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Forum

The New Long-Term Budget of the European Union and New European Taxes

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1 Introduction

The Multiannual Financial Framework (MFF) 2014–2020 of the European Union (EU) is the first long-term budgetary framework under the Treaty of Lisbon. A mid-term review/revision is a part of it. In this review, one of the important decisions is about new own resources: the introduction of European taxes. The MFF has been called a political power game among the budgetary institutions.[1] The article answers the question: what are the chances of the introduction of new taxes given the results of the power game with the present MFF? The article starts with stating the MFF as a fiscal responsibility framework: the logical outcome of the long-term evolution of the budget. Subsequently, the most likely results of the institutional power game for the present MFF will be given: in theory the budget is curtailed, in practice the cut will probably not materialize. As a result the chances are high, that at the mid-term revision, EU taxes will be introduced to finance the budgetary gap.

2 The MFF

During the eighties of the last century, the yearly budgetary negotiations were plagued by stalwart negotiations between the European Council (Council) and the European Parliament (EP). Several times the Parliament rejected the proposed budget. A fundamental reform of the Community's budgetary procedure was required. In 1988, an Inter-Institutional Agreement (IIA) between the Council, European Commission (Commission) and the EP enabled the two wings of the budgetary authority to make decisions in advance for a certain period. Financial perspectives, the predecessors of the current MFF, setting out the priorities for five to seven years, were subsequently made. The present MFF 2014–2020 is for a total of EUR 959 billion in spending commitments (1.03% of total GNI of the Member States), the so-called ceilings on commitment appropriations, and 908 in actual payments (0.98% of GNI), the so-called ceilings on payment appropriations (both are in 2011 prices).

The present framework[2] is the first one based on the Treaty of Lisbon that entered into force on 1 December 2009. Article 312(1) of the Treaty on the Functioning of the European Union (TFEU) states that 'The MFF shall ensure that the Union expenditure develops in an orderly manner and within the limits of its own resources. It shall be established for a period of at least five years. The annual budget shall comply with the MFF.'[3] The MFF is the framework within whose limits annual budgets must be agreed. As the Commission, says, the MFF 'is not the budget of the EU for seven years. It is a mechanism for ensuring that EU spending is predictable and at the same time subject to strict budgetary discipline'.[4] On the basis of political priorities it defines the maximum amounts available for each major spending. It is also a political as well as budgetary framework. Within it the EP and the Council, which are the Union's budgetary institutions, have to agree each year on the budget for the subsequent year.

Before 2009, the MFF's had no legal basis in the Treaties. The first financial perspective 1988–1992 was based on an IIA between the budgetary institutions. The legal significance, however, was considered to be more than a simple political commitment. This since the perspectives had been concluded by institutions that can enter into legal obligations under the powers conferred on them by the Treaties. Financial perspectives became part of the budgetary *acquis* of the Union and hence EU budgetary decision-making.[5]

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1 C. Dhéret, A. Marinovici & F. Zuleeg, The State of Play on the EU Multiannaul Financial Framework (MFF) 2014–2020 inter-institutional negotiations (European Policy Centre 2012), 6.

2 European Council, Council Regulation (EU, EURATOM) No. 1311/2013 of 2 Dec. 2013 laying down the multiannual financial framework for the years 2014–2020, Official J. of the Eur. Union (20 Dec. 2013).

3 Council of the European Union, Consolidated version of the Treaty on European Union and the Treaty on the functioning of the European Union, 6655/08, Brussels (15 Apr. 2008).

4 European Commission, European Commission proposal for the 2014–2020 Multiannual Financial Framework, European Union (2011) (updated version 2012).

5 B. Laffan, The Big Budgetary Bargains: from Negotiation to Authority, Journal of European Public Policy 7: 5 (2000),733.

The MFF is the constitutional fiscal framework next to the already existing fiscal rules on a balanced budget (Article 310) and the limitations on the own resources (Article 311). It is, to be specific, the so-called MFF package that every seven years has to be decided on. It consists of the MFF regulation (MFFR)[6] and an IIA.[7] Next there are, in the package some declarations on, e.g., own resources, youth unemployment and a review/ revision of the MFF.[8] In sum, in the package the expenditure side as well as the revenue side has to be decided.

3 Fiscal rules

The IMF defines a fiscal rule as a 'permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates'.[9] A fiscal rule delineates a numerical target with a view to guiding fiscal policy, it specifies a summary operational fiscal indicator and it can be readily operationalized, communicated and monitored. [10] Fiscal (budget) rules, however, do also refer to a wide range of fiscal institutions. 'Even the institutions that legislatures use to prepare budgets, and the structure of committees through which budget deliberations must proceed, can be viewed as budget rules.'[11] Fiscal rules or, more general, rules-based fiscal responsibility frameworks can be looked at as a form of incomplete constitutional contracts: rules that are designed at the contractual/constitutional level and will be executed later at the post-constitutional level. [12]

The virtue of fiscal rules[13] was already heralded by the Romans: 'The budget should be balanced, the treasury should be refilled, public debt should be reduced.'[14] Formal attempts, however, span over the last century and a half. Three waves of fiscal rules can be distinguished.[15] In the first wave, as of the twenties of the last century, the so-called golden rule was prescribed. Subnational governments in federal systems, e.g., in the US and Switzerland, had to maintain a current budget balance. In the second wave, after World War II, industrial countries, e.g., Germany, Italy and the Netherlands, introduced balanced-budget rules. Most of them were of the golden rule type. In the third and current wave, fiscal rules are supported by transparency standards and appropriate accounting conventions enshrined in broad legislation (fiscal responsibility law/ act) or international treaty, e.g., in New Zealand, Brazil, and EU's Member States.[16]

The present MFF is part of the third wave. It is the necessary and logical complement to the long-term evolution of the goals of the Union. The original goals were personal freedom and the creation of the one internal market. Gradually, however, the added goals became financial redistribution and the supply of (collective) goods.[17] Hence, in the original 1957 Treaty of Rome only a few budgetary rules were needed.[18] In time, a strong and transparent financial framework was needed – if only to curtail the yearly quarrels.[19] Because of the evolution in the goals it was no longer sufficient to adapt the existing rules: an institutional-constitutional reform was needed. The existing informal financial perspective lost its claim to efficiency and legitimacy. [20]

These broader reforms are important in view of the effects of fiscal rules on creative accounting.[21] At one extreme, the 'institutional irrelevance view' holds 'that budget rules can be circumvented by modifying accounting practices and changing the nominal timing or other classification of taxes and expenditures'.[22] On the other hand, empirical studies[23] suggest that fiscal

6 Council (2013) *supra* n. 2.

7 That IIA contains some residual aspects that were originally in the financial perspectives (the old IIA), but were not included in the MFF. European Council, Inter-institutional agreements European Parliament, Council, European Commission, Inter-institutional Agreement of 2 Dec. 2013, Official J. of the Eur. Union C 373/1 (2013).

8 European Commission, *supra*.

9 International Monetary Fund, Fiscal Rules – Anchoring Expectations for Sustainable Public Finances. 16 Dec. (2009).

10 Cp. L. Schuknecht, EU fiscal rules. Issues and lessons form political economy (European Central Bank, Working Paper Series, No. 421/December 2004); X. Debrun, et al., Tied to the Mast? National Fiscal Rules in the European Union, Economic Policy (April 2008), 299–362.

11 J.M. Poterba, Do Budget Rules Work? National Bureau of Economic Research, Working Paper 5550 (1996); Cp. P. Becker, Fortschreibung des Status Quo – Die EU und ihr neuer Finanzrahmen Agenda 2007 (Integration 2 2006).

12 J. Buchanan, The Limits of Liberty. Between Anarchy and Leviathan (Liberty Fund, Indianapolis [1975] 2000).

13 For the reason of fiscal rules see International Monetary Fund, *supra* and C.B. Blankart, 'The European Union's Debt Question: A Conceptual Viewpoint', Constitutional Political Economy 7 (1996).

14 Cicero 63 BC in G. Kopits. Fiscal Rules: Useful Policy Framework or Unnecessary Ornament? (IMF Working Paper 01/145, 2001), 3.

15 Kopits, *supra* n. 14, 4–5.

16 For the Union transparency is still a far cry. It has been said that 'the EU's budget and budgetary procedures are beyond Byzantine' (T. King, An opaque EU budget cannot be defended, EuropeanVoice, 11 Jun. 2014).

17 C.B. Blankart, The European Union's Debt Question: A Conceptual Viewpoint, Constitutional Political Economy 7 (1996) 257–265; C.B. Blankart & C. Kirchner, The Deadlock of the EU Budget: An Economic Analysis of Ways In and Out (CESifo Working Paper 989, 2003) 3.

18 Treaty establishing the European Economic Community, Title II, Financial Provisions, Arts 199–206.

19 The budgetary power game can be described as a vetocracy: 'as a war of "red lines", leaving all responsibility for achieving a coherent outcome to selected "brokers"' (G. Benedetto & S. Milio, Conclusion: Budget Policy, Past Experience and the Future, in: G. Benedetto & S. Milio, (eds), European Union Budget Reform (Palgrave MacMillan 2012, 172); Cp. J. Schild, How to Shift the EU's Spending Priorities? The Multiannual Financial Framework 2007–2013 in perspective, J. of Eur. Public Policy, 15: 4, 531–549 (2008), 533.

20 Buchanan, *supra* n. 12, 213.

21 The effectiveness of fiscal rules are usually discussed under the keyword 'escape clauses'. K. Mause & F. Groeteke, 'New Constitutional "Debt Brakes" for Euroland? A Question of Institutional Complementarity', Constitutional Political Economy 23 (2012) 279–301.

22 Poterba, *supra* n. 11.

23 J. von Hagen & I.J. Harden, 'Budget Processes and Commitment to Fiscal Discipline', European Economic Review 39 (1995) 771–779; Debrun et al., *supra* n. 10; IMF, *supra* n. 14.

rules do lead to improved performance, e.g., a stronger cyclically adjusted primary balance. Fiscal rules also increase the probability of more accurate budget projections.[24] A strong legal basis, however, of rules and strict enforcement are important.

4 Assessment of the MFF package

Has the very real rebalancing of the budgetary powers of the EU institutions after the Lisbon Treaty in terms of agenda-setting and vetoes changed the outcomes of the decisions? [25]

4.1 The Constitutionalization of the MFF

The constitutionalization of the MFF is one of the major changes introduced by the Lisbon Treaty.[26] It is about the strongest commitment one can make about fiscal sustainability. Since it requires a Treaty change, the MFF can hardly be changed under tempting situations. There is a real loss of flexibility. But how credible is this commitment? There is no political-independent control. There are no sanctions for rule breakers. [27] What is left is naming-and-shaming: the new MFF maximizes the reputational costs for those institutions that do not respect it.

4.2 Flexibility

Though the MFF ensures stability, flexibility is needed to cope with unforeseen needs. This can be done, e.g., by increasing the flexibility instruments in number and/or in terms of amount allocated, or to create more flexibility in terms of easiness of procedures.[28] Flexibility became an issue in the negotiations over the new MFF.

The new IIA 'on budgetary discipline, on cooperation in budgetary matters and on sound financial management' (Article 259 TFEU) contains provisions related to the flexibility instruments. It allows unused margins (differences between the expenditure ceilings and the money actually spent) as well as unused funds (unused payment appropriations) to be transferred onto the following year or to other parts of the budget.[29] Flexibility is both on budgeted commitments and actual payments. In short, the IIA ensures that available funds are fully used rather than returned, as was previously the case, to the Member States.

Next to the general instruments some specific flexibility measures have been introduced. There is, e.g., a special flexibility for youth employment and research. Without being limited by the annual expenditure ceilings set by the MFF funds, money can be brought forward (frontloading). Finally there is a last resort instrument to react to unforeseen circumstances: a general contingency margin which amounts to 0.03% of the EU's GNI.

4.3 Off Budget[30]

Just as state governments in the US use public authorities to circumvent constitutional debt limits,[31] the Union uses the European Investment Bank (EIB) as a sort of financial intermediary. In the US the introduction of fiscal restraints induced the engagement in off-budget activities and authorities.[32]

For the Union the result is that some funds or projects are left outside the MFF. These instruments are available outside expenditure ceilings agreed in the MFF. They are the Emergency Aid Reserve, European Globalization Fund, Solidarity Fund, Flexibility Instrument and the European Development Fund (EDF).[33] In short, though debt and/or an increase in expenditures are prohibited in the budget, it is not necessarily prohibited off-budget.[34]

Another off-budget payment is coming too. Though for the first time the MFF was cut in real terms, the actual result probably will be different. In general,

[24] S. Luechinger & C.A. Schaltegger, 'Fiscal Rules, Budget Deficits and Budget Projections', International Tax Public Finance 20, 785–807 (2013), 785.

[25] For a discussion of legal changes between the old and the new MFF see G. Benedetto, Budget Reform and the Lisbon Treaty, in: G. Benedetto & S. Millio (Eds), *supra*. For an overview of the political power game itself and the horse trading that went with it see European Parliament, The battle for the EU's long-term budget, Focus (2013); Cp. E. Campanella, What Constitutional Fiscal Rule for the Members of the EU? (VOX.EU 20 Feb. 2011).

[26] The question, however, if a government really wants to be constrained, since self-binding is the essence of constitution-making, is an open question. Maybe it is just the other way around: '[i]n politics, people never try to bind themselves, only to bind others' (J. Elster, Ulysses Unbound. Studies in Rationality, Precommitment, and Constraints (Cambridge University Press 2000), ix.

[27] Mause and Groeteke, *supra* n. 21.

[28] E. Molino & F. Zuleeg, Key Political Messages Regarding the Upcoming EU Multiannual Financial Framework (MFF) post-2013 (European Policy Centre QG-32-13-074-EN-N, 2011), 15.

[29] It is to be noted that the overall margin available under the own resources ceiling for payment appropriations is already 'used' as collateral for the outstanding amount of loans or credit lines granted to Member States under the European financial stability mechanism (B. Marzinotto, The Long-Term EU Budget: Size or Flexibility?), Bruegel Policy Contribution, Issue 2012/20, November (2012), 6.

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

[31] B.S. Bunch, 'The Effect of Constitutional Debt Limits on State Governments' use of public authorities', Public Choice 68: 57–69 (1991), 57. Cp. W. Easterly, When Is Fiscal Adjustment and Illusion? The World Bank (Policy Research Working Paper 2109, 1999).

[32] J. von Hagen, 'A Note on the Empirical Effectiveness of Formal Fiscal Restraints', J. of Public Eco. 44: 199–210 (1991), 202; Cp. J.T. Bennett & T. Dilorenzo, Underground Government: The Off-budget Public Sector (Cato Institute, Washington 1983).

[33] The EDF is also outside the MFF because Member States contribute differently to it compared to their financing of the EU budget.

[34] Blankart, 1996, *supra* n. 17, 258.

commitments (undertakings to pay) were cut by 3.4% and payments by 3.7% that is 0.3% of EU-wide GNI.[35] This gives an unusually large gap between these two amounts. This can potentially cause problems down the line. Probably the EP and the Commission think that, if necessary, there will be a bail-out. Just as there were, retroactively in 2013, so-called top-up funds necessary and furnished by the Member States.

5 Mid-term revision: implications for new EU taxes

Part of 'the flexibility deal' in the MFF package is a revision clause of the existing MFF. In 2016, the Council and newly elected EP and Commission have to reassess the political priorities and figures allocated to expenditure ceilings for the remaining years of the MFF.

Given the above assessment, the chances are great that extra funds are needed. How will the problem be solved during the mid-term review? Given that the Member States have supplied top-up funds before, there are no credible no-bailout signals. This certainly weakens the politicians' incentives to abide by the intended budget balance in the MFF. Next to that, and for this paper of the most importance, the Union has some taxation autonomy and the introduction of new EU taxes is, as the Joint Declaration on Own Resources in the MFF package states, an explicit part of the mid-term review.[36] Given that top-up funds, giving extra money to 'Brussels', are unpopular to the electorate of the Member States, two new taxes: an FTT and an EU VAT, proposed by the Commission and endorsed by the EP, may be the way-out. Especially an FTT seems opportune. The tax is presented as a way to let the financial sector pay for its part in causing the 2008 financial crisis.[37] It is called a fair, 'Robin Hood' tax; a strategy that worked in the US In the US financial institutions do have to pay record penalties.[38] An FTT also seems for the Member States to be the way to pay for the coming gap in the budget.

6 Summary and conclusion

The MFF is the logical outcome of a development of a Union focused on the creation of the single market to one that is also devoted to finance redistributive programs and (public) goods. Just fixing the existing fiscal rules was no longer sufficient: institutional-constitutional reform was needed.

With the new MFF, the first one under the Lisbon Treaty, the EP got more power. As a result, the EP and the Commission were an effective countervailing power to the wish of the Council to curtail the budget. The MFF was curtailed in name only – flexibility was the name of the (power) game.

In the 2016 mid-term revision, the problem to finance the needed extra funds will take prominence. Given that new European taxes have to be decided too, it is to be expected that they will have to fill the financial gap. Given the experiences in the US, an FTT seems to be the likely candidate.

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

36 Council, Addendum to 'I/A' Item Note (Brussels, 25 Nov. 2013).

37 European Commission, Commission Staff Working paper, SEC (2011) 1103 final.

38 BofA Deal With US Is Hung Up Over Penalties Tied to Countrywide, Merrill, Wall Street Journal, 28 Jul. (2014).