

Blankart, Charles B.; Koester, Gerrit B.

**Working Paper**

## Refocusing the EU Budget - An Institutional View

CREMA Working Paper, No. 2009-16

**Provided in Cooperation with:**

CREMA - Center for Research in Economics, Management and the Arts, Zürich

*Suggested Citation:* Blankart, Charles B.; Koester, Gerrit B. (2009) : Refocusing the EU Budget - An Institutional View, CREMA Working Paper, No. 2009-16, Center for Research in Economics, Management and the Arts (CREMA), Basel

This Version is available at:

<https://hdl.handle.net/10419/214443>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

# **Refocusing the EU Budget – An Institutional View**

Working Paper No. 2009 - 16

# REFOCUSING THE EU BUDGET – AN INSTITUTIONAL VIEW

Charles B. Blankart  
and  
Gerrit B. Koester  
Humboldt University Berlin<sup>1</sup>

July 30<sup>th</sup>, 2009

## ABSTRACT

*There is little disagreement that the EU budget should be refocused. Redistributive agricultural and structural spending should be reduced in favour of more public good spending as the Boege and Sapir reports demand. But a public choice analysis can show that the current deadlock makes a refocusing of the budget unlikely. Starting with the Treaty of Rome we demonstrate how Member States became net payers and receivers and why the underlying coalitions were fairly stable and will remain so after Lisbon. We propose an additional public good budget within an improved process of enhanced cooperation to overcome the deadlock.*

JEL-Classification: H 31, D 78, H 87

---

<sup>1</sup> Humboldt-University Berlin. Faculty of economics. Spandauer Strasse 1. D-10178 Berlin. Germany. charles@blankart.net and [gkoester@wiwi.hu-berlin.de](mailto:gkoester@wiwi.hu-berlin.de). The authors are indebted to Christian Kirchner for helpful comments.

I	Introduction .....	2
II	The EU budget development and its discussion in the literature .....	3
III	An integrated institutional approach .....	5
III.1	General approach .....	5
III.2	Application of the general approach to the EU budget .....	6
III.3	The evolution of redistribution through the budget .....	7
III.3.1	The Emergence of the European Economic Community in the Treaty of Rome (1957) - the Contractual Stage .....	7
III.3.2	Post-Contractual Stage I: France and the Financing of CAP 1958 – 1970 .....	8
III.3.3	Post-Contractual Stage II: Integration of United Kingdom/Denmark/Ireland and Spain/Portugal/Greece 1971 – 1986 .....	10
III.3.4	Post-Contractual Stage III: The Budget under Qualified Majority/Unanimity Rule 1987-2003 .....	12
	Excurses on the financial perspective .....	16
III.3.5	Post-Contractual Stage IV 2004 to 2009: The Treaty of Nice .....	17
III.3.6	The Impact of the Treaty of Lisbon: 2009 and beyond .....	18
IV	A way out of the budget deadlock .....	19
IV.1	General conditions for a way out of the deadlock .....	20
IV.2	Implementing a new public good budget within the institutions of the EU .....	21
V	Conclusions .....	22
VI	References .....	23

## I INTRODUCTION

Spending of the European Union is dominated by redistribution - mostly based on agricultural and structural programs. Large sums of money are transferred from the Member States to Brussels and back to the Member States. Only little is spent for union-wide public goods.<sup>2</sup> Furthermore detailed analyses show that many redistributive programs lead to perverted redistributive effects favouring regions with large and rich agricultural producers (see e.g. Shucksmith et al. (2005)). Many economists believe thus that redistribution is excessive and inefficient while the provision of union-wide public goods is too small. Therefore economists widely agree that a reallocation of the budget would generate welfare gains.<sup>3</sup>

Within the ongoing enlargement of the European Union, the inefficient budget spending came increasingly into the focus of policy-makers. Most important in the discussion among policy-makers are currently two political proposals for a budget reform: the “Sapir Report” (initiated by the European Commission) and the “Boege Report” (initiated by the European Parliament).<sup>4</sup> Both reports agree that a shift of spending from redistributive agricultural programs to public good provision would be welfare-enhancing. The Sapir Report demands that 45 percent of total spending should in the future be used for public good provision (especially in infrastructure and research), 35

<sup>2</sup> Expenditures for research, external activities and administration (in relation to total expenditures) could in a first rough approximation be regarded as contributions to union-wide public goods, while Member State specific expenditures could be defined as non union-wide. If we follow this definition, roughly 15 percent of the budget are spent for union-wide public goods. For the data see: European Commission (2006), EU Budget 2005, p 13.

<sup>3</sup> Alesina, Angeloni and Schuknecht (2005) identify the highest potential for an additional welfare-enhancing provision of public goods on the EU level in the areas of environmental policy, international relations, justice and migration. Another example is Tabellini’s statement that there “would be large payoffs to more central provision of public goods in the areas of defence, foreign policy, and of aspects of internal security, border patrols, immigration policy. The abolition of borders between EU countries carries with it the need to centralize aspects of law enforcement against organized crime” (Tabellini, 2002, pp. 17ff.).

<sup>4</sup> See Aghion et al. (2004) for the Sapir Report and European Parliament (2005) for the Boege report.

percent for “industrial convergence” and only 20 percent for restructuring programs including agriculture. The Boege Report focuses more on changes on the revenue side. The most important demand is that the Member States shall co-finance 25 percent of all agricultural spending of the EU. If total spending of the EU remains stable, this should increase the room for EU spending on public goods. Furthermore the incentives of Member States’ governments to call for EU spending shall be moderated by the co-financing regulation.

It is striking that the most important reform proposals initiated by the institutions of the European Union do argue with the general importance of incentive effects (as e.g. the Boege Report demands the introduction of co-financing), but fail to acknowledge that reforms have only a chance to be implemented if they are in line with the Member States’ interests given the status quo. In our view it is generally far from sufficient to ask: How should the budget look like? Instead we think that we need to ask: How did we end up in a situation where large parts of the budget are devoted to inefficient agricultural programs? Why is there so much redistribution? Why does the European Union (as an institution that has been founded to promote free exchange in a common market) spend most of its budget on redistribution? And why is redistribution so persistent? Why are some Member States consistent net payers and others consistent net receivers? We believe that all these questions cannot be answered by a cost benefit analysis of the traditional public finance type. It requires a rigorously positive analysis of the incentives, costs and constraints of political decision makers. And only such an analysis can help us to develop ways towards a more efficient and public good oriented budget in the enlarged EU. In our view this is the only suitable approach to avoid that progress with respect to the EU budget is limited to normative reform proposals without any chances to be implemented.

We offer such an approach here based on the theory of incomplete contracts. We analyze the development of the EU Budget since 1957 and show that not only voting rules (as established in the EU treaties), but as well the threat of exit played an important role in the development of EU spending. We argue that two different historically formed coalitions now have an incentive to veto changes on the financing and the expenditure side, which leads to budget deadlock and prohibits a change towards more public good provision. Based on our analysis we see the introduction of a separate budget for public goods with separate decision rules to be a viable alternative to overcome the current budget deadlock.

The paper proceeds as follows. Part II demonstrates the development of the EU budget, discusses approaches to budget analysis in the literature and establishes the need for an integrated institutional approach. We develop such an approach based on the theory of incomplete contracts in part III. We apply this approach to the historical development of the EU budget since 1957 and show how a budget deadlock developed. Based on our historical insights, the effects resulting from EU enlargement are analyzed. Finally, we discuss institutional reforms which could facilitate a way out of the deadlock towards a more efficient budget (part IV). The last part concludes.

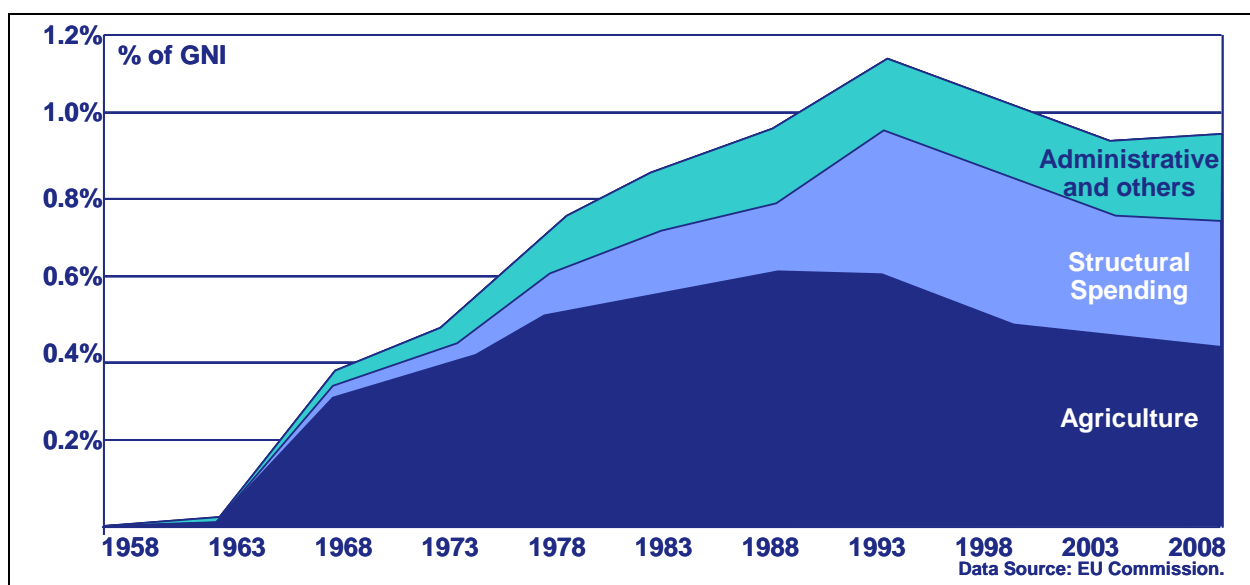
## **II THE EU BUDGET DEVELOPMENT AND ITS DISCUSSION IN THE LITERATURE**

The European Economic Community started in the early years with a very small budget of around €80m, which increased strongly only after 1965 and reached a total of €121bn in 2006 – an absolute increase by a factor of 1,500. After a slight reduction of spending with respect to GNI within the last years, the budget currently equal about one percent of EU GNI (see figure 1). While this seems to be only a small public budget, we need to note that the EU budget is levied on top of the national public budget.

In the literature we can distinguish three approaches to the budgetary process in the European Union.

*Normative approaches* are mainly concerned with four questions: How large should the budget be? How should the budget be financed? How should the budget be spent? And: Which decision making rules are “fair” to decide on the budget. Examples are the mentioned Sapir and the Boege Report as well as discussions about the advantages of an “EU tax”. A very comprehensive analysis of this kind, which includes polit-economic aspects as well and is focused on the revenue side of the budget, can be found in Heinemann et al. (2007).

**FIGURE 1:**  
**Development of the EU budget by policy area.**  
**Data source: European Commission.**



A second group are *descriptive approaches*, which discuss the design of the budgetary rules and the decisions which have been taken. Examples are Messal (1989, 1991), Messal and Klein (1993), Peffekoven (1994), Strasser (1991) EU Commission (1995) and Lienemeyer (2002). Though this literature only describes what happened, not why it happened, it is very valuable for us as it serves as a “data base” for our analysis.

A third group are *positive approaches* which try to explain the development of the EU budget based on voting power given the decision rules laid out in the Treaty. Most of these approaches focus on the development of net payments. They argue that “power politics dictate the EU’s budget” (Baldwin et al., 1997, p. 157).

While we generally share the belief of the positive literature that power is important with respect to the EU budget, we nonetheless disagree with the existing positive approaches in three important points: First, we argue that the historical development of the EU since the Treaty of Rome is crucial to understand the current budget incidence. Second, we want to show that voting power alone is not sufficient to explain the development of the budget and the budget incidence, but that credible exit threats play an important role as well. Third, we argue that we explicitly need to study the revenue as well as the expenditure side and not only the resulting net payments.<sup>5</sup> Therefore we want to propose a different approach based on the theory of incomplete contracts which integrates these three criticisms in the existing positive literature.

<sup>5</sup> Vaubel (2001, p. 36) already mentioned the problem of the different types of rules and coalitions (one on the expenditure and one on the revenue side), but did not analyze it further.

### III AN INTEGRATED INSTITUTIONAL APPROACH

How can we explain the development of the EU budget since the founding of the EU? What is the influence of the historical development on the current situation? What do we expect for the future development of the EU budget given its history? We propose to study the development of the EU budget based on a theory of incomplete contracts which is applied to the EU as a Union of states and takes exit threats into account. We will first describe our general approach and then apply it to the budget development of the EU from 1957 on.

#### III.1 GENERAL APPROACH

To study the development of the EU budget we apply the *theory of incomplete contracts* as developed for constitutions by Buchanan (1975), Brennan and Buchanan (1985) and others. It discusses the design of rules at the contractual level which will be executed later on the post-contractual level. Although decisions at the contractual level may be unanimous, their later execution may cause problems.

Based on the theory of incomplete contracts we shall distinguish two alternatives:

- I. Some decisions made on the contractual level do not require further discussion or clarification on the post-contractual level as the rights and duties of the parties have been reasonably well specified (*type I*). The contract has simply to be executed. Possible misinterpretations of the terms of contract, which may emerge later on, are not reconsidered in the political process but by courts. This holds in particular for contractual redistribution, i.e. redistribution as pre-designed in the contract which can take place according to the agreed upon rules.
- II. It has to be anticipated, however, that some provisions on the contractual level are incomplete and that new issues will emerge in the post-contractual stage (*type II*). Within the contract it therefore has to be agreed on decision rules for issues not explicitly or not sufficiently regulated on the contractual level. The application and the enforcement of these decision rules are often not called into question. It is simply assumed that the decisions according to these rules will be binding because the rules themselves have been agreed upon unanimously.

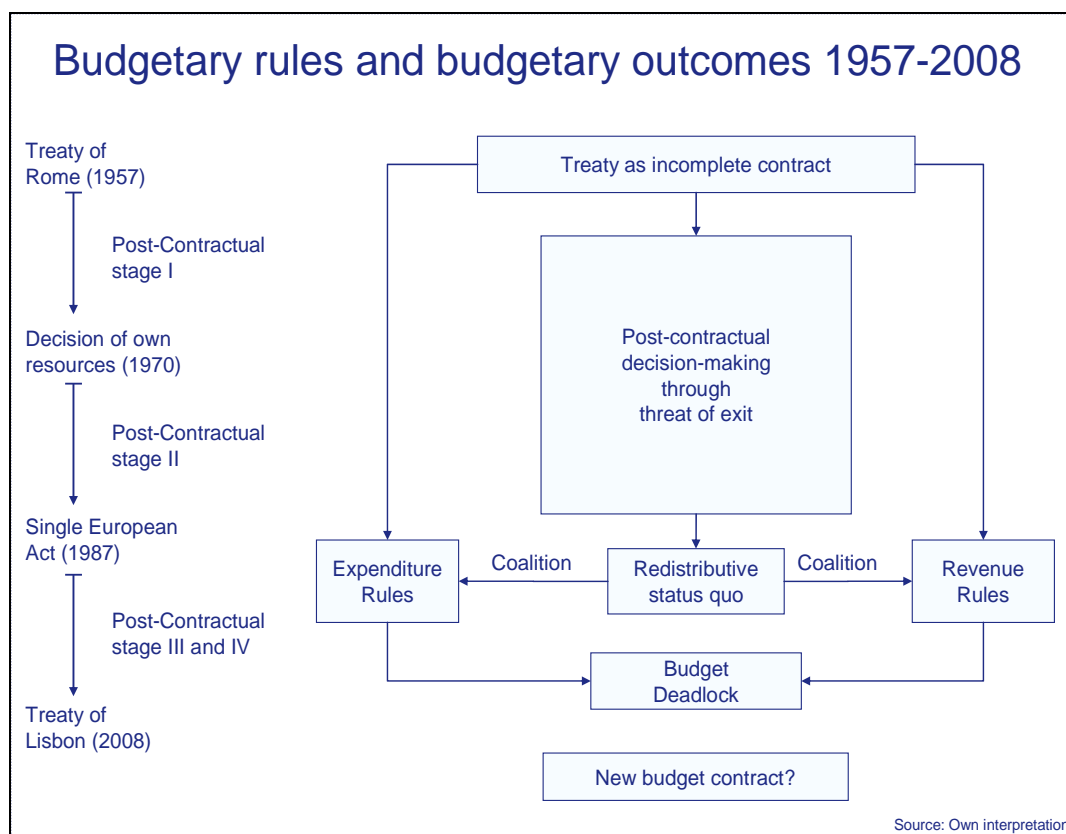
If the decision rules at the post-contractual level are just applied (e.g. to the budget process), then we could just focus on a positive analysis based on voting power resulting from the agreed upon decision rules. But in case of the EU we argue that we have to expand the general approach. In contrast to the case of a national state, where the individual citizens are the formal decision makers but have only very limited individual influence, the Member States of the EU as represented by their governments are the most powerful decision makers. They might threaten to harm the Union by terminating their contractual ties with the EU. Such a threatening has to be expected especially with respect to the rules to settle post-contractual issues which will, in general, not generate unanimously accepted outcomes. There will be Member States who win and some who lose. The latter may object to acknowledge the outcomes if they have the power to threaten to terminate the contract. If their threat is credible and has important negative consequences for the Union, special concessions for these Member States are likely to be granted instead of an “normal” application of the agreed-upon decision rules. In the same way as Member States can threat to leave the Union, accessing states may be able to exert non-entry threats.

But what determines credibility of an exit or a non-entry threat? We argue that credibility of a threat will be strong in the early stages of a contractual arrangement as long as the ties of cooperation evolving under the roof of the contract are still loose. There is not much to lose by terminating membership at this time. Market integration is still weak. Through time, however, market integration will grow, ties will become more intense, and the costs of exit will rise which makes the threat of exit less credible. Consequently the importance of the application of the constitutional rules to post-contractual decisions will increase. An early and therefore credible exit threat will lead to large concessions especially if important negative consequences for the other members of the Union are likely. This is the case if the threat comes from large and important Member States or a coalition of smaller Member States without whom the Union cannot be maintained. For non-entry threats, the importance of a state for the further development of the EU is decisive.

### III.2 APPLICATION OF THE GENERAL APPROACH TO THE EU BUDGET

What do we find if we apply the general approach of incomplete constitutional contracts including exit threats on the development of the EU budget process? We argue that we need to distinguish four different stages within the process (see figure 2).

**FIGURE 2:**  
**Budgetary rules and budgetary outcomes 1957-2008**



We start with the contractual stage. In the Treaty of Rome of 1957 we can find contractual rules of type I, which are applied without further decisions at the post-contractual level, and rules of type II which require further clarification at the post-contractual level. Had the Treaty been designed as a fully complete contract, post-contractual redistribution would not be an issue. But the Treaty of Rome was typically an incomplete contract. Therefore post-contractual decisions on redistribution had to be expected.



In the post-contractual stages I (from 1958 to 1970) and II (from 1971 to 1986)<sup>6</sup> redistribution did not only take place according to the rules agreed upon the Treaty, but also through threat. Member state governments, who had alternative policy options and who were able to harm the other Member States by terminating their membership, used their threatening power to enforce their distributive goals in the budget.

With progressing co-operation in the Common Market, however, threats became increasingly less credible in the post-contractual stage III. As inter-firm ties have been established, it has become obvious that the loss from terminating membership would be large. Therefore threat as an instrument of influencing the budget was increasingly substituted by the formal rules of the Treaty. But these rules were far from perfect. They separated the expenditure side of the budget from the revenue side. Based on the status quo, which resulted from the developments in the post-contractual stages I and II, the formal rules of the Treaty generated opposing coalitions on either side of the budget. The expenditure side is dominated by net receivers, the revenue side by net payers, and both groups exert veto power. The result is that of a budget deadlock dominated by redistribution with a fixed allocation of benefits and burdens per Member State.

### **III.3 THE EVOLUTION OF REDISTRIBUTION THROUGH THE BUDGET**

According to our presuppositions in the previous section and our general discussion of the theory of incomplete contracts, we are now able to analyze the evolution of the EU budget in the four different periods (see figure 2) in more detail.

#### **III.3.1 THE EMERGENCE OF THE EUROPEAN ECONOMIC COMMUNITY IN THE TREATY OF ROME (1957) - THE CONTRACTUAL STAGE**

The original purpose of the Union as laid down in the Treaty of 1957 was the establishment of a Common Market and not that of a system of redistribution among Member States. In article 2 of the Treaty, redistribution is not even mentioned:

*"The Community shall establish a common market and promote by progressive approximation of economic policies throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, a growing stability, the raising of the standard of living and closer relations among Member States"* (art. 2, 1957).<sup>7</sup>

Redistributive elements show up only in later articles. Art. 40 § 4 of the Treaty of 1957 mentions the establishment of „agricultural guiding and guarantee funds” and art. 123 the establishment of a ”European Social Fund”.

How can we explain the establishment of the agricultural and the social fund? To establish the European Economic Community all six founding Member States Belgium, Germany, France, Italy, Luxembourg and the Netherlands had to agree on the Treaty of 1957. While it was to be expected, that export oriented Member States such as Germany would gain from free trade in the Common Market, such gains were perceived to be much less certain for the more domestically oriented economies such as Italy and France.<sup>8</sup> Their governments feared that the rents of integration would be shifted out of their countries. Therefore they aimed at institutionalized claims on the rents which ought to be guaranteed through the Community budget. The Italian workers should be helped by the

---

<sup>6</sup> The developments on the different stages will be discussed in detail in the following parts.

<sup>7</sup> The original text of the Treaty of Rome is in German, French, Italian and Dutch. Translation by the authors.

<sup>8</sup> This perception was widespread despite the view from economics that particularly the initially closed economies should expect large gains from trade within the EU.

Social Fund to overcome their structural problems when transforming from an agrarian to an industrialized economy and the French farmers should be subsidized through the agricultural guiding and guarantee funds. Note that market intervention through funds was a rational way for the Italian and French governments to preserve a claim on the rents of integration. Only through funds could they rely to obtain the desired share of the Common Market benefits. Lump sum payments, in contrast to funds, had to be negotiated anew in every year and were therefore not as reliable as funds.<sup>9</sup>

As funds were part of the Treaty, they were not unilaterally terminable and could only be removed by a unanimous decision. They became part of the *acquis communautaire*. Given that there is always at least one loser when a fund is abolished, it is difficult to see how unanimity could be achieved without replacing the fund by some other form of compensation, i.e. by perpetuating it. Therefore a persistent element of redistribution has been built in the European Economic Community since its beginning.

Critiques that funds are inefficient and should be abolished are, based on this background, ill founded. It should rather be asked what alternative arrangements would have been at the disposal of the French and Italian governments in 1957 to secure the rents of the Common Market permanently. It would soon become clear that only arrangements, which are framed in the constitutional Treaty, were safe.

### III.3.2 POST-CONTRACTUAL STAGE I: FRANCE AND THE FINANCING OF CAP 1958 – 1970

After the establishment of the Treaty in 1957, the post-constitutional stage I started and the post-constitutional rules of the Treaty were applied.

At the beginning the budget was split in three separate branches: the administrative budget (covering the administrative expenditures of the Commission, the Council and the European Court of Justice), the agricultural budget (representing the subsidies to farmers through the guiding and guarantee funds) and the social budget (for training and reintegrating workers subject to structural change).

**TABLE 1:**  
**Contribution shares to the Administrative Expenditures and the Social Fund (1957-1970) in percent**

Member State	Administrative Expenditures	Social Fund
Belgium	7.9	8.8
Germany	28.0	32.0
France	28.0	32.0
Italy	28.0	20.0
Luxembourg	0.2	0.2
Netherlands	7.9	7.0

Source: Treaty 1957 art. 200, see also Peffekoven (1994, p. 44)

The administrative budget and the social budget were financed by fixed share contributions as laid down in art. 200 of the Treaty of 1957 (see table 1). To the administrative budget, the three large countries, Germany, France and Italy had to contribute 28 percent each. To the Social Fund, France and Germany contributed 32 percent each while Italy contributed 20 percent. Changes were subject to unanimity. With respect to the social budget, regulations pertained also on the expenditure side.

<sup>9</sup> An early emphasis of the compensation function of the EU budget has been given by Folkers (1995).

The national governments had to match granted EU subsidies with national spending of the same size (co-financing). The rules of the agricultural fund, in contrast, were quite different. First, the extent of the agricultural market was defined openly in art. 38 § 3 of the Treaty of 1957. The decision on the exact number of items to be subsumed under the common agricultural policy (CAP) was postponed. Second, neither the system of price guarantees nor that of structural aid to farmers has provided for national co-financing. Third, the contribution shares, which each Member State had to pay to the agricultural fund, were not fixed in the Treaty. They were negotiated periodically in the Council. Table 2 illustrates how much bargaining must have taken place in the process of agricultural budget determination since the common agricultural fund became effective in 1962. Five different schemes of country contribution shares had been recorded only in between 1962 and 1970. Moreover, these shares were only the general yardsticks on which further increments or decrements were negotiated from year to year.

**TABLE 2:**  
**Contribution Shares to the Agricultural Fund 1962-1970**

Member State	7/1962 6/1965 <sup>a</sup>	1965/66	1966/67	7/1967- 12/1969 <sup>b</sup>	1970
Belgium	7.90	7.95	7.95	8.10	8.25
Germany	28.0	31.67	30.83	31.20	31.70
France	28.0	32.58	29.26	32.00	28.00
Italy	28.0	18.00	22.00	20.30	21.50
Luxembourg	0.20	0.22	0.22	0.20	0.20
Netherlands	7.90	9.58	9.74	10.35	10.35

<sup>a</sup>Fixed shares only. Variable supplementary shares (according to a Member State's net imports of particular farm products) are not included.

<sup>b</sup>Only for guiding expenditures; for guaranty contributions only if not covered by custom revenues (of which 90 percent were transferred to the Community)

Of the three budgets we would expect that the agricultural budget was most vulnerable to the Member States' attempts aimed at increasing their national benefits. This resulted from two reasons: First, national redistribution via the administrative budget was hard to achieve as the administration had to be mainly at one place, at the capital of the Community. Second, the constitutional contract was (applying the theory of incomplete contracts) less complete with respect to the agricultural fund than to the social fund. The extent of the agricultural market was defined more openly, there was no co-financing and the contribution shares were frequently renegotiated.

What were the consequences of these different regulations in the Treaty? As far as the budget was concerned, responsibility rested mainly with the Council which had to apply qualified majority rule according to art. 148 § 2 / 203 § 3, 4 of the Treaty of 1957. Therefore we would expect that Member State governments were anxious to form qualified majorities in order to increase their net transfers from agricultural policies while reducing their contribution shares. But an historical analysis shows that this was done mainly not by coalition building, but by the threat of exit which dominated changes in the agricultural budget.

In these early years the stakes of the Member States in the Community were still small. Strong private enterprise contractual ties had not yet developed. Therefore, an exit threat was credible and potentially harmful when made by a larger Member State which was important for the future development of the Community. The most important example here is France. Given the vagueness of the contractual rules, the French government wanted to extend the agricultural fund in a way that was disapproved by the other Member State governments. The French intentions were outvoted by the Council in fall 1965. But given that the Community was so young and the stakes in it were still small, the French government, under President de Gaulle had the option to exit and thereby to jeopardize the Community's future substantially. The French government decided to threaten the

Community and chose to boycott all further meetings of the Council in fall 1965. Resulting from this pressure, the unanimity rule was formally resumed in the so-called Luxembourg compromise of January 29, 1966 and the expansion of the agricultural fund was pushed through by the French government by its exit threat. This led to a steep increase of agricultural spending after 1965 (see figure 1) and a strong increase in redistribution via the agricultural budget.

What we can learn here is that the credible exit threat led to a crowding out of the constitutionally adopted qualified majority rule by the unanimity rule and the implementation of the redistributive preferences of a minority. Furthermore the examples of the Social Fund and the Agricultural Fund show the relevance of strict versus weak contractual budget rules. In the case of the Social Fund, post-contractual collective decision making has been avoided because co-payments were already introduced in the Treaty. In the case of the Agricultural Fund, however, collective decision making has been shifted from the contractual to the post-contractual stage where collective decisions were taken under the French government's threat to leave the Community and to jeopardize its further existence.

Together, we can understand why the agricultural budget developed so differently from the social budget from 1957 to 1970 and why its rules were capable of bringing the Community into its first deep crisis.

### III.3.3 POST-CONTRACTUAL STAGE II: INTEGRATION OF UNITED KINGDOM/DENMARK/IRELAND AND SPAIN/PORTUGAL/GREECE 1971 – 1986

Two important changes in the budget process took place in 1970. First, a unitary budget was introduced and second, the role of the European Parliament in the budget process was strengthened. The tripartite budget – with earmarked contributions to agricultural, social and administrative spending – was given up in favour of a unitary budget within the decision on Community's own resources of 1970.<sup>10</sup> The unitary budget was financed initially by two sources of revenues: revenues of customs and other levies and a contribution by Member States calculated on their respective standardized VAT base. Later on, these two resources have become known under the names of "traditional own resources" and "VAT own resources". Formally the decision on the Community's own resources had a constitutional quality as it remained valid until it is replaced by a new decision on the Community's own resources. Thus, the status quo could only be changed by unanimity (Lienemeyer 2002, pp. 205-214).<sup>11</sup>

By the introduction of a unitary budget in 1970, the Member States gave up the possibility to directly control the spending for the different funds. How can we explain this voluntary reduction of control possibilities from a public choice perspective?<sup>12</sup> In our view four arguments were decisive: First, the planned enlargement of the Union by the UK, Denmark, Ireland and the introduction of an additional fund for structural measures made the expected bargaining costs for four different budgets with nine Member States prohibitively high. Second, the experience within the agricultural fund showed that the frequent bargaining nevertheless resulted in only relatively little change in the national contribution shares (see table 2). This experience might have increased the willingness of the Member States to fix the shares on the revenue side and to concentrate bargaining on the

---

<sup>10</sup> Decision 70/243 of the Council from April 21<sup>st</sup>, 1970 on the substitution of financial contributions of Member States by the Community's own resources.

<sup>11</sup> We shall return to the consequences of this rule in subsection IV.

<sup>12</sup> Unfortunately the positive literature studying this change is only very limited. Here a detailed study would be worthwhile.

expenditure side. Third, the unanimity requirement for changes in the revenue system gave effectively every Member State a veto-right which could be used to prevent changes in the revenue structure or even to exert pressure on expenditure decisions. Finally, the Commission with its monopoly as an agenda setter had the power to choose a proposal that was not against its interests. The Commission preferred a unitary budget over a tri- or four-partite budget because the influence of the Commission as the agenda setter was stronger in a unitary budget, as it allowed for much more discretion in shifting funds in between programs.

While the budget process had been an exclusive matter of the Council so far, the European Parliament received competences with respect to the spending of the budget in 1970.<sup>13</sup> Most importantly the Parliament got the “last say” with respect to the non-compulsory expenditures (especially for structural funds, administrative matters and research).<sup>14</sup> However, in the period from 1971-1986 this change in the budget process had only minor consequences for the budget incidence. Non-compulsory expenditures for structural funds and research (the two fields where Member States could try to increase their revenues from the EU budget) accounted for only 5.1 percent of the whole budget in 1970.<sup>15</sup> Although this share increased to 15.8 percent in 1985, it was still too limited to affect the net payment positions substantially.<sup>16</sup> Therefore we neglect the influence of the Parliament in the period from 1970 to 1986 for our analysis here.

The changes in the budget procedure and the introduction of a unitary budget and unanimity requirements on the revenue side did not lead to a reduced importance of threats of exit in the history of the Community from 1971 to 1986. Now the question was about the UK rebate on the contributions to the budget. When the United Kingdom joined the Union in 1973, it was supposed to accept the system of the Community’s own resources of 1970 as an *acquis communautaire*. It had not only to waive all its customs revenues to the Community, but also to contribute to the VAT own resources. Given that British agricultural imports were large and own (subsidized) agricultural production relatively small (compared to those of other Member States), the overall balance resulted in a large net transfer in favour of the Community which was unacceptable for the British tax payers and their government (see table 3). Under the threat that the British citizens would vote against EC membership and the United Kingdom would leave the Community, the Council granted several yearly rebates and repayments up to 1984 when a permanent rebate was conceded in the own resources decision of the Council and the Member States.<sup>17</sup> Here again threat of exit led to direct effects on the budget.

---

<sup>13</sup> The European Parliament received in 1975 furthermore the right to turn down the whole budget ultimately with a majority of 2/3 of the vote cast.

<sup>14</sup> The Parliament became able to finalize changes of the budget with respect to the non-compulsory expenditures with 60 percent of the vote cast (and 50 percent of its members).

<sup>15</sup> Altogether non-compulsory expenditures accounted for 8.1% of all expenditures.

<sup>16</sup> Furthermore majority coalitions in the Parliament were not able to expand the size of the total budget for non-compulsory expenditures, as the size was determined by the difference in between revenues and the compulsory expenditures which were both decided in the Council.

<sup>17</sup> It has to be added that the establishment of the European Regional Development fund had also the specific purpose to increase British receipts in order to reduce the British net payer position.

**TABLE 3:**  
**Net Receipts from the EU Budget 1981 – 1984 in million ECU**

Member State	1981	1982	1983	1984	Σ 1981-84
Belgium	320	310	210	330	1170
Denmark	280	280	330	500	1390
Germany	-1770	-2320	-2300	-2950	-9340
Greece	160	690	940	990	2780
France	540	0	10	330	220
Ireland	590	740	770	920	3020
Italy	780	1520	1320	1710	5330
Luxembourg	270	250	270	280	1070
Netherlands	220	350	370	510	1450
United Kingdom	-1380	-1820	-1910	-1950	-7060

Source: Messal (1991, p. 113) and own calculations

Threat rather than formal decision making rules also determined the concessions made to the coalition of the Spanish, Portuguese and Greek governments at the time of their accession in 1981/86 and even more subsequently when the Single Market was at stake in 1986. One has to remember that democratic regimes were in place in Portugal only since 1976, in Spain since 1975 and in Greece since 1974. In the early eighties these three regimes were still by far less stable than the other Western and North-Western European states. The last military coup took place in Spain as late as 1981 and the constitutional goal of a transformation of Portugal into a socialistic regime was abolished only in 1982. Therefore it was not implausible to assume that these nations might fall back into communism or autocracy which were still popular at that time. Hence, the alternatives for the populations of Spain, Portugal and Greece outside the Community had to be estimated as relatively tempting compared to membership. The EC Member States on the other hand might have felt uneasy with communist or autocratic neighbours in the East as well as in the South. Therefore, one can understand that they were willing to pay a special price for the accession and adherence of these countries. This price was paid especially by spending through the structural fund which doubled in the eighties (see figure 1).

*To sum up:* The concessions made to France and to Spain/Portugal/Greece on the expenditure side and to the United Kingdom on the revenue side make clear that it were often not so much the formal decision rules of the Treaty, but rather governments' capacity to credibly threaten to harm the Community by terminating membership that was decisive. But not all Member States were able to exert such threats. Germany had no credible alternative to its membership in the Community. Though its net payments were at least as large as those which the United Kingdom was expected to make (see table 3), it was unable to exert threat. For nobody seriously thought that Germany was willing to leave the Community. Geographically enclosed between France and the COMECON it had nowhere to go. It turned out that the German government had even to contribute to filling the gap resulting from the British rebate which further increased its net payer position.

### III.3.4 POST-CONTRACTUAL STAGE III: THE BUDGET UNDER QUALIFIED MAJORITY/UNANIMITY RULE 1987-2003

In the following years, the power of governments to enforce budget decisions by threat of exit decreased continuously. Member States grew closer together. Firms made cross border investments. A network of market ties emerged, making threats of exit increasingly less convincing. Sweden, Finland and Austria became members of the Union in 1995, but as their outside options were very limited, they were not able to negotiate special concessions.

As it had become evident that Member States would firmly adhere to the Community, it became possible to depart from the Luxembourg Compromise of 1966 and to return gradually to the collective decision rules of art. 148 § 2 of the Treaty of Rome (1957). A first step was the Single European Act of 1987 where qualified majority rule was extended to the issues of the Single Market. A second step was the compromise of Ioannina of 1994 where qualified majority was maintained (even with Austria, Finland and Sweden as new members), but the minority required for blocking an issue (temporarily) was set at 23 votes (26 percent) instead of 26 votes (29 percent) out of 87 votes. The actual endpoint of this development was the Treaty of Amsterdam of 1997 (in effect since 1999) which introduced qualified majority rule for Council decisions in important parts of budget policy.

What would we expect based on the change of the collective decision rules? Generally theories of decision making would predict that the application of qualified majorities instead of unanimity increases the likelihood of changes in the EU budget and the net payment positions of different countries as the number of possible winning coalitions increases.<sup>18</sup> But what do we observe? We have calculated the average net payments per head for the period from 1995 to 1999 (when unanimity requirements were in place with respect to almost all expenditure and revenue decisions) and the period from 2000 to 2003 (when qualified majority was in place for important expenditure decisions and unanimity continued to be applied for revenue decisions). We have decided to start the second period in 2000 (although qualified majority was in place since 1999) to account for the slack in policy-making and the time-lag in between political decisions and the visibility of their fiscal consequences.<sup>19</sup> These two periods should be especially suitable for a comparison because of the stability of membership (EU 15).

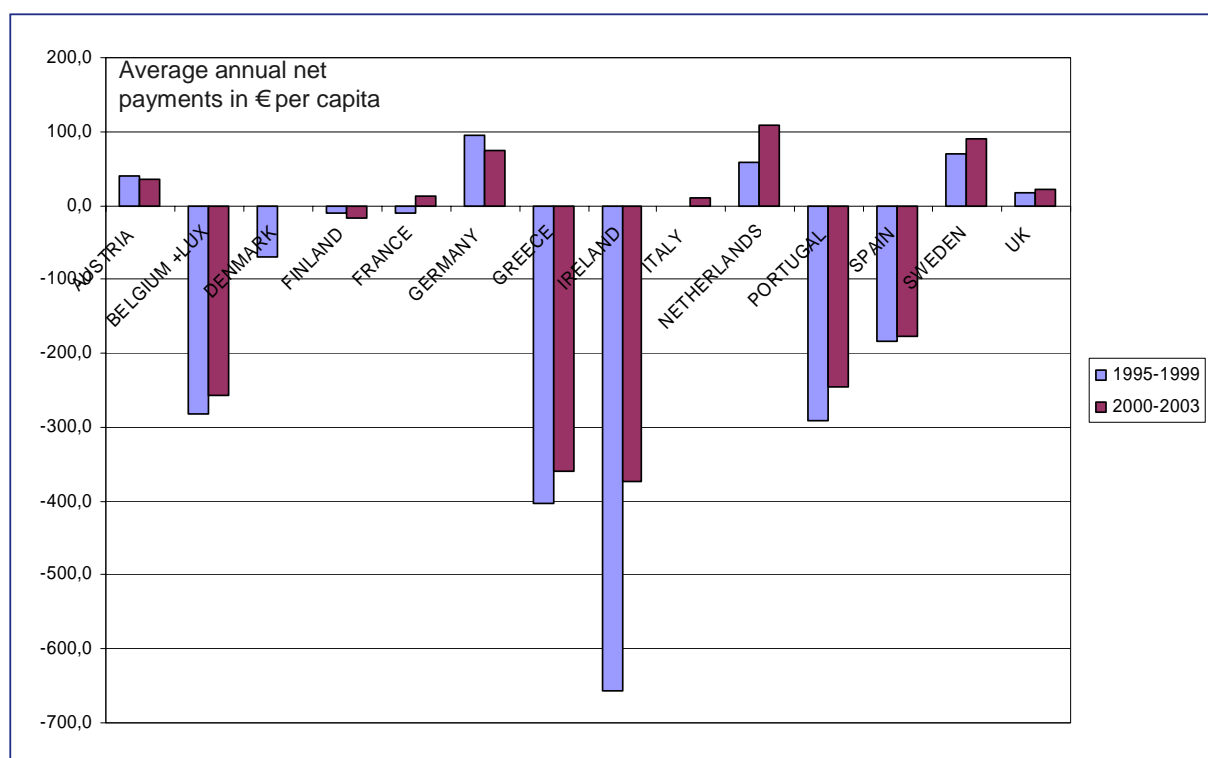
Figure 3 shows the average annual net payment positions per head in the periods analyzed. In the period from 1995 to 1999 we observe eight net receiver states. Ireland, Greece, Portugal, Belgium/Luxembourg and Spain receive large net payments per head, while Denmark and Finland receive moderate net payments. Net payers are Germany, Sweden, the Netherlands, Austria and the UK. France and Italy are break-even states. They are formally net receivers, but the received payments are so small that we treat them as break-even states. If we compare these net payment positions with the average positions per head in the period of 2000-2003, we find a striking stability. France and Italy continue to be break-even states and continue to show a net payment of close to zero. Of all other Member States of the EU 15 none changes from a net recipient to a net payer or vice versa. And even the extents of average payments per head of the Member States do barely change. Only Denmark, which had been a net receiver in 1995-1999, became a break-even state.

---

<sup>18</sup> See e.g. Hosli (1996).

<sup>19</sup> The results change only marginally if we analyze the periods 1995-1998 and 1999-2003 instead.

**FIGURE 3:**  
**Average annual net payments per head before (1995-1999) and after (2000-2003) the Treaty of Amsterdam in Euro per capita**



How can we explain this result? In our view we need to start with the status quo before 1999. Based on exit threats (combined with other effects as for example the relative importance of the agricultural sector), a group of net receivers came out of the budget process since 1957 while other states (especially those without credible exit options) became net payers. Thereby we ended up in a situation of eight net receivers (Ireland, Greece, Portugal, Spain, Denmark, Belgium, Luxemburg and Finland), five net payers (Germany, Sweden, the Netherlands, Austria and the UK) and two break-even states (France and Italy). If we analyze voting power of the groups of net receivers and net payers we find that net receivers had a comfortable blocking minority of 34 out of 87 votes in the Council in 1999 (see table 4), strong enough to maintain the status quo of the allocation of the Union's budgetary resources on agriculture and structural funds (i.e. to block any departure from last year's budget allocations). The net payers were in a minority position too. They achieved 33 votes only. The two break-even states, France and Italy, had 10 votes each. Even an attempt by net receivers or net payers to attract the votes of the break-even states would not have changed the outcome. Such coalitions would have fallen short of qualified majority of 62 votes. Our results do not change if we treat Denmark, which accounts for 3 votes, not as a net receiver but as well as a break-even state.<sup>20</sup> Similarly, a proposal to reallocate some of the redistributive funds to provide public goods is unlikely to be accepted by the blocking minority of actual net receivers. The costs of reduced transfers are very likely to be borne by them, while the benefits of public goods accrue typically to all Member States.<sup>21</sup>

<sup>20</sup> Denmark is a special case here. It has been a net receiver state in the period from 1995-1999 and a break-even state in the period from 2000-2003. If we analyze the whole period from 1995-2003 Denmark is a net receiver state. Therefore we have decided to treat Denmark in the following calculations as net receiver state. However, even a classification as break-even state would not affect the validity of our general argument.

<sup>21</sup> A critical review of the assumptions made: First of all, one may object that it is a simplification to focus on the Council as a decision maker. Indeed, there are further players such as the Commission which has to make mid-term projections and to prepare the yearly budget. Moreover, negotiations take place between the Commission and the Council. But we argue that the ministers of the Member States have to fight fiercely in the Council for their national interests as contributors and receivers of funds. The better they fight, the larger is the support they will receive from



**TABLE 4:**  
**Votes of net receiver states, net payer states and break-even states in the Council under the rules of the Treaty of Amsterdam 1997 – 2003, EU 15**

<b>Group of Member States</b>	<b>Number of votes</b>	<b>Total votes</b>	<b>Blocking minority</b>	<b>Qualified majority</b>
Net receiver states	<b>34</b>	<b>87</b>	<b>26</b>	<b>62</b>
Net payer states	<b>33</b>	<b>87</b>	<b>26</b>	<b>62</b>
Break-even states	<b>20</b>	<b>87</b>	<b>26</b>	<b>62</b>

Source: Own calculations.

On the *revenue side* each Member State's burden has been determined by unanimity since the first decision on own resources of 1970.<sup>22</sup> In addition, the form of unanimity applied here is an “*asymmetric*” and hence a very strong one as an existing decision on allocating contributions cannot be abolished unless it is replaced by a new unanimous decision.<sup>23</sup> This principle has important consequences for the net budget incidence. If the incidence of expenditures and of revenues is not matched and the member states can be divided in a group of net payers and net receivers, then there is no way for the net payers to get rid of their burden. They will neither be able to reduce the general contribution rates, nor to shift their own burden on the shoulders of the net receivers. Both attempts will fail to be accepted by the latter. There is only one way for the net payers to protect their interests: to block proposals to further increase their contributions to the Union's own resources (which are likely to come from the net receivers). Such a blockade is indeed the only way for net payers to protect themselves against an increase of exploitation by the net receivers.<sup>24</sup> Any promises by net receivers that higher contributions would be used for providing union-wide public goods (or would be acknowledged as an advance in later negotiations)<sup>25</sup> cannot be taken seriously. For under general fund financing, the net receivers have the power to channel these funds towards themselves.

But what about the European Parliament in this period? Did we observe coalitions differing from those dominant in the Council which tried to increase their net-payer positions based on the non-compulsory (in particular structural) expenditures now belonging to the Parliament's competences? The strong increase of these expenditures in the nineties (from 15.8 percent of the budget in 1985 to 39.7 percent in 2000; see figure 1) seems to confirm this hypothesis. But a closer look reveals that in fact little change took place. The trends in figure 1 disguise that mostly a substitution took place from means for price support for agricultural products to means for structural support in agriculture. Institutionally this meant a substitution from the price guarantee section of the CAP to the structural guidance section of the CAP which belongs to the structural funds. As a large part of the other structural funds went to backward industrial and hence often agricultural regions as well, apparently

---

their voters at home. And after all, they have to survive their national elections. Therefore we expect national interests to dominate the strategic behaviour in the Council and the final outcome.

<sup>22</sup> 70/243/EGKS, EWG, Euratom, Abl., Nr. L 94 (1970), p. 19.

<sup>23</sup> Strictly speaking: The decision on European Communities' own resources is open-ended and therefore has to be ended unanimously which will not be done before a new own resources decision has been agreed. See: art. 269 [ex 201] of the Treaty and Council Decision on the system of the European Communities' own resources (2000/597/EC, Euratom).

<sup>24</sup> Note that under simple majority rule, in contrast, net payers could bribe some of the net receivers in order to break up an exploitative majority coalition.

<sup>25</sup> For example, extra payments which chancellor Merkel assigned to Poland in the financial perspective 2005 did not affect Poland's position in the Treaty negotiations of 2007.

the same group of net receiver Member States as before benefited. This is not astonishing as net receiver states and break-even states encompassed nearly 60 percent of the seats in the European Parliament of EU 15 (and actually nearly 70 percent of EU 27). And the net payer states were not able to bribe enough net receiver and break-even states in order to form a qualified counter coalition to reallocate the Union's expenditures to their countries. Therefore it seems legitimate to largely abstract from the European Parliament as a decision maker in budgetary matters in this period.

Some studies on EU-finances argue that the multiannual financial framework instead of the annual budget should be the basis for analysis (see e.g. Heinemann 2005). Indeed this framework has been superimposed on the budget in 1988 in order to prevent the EU institutions (Commission, Council and Parliament) from overdrawing the Union's own resources and to run into deficits. The multiannual framework limits the payment appropriations to a ceiling below the Union's own resources less a margin for "unforeseen expenditures".

## **EXCURSES ON THE FINANCIAL PERSPECTIVE**

Now one could argue that the multiannual financial framework – the seven-years financial perspective introduced in 1988 as combined agreement both on the size of the budget and the basic structure of spending – could have been a decisive innovation to overcome the budget deadlock. However, this has not been the case especially for two reasons.

First, the commitment to the multiannual framework has to be seen on the background of the presented annual budget deadlock. The financial perspective includes especially longer-term spending programs, but generally the principle of annuality of the EU budget remains (based on the Treaties) fully applicable. Therefore the "normal" budgetary rules pre-determine the agreement under the (non-enforceable) financial framework as the ordinary annual budget procedure remains to be the fall-back position for the member states. Or the other way around: The application of unanimity on the level of the financial framework can only be understood on the background of the budget deadlock (a qualified majority for either net payers or net receivers would be likely to blow up the financial perspective).

And second, one has to note that the financial framework has to be passed by unanimity *and* does not specify the distribution of expenditure to the different member states in full detail. With regard to the revenue side, the financial framework does therefore not change the general incentive of the net payer states to block increases of the budget ceilings. Here one vote continues to be enough to block any changes (asymmetric unanimity). And on the expenditure side the multi-annual financial framework does not fully restrict the bargaining on the allocation of expenditures to member states in the annual budget procedure. Instead of breaking up the budget deadlock, the multiannual financial framework therefore increases the already very large status quo bias. And the unanimity requirement cements the payment positions of the member states even further. This is unlikely to change if the financial perspective is made enforceable as foreseen under the Treaty of Lisbon.

## **End of Excursus**

*To summarize:* The historical development of decision making on the EU budget has resulted in a *re-distributive deadlock*. Net receivers use their blocking power to object any reallocation of resources away from their narrow individual interests, and net payers (anticipating net receivers' power to attract the additional resources to themselves) veto any increase in their financial burden. But net payers cannot enforce a decrease of their burden. This would be objected by net receivers under the asymmetric unanimity rule. Therefore the status quo is a stable equilibrium which means that the net budget incidence as it came out of the power play in the post-contractual stages I and II will be preserved. The claims by the Boege and Sapir Reports that more public goods should be provided will remain politically unnoticed.

It is important so see the effect of the *asymmetric unanimity rule* for decisions on Union's own resources. Had the net payers the possibility to unilaterally terminate an existing own resources decision, e.g. after the usual seven year duration of a financial framework, the unanimity rule would be *symmetric*, and all Member State governments would be under pressure to discuss budget revenues and expenditures de novo and as a whole. The separation of revenues from expenditures would be abolished, and substantial reforms might become feasible. Though such a reform of the unanimity rule might be desirable, it is irrelevant for our discussion; for no unanimity would be found to support it. Therefore it is unlikely that the EU budget process can be reformed within its own rules like "Munchhausen pulling himself out of the swamp by his own hair".

*An example* may illustrate how sensitively governments often react to proposals to change the distribution of the burden. When, in anticipation of the Berlin summit of 1999, the German government made some exploratory calculations on the possibility of obtaining an UK type rebate on its contributions, the Spanish government promptly reacted by submitting a counter-proposal requiring that Member States' contribution rates should rise progressively with respect to GNP with the obvious effect that the German government should pay more instead of less to Union's own resources.<sup>26</sup> The Spanish proposal was not even mentioned at the summit, but it had the effect of taking the German proposal off the agenda, and the status quo was maintained.

If these deliberations are correct, the likely result is effectively one of non-decision making. Based on this budget deadlock, union-wide public goods are unlikely to be provided in a larger amount, as those who benefit from redistribution in the status quo have to give up their privileges to finance these public goods and those who pay for the budget are reluctant to pay more because they cannot earmark their contributions for the provision of public goods. The budget is likely to grow in line with the built-in rules. These rules are defined by the ceiling of 1.24 percent of Union's Gross National Income (GNI) as assessed in the own resources decision of 2000.<sup>27</sup> The ceiling has been renewed in the 2005 summit and it will remain at this level until 2013. Some readers may not be too unhappy with the deadlock because it guarantees a sort of "second best": As long as it is apparently not feasible to provide (more) union-wide public goods, they may say, it is fortunate that the budget cannot grow faster than the rate of growth of Union GNP limiting further redistribution.

### III.3.5 POST-CONTRACTUAL STAGE IV 2004 TO 2009: THE TREATY OF NICE

In 2004 an enlargement of the European Union from 15 to 25 Member States took place and from 2007 on Romania and Bulgaria became the 26<sup>th</sup> and the 27<sup>th</sup> member. How does the enlargement affect the budgetary process?

So far we dispose only of very limited data of the impact of enlargement of the European Union on the budget incidence. With respect to the future development we believe that the mechanisms of exit threat of the post-contractual stages I and II will not re-emerge. The Union has become large enough to bear the exit of some of the new accession states. Therefore accession states lack a threat potential comparable to that of France in the sixties or the UK and Spain in the seventies and eighties.<sup>28</sup>

Table 5 shows the groups of net receivers, net payers and break-even states under the rules of the Treaty of Nice, now including the accession states which have all been added to the net receiver states identified under the Treaty of Amsterdam.<sup>29</sup> As we see, net receiver states will not only keep,

<sup>26</sup> See H. Bänder, Die mühsame Suche nach dem richtigen Reformmodell, *Franfurter Allgemeine Zeitung* Nr. 193, 21 August 1998, p. 12.

<sup>27</sup> Less the margin for "unforeseen expenditures", see above.

<sup>28</sup> A good sign of this development is that the right of exit is integrated in the Treaty of Lisbon (see art. 49a).

<sup>29</sup> We continue to treat Denmark as a net receiver state.

but even increase their blocking minority. This may hold even if some of the accession states and of the break-even states may become net payer states as a consequence of the further enlargement.<sup>30</sup> But net receivers (traditional and new) will not attract as many votes as to achieve a qualified majority. But they will be able to block policies reducing transfers to them. Net payers (even when augmented by some successful accession states) will remain weak. They have just enough votes to form a blocking minority, but are far off a qualified majority even in a coalition with the break-even states. Therefore the net receivers will be able to maintain the size of the agricultural and of the structural funds and to suppress public good programs. On the other hand net payers can use their voting power to block further expansion of the budget. All in all little change has to be expected. Only the strain on the resources of the budget is likely to increase.

**TABLE 5:**  
**Votes of net receiver states, net payer states and break-even states in the Council under the rules of the Treaty of Nice 2004 – 2013 EU 27**

<b>Group of Member States</b>	<b>Number of votes</b>	<b>Total votes</b>	<b>Blocking minority</b>	<b>Qualified majority</b>
Net receiver states (old and new)	196	345	91	255
Net payer states	91	345	91	255
Break-even states	58	345	91	255

Source: Own calculations.

It is interesting that a study based on the multiannual financial framework from 2007 to 2013 by Heinemann (2005) predicts a distribution of net payer and net recipient votes in the Council that is similar to our calculations.<sup>31</sup> We see this as further evidence for our argument of stable coalitions of net payers and net receivers with respect to the EU budget.

### III.3.6 THE IMPACT OF THE TREATY OF LISBON: 2009 AND BEYOND

The Treaty of Lisbon, which is planned to come into effect in 2009, includes two important changes: First, new decision rules in the Council are to be implemented and second, the role play of the Council and the European Parliament in the budget process is changed. With respect to the decision rules in the Council, the Treaty of Lisbon foresees new rules starting in 2014 (2017 in exceptional cases), requiring a double majority of 55 percent of the Member States (i.e. 15 States for approval) which have to represent at least 65 percent of the total EU population.<sup>32</sup> Furthermore, four Member States will be sufficient to form a blocking minority.

Table 6 shows the distribution of votes in between net receiver, net payer and break-even states under the new rules of the Treaty of Lisbon. Thereby we continue to hold the net payment positions of the 15 “old” member states constant from the time under the Treaty of Amsterdam and treat the 12 “new” members as net recipients as before. We see that based on the new rules the existing

<sup>30</sup> Malta, Slovenia, Czech Republic and Cyprus will receive an extra payment avoiding that they are pushed into a net payer position.

<sup>31</sup> Based on the study of Heinemann (2005, p. 18), net receivers in the period 2007-2013 dispose of 178 votes and net payers including break-even states of 167 votes.

<sup>32</sup> The transitory regulations of the treaty of Lisbon (art. 3 § 3) foresee that - on demand of any member of the Council - a population criterion of 62% can be applied already from 2009 on. However, this has no influence on the majority coalitions discussed here.

coalition of net receiver states will easily be able to maintain their blocking minority as they outnumber the other two groups. But they will (even in a coalition with the break-even states) not be able to meet the population criterion which would allow them to attract even more resources from the agricultural and structural funds. The coalition of net payers will fail on both; state votes and population even in a coalition with the break-even states. But they can block an extension of expenditures in favour of the net receivers and, as a last resort, an increase of Union's total amount of own resources at their costs due to the unanimity requirement of art. 269 TEC.

**TABLE 6:**  
**Votes of net receiver states, net payer states and break-even states in the Council under the Lisbon Treaty (EU 27)**

<b>Group of Member States</b>	<b>Number of votes</b>	<b>Total votes</b>	<b>Blocking minority</b>	<b>65% of the population</b>
Net receiver states	20	27	4	194.7 < 320.4
Net payer states	5	27	4	176.5 < 320.4
Break-even states	2	27	4	121.7 < 320.4

Source: Own calculations.

With respect to the European Parliament the situation is more complex. We remember from the previous section that following 272 TEC the European Parliament has currently the last word in non-compulsory expenditures (especially structural fund money and administrative expenditures) and can turn down the budget as a whole. Based on art. 314 of the Treaty of Lisbon TFEU, the whole budget will be decided by the Council and the Parliament on equal footing. Many comments see the position of the Parliament to be reinforced compared to the status quo. However, this is not the case. The constitutional draft of 2003 had originally foreseen that the Parliament can enforce its view in case of disagreement on any part of the budget.<sup>33</sup> But the intergovernmental conference of 2004 decided that in case of disagreement in the Conciliation Committee the Commission has to write a new budget draft and the process starts anew.<sup>34</sup> Compared to art. 272 TEC the position of the European Parliament is therefore clearly weakened. Under the present regulation of 272 TEC the Parliament has the last word for all non-compulsory expenditures, while the Parliament will have to compromise on all expenditures with the Council in the Conciliation Committee under art. 314 of the Treaty of Lisbon TFEU.

Taken together we therefore expect that the Council, which is dominated by net receiver states, will reinforce its dominant position in the budgetary process. Little or no change has to be expected in the revenue or expenditure structure from Lisbon and its reforms of the decision rules and the budget process. Consequently we see little chances for an increase in the provision of union-wide public goods.

#### **IV A WAY OUT OF THE BUDGET DEADLOCK**

We have shown that the gridlock of the EU budget is caused by two factors: First, the actual net

<sup>33</sup> "[T]he Parliament may ... acting by a majority of its component members and three fifths of the votes cast, confirm its amendments." art. III-310 § 8 of the constitutional draft of 2003.

<sup>34</sup> A majority decision of the Parliament (as in art. III-310 § 8, 2003) can (following art. 314 Treaty of Lisbon TFEU) only take place in the very unlikely case that the representatives of the Council (in corpore) first come to an agreement with the representatives of the Parliament in the Conciliation Committee and then come to the conclusion that they disagree formally in the Council.

payers are reluctant to agree on an expansion of spending e.g. for union-wide public goods as additional means cannot be strictly earmarked. Therefore net payers have to fear that their additional contributions will be diverted into redistribution favouring the coalition of net receiver states. Second, net payers cannot unilaterally withdraw means from the budget. Their current contributions are subject to an asymmetric unanimity requirement inherent in the EU own resources decision in the sense that unanimity is required to terminate the status quo and hence one single vote is sufficient to continue it.

#### IV.1 GENERAL CONDITIONS FOR A WAY OUT OF THE DEADLOCK

Based on the Treaty of Nice and the Lisbon Treaty we have to expect that the unanimity rule on the revenue side and the qualified majority rule on the expenditure side will be maintained in future years. Even based on the new vote distribution (in effect from 2014 on) this means that no group of net payers or net receivers has a majority which is large enough to change expenditure policy. Hence, the mainly redistributive nature of the EU budget is likely to continue.

How could this deadlock be broken up and an increased provision of public goods with benefits for all citizens in the Union be realized? In our view the following five conditions are decisive for an implementable reform proposal:

- a. *Separation*: We have seen that the means for additional public goods cannot be raised according to the actual budgetary rules. Net receivers would channel the means into redistribution and, in anticipation of net receivers' behaviour, net payers would refuse to contribute. Therefore, a new, separate budget "*the public good budget*" has to be introduced encompassing all or a subgroup of Member States.<sup>35</sup> But the old budget "*the general budget*" has not to be given up in order to avoid that there are losers.<sup>36</sup>
- b. *Symmetric unanimity*: The new budget procedure has to be designed in a way that no party risks to be exploited. Therefore the additional budget requires consent of all participating Member State governments. To make the unanimity rule symmetric and avoid that Member States get locked into the status quo, an individual right of termination (at the end of pre-assigned periods) needs to be included.
- c. *Right of initiative*: To make sure that all pareto-improving public goods projects - and not just those favoured by the European Commission - have a chance of implementation, every Member State government should have the right to propose new projects within the public good budget.
- d. *Institutional congruency*: To reach Wicksellian institutional congruency (between beneficiaries, decision makers and contributors, Wicksell 1896), the Member States agreeing on a separate provision of public goods should not only profit from the benefits of these goods, but as well bear their costs.

---

<sup>35</sup> We doubt that new rules can be adopted without an integration of the status quo. Insofar our proposal differs from other institutional approaches as e.g. the one of Buchanan and Lee (1994).

<sup>36</sup> A current proposal of Friedrich Heinemann et al. (2007) on the reform of the revenue system takes a similar path (Heinemann et al. 2007). Heinemann et al. argue in favour of a separation of the budget into expenditures, which do not have clear or politically sensitive redistributive effects and expenditures, which have critical redistributive effects (as especially spending within the CAP and the structural fund). The two budgets shall be financed by different means and a general correction mechanism shall replace individually determined rebates (as e.g. the UK rebate). However, this proposal differs from our approach in fundamental points. Most importantly our approach does not attempt to split expenditures of the current budget, but to introduce a completely new budget. Furthermore we focus not so much on the financing side of the budget but on the more important expenditure side. While we agree that the approach of Heinemann et al. is superior to most existing normative reform proposals by integrating polit-economic arguments, we are less optimistic with respect to the chances of breaking the current budget-deadlock via new revenue rules.

- e. *Contributions*: Since willingness to pay for public goods depends on a number of factors such as the characteristics of the good, individual preferences, income, prices etc., the rules of financing should be flexible. They should take the form of individual contributions rather than general rate based payments.

Based on the unanimity requirement, a budget procedure based on these five conditions guarantees that nobody is made worse off compared to the actual gridlock with little or no public good provision. Strategic behaviour, which is typical under the unanimity rule, is mitigated as Member States have to commit to the public good budget for a pre-assigned period in the short-term (which creates stability), but can drop out in the long-run (see condition b). Additionally, the principle of one country one vote holds. Hence there is no need for weighting votes. Furthermore, the public good budget does not necessarily need to be a unitary budget. It may consist of several sub-budgets, which are approved sequentially as in the early years of the EEC.<sup>37</sup> So the process reveals for each separate budget, whether the benefits exceed the costs.

It is important to note that our proposal of a new “public good budget” shall not be imposed based on welfare considerations (as e.g. those by Boege and Sapir). It just opens a window of opportunity which can be employed by the Member States. In this sense our budget proposal is strictly positive and pareto-improving.

#### **IV.2 IMPLEMENTING A NEW PUBLIC GOOD BUDGET WITHIN THE INSTITUTIONS OF THE EU**

How could our newly proposed public good budget be implemented within the institutions of the European Union? In our view the existing option of an “enhanced cooperation” can be an important starting point.

Enhanced cooperation - as a mechanism for intensified cooperation of a group of eight or more Member States within the constitutional framework of the EU and its procedures - has been originally introduced in the articles 43 and 44 TEU and art. 11 TEC of the Treaty of Amsterdam of 1997. The strict regulations for authorization limited the possibilities to start enhanced cooperation and the Commission and the Council had many opportunities to veto enhanced cooperation at each stage of the process. Hence, it is not astonishing that enhanced cooperation did not really become popular and has as such never been applied.<sup>38</sup> In the Treaty of Nice of 2002, the Member States somewhat relaxed the rules of enhanced cooperation (art. 43 – 45 TEU Nice and 11 – 11a TEC Nice). A further liberalization is foreseen to take place under the Treaty of Lisbon (art. 20 TEU Lisbon and art. 326 – 334 TEC Lisbon). In particular the authorization criteria shall be downgraded enabling the Council to authorize enhanced cooperation just by a qualified majority (as defined in art. 280e TEC Lisbon).<sup>39</sup> Furthermore the so called “passerelle system” shall be introduced in the Lisbon Treaties. This allows the participants of an enhanced cooperation to choose the applicable decision rule and legislative procedure by themselves (art. 280h TEC Lisbon).<sup>40</sup>

<sup>37</sup> It has to be remembered that the Union never had a fully integrated budget. The budget of the European Community of Coal and Steel (during its existence) as well as the budget on loans and credits has always been separated from the general budget (see Strasser 1991, pp. 46-49). Furthermore the existence of separately financed “public good budgets” in other international organizations (as for example in the OECD) prove the feasibility of such an approach (see e.g. Heinemann et al. 2007, pp. 76 ff).

<sup>38</sup> For a discussion of e.g. the Schengen acquis and its relation to the processes of enhanced cooperation see CEPS, EGMONT and EPC (2007, pp. 97 ff).

<sup>39</sup> Except for projects of enhanced cooperation in the area of Common Foreign and Security Policy.

<sup>40</sup> For a discussion of the general mechanism of enhanced cooperation see especially CEPS, EGMONT and EPC (2007), pp.97 ff, De Schoutheete (2001) and Bribosia (2007).

Based on the reforms in the Treaty of Lisbon any group of nine<sup>41</sup> or more Member States would in principle – given the support of a qualified majority in the Council – be able to implement an additional public good budget within a process of enhanced cooperation.<sup>42</sup> Based on the “passerelle system” they could agree on our proposed symmetric unanimity rule for decisions on this budget. As the Treaty of Lisbon (art 332 TEC Lisbon) foresees, the costs for such a budget would be borne by the participating member states (as required by our criterion of institutional congruency)<sup>43</sup> and in our view a system of contributions could be introduced for this budget.<sup>44</sup>

While it generally seems possible to implement an additional public good budget within a process of enhanced cooperation, several obstacles remain under the Treaties. These would need to be reformed in order to facilitate the set-up of an additional budget in the form proposed above. First, the establishment of enhanced cooperation is only foreseen as a “last resort” for a number of at least nine Member States if the objectives cannot be attained within the regular union-wide legislative procedures (art. 20 TEU Lisbon). In our view this excessively restricts the ability of Member States to agree on additional public good projects. Therefore the “last resort” status and the fixed minimum requirement for participating member states should be abolished. To avoid discrimination, the Commission should instead have to prove that a proposal encompassing a larger number or all Member States is feasible. If the Commission fails to do so, enhanced cooperation among any subgroup of Member States should be allowed to take place. Second, the Commission’s exclusive right of initiative within a process of enhanced cooperation should be abolished as it violates our demand of a right of initiative for every participating Member State. And finally, the European Parliament currently needs to assent all decisions under enhanced cooperation with a majority of its members, if the issue would normally fall under the co-decision procedure.<sup>45</sup> This should be the case for most public good projects. However, we find that the participation of the European Parliament in unanimous decision making of a group of Member State governments is an unnecessary complication and a further blockade option for Member States not participating in special public good projects. Therefore we propose not to include the European Parliament under the additional public budget procedure within enhanced cooperation.

## V CONCLUSIONS

In this paper we demonstrated that we are in a situation of a persistent deadlock on the expenditure as well as on the revenue side of the European budget. It is not that some Member States randomly become winners and some become losers in the budgetary process, but that the rules persistently favour some at the costs of others so that there is little exchange between the two groups. Whether a Member State is on the winning or on the losing side has depended a lot on its ability or inability - in the early years of European Economic Community - to exert threat in order to influence the emerging division between those who receive and those who pay. Thereafter unanimity or close to unanimity rules had the effect that changes of this status quo were difficult to achieve as the veto power of potential losers has been strong. Since then stable coalitions have dominated either side of the budget and are likely to block any substantial changes in the enlarged EU.

---

<sup>41</sup> The minimum number of participants for enhanced cooperation was increased in the Lisbon Treaty from eight to nine.

<sup>42</sup> It should be noted that the anti-discrimination rules (art 327 and 328) ensure that the enhanced cooperation remains open for late-comers. See as well e.g. the discussion in Bordignon and Brusco 2006.

<sup>43</sup> Except for administrative costs, which are borne by the EU budget. Before the Treaty of Nice, all costs of programs of enhanced cooperation were assigned to the EU budget.

<sup>44</sup> The concrete form of cost-sharing is not specified in the Treaty. See art. 331 TEC Lisbon.

<sup>45</sup> For a discussion of the role of the European Parliament see especially CEPS, EGMONT and EPC (2007, pp.5 ff and 97 ff).



These findings lead to a pessimistic evaluation of normative approaches based for example on the Boege or the Sapir report. So far we are not aware of a normative proposal which could seriously be expected to break up the existing deadlock on the revenue or on the expenditure side.

In this paper we do not want to add one more proposal on what should be done to improve the EU budget allocation. We rather say: If the present situation is inefficient in that subsidies are too large and the amount of provided public goods is too small, then we must focus on institutional improvements which allow us to realize the possible efficiency gains. We show that a separate budget for public goods in addition to the statutory EU budget could be such an institutional improvement that opens a window of opportunity to escape from the current budget deadlock. The process of enhanced cooperation and its recent reforms in the Nice and Lisbon Treaties seem to be a good starting point to implement such a separate public good budget.

## VI. REFERENCES

- Aghion, P. et al. (2004): An Agenda for a Growing Europe: The Sapir Report. Oxford: Oxford University Press.
- Alesina, A., I. Angeloni and L. Schuknecht (2005): What does the European Union do? *Public Choice*, 123 (3): 275-319.
- Bordignon, M. and S. Brusco (2006): On enhanced cooperation, *Journal of Public Economics*, Elsevier, vol. 90 (10-11), November, pp. 2063-2090.
- Baldwin R.E., François J.F. and Portes R. (1997), The costs and benefits of eastern enlargement: the impact on EU and central Europe, *Economic Policy*, 24 (April): 127-176.
- Blankart, Ch. B. (1996), The European Union's Debt Question: A Conceptual Viewpoint, *Constitutional Political Economy*, 7: 257-265.
- Brennan, G. and Buchanan, J.M. (1985), *The Reason of Rules. Constitutional Political Economy*, Cambridge (Cambridge University Press).
- Bribosia, H. (2007), Les coopérations renforcées: quel modèle d'intégration pour l'Union européenne?, Thèse de doctorat (Florence, Institut universitaire européen).
- Buchanan, J.M. (1975), *The Limits of Liberty: Between Anarchy and Leviathan*, Chicago: University of Chicago Press.
- Buchanan, J.M. and Lee, D.R. (1994), On a Fiscal Constitution for the European Union, *Journal des économistes et des études humaines*, 5 (Nr. 2-3): 219-232.
- Clemens, J. und A. Lemmer (2006): *Financing the EU Budget - Present Situation and Perspectives*, CESifo DICE Report 1, 39-44.
- CEPS, EGMONT and EPC (2007): *The Treaty of Lisbon – Implementing institutional innovations*. Joint study. November.
- De Schoutheete, Ph: (2001): Closer cooperation: Political background and issues in the negotiation, in Monar, J and W. Wessels (eds.), *The European Union after Amsterdam* (London and New York, Continuum).
- EU Commission (2001), Aufteilung der operativen EU-Ausgaben 2000 nach Mitgliedstaaten, Brussels.
- Europäische Kommission (1995), *Die Finanzverfassung der Europäischen Union*, Luxemburg.
- EU Commission (2006), *Aufteilung der EU-Ausgaben 2005 nach Mitgliedstaaten*, Brussels.
- European Constitutional Group (1993), *A Proposal for a European Constitution*, London, [www.European-Constitutional-Group.org](http://www.European-Constitutional-Group.org).
- European Parliament (2005): Boege Report on Policy Challenges and Budgetary Means of the enlarged Union 2007 -2013. Strasbourg/Brussels.

- Folkers, C. (1995), Welches Finanzausgleichssystem braucht Europa? In: Karl, H. (Ed.), *Regionalentwicklung im Prozess der Europäischen Integration*, Bonn: Europa-Union-Verlag, pp. 87-108.
- Heinemann, F. (1998), *EU Finanzreform 1999. Eine Synopse der politischen und wissenschaftlichen Diskussion und eine neue Reformkonzeption*, Gütersloh: Verlag Bertelsmann Stiftung.
- Heinemann, F., Mohl, P., Osterloh, S. and Wendt, C. (2007): *Reformoptionen für das EU-Eigenmittelsystem*, Mannheim.
- Heinemann, F. (2005), EU-Finanzplanung 2007-2013, *Haushaltsoptionen, Verteilungswirkungen und europäischer Mehrwert*, Bertelsmann Stiftung, Europa Vordenken, Gütersloh.
- Hosli, M.O. (1996) Coalitions and Power: Effects of Qualified Majority Voting in the Council of the European Union, *Journal of Common Market Studies*, 34 (No. 2, June): 255-273.
- Kurbas, S., De Clerck-Sachsse, J. and Gaëtane, R.-N. and J.I. Torreblanca (2006): From Threat to Opportunity: Making Flexible Integration Work, EPIN Working Paper, No. 15/. September.
- Lienemeyer, M. (2002), *Die Finanzverfassung der Europäischen Union*, Baden-Baden: Nomos.
- Messal R. and Klein, A. (1993), Finanzlasten und Eigenmittelstruktur der europäischen Gemeinschaft, *Wirtschaftsdienst* 73 (No. 7): 375-383.
- Messal, R. (1989), *EG-Finanzierung und Lastenverteilung – Die Reform des EG-Finanzierungssystems 1988* – Bonn: Stollfuss Verlag.
- Messal, R. (1991), *Das Eigenmittelsystem der Europäischen Gemeinschaft*, Baden-Baden: Nomos.
- Milbrandt, B. (2001), *Die Finanzierung der Europäischen Union. Perspektiven für eine Osterweiterung*, Baden-Baden: Nomos.
- Mueller, D.C. (1984), Voting by Veto and Majority Rule, in: Hanusch, H. (Ed.): *Public Finance and the Quest for Efficiency*, Detroit Mich. (Wayne State University Press), pp 69-86.
- Mueller, D.C. (1989), *Public Choice II*, Cambridge (Cambridge University Press).
- Mueller, D.C. (2003), *Public Choice III*. New York (Cambridge University Press).
- Peffekoven, R. (1994), *Die Finanzen der Europäischen Union*, Mannheim: Bibliographisches Institut und Brockhaus AG.
- Shucksmith, M., Thomson, K & Roberts, D (eds) (2005), *CAP and the Regions: the Territorial Impact of the Common Agricultural Policy*. CAB International.
- Stegarescu, D. (2001), *Zahlmeister und Nutzniesser der EU – Die Nettzahlungssposition als Vergleichsmaßstab*, Manusc. Mannheim: Zentrum für Europäische Wirtschaftsforschung.
- Strasser, D. (1991), *Die Finanzen Europas*, Luxemburg: Amt für amtliche Veröffentlichungen der EG, 7th ed.
- Tabellini, G. (2002), Principles of Policy Making in the European Union: An Economic Perspective, *CESifo Forum*, Vol. 3, No. 2, pp. 16-22.
- Vaubel, R. (2001), *Europa-Chauvinismus. Der Hochmut der Institutionen*, München: Universitas.
- Wicksell, K. (1896), Finanztheoretische Untersuchungen, Jena: Gustav Fischer. Engl. A new principle of just taxation. In Musgrave, R. A. and A.T. Peacock (eds.), (1958), *Classics in the theory of public finance*, 72-118. London: Macmillan.
- Widgrén M. (1994), Voting power in the EC decision making and consequences of two different enlargements, *European Economic Review*, 38: 1153-1170.
- Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie (1999), *Neuordnung des Finanzierungssystems der Europäischen Gemeinschaft*, BMWi-Dokumentation, Nr. 455, Berlin.