

### Lost in stagnation: the EU's next multiannual financial framework (2014–2020) and the power of the status quo

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# SWP Research Paper

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and Security Affairs



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## Lost in Stagnation

The EU's Next Multiannual Financial  
Framework (2014-2020) and the  
Power of the Status Quo

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### **Lost in Stagnation**

#### **The EU's Next Multiannual Financial Framework (2014–2020) and the Power of the Status Quo**

The European Union's Multiannual Financial Framework (MFF) defines its strategic goals for 2014 to 2020 and lays out how their implementation is to be financed through the EU budget. It states upper limits for the EU's total annual spending and for the individual budget headings. The European Commission published drafts for the MFF and the implementing regulation on 29 June 2011 and amended versions on 6 July 2012. The critical phase of this exceptionally tricky round of negotiations has begun. The Commission is proposing a Financial Framework to run for seven years, with the amended version comprising a total volume of about one trillion euros (€1,033 billion at constant 2011 prices). This enormous sum of commitment appropriations represents 1.08 percent of the gross national product (GNP) of the EU-27.

At the end of the negotiating process there must be a compromise accepted by all the member-states and the three EU organs: European Commission, European Council and European Parliament. The four previous budget rounds have always reached such a consensus in the end, and there is no doubt that will be the case this time too. However, the Multiannual Financial Framework, the spending priorities and the EU's own resources mechanism – in short, the EU's existing funding and budget system – have been under criticism for decades. Broadly speaking, the following complaints come up again and again:

- ▶ The Financial Framework's current volume of about 1 percent of EU GNP is too small to achieve a real steering effect.
- ▶ On the spending side limited resources are concentrated too heavily in just two fields, agriculture and cohesion policy, leaving insufficient funding available for financing European public goods.
- ▶ European funding is unfairly distributed, with even relatively prosperous member-states receiving grants and subsidies under the two largest budget headings.
- ▶ The budget funding mechanism is overly complicated and lacks transparency. The revenue side is governed by numerous corrections and rebates, the best-known example being the British budget rebate.

- ▶ The own resources mechanism grants the EU only very limited budgetary autonomy, for it cannot make its own decisions about the volume or sources of its revenues. The member-states fund the EU budget almost completely through their national budgets, and therefore have the last word on volume and modalities of funding.

In other words, the EU budget is far from meeting the standards, expectations or criteria that apply to national public budgets. The EU budget, critics say, is primarily used to fund redistributive policies with marginal growth effects, and the prohibition on borrowing robs the Union of the flexibility to respond to short-term challenges, because spending and revenues must always balance. Moreover, the EU cannot make its own autonomous decisions about how to fund its budget.

These criticisms are largely – if not in all points – shared by decision-makers in the EU organs and member-states. Certainly, the European Commission, the European Parliament and the European Council of heads of state and government have repeatedly acknowledged the necessity to overhaul the EU budget, and underlined the need for action. But if that is the case why have no fundamental reforms to address the problems yet been considered or implemented?

This paradox stems above all from the extreme path-dependency of the European budget system. Every compromise reached consolidates institutional structures and increases the costs of change, even as the outcomes of the negotiations become ever less convincing and indeed unsatisfactory for those involved.

If the criticisms of the existing system are shared even by the central players, it is high time to search for new ways to stimulate reform activities and shake off inertia. But in view of the political realities there seems little point in disseminating yet more normative proposals for an ideal European Financial Framework, priorities and public goods the EU should pay for, and how it should fund its budget fairly and adequately. There are already plenty of studies of that ilk, none of which have done anything to overcome fundamental disinterest, inertia and fixation on the status quo. Nor is the current round of negotiations moving towards an optimised EU budget adequate to the theoretical requirements of financial federalism. Instead the strong current of political realism forces negotiators to find a result acceptable to member-state governments and parliaments within the prescribed timeframe.

In this negotiating environment a gradual reconfiguration is the best that can be expected, in the sense of a pragmatic shifting of spending priorities. To this end, the talks on the new legal basis for the central spending policies of cohesion and agriculture must be closely tied to the talks on the Financial Framework itself.

The current economic and debt crisis might provide a lever to crack open ossified structures and initiate a long-term reform process. But the net payers, in particular, are pursuing a strategy of strictly separating the euro crisis and the MFF talks. A linkage strategy could involve channelling support from the European Structural Funds only to states that make credible efforts to overcome the structural competitive disadvantages that are the actual underlying cause of the crisis. The EU objectives and funding eligibility of cohesion policy would need to be brought in line with the new competitiveness indicators. European funding policy could thus slowly and incrementally be realigned to new fields and goals. Such an outcome can open the door to an effective long-term reform of the EU's budget and finance systems. The end of this process could be a truly federal budget as a central pillar of a European Political Union.

# The EU Budget Negotiation System

On 29 June 2011, the European Commission published its drafts and proposals for the next Multiannual Financial Framework.<sup>1</sup> By the end of 2011, fifty-seven proposals relating to the legal basis for European spending programmes had been submitted, in almost all policy areas.<sup>2</sup> The most important are the legislative proposals of October 2011 for the two largest spending blocks in the EU budget, European cohesion policy and the Common Agricultural Policy (CAP).<sup>3</sup> Since then, the Commission's comprehensive package has been negotiated in the Council of Ministers, initially under the Polish Presidency in the second half of 2011, then under the Danish Presidency in the first half of 2012, and now under the Cypriot Presidency. At the end of its term, the Danish Presidency published a "negotiation box" summarising the stage the talks had reached.<sup>4</sup> Cyprus's negotiation box now provides the first idea of the structure of an overall

compromise, although without yet stating concrete budget forecasts or figures.<sup>5</sup> The heads of state and government discussed the MFF for the first time on 28/29 June 2012, agreeing only to seek agreement by the end of 2012.<sup>6</sup> An extraordinary European Council on 22/23 November 2012 will be an important stage in this process. Last but not least, the European Parliament defined its negotiating position in June 2011,<sup>7</sup> and passed a resolution calling for proper account to be taken of its demands with a large majority on 11 June.<sup>8</sup>

The Multiannual Financial Framework for 2014 to 2020 will be the fifth since 1988. Altogether the MFF has been a very successful instrument, having guaranteed the EU's budgetary stability for more than two decades. The Treaty of Lisbon incorporates this central component of European budget policy into European treaty law (article 312, Consolidated Version of the Treaty on the Functioning of the European Union). The new treaty contains certain important modifications to previously informal instruments and procedures, which are now being applied for the first time. Thus in future the Multiannual Financial Framework will be adopted in the legally binding form of a EU regulation, meaning that the fundamental budgetary decisions it contains require the unanimous agreement of all member-states and the consent of all three EU organs.<sup>9</sup> The European Parliament has been formally integrated into the legislative process. It must be kept properly informed of the progress of negotiations and at the end of the process approve

1 European Commission, *A Budget For Europe 2020*, COM(2011) 500 final (Brussels, 29 June 2011); European Commission, *Draft Interinstitutional Agreement Between the European Parliament, the Council and the Commission on Cooperation in Budgetary Matters and on Sound Financial Management*, COM(2011) 403 final (Brussels, 29 June 2011); European Commission, *Proposal for a Council Regulation Laying Down the Multiannual Financial Framework for the Years 2014–2020*, COM(2011) 398 final (Brussels, 29 June 2011).

2 The proposals are collected in Annex 1 to Communication from the Commission, *A Simplification Agenda for the MFF 2014–2020*, COM(2012) 42 final (Brussels, 8 February 2012), [http://ec.europa.eu/budget/library/biblio/documents/fin\\_fw1420/com\\_2012\\_42.5\\_annex1\\_en.pdf](http://ec.europa.eu/budget/library/biblio/documents/fin_fw1420/com_2012_42.5_annex1_en.pdf).

3 On 6 July 2012 the European Commission published an amended proposal for the MFF 2014–2020, to take account of two new challenges: a) the effect of Croatia's accession to the EU on the budget and b) the influence of the latest economic data and the distribution of the European Structural Funds among member-states. In the amended version the total volume increased by €8 billion to €1,033 billion in commitment appropriations (1.08 percent of EU GNP). In the payment appropriations the amended proposal totals €988 billion (1.03 percent of EU GNP). European Commission, *Amended Proposal for a Council Regulation Laying Down the Multiannual Financial Framework for the Years 2014–2020*, COM(2012) 388 final (Brussels, 6 July 2012).

4 Council of the European Union, *Multiannual Financial Framework (2014–2020) – Negotiating Box*, 11539/12 (Brussels, 19 June 2012).

5 Council of the European Union, *Multiannual Financial Framework (2014–2020) – Negotiating Box*, 13620/12, Brussels (18 September 2012).

6 European Council, *Conclusions*, EUCO 76/12 (Brussels, 29 June 2012), item 6.

7 European Parliament, *Investing in the Future: A New Multiannual Financial Framework (MFF) for a Competitive, Sustainable and Inclusive Europe*, P7\_TA-PROV(2011)0266 (Strasbourg, 8 June 2011).

8 European Parliament, *Multiannual Financial Framework and Own Resources*, P7\_TA-PROV(2012)0245 (Strasbourg, 13 June 2012).

9 Unanimous agreement is required at least until the European Council unanimously decides to adopt the next financial framework by qualified majority.

by majority vote the draft regulation negotiated by the member-states. Here, a new and confident actor with its own budgetary interests and objectives has entered the negotiating arena.

The Treaty of Lisbon also places limits on excessively rigid negotiating positions. Article 312 (4) stipulates: “Where no Council regulation determining a new financial framework has been adopted by the end of the previous financial framework, the ceilings and other provisions corresponding to the last year of that framework shall be extended until such time as that act is adopted.” According to the European Commission’s proposal the 2013 budget amounts to about €138 billion in payment appropriations. The Council adopted its position on the Commission’s draft budget on 24 July 2012 and set the upper limit of payments at €132.7 billion. The European Parliament, however, asked for an increase to €137.9 billion in payment appropriations. Conciliation between Council and Parliament on the 2013 annual budget will start in November 2012 and will be of great political importance as these figures will set the lower limit for the MFF as specified in primary law.

The outcome of this twenty-five-year development process is a well-oiled negotiating process in which most conflicts are predictable and roles are largely known and accepted. This ensures (at least for the moment) that the budget talks can end in an unchallenged consensus that guarantees seven years of budgetary stability and security of planning.<sup>10</sup> The participants prefer to agree on the lowest common denominator in a familiar procedure rather than becoming entangled in the conflicts that an (over-)ambitious initiative to modernise and reform would involve – especially given that it would contain the risk of the negotiations failing. The European budget and finance system no longer offers opportunity for the institutional power struggles that raged between the EU’s organs in the 1970s and 1980s. The convenient if also unsatisfying stability and predictability of compromise weighs heavier than the insecurity and incalculability of fundamental reconfiguration.<sup>11</sup>

<sup>10</sup> Johannes Lindner, *Conflict and Change in EU Budgetary Politics* (London, 2006); idem., “Institutional Stability and Change: Two Sides of the Same Coin”, *Journal of European Public Policy* 10, no. 6 (2003): 921–35.

<sup>11</sup> Joachim Schild, “How to Shift the EU’s Spending Priorities? The Multi-annual Financial Framework 2007–13 in Perspective”, *Journal of European Public Policy* 14, no. 4 (2009): 531–49.

## Status quo as probable outcome

Despite heated conflicts along often familiar lines, despite classical distribution problems, and despite the difficult circumstances, the European Union has always succeeded in agreeing a compromise for the next Multiannual Financial Framework. And it will again this time. All the parties have an interest in achieving the minimum objective of the budget negotiations and concluding them with a compromise. They wish to demonstrate the EU’s viability with a Financial Framework that guarantees plannability and predictability and provides adequate funding for its central tasks.

The procedures are well-practised, and the predictably tricky negotiations will, if experience is anything to go by, receive intense media attention. For that reason, too, agreement on an overall package will be reached in the end. A scenario for a conceivable outcome can already be sketched out:

- ▶ The total volume of the next Multiannual Financial Framework will lie roughly in the middle between the European Commission’s proposal and the position of the net payers: in other words, around €1,050 billion.
- ▶ The structure of the next Financial Framework will, as suggested by the European Commission, very closely follow the precepts of the European growth and employment strategy “Europe 2020”.
- ▶ The member-states are keeping an especially close eye on the tangible short-term consequences of the budget compromise and its repercussions on their national net balance, at the expense of the Commission’s proposals for long-term structural change. A one-sided concentration on the budget headings monopolises attention and increasingly determines the priorities of the national delegations. Consequently the Commission can implement its more technical proposals for a more outcome-orientated and conditional spending policy with more intense evaluation and monitoring.
- ▶ The member-states will reject the Commission’s proposals for a fundamental overhaul of the own resources mechanisms and especially the introduction of an EU tax. They will at best postpone a decision on this to a later round.
- ▶ Unless the financial and debt crisis suddenly worsens in the second half of 2012, the negotiating process will not conclude as planned (and as required for the EU Structural Funds and the operational programs of the regions to start in time) in Novem-

ber or December 2012 with an agreement in the European Council. The efforts of the President of European Council, Herman Van Rompuy, and the Cypriot Presidency to meet this deadline will be in vain. But the failure of the heads of state and government to agree at the first attempt is part of the script. Consensus will not be achieved until an extraordinary crisis meeting of the European Council in February or March 2013.

- ▶ The European Parliament, which is kept informed about the progress of negotiations in the General Affairs Council by the respective Council Presidency, must subsequently approve the heart of the overall package, the council regulation for the Multiannual Financial Framework. MEPs will initially pour criticism over the agreement reached by the heads of state and government and reject it as completely inadequate. The Irish Council Presidency and the leaders of the political groups in the European Parliament are in line for tough negotiations that will drag on until May 2013. MEPs will call for spending to be increased, which the Council will reject because that would mean straying too far from the compromise signed off by the heads of state and government. After several rounds of talks a number of concessions will be granted, such as increasing the flexibility instruments and the European Globalisation Fund. But the total volume of the Financial Framework agreed by the European Council will remain fundamentally unaltered, with the European Parliament at most gaining cosmetic corrections.

Altogether, it can be predicted that all parties involved will approve a budget package and the outlines of the next Financial Framework will remain relatively close to the present status quo. Fundamental fiscal issues, such as major transfers between existing budget headings or the introduction of a new source of own resources in the form of an EU tax, will be put on the back burner or shunted into slow-moving reform procedures. The negotiating process will obey familiar patterns of behaviour and well-known conflicts and groupings will determine the debate.

## Familiar procedures and script

Let us now take a closer look at this oft-rehearsed negotiating process. What conflicts dominate, what steps have already been taken, and how are the roles

distributed? What are the informal plot lines and their unspoken rules?

*Difficult circumstances:* The political and economic conditions for compromise have steadily deteriorated over the past two decades. The negotiations over the first package in 1988 occurred during a phase of economic prosperity and under the fragile political stability of the Cold War. The next package, Delors-2, by contrast was negotiated during the insecurity and instability following the upheavals of 1989/90, where it was already foreseeable that the advantageous situation of the biggest net payer, the Federal Republic of Germany, was set to deteriorate. The background for the negotiations over the third Multiannual Financial Framework, the Agenda 2000, was equally troubled, with the European Commission under Jacques Santer forced to resign over accusations of corruption and nepotism, the conflict in former Yugoslavia escalating with the NATO bombing of Serbia, and the upcoming eastern expansion facing the EU with great political, economic, social and budgetary challenges. The last round to date, in 2004/2005 for the current Financial Framework, was overshadowed by stormy internal distribution conflicts and new problems arising through globalisation.<sup>12</sup>

*Longer negotiating period:* Since the negotiations for Delors-1, which ended after pretty much exactly twelve months with an extraordinary meeting of the European Council on 11/12 February 1988 in Brussels, the talks have grown ever more protracted. The last round took nearly two years and was not completed until 16/17 December 2005. The reasons for this include significantly greater public attention, which increases the pressure on decision-makers to maximise national gains and hold out as long as possible for maximum demands. The repeatedly expanded EU now also has many more parties at the negotiating table, all of whom possess a veto. That considerably hampers the process of finding compromise.

*Traditional conflicts:* Traditional lines of conflict have become ingrained in the negotiations. Although the opposition between net payers and net receivers is paramount there are also distribution conflicts between individual policy areas, especially agriculture and cohesion. Alongside tensions between the economically strong northern European member-states and the traditionally more backward southern Euro-

<sup>12</sup> Peter Becker, "Fortschreibung des Status quo – Die EU und ihr neuer Finanzrahmen", *integration* 29, no. 2 (2006): 106–21.

pean countries, eastward expansion has added a dimension of East-West distribution conflict. All these frictions regularly manifest themselves in specific legal and implementation issues within individual policies: for example, which agricultural products should be subsidised from the EU budget and how generously, or what criteria should be used to distribute the European Structural Funds.

Such conflicts proliferate when a top-down approach limits the sum to be distributed from the outset,<sup>13</sup> as chosen by the European Commission for its current proposal which caps the total volume of the MFF at about 1 percent of EU GNP. Certain net receivers understandably criticised the Commission's decision as premature. The Polish Presidency chose neither to raise this point during the initial sessions in the General Affairs Council nor to include it in its interim report of December 2011.<sup>14</sup> The subsequent Danish Presidency, on the other hand, prioritised this approach as a guiding principle in its first negotiating session on 27 January 2012.<sup>15</sup>

From the perspective of the governments and parliaments of the member-states, the net balance remains the decisive point for assessing the outcome. National negotiating strategies are consequently characterised by the relationship between gross payments into the EU budget via the EU's own resources mechanism and the returns from EU spending programmes, especially under the two largest budget headings.<sup>16</sup>

13 The top down approach first defines the maximum available budget volume without reference to wishes or requirements. Only then are tasks given priorities and funds distributed among the various spending headings of the financial framework. The bottom up approach, on the other hand, first lists the EU's upcoming challenges and the tasks the member-states have entrusted to the expanded EU, before calculating how much money is required to fulfil these tasks, wishes and requirements.

14 Council of the European Union, *Multiannual Financial Framework (2014–2020) – Report on Progress of Work within the Council in the Second Semester 2011*, 17448/1/11 (Brussels, 1 December 2011).

15 Council of the European Union, *Multiannual Financial Framework (2014–2020) – Questionnaire on the Main Priorities and the Budgetary Framework, Including the Overall Amounts*, 5380/12 (Brussels, 20 January 2012).

16 One undeniable sign of this is that the member-states now possess computer-based calculating tools that they use during the negotiations to directly calculate the repercussions of specific reform proposals on their net balance, especially shifts and reallocations within the EU budget. This applies especially during the final phase of the negotiations in the European Council, when the dynamism of deals speeds up and binding political compromises must be forged. The success

Thus France, as a major net payer, seeks to restrict the volume of the EU budget while at the same time, as the biggest recipient of agricultural spending, retaining a special interest in defending the CAP subsidies in the EU budget. Paris therefore frequently points to possibilities for making savings in the European Structural Funds. Because significant resources from these still flow into its eastern states in particular, Germany for its part seeks to avoid tangible cuts in funding volumes that would reduce its returns and worsen the German net balance. The Finnish government is in a similar position, declaring its openness for cuts in all policy areas including the Structural Funds but seeking exceptions for the thinly populated Lapp regions of its far north. The British follow a comparable logic, but focusing on the revenue side because their budget rebate always reduces the British net payment regardless of their returns from European spending programmes. In short, the focus on national net balances affects the EU's spending priorities.

*Practised procedure:* The negotiating process follows a well-trodden informal course with various assigned roles.<sup>17</sup> At the beginning the European Commission uses its monopoly of initiative to mark out the scope of the negotiations and attempts to embed its own substantive objectives and initiatives. After that the member-states dominate the talks in the General Affairs Council.<sup>18</sup> The European Council's involvement is initially restricted to being kept regularly informed about progress. The heads of state and government only become actively involved when an agreement on the whole package is in the offing or stalled negotiations need to be set in motion again. Consensus-finding in the European Council forms the political

of a negotiating strategy may thus depend in part on the quality of the computer software used.

17 Brigid Laffan, "The Big Budgetary Bargains: from Negotiation to Authority", *Journal of European Public Policy* 7, no. 5 (2000): 725–43. Laffan speaks of an European budgetary *acquis*.

18 The General Affairs Council, in which the foreign and Europe ministers of the member-states meet, still retains the leading role in the budget talks and has resisted takeover attempts by the finance ministers and the Economic and Financial Affairs Council. This division of roles means that the negotiating strategies of the member-states have a more European orientation and are more focussed on an overall compromise. The negotiations should not be determined by budgetary aspects alone, but by the search for a balance between fiscal cost/benefit considerations and the integration of EU policies.

conclusion of the negotiating processes between the member-states. Only then, in the phase of passing the package into law, does the European Parliament become directly involved in the negotiations.<sup>19</sup>

*The shadow script:* Behind the specifics, an unspoken dramaturgy for the negotiating process has emerged. After assessing the Commission's proposal and a general airing of views among the member-states, the negotiations concentrate on specific policy areas and questions of detail. Because these talks follow the general principle of multilateral package negotiations, where nothing is agreed until all points have been covered, the various negotiating strands must in the end be brought back together. The negotiating box serves as the instrument for this. This unofficial working document (non-paper) under the responsibility of the Council Presidency is presented in the format of conclusions of the European Council and forms the basis for the step-by-step search for compromises reconciling opposing national positions. Once this has reduced the list of open questions and unresolved conflicts to a manageable number, the package is presented to the European Council for the final round. But before the heads of state and government reach agreement, a phase of stagnation usually intervenes where the foreign ministers are unable to achieve further progress. The European Council's first attempt to agree an overall compromise usually fails too, upping the pressure on all involved to reach consensus. At the same time this helps the heads of state and government to justify the final outcome to their own populations and national media and to demonstrate convincingly that they fought to the last for their own national financial and budget interests. After matters have come to a head agreement is generally reached at the second attempt, often after long and conflictual bi- and multilateral talks and repeated rows during the concluding summit meeting of the heads of state and government.

**19** Under the Treaty of Lisbon the Financial Framework now requires a regulation to be legally binding. Previously this was always achieved through an inter-institutional agreement between the EU's three organs: Council, Parliament and Commission. Peter Becker, "Eine Finanzverfassung für die EU: Die neue Balance zwischen Rat und Parlament im Haushaltsverfahren", in *Interinstitutionelle Vereinbarungen in der Europäischen Union: Wegbereiter der Verfassungsentwicklung*, ed. Daniela Kietz et al. (Baden-Baden, 2010), 252–76.

## Reform: Need and Willingness

So at the end of the process there will be a result, if not necessarily the best or most desirable, and the European Union will have once again proven its ability to come to a decision when required. So why does the criticism of the EU's budget and finance system not go away? Why are fundamental reforms so consistently advised and demanded? This raises two interlinked two questions:

- ▶ At what points in the European budget and finance system is the need for fundamental change recognised, and who expresses this need for reform?
- ▶ If the European Union's organs and decision-makers recognise the need for reform, why are they unwilling or unable to channel this insight into political change?

### The criticisms of the EU budget and the need for reform

Discussion about the necessity and practicability of reforming the EU budget has been going on for decades,<sup>20</sup> often pointing to apparent structural deficits that, it is said, cannot be rectified by mere tinkering. In what has become a broad-based discussion, it is conspicuous that while critics largely agree about what comprises the false incentives on the spending side, opinions diverge more widely where the revenue side is concerned. Here the debate revolves around the possible introduction of a new source of own resources about which the EU could decide more autonomously, in other words an EU tax.

The probably best-known (and most frequently cited) criticism of recent years originates from a group of advisers to the European Commission led by the Belgian economist André Sapir. Their report, "An Agenda for a Growing Europe", published in 2003, calls the EU budget a "historical relic": "Expenditures,

<sup>20</sup> Standing for the German debate: Gero Pfennig, "Eine neue Finanzverfassung für die EG – Basis für eine föderative Europäische Union", *integration* 9, no. 4 (1986): 143–55; for the debate at the European level: *Report of the Study Group on the Role of Public Finance in European Integration* (MacDougall report) (Brussels, April 1977).

revenues and procedures are all inconsistent with the present and future state of EU integration."<sup>21</sup>

The wide-ranging spectrum of criticisms and specific complaints can be summarised as follows:<sup>22</sup>

- ▶ The volume of the Multiannual Financial Framework presently comprises about 1 percent of EU GNP, and the annual budgets usually lie below that. The EU-27 possesses a much smaller budget than some of its member-states: the €126.5 billion figure for 2011, for example represented only roughly 41 percent of the German national budget. So from the very outset the budget limits the room for manoeuvre available to the EU, whose most important political instrument would be precisely the possibility to grant financial assistance and set incentives.
- ▶ Setting budget headings and their funding for seven years makes the budget inflexible. Because the total volume of the MFF is limited and the shares of the individual policy areas are fixed, the Union can respond only slowly to new challenges, and only through transfers between headings. Only every seven years is it possible to realign European spending priorities or to correct the budget to redistribute burdens or adapt to new external or internal circumstances. It is almost impossible to carry unspent funds over from one financial year to the next or transfer them between budget headings, as that requires reopening a consensus achieved in long drawn-out talks, renegotiating the issue and

<sup>21</sup> *An Agenda for a Growing Europe: Making the EU Economic System Deliver, Report of an Independent High-level Study Group Established on the Initiative of the President of the European Commission* (Sapir report) (Brussels, July 2003), 162.

<sup>22</sup> See, among many: Alan Mayhew, "The EU Budget: Not 'Fit for Purpose' but Change is Afoot, Gradually", in *After the Crisis: A New Socio-economic Settlement for the EU*, ed. Roger Liddle (London: Policy Network, 2009), 63–76; Rolf Caesar, "Die Finanzwirtschaft in der EU – 'Historisches Relikt' oder solide Zukunftsbasis?" *Zeitschrift für Politik* 53, no. 3 (2006): 333–52; Daniel Tarschys (ed.), *The EU Budget: What Should Go In? What Should Go Out?* SIEPS report 3 (Stockholm: Swedish Institute for European Policy Studies, May 2011); Friedrich Heine-mann, Philipp Mohl, and Steffen Osterloh, "Reforming the EU Budget: Reconciling Needs with Political-Economic Constraints", *Journal of European Integration* 32, no. 1 (2010): 59–76.

- reaching a new compromise among the 27 member-states and the consent of the European Parliament.
- ▶ On the spending side most of the EU's limited resources are consumed by just two policies that serve principally redistributive ends. The Common Agricultural Policy and the Structural Funds consume about 78 percent of all spending from the Financial Framework, leaving less resources or none at all for modern, innovative projects. To this extent the European budget appears to be neither prepared for the challenges of globalisation nor orientated on the expectations of the EU's citizens.<sup>23</sup>
  - ▶ Relatively prosperous member-states enjoy funding and subsidies under the two largest headings of the EU budget. Funds are thus distributed not by criteria of standard of living or need but according to the logic of European package negotiations. In such package deals, support for an overall compromise is often bought by promises of compensation.<sup>24</sup>
  - ▶ On the revenue side the EU budget suffers from lack of transparency, unnecessary complexity and inflexibility. EU funding is governed by corrections and rebates originating from package deals that follow no rational logic. The best-known is the British budget rebate, which guarantees the United Kingdom the reimbursement of two thirds of its net contributions.<sup>25</sup>
  - ▶ The EU possesses hardly any own resources worthy of the name. Almost 90 percent of the EU budget comes from the member-states' national budgets. The European Union has no right of its own to raise taxes and is forbidden to borrow. So also on the revenue side it can respond only slowly and cumbersome to changing circumstances and new challenges. The member-states place narrow limits on its budget policy and make it dependent on funds from its members.
- ▶ Unlike the nation-states, the EU has no comprehensive budget legitimised by parliament. While the changes associated with the Lisbon Treaty enhance the role of the European Parliament on the spending side by granting it equal rights to the Council of the European Union, the member-states still dominate on the revenue side. The EU's budget and finance system thus represents a hybrid form with adequate parliamentary legitimisation at the European level only on the spending side.
  - ▶ The biggest criticism is without doubt the way member-states think in net balance categories.<sup>26</sup> This "poisonous"<sup>27</sup> fixation on net positions is of limited sense, the critics say, because it takes no account of other effects of European integration and EU membership that cannot be expressed in a purely fiscal juxtaposition of payment and receipt.<sup>28</sup> Moreover, thinking in net balances cements the status-quo orientation of the member-states and leads to tangible negative medium- to long-term consequences. The discussion about what the EU should spend its money on becomes dominated by a balance sheet of short-term cost-benefit calculations that neglects the question of the usefulness and longer-term advantages of European policies and funding. The criterion of European added value remains largely marginal to national negotiating stances. This orientation on fiscal aspects of the EU budget creates a system equipped with an ever growing number of adjusting levers, without which no compromises would ever be reached. Thinking in terms of net balances is therefore a source of exceptions to the rules and of growing complexity and lack of transparency in the European budget and funding system. Once introduced, corrections tend to become entrenched. It is not only the adaptability of the EU budget that suffers, but also the political viability of the EU as a whole.

While these criticisms are not all shared en bloc by all political, economic and scholarly commentators,

<sup>23</sup> European Commission, *Eurobarometer 75, Spring 2011: Europeans and the EU Budget* (Brussels, August 2011).

<sup>24</sup> Susanne Neheider, *Die Kompensationsfunktion der EU-Finzenzen* (Baden-Baden, 2010).

<sup>25</sup> The British budget rebate was agreed in 1984 after difficult negotiations in the European Council at Fontainebleau. Because repeated amendments have made it extremely complicated, the member-states adopted a working document at the proposal of the European Commission. Council of the European Union, *Commission Working Document on Calculation, Financing, Payment and Entry in the Budget of the Correction of Budgetary Imbalances In Favour of the United Kingdom ("the UK Correction") in Accordance with Articles 4 and 5 of Council Decision 2006/xxx/EC, Euratom on the System of the European Communities' Own Resources, 9851/07, ADD 2* (Brussels, 23 May 2007).

<sup>26</sup> See, among many: Peter Becker, *Der EU-Finanzrahmen 2007–2013: Auf dem Weg zu einer europäischen Finanzverfassung oder Fortsetzung der nationalen Nettosalddpolitik?* SWP-Studie 36/2005 (Berlin: Stiftung Wissenschaft und Politik, November 2005).

<sup>27</sup> Jacques Le Cacheux, *European Budget: The Poisonous Budget Rebate Debate*, Studies & Research; 41 (Paris: Notre Europe, June 2005).

<sup>28</sup> Lars P. Feld and Sarah Necker, *Fiskalföderalismus in der Europäischen Union: Herausforderungen für die Reform der Finanzverfassung der EU* (Brussels, 2010).

there is a broad consensus that reform and adaptation are urgently needed and that the existing European budget and finance system must be made to function more smoothly.

### **Necessity of reform does not necessarily mean ability to reform**

Decision-makers in the EU organs and the member-states fundamentally agree that the European budget and finance system needs to be reformed, as repeatedly demanded by the European Commission, the European Parliament and the European Council of heads of state and government. For all its contradictions and disagreements,<sup>29</sup> the reform discussion of 2007/08 certainly documented the need to overhaul the EU's budgetary instruments.<sup>30</sup>

What was at that stage the largest public consultation held by the European Union, and the debate during the ongoing review process, produced an extensive and diverse collection of reform proposals.<sup>31</sup> The European Commission's report ultimately argues for all future spending from the EU budget to be much more strongly guided by efficiency criteria and for flexibilisation of the Multiannual Financial Framework. "The modernisation of the EU budget must therefore be about targeting, about maximising the benefits from every euro spent, and about setting the budget firmly in the context of the other ways in which the European Union, its institutions and its Member States, can put Europe on the path to growth and jobs for the future."<sup>32</sup> Nevertheless, the review

<sup>29</sup> Peter Becker, *Auf dem Weg zur Reform des EU-Haushalts: Eine Zwischenbilanz des Konsultationsprozesses*, SWP-Aktuell 57/2008 (Berlin: Stiftung Wissenschaft und Politik, June 2008); Rolf Caesar, "Der 'Budget Review' 2008/2009: Durchgreifende Reformen im EU-Haushalt?" *Wirtschaftsdienst* 88, no. 5 (2008): 317–21.

<sup>30</sup> Austrian Chancellor Wolfgang Schüssel was reported to have said: "Next time we'll be going for each other's throats", *Süddeutsche Zeitung*, 31 December 2005; similarly Wolfgang Schüssel, *Europas Finanzen – Das alte System ist ausgereizt*, spotlight europe 2007/08 (Gütersloh and Munich, November 2007).

<sup>31</sup> This reform debate produced more than three hundred statements from governments, associations, institutions, civil society groups and individual scholars. Statements submitted during the European Commission's public consultations are available at [http://ec.europa.eu/budget/reform2008/issues/read\\_en.htm](http://ec.europa.eu/budget/reform2008/issues/read_en.htm).

<sup>32</sup> European Commission, *The EU Budget Review*, COM(2010) 700 final (Brussels, 19 October 2010).

process produced no fundamental political decisions to change the European budget arrangements. The consultation phase had demonstrated all too clearly that the EU organs, the member-states and also the many interest groups and NGOs were incapable of discussing the budget review in isolation from the budget negotiation process. National governments in particular interpreted the review as an early starting shot for the MFF 2014–2020 talks, and tactical considerations automatically permeated the national position papers. The collective European desire for reform was unable to prevail against national interests and sectoral and civil society preferences.

Nor was the Commission's final report, published a year behind schedule, able to paper over the substantive and temporal closeness to the actual budget negotiations. While the Commission supported certain innovative proposals and attempted to draw fundamental lessons for the European budget and finance system, it avoided taking clear positions or setting clear priorities. On the one hand it demanded that the principle of European added value be the yardstick of all EU spending. On the other it demanded consolidating the principle of European solidarity as the cornerstone of all community policies. It was certainly aware that in the course of the review discussions these two precepts had become the opposing slogans of the two camps. The net payers instrumentalised "European added value" to argue for a restriction of the budget volume. The net receivers appealed to "European solidarity" to insist on increasing European spending and subsidies.<sup>33</sup>

In the meantime simply completing the complicated and conflictual negotiating process with any kind of compromise appears more important than negotiating an agreement that satisfies requirements and wishes for a future EU. Successful conclusion of the process has turned into the actual objective of the negotiating processes and the collective bottom line. Reforms and the substance of the agreement have received short shrift.

All involved agree fundamentally that the Financial Framework must be thoroughly crisis-proofed and prepared for meeting future challenges. Although the EU budget will certainly not in the foreseeable future become a crisis response instrument with which the Union and its member-states could tangibly stimulate

<sup>33</sup> Peter Becker, "The European Budget and the Principles of Solidarity and Added Value", *International Spectator* 47, no. 3 (September 2012): 116–29.

growth, the MFF could still serve as a supplementary and supporting instrument offering incentives and assistance for medium- to long-term structural reforms in the member-states. European incentives for sustainable and intelligent economic growth could lend support to national budget consolidation processes. At least that is the goal the European Commission is pursuing with its proposal for a “Budget for Europe 2020”, and which the European Parliament confirms in calling for European resources to be identifiably applied to the European growth and employment strategy. The EU budget should have a “strong catalytic effect” for more growth and employment in the EU.<sup>34</sup> It would definitely be wrong to throw away the possibility of using the (admittedly restricted) resources of the MFF to tackle the current challenges faced by the EU. Accepting the failure of the negotiations is equally out of the question, for especially in times of vanishing trust in the EU’s capacity to intervene decisively or institute reforms this would represent a fatal signal at the worst conceivable time.

In the long term the MFF should support the European Union on its way to becoming an “ever closer union among the peoples of Europe”. But this presupposes that the member-states cease regarding the Financial Framework from the selfish perspective of their national net balances. In moving towards the ultimate goal of a Political Union, it is not enough to simply build a fiscal union and introduce institutional reforms for greater legitimacy of the EU organs. The Multiannual Financial Framework must be also developed into a constitutive component and an instrument for autonomous political action.

<sup>34</sup> European Commission, *A Budget For Europe 2020* (see note 1).

## Starting Points for Reforming the EU Budget

Although the forces of inertia and scepticism about changes to the status quo still dominate, the shared insight of political decision-makers remains that the European budget and finance system requires structural modifications. Yet the hurdles appear too high for a political turnabout.

### Evolutionary adaptation and gradual change

Normally change occurs as an evolutionary process of incremental modifications: the gradual adaptation of existing institutions, processes and structures, triggered or amplified by institutional learning processes.<sup>35</sup> Alterations to the negotiating situation and framework and their perception by the actors can also be sources of change, and this in turn can have consequences for the definition of member-states' preferences and interests.<sup>36</sup>

In view of the political, economic and financial importance of the MFF, the member-states negotiate at the highest political level in the European Council. But twenty-seven heads of state and government means twenty-seven potential vetoes. The greater their number the smaller the prospect of sweeping reform, especially where budgetary decisions are involved.<sup>37</sup> Moreover, the further apart the negotiating positions the greater the tendency to adhere to the status quo. The great discrepancy between the negotiating posi-

tions of net payers and net receivers, as reflected in their net balances, reduces the willingness to accept change. Both sides fix their positions at an early stage according to their net payments, increasing their resistance to reform. The status quo becomes the lowest common denominator.

However, the veto player theorem can also be applied to advantage. If the opposing standpoints of the member-states move closer and their negotiating positions thus become more coherent, the likelihood that they will agree on change increases.<sup>38</sup> Currently respective net balances determine what positions the member-states will adopt in the budget negotiations. So the first step would be to minimise the redistribution volume of the EU budget and the differences between the net balances. To this end the Commission and European Parliament are calling for an autonomous source of own resources, to make part of the EU budget independent from the payments from the national budgets and thus bracket it out from the net balance calculations.<sup>39</sup>

Another possibility would be to cap net payments, for example through a generalised mechanism for correcting budgetary imbalances of the kind the European Commission proposed in the last negotiating round in 2004.<sup>40</sup> It would cap the contributions of all net payers at a given threshold (defined in percent of national GNP) and partially reimburse net contribu-

<sup>35</sup> Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton, 2004), 137ff. See also Richard Deeg, "Change from Within: German and Italian Finance in the 1990s", *Beyond Continuity: Institutional Change in Advanced Political Economies*, ed. Wolfgang Streeck and Kathleen Thelen (Oxford, 2005), 169–202 (170ff). Deeg lists "learning effects", "coordination effects" and "adaptive expectations" as self-reinforcing mechanisms.

<sup>36</sup> Schild, "How to Shift the EU's Spending Priorities?" (see note 11), 546.

<sup>37</sup> George Tsebelis, "Decision Making in Political Systems: Veto Players in Presidentialism, Parliamentarism, Multicameralism and Multipartyism", *British Journal of Political Science* 24, no. 3 (1995): 289–325; George Tsebelis and Eric C. C. Chang, "Veto Players and the Structure of Budgets in Advanced Industrialized Countries", *European Journal of Political Research* 43, no. 3 (2004): 449–76.

<sup>38</sup> By contrast the conclusion that the number of veto players must first be reduced in order to lessen the influence and blocking options of individual actors in the negotiations appears extremely unrealistic. That would imply the introduction of majority voting for the budget negotiations. It is unlikely that a member-state would agree to such a reduction of its influence where under Article 312(2) of the Treaty on the Functioning of the European Union voting modalities can only be altered unanimously.

<sup>39</sup> Calculations by the European Commission estimate that its proposed European financial transaction tax alone would reduce the GNP contributions of the member-states by €54 billion by 2020.

<sup>40</sup> European Commission, *Financing the European Union – Commission Report on the Operation of the Own Resources System*, COM(2004) 505 final (Brussels, 14 July 2004). On the details of the proposal see Becker, *Der EU-Finanzrahmen 2007–2013* (see note 26), 16–18.

tions exceeding the threshold, thus fundamentally limiting the redistribution volume of the EU budget.<sup>41</sup>

The biggest difficulties here stem from the special privilege claimed by the United Kingdom with its indefinite rebate mechanism, granted in 1984 in Fontainebleau. According to calculations by the European Commission the United Kingdom would be the biggest loser from the introduction of a generalised correction mechanism,<sup>42</sup> because its special position would be relativised in comparison to other net payers.<sup>43</sup> In order for the United Kingdom to agree to a generalised correction mechanism, its long-standing demand for fundamental overhaul of the Common Agricultural Policy would have to be granted in return. From the British perspective a reform to tangibly reduce direct payments to farmers would be a victory that would sell well domestically. The symbolically important first step towards national co-financing of agricultural direct payments no longer appears to be the decisive sticking point.<sup>44</sup>

**41** However, for the current negotiations the Commission has put its generalised correction mechanism proposals on ice and instead proposes introducing temporary lump sum corrections limited to the duration of the Financial Framework for the United Kingdom, Germany, the Netherlands, Austria and Sweden. European Commission, *Proposal for a Council Decision on the System of Own Resources of the European Union*, COM(2011) 510 final (Brussels, 29 June 2011). In its accompanying document the Commission justifies this proposal on the basis that temporary lump sums for individual member-states are more comprehensible, more transparent and easier to apply than a generalised correction mechanism. European Commission, *Commission Staff Working Paper: Financing the EU Budget: Report on the Operation of the Own Resources System*, SEC(2011) 876 final (Brussels, 29 June 2011), 47ff.

**42** Domestically the British government could portray the introduction of an indefinite generalised correction mechanism as the continuation of its budget rebate, which had simply been extended to a few other states – presuming it was willing to negotiate the rebate question at all. A temporary generalised correction mechanism would be absolutely out of the question for the United Kingdom.

**43** Calculations by the Commission in 2004 showed that the British rebate would have roughly halved at the time. The European Commission's new proposal for temporary lump sum corrections would reduce the British rebate from the current capped maximum of €10.5 billion to €3.6 billion. This drastic reduction would be a consequence of the Commission's proposal to introduce a new source of own resources in the form of an EU tax, which would significantly reduce the national GNP contributions subject to rebates.

**44** In its report on the EU budget negotiations the House of Lords relativised the importance of co-financing in direct payments – saying they were not a “panacea” – and prioritised reducing direct payments. In the event of such a com-

prehensive reform of the first pillar of the CAP the British Upper House even indicated its willingness to countenance the end of the British rebate. House of Lords, European Union Committee, *13th Report of Session 2010–2011, EU Financial Framework from 2014*, HL Paper 125 (London, 5 April 2011).

But national co-financing in the CAP would provoke political outrage in France, with such a “renationalisation” of agricultural policy triggering massive and very emotional cross-party reactions might well culminate in a complete boycott of all reform efforts or even of the MFF negotiations.<sup>45</sup> The CAP remains so enormously symbolic for *la France rurale*, and thus for French domestic politics, that it will be impossible to implement fundamental changes such as national co-financing against the French. The realistic option would be to pursue smaller, almost imperceptible changes without great symbolic significance, supported by new additional instruments for redistributing CAP resources. One way out for the French government might be to continue slowly reducing the direct payments of the first CAP pillar while at the same time and in the same scope expanding the second, co-financed rural development pillar. Such an approach would permit the modernisation of the policy in line with political realities while allowing Paris to point to the CAP's unchanged importance in the EU budget. One new instrument here could be a European risk fund to protect farmers against the vagaries and volatility of the global agricultural commodity markets, as long demanded by France. Depending on its details, the idea floated by the Commission of a greening factor in the first pillar could offer a flexible instrument for reconciling British and Swedish modernisation demands with Franco-German stabilisation interests.<sup>46</sup>

Alongside the Franco-British aspect there would also have to be compensation for the other net receivers in southern and eastern Europe. This would only be possible in the realm of the European Structural Funds. Backward regions in these member-states could be supported by two routes through the EU budget: firstly by reducing co-financing rates to provide relief to national budgets, and secondly by reconfiguring funding priorities, which would occur at the

prehensive reform of the first pillar of the CAP the British Upper House even indicated its willingness to countenance the end of the British rebate. House of Lords, European Union Committee, *13th Report of Session 2010–2011, EU Financial Framework from 2014*, HL Paper 125 (London, 5 April 2011).

**45** At the least extensive compensation for France and European farmers would be required, which would counteract the reform gains.

**46** In its package of proposals the European Commission argues for coupling 30 percent of the direct payments to sustainable ecological agriculture as greening components. Examples include landscape management through ecological focus areas, avoidance of monoculture through improved crop rotation and the preservation of permanent pasture.

expense of regions in the more prosperous member-states of western and northern Europe. Such a sacrifice is, however, almost inconceivable because it would worsen their net balances. Capping contributions with a generalised correction mechanism might limit the effect, but at the expense of exacerbating the domestic political repercussions of the common pool problem,<sup>47</sup> where the special character of the European Union as a multi-level system with complex and opaque finances creates incentives to expand the budget or at least not to change it. The interest of national and regional politicians and administrators in increasing the resources available for jointly funded European spending policies inevitably grows if their own constituency, region or country is likely to benefit from transfers. This tendency arises out of the asymmetry between the sourcing and benefits of shared funds.

These distorted incentives also lead to a situation where national or regional self-interest increasingly supplants the idea of joint funding of European public goods.<sup>48</sup> A prime example is the demand of the German states to leave the European cohesion policy unchanged. While Germany's contributions to the EU budget originate exclusively from the national budget, payments from the European Structural Funds flow largely into state budgets.<sup>49</sup> It requires no great leap to comprehend that these beneficiaries are eager to secure inflows to whose funding they need not contribute. While the German government could employ a generalised correction mechanism to place a ceiling on its net contribution and shield its national budget, this would leave the federal state budgets struggling with revenue losses – in the context of immense pressure to make savings because of the German and European “debt brakes”.

The negotiations need to focus on increasing the efficiency and added value of deployed resources by applying EU funds more precisely and effectively.

<sup>47</sup> Friedrich Heinemann, “Das common pool-Problem in der EU-Finanzverfassung”, *Zeitschrift für Staats- und Europawissenschaften* 4, no. 2 (2006): 188–213.

<sup>48</sup> Heinemann also shows that EU enlargement has further worsened the common pool problem. *Ibid.*, 197.

<sup>49</sup> The German government currently has two programmes of its own that rely on the EU Structural Funds: an ESF programme with a volume of €3.5 billion and an ERDF programme for funding the national transport development plan with a volume of €1.5 billion. So of approximately €26.4 billion from the European Structural Funds to which Germany is entitled in the 2007–2013 funding period, only €5 billion or 19 percent flow back into the federal budget.

More flexible ways need to be found to modify funding programmes and spending priorities, and to adapt them more quickly to changing circumstances. But the goal of achieving a more efficient funding policy without increasing its volume will only be achievable if the outcomes are more closely monitored and conditionalities applied. In order to make EU funding measures more effective, member-states would have to permit sharper monitoring of their programmes, tighter supervision of national implementation, and stricter evaluation and success controls. These heavily technical/administrative issues are discussed not in the actual MFF negotiations themselves, but in the talks about the new Structural Funds regulations. However, the two formally separate negotiating processes will have to be coordinated even more closely with one another. Technical details of the Structural Fund regulations are to be subordinated to this general strategy of gaining more efficiency.

There is, however, a double misunderstanding that causes participants to hold fast to known and familiar procedures and avoid making a start with fundamental changes and comprehensive reforms:

Firstly, the potential advantages of structural reform of the European budget and finance system appear to be a long-term matter at best, while the foreseeable drawbacks of new distribution conflicts or even delays in agreeing a new budget compromise will be immediately obvious in the negotiations.

Secondly, the interest in comprehensive reform and the possibilities of enforcement are unequally distributed. Greater budgetary autonomy, a larger EU budget or spending policy reform would in the first place strengthen the EU and its organs (especially the European Commission), while the member-states would again have to relinquish national sovereignty and domestic budgetary latitude. And it is the member-states that largely decide whether to strengthen the European institutions at the expense of their own powers.

Among the member-states (and especially heads of state and government facing elections), interest in transferring powers to the European Union and its organs is naturally limited. The situation is further complicated by the fierce distribution conflicts that generally accompany the negotiations, incurring immediate political reform costs whereas integration gains are expected for the distant future (if at all) and their potential distribution remains unclear.

It is therefore rather unlikely that the spending priorities of the EU budget will be fundamentally

redefined, as the critics repeatedly demand, to redirect spending to areas that promise European added value: education, innovation, research, external border protection or defence. In log-jammed negotiations with reciprocal blockades and compensation expectations, a substantial redistribution of resources away from the two biggest spending blocks, CAP and cohesion, is unlikely. Proposals to subdivide the budget or supplement it with a parallel investment budget are also unrealistic.<sup>50</sup>

The path of inconspicuous gradual and sustainable reforms within the existing European spending priorities currently appears more viable.<sup>51</sup> This was in fact the route the European Commission chose to break the logjam in 2005. The first step was to cautiously reduce the resources of the CAP and the cohesion policy and initiate a “subsidy withdrawal”. In a second parallel step the policies were aligned with the new funding objectives, thus shifting the longer-term substantive priorities of agricultural and cohesion policy.<sup>52</sup> The budget headings kept their old names, remaining formally unchanged and retaining their symbolic meaning, but were used to fund new policies. The substance of the policies was gradually re-oriented through incremental changes. Only at the end of the reform process and the financial “weaning” can the policies finally be redefined. But by that time this will no longer be understood as a fundamental change of direction. In the long run the risk of blockade steadily recedes.

Such a gradual functional shift could be backstopped by tying funding policies to the European climate and energy targets, for example by fixing the greening components in the CAP direct payments or

by setting binding funding objectives for the Structural Funds.<sup>53</sup> It would also be especially important to focus future cohesion and agricultural programmes on the Europe 2020 strategy and the overarching economic policy objectives of improving community and member-state competitiveness.<sup>54</sup> This naturally includes close linkage, institutionally consolidated by the new regulations, with existing funding policies and the new reform goals and instruments derived from the lessons of the current euro crisis.<sup>55</sup> One guiding principle could be to use the MFF for economic policy response and management. Further, this gradual reform process must be consolidated through positive, self-reinforcing incentives and safety mechanisms so that it does not break off, but opens up an alternative, irreversible road to reform.<sup>56</sup> It would remain sensible to make it easier to reallocate and carry over unused funds from one financial year to the next. This, too, would expand the EU’s practical options and increase the response speed of the member-states.

Such a cautiously managed process also fits with the traditional scepticism of political institutions and administrations towards fundamental and far-reaching reforms. Niklas Luhmann identifies these “conservative traits” of administrations as a significant

<sup>53</sup> The actual political benefit is simply to make any kind of start with redefining funding objectives. But the actual greening component in the first pillar of the CAP is likely to remain limited and possibly to be further weakened in implementation during the funding period. A similar process can be expected in the structural policy when the Structural Funds are brought in line with the Europe 2020 strategy. Here too the reformed finding priorities are ambiguously formulated.

<sup>54</sup> This is the intention of the European Commission’s proposals for consolidating the legal bases of the multi-year spending programmes in a single European legal framework and coordinating the strategic orientations of all the funds. European Commission, Commission Staff Working Document, Elements for a Common Strategic Framework 2014 to 2020, the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund, SWD(2012) 61 final, parts 1 and 2 (Brussels, 14 March 2012).

<sup>55</sup> The last Financial Framework already reconciles the funding objectives of the European Structural Funds with the goals of the Lisbon strategy. Peter Becker, *The Modernization of European Cohesion Policy*, SWP Research Paper 7/2009 (Berlin: Stiftung Wissenschaft und Politik, May 2009).

<sup>56</sup> “In such a process, moves in a particular direction can be self-reinforcing, making it increasingly difficult over time to reverse course.” Pierson, *Politics in Time* (see note 35), 149.

<sup>50</sup> Charles B. Blankart and Gerrit B. Koester, “Stillstand trotz Reform – die politische Ökonomie des EU-Haushalts von Rom bis Lissabon”, in *Einnahmen- und Steuerpolitik in Europa: Herausforderungen und Chancen*, ed. Kai A. Konrad and Tim Lohse (Frankfurt am Main, 2009), 13–46; Susanne Neheider and Indhira Santos, “Reframing the EU Budget: Decision-Making Process”, *Journal of Common Market Studies* 49, no. 3 (2011): 631–51.

<sup>51</sup> Ebbinghaus refers to such a long-term process as a “development pathway”. Bernhard Ebbinghaus, *Can Path Dependence Explain Institutional Change? Two Approaches Applied to Welfare State Reform*, MPIfG Discussion Paper 05/2 (Munich: Max-Planck-Institut für Gesellschaftsforschung, 2005).

<sup>52</sup> According to Streeck and Thelen such a process can be classified as “institutional conversion” where existing institutions “are redirected to new goals, functions or purposes”. Wolfgang Streeck and Kathleen Thelen, “Introduction: Institutional Change in Advanced Political Economies”, in *Beyond Continuity*, ed. Streeck and Thelen (see note 35), 1–39, 26.

obstacle to far-reaching change.<sup>57</sup> This is exacerbated by the interest administrations possess in proving or increasing their importance through generous allocation of resources. Administrations fight for “their” budgets and attempt to prevent cuts. This pattern is not only observed in the European Commission and its departments and services, but equally in administrations at member-state level. During the European budget negotiations the same distribution conflicts also regularly arise within national administrations and influence the positioning of the European Commission. When coordinating their own country’s negotiating position all national ministries seek to maximise the European budget heading for their own policy area, in order to subsequently benefit from European funds.

### The economic crisis as a force for path change

Much more rarely, institutional change is brought about by a complete change of policy path, in the sense of a caesura and a correction of the chosen direction.<sup>58</sup> Because of the foreseeable costs of change, such a path change will mostly require the help of an exogenous shock. Niklas Luhmann’s theory that “programmes are generally not modified in good time, but only when a tangible crisis looms” applies especially to complex systems:<sup>59</sup> a crisis or a single exogenous event reveals the limits of the existing system, multiplies the political costs of clinging to existing structures, or uncovers new incentives that make changing these structures appear more profitable.

<sup>57</sup> “Systems may thus easily end up clinging to programmes that have become inadequate, pursuing outdated objectives or responding to signs that have long lost their original meaning. Fundamentally the function of programmes needs to be continuously monitored in order to ensure that they are still coherent. But monitoring and modification encounter certain difficulties stemming from the specifics of the programmed decision-making process that are not easy to overcome. This introduces conservative traits into administrations.” Translated from Niklas Luhmann, *Politische Planung: Aufsätze zur Soziologie von Politik und Verwaltung*, 3rd ed. (Opladen, 1983), 133.

<sup>58</sup> See also Michael Howlett, “Process Sequencing Policy Dynamics: Beyond Homeostasis and Path Dependency”, *Journal of Public Policy* 29, no. 3 (2009): 241–62.

<sup>59</sup> Translated from Luhmann, *Politische Planung* (see note 57), 133.

The present economic and debt crisis in the European Union, which is frequently discussed as the worst and most consequential economic, institutional and political crisis since the beginning of the integration process, could represent such an exogenous shock or force for change, especially as the negotiations for the EU’s next Multiannual Financial Framework are being conducted simultaneously with responses to the crisis. However, the parallel negotiating and coordinating processes are currently almost unconnected. At best the crisis is cited to back up traditional demands for a greater share of the EU budget or reductions in the national contribution to it. The net payers claim that the crisis requires European-level spending cuts alongside national budget consolidation efforts. The net receivers argue that the crisis demands the opposite: increased and clearly visible European solidarity in the form of EU programmes.

It must be noted that the EU budget and existing European spending policies offer little scope for responding quickly, appropriately, and focusedly to the crisis in the eurozone and in individual member-states. The EU budget is plainly too small to be a useful growth instrument, while the stipulation of spending priorities in the Multiannual Financial Framework is specifically intended to prevent resources being reallocated quickly and flexibly. But in a crisis exactly that would be necessary.

There is an obvious contradiction between the challenges of the economic and financial crisis and the present functioning of the community budget. The EU budget pursues different objectives than those of the national budgets. It is designed to fund multi-year subsidy programmes and principally long-term development programmes. It is not appropriate for the fast and flexible responses that are needed in times of crisis. So the EU budget is currently not an effective instrument for European crisis response.<sup>60</sup> What the Financial Framework does offer is financial and medium-term predictability, political and legal depen-

<sup>60</sup> The MacDougall Report of 1977 supplied the first very early indication of the consequences of a common currency for economic management via the community budget. In it, the experts proposed supporting the common currency zone with a significantly expanded community budget. Even today there are still individual voices calling for an EU budget with a volume of up to 10 percent of EU GNP. One such is MEP Othmar Karas (ÖVP), one of the vice-presidents of the European Parliament: “Die EU braucht Eigenmittel”, press release, 25 May 2011, <http://www.othmar-karas.at/de/presseaussendungen.php?id=787&jahr=2011>.

dability and the particular stability of the attained consensus. This special added value of the current budget system would be called into question if the EU budget were to be used for flexible short-term crisis response. These fundamental considerations also mean that spending policy commitments can by no means be modified as unproblematically as is demanded.

Nonetheless, it would be helpful to link the ongoing budget negotiations with the new instruments for stabilising the eurozone. That could provide new stimuli for reforming the European budget and finance system and certainly initiate a fundamental transformation and functional realignment of the EU budget.

European resources should be used above all to generate economic growth and improve competitiveness without unduly restricting the flexibility of national and regional funding priorities. Concrete connections should be created with the new economic management instruments of the European semester for closer economic policy coordination.

There is good reason to believe that the roots of the current debt crisis lie in the inadequate competitiveness of certain eurozone member-states that upset the balance of trade and in turn led to overindebtedness of public budgets. If this theory is correct, the EU budget could be used to establish an instrument to rectify these imbalances through intra-community transfers. It would appear sensible to tie spending from the European cohesion funds to an investigation of macroeconomic imbalances instead of the national prosperity.<sup>61</sup> For member-states with low competitiveness the Commission would formulate recommendations for eliminating the discrepancies and improving competitiveness.<sup>62</sup> Thus the eligibility and distribution yardstick for cohesion spending would be the threat of macroeconomic imbalances rather than per-capita GNP. This new perspective on eligibility would also change the roles and opportunities of the member-

states and Commission. The European Commission would acquire a decisive say in the use of EU budget programmes in the affected member-states: investigating imbalances, making proposals for corrective and preventive measures, and preparing reports assessing their success. Such a system should be designed to motivate member-states to observe the deficit criteria and move towards the competitiveness indicators of the scoreboard rather than as a sanction mechanism. The institutional connection between cohesion policy conditioning on the one side and the incentive effect of EU spending programmes and the preventive effect of the new economic governance structures on the other can be created only in the course of the negotiations over the regulations for the European funding instruments.

Nonetheless, this realignment would be a first step, and a turn away from the ingrained informal rules of the European MFF negotiations. The compensation function of receipts from the EU budget would decline and the orientation on the national net balance would be relativised too. The political rationale of the budget and the negotiations would no longer be determined by states demanding redistribution and having their consent to major European integration projects bought with spending promises. The guiding principle could instead be the collective need for economic management and adaptation. The budget of the European Union would grow piece by piece into a small but useful instrument for creating economic policy impulses.

<sup>61</sup> “Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the Prevention and Correction of Macroeconomic Imbalances”, *Official Journal of the European Union*, L 306, 23 November 2011, 25–32.

<sup>62</sup> In the process for preventing and correcting macroeconomic imbalances the European Commission has published its first Alert Mechanism Report analysing and evaluating internal current account imbalances using a set of indicators (scoreboard). *European Commission, Alert Mechanism Report: Report Prepared in Accordance with Articles 3 and 4 of the Regulation on the Prevention and Correction of Macro-economic Imbalances*, COM(2012) 68 final (Brussels, 14 February 2012).

## Outlook

The force of the euro crisis appears to be so powerful that the inherent flaws of the common currency and even the possibility of a financial transfer in the eurozone may now be openly discussed.<sup>63</sup> If the option of a limited European transfer union is now conceivable in the medium to long term, then the task today is to set the correct course at the beginning of this new European economic, currency and budgetary trajectory. In the course of such a debate the following questions will arise:

- ▶ Should assistance within the community only be made available after the inception of an integration-threatening debt and economic crisis, and then in almost unlimited scope (as with the ESM)? Or should transfers be planned, preventive and coupled to structural reforms with an agreed cap on redistribution volume (through a European financial transfer system)?
- ▶ Who can and should be eligible for a financial transfer: all members of the EU or only eurozone states?
- ▶ To what criteria or conditions should European transfers be tied?

During the crisis Germany's Europe policy has to date followed the principle of "conditional help to help themselves". Berlin made its consent to the bailouts and to the ESM dependent on the recipients credibly promising to introduce structural reforms. The Fiscal Compact made this promise by the crisis states binding under international law and actionable before the European Court of Justice. Applied to a long-term restructuring of the European budget and finance system this strategy would mean that only member-states that promised to carry out the mea-

<sup>63</sup> Klaus-Dieter Frankenberger reports German Bundestag member Rainer Stinner as saying that "despite the countervailing mood of the German population and contradicting the official stance of the German government, a transfer union is coming". Klaus-Dieter Frankenberger, "Wessen Werte für Europa?" *Frankfurter Allgemeine Zeitung*, 19 March 2012. Similar also Thieß Petersen, *Stabilität hat ihren Preis*, spotlight europe 2012/02 (Gütersloh and Munich, March 2012), and Nicolaus Heinen, *Transferunion Europa: Wie groß, wie stark, wie teuer?* Beiträge zur europäischen Integration, EU-Monitor 81 (Frankfurt am Main: Deutsche Bank Research, 28 June 2011).

asures and structural reforms proposed by the European Commission to improve growth and national competitiveness would be entitled to receive EU (or eurozone) transfers.

Such an institutional coupling of structural reforms and financial transfers could then introduce an upper limit on the total volume of transfer payments and guarantee their effective use. This would be the first step towards a restricted-volume community financial transfer mechanism linked to the Union's new economic management instruments.

In all events, an instrumentalisation of the crisis and the budget negotiations for disintegrative purposes must be avoided. The goal of gradual institutional transformation cannot be the re-nationalization of policies through slow financial starvation. Instead, the current crisis should be used to advance long-term integration of joint economic, budget and finance policy. Further down the line a truly federal financial system for a political union could emerge, as floated in 1986 by the European affairs spokesperson of the CDU/CSU group in the German Bundestag, Gero Pfennig.<sup>64</sup> It would possess its own revenue powers, could raise European taxes, and would possess separate European and member state budgets and a vertical European financial transfer system.

### Abbreviations

CAP	Common Agricultural Policy
CDU	Christian Democratic Union
CSU	Christian Social Union
ERDF	European Regional Development Fund
ESF	European Social Fund
ESM	European Stability Mechanism
EU	European Union
GNP	Gross national product
MEP	Member of the European Parliament
MFF	Multiannual Financial Framework
ÖVP	Austrian People's Party

<sup>64</sup> Pfennig, "Eine neue Finanzverfassung für die EG" (see note 20).