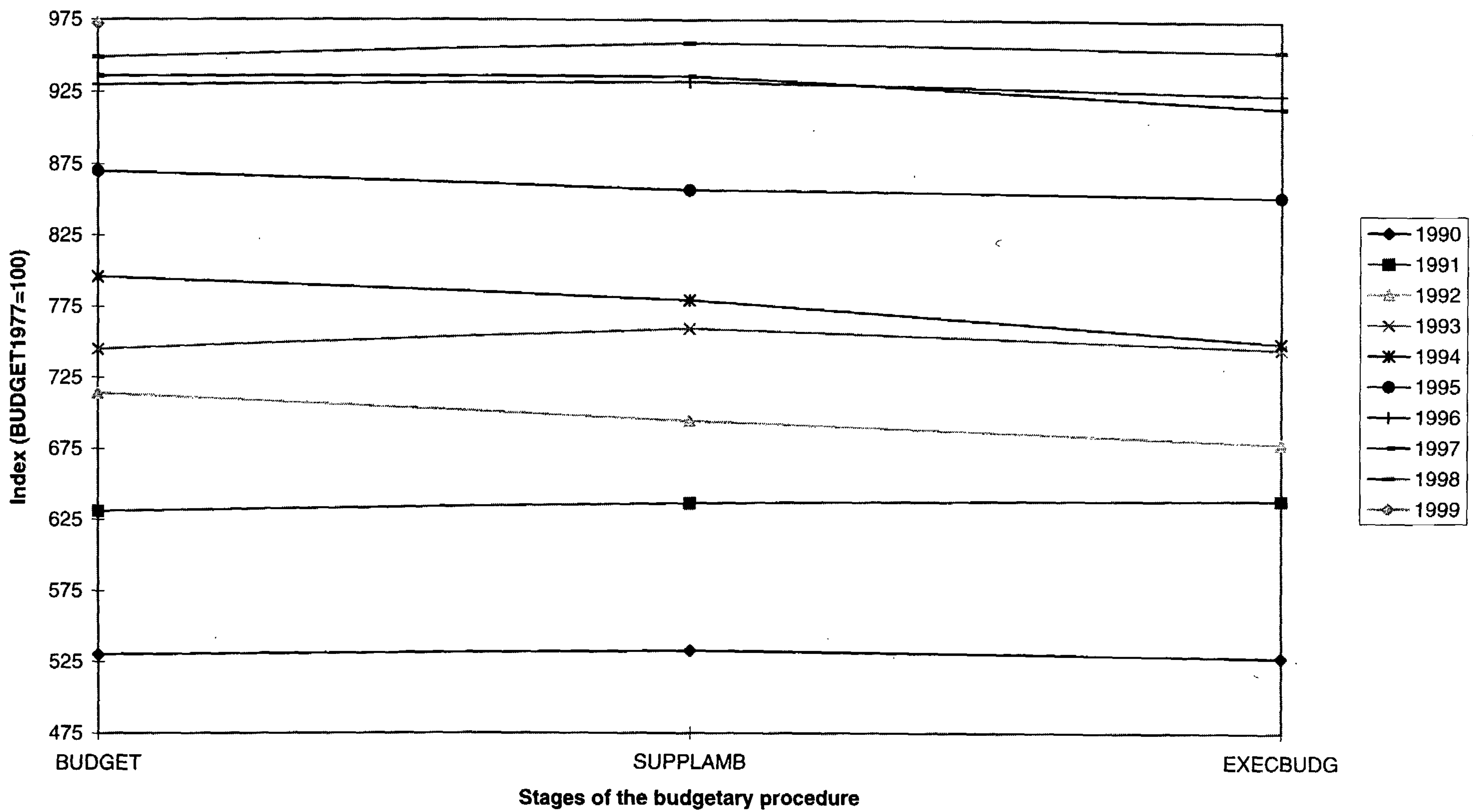


FIGURE 4 Evolution of EU-revenues, 1990-1999 (current prices, BUDGET1977=100)



{figure 3 about here}

{figure 4 about here}

Figures 3 and 4 offer information similar to figures 1 and 2, but now for the *revenue side* of the budget. Here only three stages of the budgetary procedure are relevant: the budget (BUDGET), the amended and supplemented budget (SUPPLAMB), and the executed budget (EXECBUDG)[8].

From figures 3 and 4 it can be concluded that, as far as the revenue side is concerned, the implementation of the budget is quite uneventful. In some years (1983, 1986, 1988 and 1993) the initial revenue estimation has been adjusted upwards considerably during the budgetary year (often this has to do with incorporating the budget surplus of the previous budgetary year). Recently, downward adjustments are more common (1992, 1994, 1995). In most years in the period 1977-1999, however, there is hardly any discrepancy between estimated and actual revenue.

3. Europe's budgetary patchwork

In this section we will briefly discuss the budgetary rules that are in effect as far as the EU-budget is concerned, or will come into effect in the near future. First we will discuss the relevance of the so called budgetary principles to the EU-budget.

Budgetary principles and the EU-budget

In the 1930's, J. Wilner Sundelson, an American professor of public finance, put together a survey of budgetary principles used in different (continental) European countries, notably France, Germany and Italy (Sundelson, 1935). Sundelson was surprised to find a rich literature on these principles, especially when compared with the more pragmatic North-American and British literature.

[8] As opposed to the expenditure side of the budget, the revenue side of the budget remains unchanged throughout

Unlike most modern literature[9], in which the various budgetary principles are discussed without assigning them to different groups, most of the older literature on budgetary rules uses some kind of classification. For example, Jèze (1910) distinguished between rules relating to the duties of executive and legislative bodies on the one hand (like the rule of prior authorisation), and rules relating to the budgetary procedure on the other (like the rule of unity of the budget). As Sundelson (1935: 241) rightly puts this classification is not consistent, because the groups are not mutually exclusive. Neumark (1929: 125) used the concepts of statics and dynamics to classify budgetary rules. According to Neumark, static rules refer to the budget 'in equilibrium', dynamic rules deal with the preparation, acceptance and execution of the budget. Neumark breaks down the static rules into two groups, the material static rules (comprehensiveness and non-assignment of revenues) and the formal static rules (unity and clarity). This classification is as deficient as Jèze's however, because a static formal rule like unity bears reference not only to the arrangement of the budget but to the budgetary procedure as well; unity of the budget does not only mean that there must be one integral budget but does also imply that such a budget is submitted to parliament in its entirety.

Sundelson's own classification consists of three groups, of which two are relevant to this paper[10]:

- budgetary rules concerning the relation between the budgetary system and the fiscal activities of the political unit: comprehensiveness, exclusiveness;
- budgetary rules concerning the treatment by the budgetary mechanism of the factors included in the system: unity, specification, periodicity (annuality), accuracy.

Below we will briefly discuss the relevance of these principles to the EU-budget[11]. We will supplement Sundelson's classification with the principle of prior authorisation. Moreover, we will discuss two additional principles, non-compensation and non-assignment, that are part of the principle of comprehensiveness and unity respectively.

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the stages of preparation and adoption of the budget.

[9] Like Strasser (1991) and Walder (1992), who both list the budgetary principles that are relevant to the EU-budget.

[10] The third group mentioned by Sundelson are the budgetary rules concerning the forms and techniques for presentation of the budget contents: clarity, publicity.

[11] Except for the (too obvious) principle of accuracy.

According to the principle of comprehensiveness (completeness, universality) all government expenditures and revenues must be part of the budget, and of the budgetary procedure. The principle is put into words for the general EU-budget in article 199 EEC Treaty. The principle is violated by the exclusion from the general EU-budget of the borrowing and lending transactions of the European Investment Bank.

In our view the principle of non-compensation (or gross budgeting) is part of the principle of comprehensiveness. This rule states that expenditures and revenues that are somehow related must be entered into the budget separately so that the full magnitude of fiscal activities remains perceptible. Both principles (comprehensiveness and non-compensation) are connected in that comprehensiveness is only attained if gross expenditures and revenues are included in the budget. In the Financial Regulation (FR) on the EU-budget this principle is discussed in detail, and some -minor- exceptions to the rule are allowed. The principle was violated by the existence of 'negative expenditures' (the co-responsibility levies that used to be part of the Common Agricultural Policy) and is still violated by the 'negative revenue' (the deduction of collection expenses from revenue transfers by member states).

The principle of exclusiveness is a corollary to comprehensiveness: all fiscal activities must be part of the budget (comprehensiveness) and only fiscal operations must be part of the budget (exclusiveness). The budget must not be used as a pack mule for non-fiscal information or for legislation. Although this principle has not been laid down for the EU-budget, the budget does comply with it.

According to the principle of unity a single budget method and procedure must be used for all expenditure and revenue[12]. Special, annexed, or extraordinary budgets are not allowed; a single ordinary budget suffices. This principle is violated by the existence of a separate operating budget for the European Coal and Steel Community (ECSC), and -more relevant-

[12] Self-evident as the rules of universality and unity may seem, they give cause to some confusion in the literature. Some authors mix up or equate universality and unity. However, a budget can be comprehensive and be not unified (e.g. made up of different budgets) at the same time. Moreover universality (as well as its corollary exclusiveness) has to do with the demarcation of fiscal and non-fiscal activities, whereas unity has to do with fiscal activities only.

the peculiar way the European Development Fund (EDF) is treated: it is part of the budget as a p.m.-item, or an item with a zero estimate, and additional (non-zero) estimates in an annex to the budget, outside the general budgetary framework.

The principle of non-assignment states that no revenue must be assigned for any special expenditure. In other words: earmarking is not allowed. Obviously this principle is connected with the rule of unity (as is the rule of non-compensation with the rule of universality): violations of the non-assignment rule often mean the formation of special budgets, or in general lead to different treatment of different groups of expenditure and/or revenue. Earmarking is allowed for a number of smaller revenues listed in the FR, and in the case of the monetary reserve which is earmarked for costs within the CAP due to monetary disturbances[13].

If a budget would only consist of total expenditure and revenue estimates (a lump-sum budget), no proper decision-making and allocation would be possible. Some specification must take place. On the other hand, too much specification can lead to rigid budgets. Neumark (1929: 297 ff.) has distinguished between two kinds of specification, qualitative specification and quantitative specification. The rule of qualitative specification states that appropriations are to be expended exclusively to the ends that are specified in the budget. Rigidity can be avoided by the use of fixed transfer rules. The rule of quantitative specification states that expenditures are only allowed to the extent that funds are available in the budget. Infractions of the qualitative specification rule (e.g. transfers within the budget) do not disturb overall budgetary outcomes, infractions of the quantitative specification rule do.

Both specification principles are relevant to the EU-budget. Transfer rules have been laid down in the EEC Treaty as well as in the FR. These transfer rules are highly complicated due to the system of split and non-split appropriations that is used in the EU. That system will be briefly discussed below. Quantitative specification is problematic within the EU, especially in the field of compulsory expenditure. Supplementary budgets are used almost each budgetary year. Although the use of these budgets is formally limited to 'unavoidable, exceptional or unforeseen circumstances' (FR), supplementary budgets are often used to make additional

[13] With the realisation of EMU, the monetary reserve has lost its significance. Therefore, in the coming years, the

budget appropriations available for regular and foreseeable expenditure, to update revenue estimates, and to incorporate the budget surplus or deficit of the previous year into the budget. The rule of periodicity implies that a choice must be made as far as the length of the budgetary period is concerned, and whether the fiscal year(s) match(es) the calendar year(s) or not. The EU uses an annual budget with matching fiscal and calendar years. One could argue, however, that with the Financial Perspectives becoming more and more important and more and more detailed, actually a 5-7 year 'budget' is used, that is fleshed out every year.

As far as annuality is concerned, the possibility of carrying-over resources from one year to the next is important. Carrying-over is complicated within the EU due to the system of appropriations that is used[14]. The general EU-budget uses two different appropriations. First, there are the non-differentiated appropriations. With these appropriations it is possible to enter into commitments during the year, and then to make the relevant payments over two years: the year in question, and the following year[15]. Under certain circumstances, the amounts are carried forward to that year automatically, in other cases an explicit carry-over decision has to be taken[16]. Secondly, there are the differentiated appropriations. These consist of both commitment appropriations and payment appropriations. Commitment appropriations represent the upper limit of the expenditure that may be incurred during the year. Payment appropriations permit the commitments entered into the year and any preceding years to be fulfilled (Strasser, 1991, p. 51-52). With differentiated appropriations both commitment and payment appropriations that are not used by the end of the year will in principle lapse. However, the commitment appropriation corresponding to the amount of the commitment cancelled may be made available again (by the Commission) when it is essential to carry out the programme originally planned, unless the budget for the current financial year has funds available for this purpose.

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monetary reserve will be phased out.

[14] Von Hagen and Harden (1994: 326/327) discuss four different conceptual bases of 'appropriation'. Applied to the EU the appropriation-system used there takes a lot after the Belgian system.

[15] Personnel appropriations can not be carried over.

[16] Article 6(1)(c) respectively 6(1(b) of the Financial Regulation. The carry-over decision is taken by the Council in the field of compulsory expenditure (after consulting Parliament), and by Parliament in the field of non-compulsory expenditure (after consulting the Council), by analogy with the distribution of budgetary authority in the ordinary budgetary procedure.

The principle of prior authorisation states that all expenditures and revenues should be authorised before the execution of the budget. Combined with the rule of annuality, this means that the budget must be approved before the budgetary year commences.
Since 1977 the budgetary procedure has so often been the arena for fights between Commission, Council and Parliament, that the principle of prior authorisation has frequently been violated, and the Commission had to resort to the system of provisional twelfths to finance its activities.

The balanced-budget-rule

This rule is laid down in the Treaty of Rome, and has been confirmed on numerous occasions. It is both an ex ante and an ex post rule. At the *stage of authorisation* the rule simply implies that estimated expenditure (in terms of payments appropriations) and estimated revenues should be in equilibrium. At the *stage of execution* of the budget, however, things can become quite complicated, due to the system of differentiation of appropriations that is used, combined with the rule of budgetary annuality.
The budgetary outcome for a certain budgetary year is roughly made up of all the revenue collected in respect of that year, and the amount of payments made against appropriations for that year increased by the appropriations for the same year that are carried over (Strasser, 1991, p. 58). If there is a surplus, it is entered into the budget of the next year (usually by modifying the relevant budget) as additional revenues. If there is a deficit, it is entered into next year's budget as additional expenditure.

The maximum rate of increase in non-compulsory expenditure

This budgetary rule can already be found in the 1970 Luxembourg Treaty, and has first been applied to the budget for 1975. The rule implies that each year the budget is prepared based on a maximum rate of increase in non-compulsory expenditure. That rate in its turn is based on a number of macro-economic indicators (the growth of EU-GNP, the growth of member states' budgets, and the growth of the costs of living). The maximum rate, that is determined by the Commission, has varied considerably over the years.

Although it is clearly a rule that would fall into the category 'numerical targets', it has a procedural dimension as well, which has to do with the classification of EU-expenditure into compulsory and non-compulsory expenditure (CE and NCE). This distinction, which figured in the 1975 budget for the first time, has relevance for the budgetary competence of the Council and Parliament. The Council decides on CE, with Parliament making suggestions for change in its first reading, Parliament decides on NCE by making amendments on the draft budget in its first reading, and having a final say on NCE in its second reading.

Since the introduction in 1990 of the system of Financial Perspectives the maximum rate of increase in non-compulsory expenditure has been incorporated into these perspectives.

VAT-call-up-rate

As the traditional resources of the EC (agricultural levies, and customs duties) were not sufficient, an additional source of revenues had to be found in the early seventies. Running parallel to the harmonisation of the VAT-base in the Community, it was decided that the EC should have a small part of the VAT-revenues of the member states. Initially the amount of VAT-revenues each member state had to transfer to Brussels was determined by applying a maximum rate of 1% to an assessment VAT-base determined uniformly for each individual member state. In 1985 the call-up-rate was increased to 1.4%. In 1988 it was decided that the assessment base should only be taken into account up to 55% of the member state's GNP. At the Edinburgh Summit of 1992 this VAT-ceiling was lowered to 50% GNP, and the VAT-call-up-rate was reduced to 1%. At the Berlin Summit of 1999 it was decided that the call-up-rate will be reduced to 0.75% in 2002 and to 0.50% in 2004.

The own resources[17] ceiling, and the Financial Perspectives

With the (re)introduction of contributions by member states based on their GNP, in 1988, a GNP ceiling was established. The total own resources of the EU are not allowed to exceed 1.2% EU-GNP. In 1992 the ceiling was raised slightly to 1.27% EU-GNP (with a 0.03%

[17] The term 'own resources' is EU-jargon. Most of these resources are transfers from the member states to the EU; unfortunately the term implies that these revenues are derived from real EU taxes.

margin). The Berlin European Council has re-confirmed that ceiling[18].

Together with the introduction of the own resources ceiling, the system of Financial Perspectives was established. This method of ensuring budgetary discipline was adopted in 1988, and first fully applied in the budget for 1990. A Financial Perspective indicates the volume and breakdown of foreseeable expenditure, including expenditure for new policies. For this breakdown appropriations for commitments are used. The own resources ceiling, however, is confronted with the overall level of appropriations for payments, as a % of EU-GNP.

At the Berlin Summit a new Financial Perspective was established for seven years (2000-2006), using constant 1999 prices, with automatic technical adjustments for inflation. It is based on the assumption of accession of new member states in 2002. After accession the Financial Perspectives will be updated, taking into account the actual number of acceding countries.

The decision on the level of revenue, and its composition, is taken separately by the Council, after consulting Parliament. These decisions have to be ratified by (the parliaments of) the member states (article 201 EEC).

The breakdown within the Financial Perspectives.

The Financial Perspectives use different headings, between which transfers are not allowed. At the Berlin European Council, in keeping with the proposals in Agenda 2000 by the Commission, a lot of decisions were made that increased the rigidity of the Financial Perspectives. Within the overall level of allocation for heading 2 (Structural Operations) the levels of allocation for the Structural Funds and the Cohesion Fund are laid down. Within the allocation for the Structural Funds, a subdivision is made meticulously for the three new Objectives[19]. 5% of the structural fund commitment appropriations should be set aside for the Community initiatives, of which at least 50% will be allocated to INTERREG. 1% of the structural fund allocations will be set aside for innovative actions and technical assistance [20].

[18] Point 70, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[19] Point 30, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[20] Points 41, Presidency Conclusions, Berlin European Council, 24-25 March 1999.

Furthermore, it has been decided that the total annual receipts in any member state from structural operations (including the Cohesion Fund) should not exceed 4% of national GDP.
Also as a result of the Berlin Summit, expenditure for the three pre-accession instruments (PHARE, the agricultural instrument and the structural instrument) is to remain at a constant level throughout the period 2000-2006 (heading 7: 3.120 mEuro, 1999 prices)[21]. Furthermore, following the conclusions of the Cardiff Summit, it has been concluded that expenditure reserved for EU-15 (headings 1-6) cannot at any time be used for pre-accession assistance (heading 7), and conversely, expenditure reserved for pre-accession assistance cannot be used by EU-15[22]. Moreover, a maximum amount of payment appropriations to cover expenditure resulting from new accessions over the period 2000-2006 has been laid down in the Financial Perspectives[23]. Again, these amounts can only be used to cover expenditure arising as a direct consequence of enlargement, and not for headings 1-7. Conversely, expenditure earmarked for heading 1-7 cannot be used to supplement the cost of new accessions[24].

Tripartite agreements and budgetary discipline

The decision on the Financial Perspectives is not a unilateral declaration, but a genuine Council decision, prepared by a formal proposal by the Commission, and after taking the opinion of Parliament. A Financial Perspective thus is a binding financial framework for all the budgetary authorities. The 1988-1992 Financial Perspective was laid down in the Inter-institutional Agreement on budgetary discipline and improvement of the budgetary procedure of 1988, which was updated by a similar Inter-institutional Agreement in 1993, which incorporated the Financial Perspectives for the period 1993-1999[25].
Apart from laying down the Financial Perspectives, the Inter-institutional Agreements on budgetary discipline and procedure have brought into being a number of procedural budgetary rules, like procedural rules by which to adjust the Financial Perspectives. Earlier, in 1975, the

[21] Point 8, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[22] Point 13, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[23] Point 10, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[24] Point 14, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[25] A new Inter-institutional Agreement which will incorporate the Financial Perspectives 2000-2006, as decided upon by the Council in Berlin, will be concluded in the near future.

trialogue was first used: a dialogue between the three budgetary institutions on current budgetary issues. This trialogue took place in 1975, and then again from 1977, on the initiative of Parliament. The trialogue was formalised by the Joint Declaration of 30 June 1982, which laid down measures designed to ensure smoother completion of the budgetary procedure, including a classification of CE and NCE.

The agricultural guideline

The most important cause of the EC's budgetary difficulties in the eighties was the steady increase in EAGGF-Guarantee expenditure. As these expenditure is compulsory it was not covered by the maximum-rate-of-increase-rule.

The agricultural guideline was established in 1988, as part of the Council Decision on budgetary discipline and the Inter-institutional Agreement of 1988. It is part of the Financial Perspectives. The guideline states that compulsory expenditure in the EAGGF Guarantee Section[26] is allowed to grow, but by less than economic growth (74% of the growth of total EU-GNP), taking the level of 27.500 mECU for 1988 as a basis.

As the agricultural guideline only covers EAGGF-Guarantee expenditure it is a limited budgetary rule. For other compulsory expenditure the framework of the Financial Perspectives applies, which means that that expenditure is subjected to the broad guideline made up by the revenue ceilings, in combination with the balanced budget rule.

In the Financial Perspectives the guideline serves as the upper limit of the EAGGF-Guarantee expenditure. In the Financial Perspectives for 2000-2006 the guideline covers the expenditure under heading 1 (agriculture) as well as amounts under heading 7 (pre-accession expenditure) and amounts under the heading "available for accession", as far as these amounts relate to agriculture.

At the Berlin Summit it was decided that the agricultural guideline will remain unchanged for the moment, but will be reviewed. At the same time however, it appears that a new budgetary

[26] More precisely, it is corrected expenditure, defined as the 1988-expenditure-base of ECU 27.5 billion less expenditure on sugar and iso-glucose levies, food aid refunds and ACP sugar refunds, which is permitted to grow by a maximum rate of 74% of the growth rate of total nominal EU-GNP. The estimated expenditure on these three items is then added back to the updated corrected expenditure to obtain the agricultural guideline for any given year (Matthews, 1996: 499/500).

rule has been introduced by the European Council for agricultural expenditure, aiming at stabilising (in real terms) agricultural expenditure over the period 2000-2006[27]. Whereas the Commission, in its draft Financial Perspectives for 2000-2006, equated the expenditure under heading 1 (including agricultural pre-accession aid) with the ceiling resulting from the agricultural guideline[28], the Council has opted for a more moderate level of allocation (the Financial Perspective ceiling for agriculture), more in keeping with actual levels of spending.

4. A critical assessment

In the introductory section two different systems of commitment to fiscal discipline were put forward, following Von Hagen en Harden (1994). First, there is a system which uses numerical targets that are in force throughout the budgetary procedure. Secondly, there is a system that relies on the strategic dominance in the budgetary procedure of a party that puts the public interest (in casu the efficiency of the public finances) first. The difference between these two commitment systems can be illustrated by using table 1[29].

[27] Points 19, 21 and 22, Presidency Conclusions, Berlin European Council, 24-25 March 1999.
[28] Table 19, General report 1998.
[29] There is a lot that can be said against the original tables by Von Hagen and Harden. The -adapted- table here merely serves as an illustration.

Table 1 Characteristics of the budgetary procedure at different stages, according to Von Hagen and Harden (1994).

Government stage	*Strategically centralised*	*Decentralised guided*	*Decentralised*
Budget targets and guidelines	By PM or MF	By cabinet on proposal of MF	Cabinet
Compilation of draft	By MF, in bilateral negotiations	By MF, serving as intermediary between spending ministers and cabinet	Simple collection of bids
Reconciliation	PM or senior cabinet committee	Senior cabinet committee	Cabinet
Parliamentary stage	*Restrictive procedure*	*Intermediate*	*Open procedure*
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 government-parliament	Amendments by parliament require consent by government	Amendments may cause fall of government	No special stipulations
Implementation stage	*Restrictive procedure*	*Intermediate*	*Open procedure*
Expenditure management	Disbursement approval required, cash limits, MF can block expenditures	Disbursement approval required, and/or use of 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, rarely used	By new law, commonly used	By approval of MF

PM: Prime Minister, MF: Finance Minister
Taken from Von Hagen and Harden (1994), Milesi-Ferretti (1997), adapted

In the commitment system that relies on strategic dominance, the stage of preparation of the budget can be characterised as strategically centralised, with restrictive procedures in the parliamentary stage, and in the implementation stage. In the commitment system that relies on numerical targets, the procedures can be less centralised and less restrictive, as long as the initial budget target remains unchanged.

In our view, if we apply this line of thought to the EU, the dominant strategy that is actually used is the numerical target system. The Financial Perspectives provide the overall budget target as well as budget targets and guidelines for specific groups of expenditure. Throughout

the budgetary procedure authority is shared, in stead of put into the hands of one budgetary party. In the stage of budget preparation all parties are involved in establishing the Financial Perspectives, and both Commission and Council are involved in making the draft budget, in a decentralised way (simple collection of bids by the Commission, absence of a figure like a Minister of Finance). In the stage of adoption of the budget, the intermediate case applies: dominance is shared by the Council (CE) and Parliament (NCE). In the stage of implementation of the budget, the intermediate case also applies, with conditional transfers, and the frequent use of supplementary budgets.
The basic choice within the EU for a numerical target system and shared budgetary authority is also evident in the Presidency Conclusions of the Berlin European Council: "[...] the European Council hopes that a new agreement can be established between the European Parliament, the Council, and the Commission on terms ensuring budgetary discipline, while preserving the overall balance of powers between the institutions and clearly ring-fencing pre-accession and accession-related expenditure for the entire duration of the financial perspective"[30].

How well has this system worked over the years? If we call to mind the results of the empirical analysis of section 2, the system has been adequate in constraining budgetary behaviour within the budgetary procedure. The implementation of the revenue side has always been very straightforward, and the expenditure budget is almost never overrun. In the eighties the budget used to fluctuate throughout the procedure due to friction between the three budgetary authorities, but in recent years the levels of expenditure in preliminary draft budgets, draft budgets, amended budgets, and final budgets do not diverge considerably. The only real problem as far as budgetary discipline is concerned turns out to be the choice of spending levels in the Financial Perspectives themselves, and the corresponding growth of the budget over the years. We will address that problem below.

As was made clear in section three the Financial Perspectives system consists of two main

[30] Point 17, Presidency Conclusions, Berlin European Council, 24-25 March 1999.

elements:

- the overall own resources ceiling, and the corresponding overall ceiling of expenditure;
- specific ceilings that are either an explicit part of the perspectives, like the agricultural guideline and the ceilings per heading, or are deduced from the perspectives (like the maximum rate of increase in non-compulsory expenditure). Some specific expenditure ceilings are not within the perspectives as such, but are part of the accompanying text, like the rules on the structural policies, and the rules on accession-related expenditure. The VAT-ceilings are also part of the accompanying text.

Let us deal with the *overall ceiling* first.

As was discussed above, this rule limits the total of the EU's own resources and was introduced together with the (re)introduction of the GNP-contributions. It is not clear how we should interpret the rule: as a general constraint on the size of a government in proportion to the private sector (inter-sectorial rule), or as a demarcation of the financial territory of different levels of government within the EU (intergovernmental budgetary rule). Judging by the Presidency Conclusions of the Berlin European Council, it is the latter: "In agreeing a new financial perspective which will ensure similar budgetary rigour at the level of the Union as applied at national level, and that EU spending does not grow faster than national public expenditure, the Union's overall level of spending will, as of now, be stabilised in a consolidated framework"[31].

As it is expressed in proportion of actual GNP, a major drawback of this rule is its sensitivity to short-term economic fluctuations. This disadvantage is partly undone by the 0.03%-margin. The main problem with the rule is the slack it created in the overall level of expenditure. However, it seems like the new Financial Perspectives 2000-2006 stand for a financial framework that is much more tight than its precursors. In table 2 we compare the draft perspectives by the Commission, which were in keeping with previous perspectives, and the perspectives as they have been decided on by the Council.

[31] Point 70, Presidency Conclusions, Berlin European Council, 24-25 March 1999.

Table 2 Financial Perspectives 2000-2006, EUR million, 1999 prices, appropriations for commitments (EU-15), for a number of years.

		2000	2002	2004	2006
1. Agriculture	Commission Council	46.050 41.440	47.820 44.420	49.670 43.280	51.610 42.180
2. Structural operations	Commission Council	36.640 33.085	36.640 31.905	34.450 30.635	32.470 30.210
3. Internal policies	Commission Council	6.390 5.900	6.880 6.000	7.230 6.100	7.600 6.200
4. External action	Commission Council	6.870 6.110	6.880 6.130	7.230 6.150	7.600 6.170
5. Administration	Commission Council	4.730 4.560	4.910 4.700	5.100 4.900	5.300 5.100
6. Reserves	Commission Council	850 900	600 650	350 400	350 400
A. Total appropriations for commitments	Commission Council	101.530 91.995	104.100 93.805	104.410 91.465	105.230 90.260
B. Total appropriations for payments	Commission Council	98.800 89.590	102.930 94.130	103.810 91.720	104.560 89.310
C. B as % GNP	Commission Council	1.24% 1.13%	1.22% 1.13%	1.18% 1.05%	1.13% 0.97%
D. Available for accession (in % GNP)	Commission Council	- -	0.02% 0.05%	0.06% 0.10%	0.11% 0.16%
Ceiling on appropriations for payment as % GNP, including accession (on EU-15 GNP)	Commission Council	1.24% 1.13%	1.24% 1.18%	1.24% 1.15%	1.24% 1.13%
Own resources ceiling	Commission Council	1.27% 1.27%	1.27% 1.27%	1.27% 1.27%	1.27% 1.27%
Overall margin (on EU-15 GNP)	Commission Council	0.03% 0.14%	0.03% 0.09%	0.03% 0.12%	0.03% 0.14%

Sources: General Report 1998 European Commission, Presidency Conclusions Berlin March 1999
Headings 1-6 include pre-accession aid (heading 7 in the Financial Perspectives)

As the 0.03%-margin is a margin that can be used upwards and downwards, the Council has rightfully chosen 1.27% as the own resources ceiling, in stead of 1.24% (1.27 minus the 0.03% margin) as the Commission did. On the other hand, the Council is much more economic than the Commission. Including accession-related expenditure, of the 1.27%-ceiling on average only 1.15% is used. In our view the Council should have decided to actually lower the ceiling to 1.15%. What use is a ceiling if you do not bump your head every once in a while? Of course there is always the 0.03%-margin that can be used. Moreover, the Council has proposed to the other budgetary partners to include the possibility in the Inter-institutional Agreement of introducing a provision aimed at ensuring some flexibility in the financial perspective during the annual budgetary procedure up to a limit of 200 million euro per annum[32].

The Financial Perspectives also contain specific ceilings, like the *agricultural guideline*. In the draft perspectives by the Commission heading 1 corresponds to the agricultural guideline. The Council has not adopted that level of agricultural expenditure, and rightfully so. In our view the agricultural guideline as such can even be done away with, and should not be 'reviewed' as the Council proposes. Table 3 shows how superfluous the agricultural guideline has been since its introduction in 1988.

Table 3 Agricultural expenditure (EAGGF Guarantee Section) in comparison to the agricultural guideline (mECU, current prices)

	1988	1989	1990	1991	1992	1993
Agricultural guideline (1)	27.500	28.624	30.630	32.511	35.039	36.657
Budget appropriations[33] (2)	27.500	26.741	26.431	32.419	33.078	36.292
(2) as % of (1)	100%	93%	86%	100%	94%	99%
Outcome (3)	26.400	24.406	25.069	30.961	31.119	34.590
Margin: (1)-(3)	+1.100	+4.218	+5.561	+1.550	+3.920	+2.067
Margin as % of (1)	4%	15%	18%	5%	11%	6%

	1994	1995	1996	1997	1998
Agricultural guideline (1)	36.465	37.994	40.828	41.805	45.188
Budget appropriations (2)	35.772	36.920	41.313	41.233	40.437
(2) as % of (1)	98%	97%	101%	99%	90%
Outcome (3)	32.970	34.503	39.108	40.418	38.748
Margin: (1)-(3)	+3.495	+3.491	+1.720	+1.387	+6.440
Margin as % of (1)	10%	9%	4%	3%	14%

Sources: Matthews (1996), European Commission, European Court of Auditors

From table 3 it follows that the agricultural guideline never has been a very tight budgetary rule. In most years the budget appropriations have been set at or close to the guideline level. The actual level of EAGGF Guarantee Section expenditure is always well below the guideline and the appropriations level; in some years the margin is considerable.

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[32] Point 18, Presidency Conclusions, Berlin European Council, 24-25 March 1999.

[33] Budget appropriations (taken from amended and supplemented budgets) include additional appropriations (from the monetary reserve) to cover costs due to monetary disturbances.

An important issue in that respect is that Financial Perspectives, which include the agricultural guideline, are always in constant prices, and are upgraded for inflation each year by the general GNP deflator. However, the price increase of agricultural products (still an important determinant of agricultural expenditure) is usually less than this general figure. As the execution of the Financial Perspectives advances, the guideline will thus show more and more slack.
An important drawback of intra-expenditure rules like the agricultural guideline, is that they give cause for creative budgeting. As Crawford (1995:109) has pointed out, some of the CAP's spending has been tucked away in the structural funds by neat accounting, following the introduction of the agricultural guideline.

The rigidity of the perspectives, and the incentive that creates for creative budgeting, are the main objections we have against the very specific rules laid down in the Financial Perspectives 2000-2006 for the *structural policies* and for *accession-related expenditure.* For a framework, these rules are overdone, and may stand in the way of the efficient allocation of resources. The Financial Perspectives should act as guidelines on the level of headings, and should not replace annual budget decisions.

Another important specific ceiling is made up by the *VAT-rules.* As with the own resources ceiling, the VAT-rules have multiple grounds. First, the call-up-rate serves as an intergovernmental budgetary rule, dividing the VAT-revenues between a member state and the EU. Secondly, the VAT-ceiling serves as an intergovernmental budgetary rule as well, because it is aimed at preventing unfair differences in magnitude between the VAT-transfers of the different member states, resulting from differences in tax systems. Thirdly, combined with the own resources ceiling, the VAT-rules serve as an intra-revenue rule, as a result of which the GNP-contributions are used to top up the other own resources.
In our view (see Groenendijk, 1998a) the VAT-resources should be done away with. There is no need to single out one national tax as a EU-resource. It is better either to introduce real EU-

taxes, or to let member states tax their subjects according to their own preferences, in concordance with the tax co-ordination efforts within the EU (see Groenendijk, 1998b).

5. Conclusions

Our analysis in section two and four was limited to an assessment of overall budgetary discipline, taking the general EU-budget and the current organisation of that budget as given. However, from the discussion of the various budgetary principles and rules in section three, another issue could have been singled out for further assessment, namely the 'grand design' of the EU-budget. The EU's general budget does not include the financial operations of he European Investment Bank, of which lending totalled 29.5 billion EUR in 1998. It does not properly include the European Development Fund, which has a budget of 14.5 billion ECU in the period 1995-2000. It has a highly complicated system of non-differentiated and differentiated appropriations. These things combined, in our view, point in the direction of the introduction of a budget system which uses a current and a capital budget.

However, the 'grand design' of the EU-budget has not been the subject of this paper. The central question was whether the EU should set out for more numerical rules, or whether it should rely more heavily on procedural rules in which one of the budgetary authorities has strategic dominance.

In the EU a numerical target system of commitment to budgetary discipline is used since the introduction of the Financial Perspectives in 1990. This system has been successful in ensuring budgetary discipline throughout the budgetary procedure. It has truly acted as a more or less binding framework for all parties involved. However, in our view, the overall level of the perspectives has been too high.

In Agenda 2000, and at the Berlin European Council, both Commission and Council have walked the beaten path of numerical rules again. Compared to the draft perspectives by the Commission, the Council has rightfully chosen a moderate level of expenditure for the period 2000-2006. In stead of maintaining the 1.23% own resources ceiling, and creating a considerable margin under that ceiling, the Council should have lowered the own resources ceiling to 1.15% EU-GNP. Budgetary rules should hurt now and again.

The Financial Perspectives contain a number of specific ceilings that are neither necessary nor desirable, like the agricultural guideline, and the VAT-ceilings. Unfortunately, Commission and Council have introduced some more specific rules, in the field of structural policies, and regarding accession-related expenditure, which give cause to rigidity and creative budgeting. The Financial Perspectives should act as guidelines on the level of headings, and should not replace annual budget decisions.

From the work by Von Hagen and Harden it follows that an alternative strategy to ensure budgetary discipline could be the introduction of procedural rules which give one of the parties involved strategic dominance over the other. Commission and Council have wrongly steered clear of that possibility, as they have of more issues of institutional reform within the Union.

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