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ABSTRACT

The EU has several aspects which allow us to speak about an emerging Federal System. Generally the EU budget is not mentioned to be among them. The budget has been characterised as poor-sized, inflexible and dependent on member state contributions. But there are several reasons for considering an evolution of the EU budget towards a genuine budget with federal characteristics. This is noticeable with regard to its spending structure, concerning the production of public goods, and the budgetary decision making process, especially regarding the role of the European Parliament. The main argument of this text is that the EU budget is evolving towards a budget in a federal sense based on the rationale that all member states and the Union have common objectives rooted in common values.

KEYWORDS: EU budget, federalism, budgetary decision process

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The EU budget - from a bargaining tool to a federal budget?

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1. Introduction

The meeting between Italian Prime Minister Matteo Renzi, German Chancellor Angela Merkel and French President François Hollande on the island of Ventotene on 22 August can be seen and judged from different points of view. But the meeting place was not a coincidence. The “Ventotene Manifesto”, written by Ernesto Rossi and Altiero Spinelli, was one of the key driver behind the movement for European unification. The Manifesto encouraged a federation of European states and is widely seen as the birth of European federalism. 70 years after the publication of the Manifesto, the EU seems to be far away from becoming a federal system, but the economic and financial crisis, which most of the EU member states have endured over the past several years, highlighted again the need for a sustainable multilevel system of fiscal and economic governance in the EU. Advances have been made especially in the past few years within the Economic and Monetary Union (EMU) but also regarding the institutional development.

Applying a wider concept of federalism, it seems that, the EU has already several aspects which allow us to speak about a well stabled multilevel system or about an emerging federal system (Burgess, 2000; 2012; Börzel, Hösli, 2003; Hallerberg, 2006; Menon, Schain, 2006; Hueglin, Fenna, 2015; Law, 2013). There are at least two constitutionally established tiers of government, each with its own powers and responsibilities; there are provisions for the representation of territorial views within the EU policy-making institutions, there are courts to adjudicate disputes and interpret the treaties, as well as processes and institutions to facilitate intergovernmental collaboration. However, in addition to the formal constitutional distribution of legislative and executive authority, the allocation of revenue resources between at least two orders of government is one of the key features of federal system in order to ensure some areas of genuine autonomy for each order of government (Watts, 2008, 9).

During the past decades the revenue and spending structure of the EU budget has undergone an important evolution. Nevertheless the gap remains open between ambitions and genuine fiscal autonomy for the EU. The reform debates on the EU budget can be dated back to the beginning of the European integration process. Mainly three conflictive issues have been since then under discussion reflecting the multi-dimension of the EU budget. Firstly, the debate on the general principles underlining the EU budget, secondly, the spending side or the Union’s policies which could be reached with the budget, and thirdly the revenue side or how the EU should be financed. Although tensions between contributing member states (net contributors) and recipient

member states (beneficiaries) have always characterised the history of the budget, new tensions have emerged, including the effect of the Eastern enlargement which has increased the demands on spending, added to the effect of the post-2008 economic crises. Currently there are debates ongoing about the contribution of the EU budget to the European Fund for Strategic Investments and to specific measures to address refugee crisis. These developments have had an impact on the EU budget over the past years. However, recent literature analysing the evolution of the EU budget concentrated mainly on questions related to stabilisation mechanisms underlining the poor performance of the budget. (Calmfors, 2015) The long term developments of the budget haven't been analysed very frequently.

Departing from the theory of fiscal federalism, in this text we will shortly present the main characteristics of federal budgets, the underlining principles, the financing mechanisms and, with special emphasis, the spending structure, and compare these features with the characteristics of the EU budget. Although the theory of fiscal federalism can only be applied to a limited level to the EU, because of its specific nature (distribution of responsibilities and decision making structure), the theory is helpful in order to detect the basic federal features underlining the EU budget. Taking into account the notion of the federalizing process, as devised by C.J. Friedrich, by which "[...] a number of separate political organisations [states] enter into arrangements for making joint decisions on joint problems" (Friedrich, 1955, 517), we will argue that the EU budget is increasingly becoming an instrument based on joint decision making among the European level and national level regarding joint problems and common objectives. The notion of federalizing includes also a process through which the federal government expands its power to take final decisions in certain areas of public policy.

2. Fiscal Federalism and the EU budget?

The concept of fiscal federalism constitutes the core area of federalism which measures the degree of division of powers among the constituent units and federations. Already Hamilton underlined the difficulties of establishing a multilevel system of public finance. Theoretically fiscal decentralization in multi-level system follows the scope and elements of the devolution of power and functions fostering the division of powers and functions. However in praxis, there are important differences among federations regarding the underlining principles of fiscal decentralisation and how multi-level systems organise their spending programmes and revenue structure. In this sense the traditional topics of budgetary principles, intergovernmental fiscal arrangements and assignment of responsibilities of fiscal federalism are answered in a different way by federal and multilevel systems. Nevertheless there are some basic assumption related to

the general principles as well as concerning the revenue and spending structures which could give reference to actual practices followed in the EU.

2.1. General principles

The literature on fiscal federalism has developed budgetary principles or guidelines for assigning expenditure and revenue responsibilities among governments, as well as regarding the decision making process (Feld, Necker, 2010). The fundamental aim of fiscal federalism is to find the most suitable way of sharing responsibilities and of using instruments through the various levels of government in order to optimize their performance and transparency. The EU budget obeys these general principles and detailed rules, which are largely based on those that apply in national budgetary law.

Some authors provide a strong rationale for decentralized fiscal constitutions on the grounds of subsidiarity (Kincaid, Shah, 2007; Boadway, Shah, 2009). According to the principle of subsidiarity, centralization should only occur for a small number of policies which have a clear supranational nature. A policy should be assigned to lower levels of government, and thus closer to the citizens it affects, unless there are demonstrable benefits of conducting the policy at a higher level (Begg, 2012). With regard to fiscal arrangements, also expenditure responsibilities, revenue raising powers, and regulatory functions should be exercised by the lowest order of government unless a convincing case can be made for assigning these to higher orders of government. Similar to federal countries, the subsidiarity and proportionality principles are paramount in the EU and laid down in the Treaty on the European Union (TEU). Based on these principles the EU only performs those tasks which cannot be performed effectively at a more immediate or local level and only acts to the extent that is needed to achieve its objectives.¹ Consequently, the budget can only be used to finance EU public goods when member states and their constituent units may not be able to finance these public goods. The principle of additionality underlines this practise meaning that the EU spending programmes should not replace, but be an addition to national regional policy funds.

If the theory of fiscal federalism is taken into account it could also be argued that every level of government, constituent unit, state/national and European, should have an independent control of financial resources sufficient to perform its own functions. In this sense the fiscal capacity of each level of government has to meet its responsibilities; if not, in most federal countries, governments receive transfers from other levels of government especially if they require them to

¹ Article 5(3) of the TEU and Protocol (No 2) of the application of the principles of subsidiarity and proportionality.

implement policy programmes in a defined manner or if they have to administer programmes in areas normally viewed as competences of other levels of government. At the EU level, this principle is enshrined in article 311 of the Treaty on the Functioning of the European Union (TFEU), according to which the Union shall provide itself with the means necessary to attain its objectives and carry out its policies.

Following classic definition of fiscal federalism that offered by K.C. Wheare, all levels of government should have the right incentives for efficient and equitable delivery and financing of public services (Wheare, 1963). The stability of a federal system and the support for this idea depends on a fair distribution of the benefits. However larger markets allocate resources and generate growth more effectively but also unevenly. In federal countries transfers from one tier of government to another or among them are used to tackle these unbalances. There are several references regarding this cohesion principle at the TEU and TFEU. For example, according to art. 2 TEU the Union shall promote economic, social and territorial cohesion, in addition to solidarity among member states. Federal constitutional systems include, explicitly or implicitly, the principle of solidarity. The word federalism itself comes from foedus, which means compact. A social compact means partnership and mutual aid, together with protection. According to Habermas the stability for a federal system requires solidarity –social inequalities cannot become permanent structural features (Habermas, 2012). A solidarity advocated through Schumann already in 1950: "Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity"². In a federal context, social solidarity is related to territories, not to individual persons, meaning the social dimension refers to people living in different parts of a country. The idea behind these arrangements is related to the retention of regional autonomy and the development of a national market economy. The EU cohesion policy is based on this rationale. The cohesion policy of the EU is a policy with the stated aim of improving the economic well-being of regions in the EU and also to avoid regional disparities (European Commission, 2011).

Finally, the principle of the efficiency has become a central term of budgetary debates. The theory of fiscal federalism assumes that a federal system of government contribute to an efficient distribution and allocation of resources. The principle of efficiency is concerned with the relationship between resources employed and results achieved (Cipriani, 2013). Similar to debates undertaken in federal countries, it is argued that public spending at the EU level

² Schuman Declaration, 9 May 1950

produces added value as it can plug gaps left by the dynamics of national policy-making, creating economies of scale and avoiding unnecessary overlaps. Spending coming from the EU level can also be more cost-efficient due to cross-border externalities, where some policies have an impact not only on the country where they are implemented but also on its neighbours (Molino, Zuleeg, 2011). So the European dimension can maximise the efficiency of member states' finances and help to reduce total expenditure and secure better results. In this sense the principle of efficiency has a strong relation to the multi-level character of the EU-budget. "The EU budget [...] exists because there are activities that need to be funded to enable the EU to function or because they can be done more effectively through the collective funding of the EU budget" (European Commission, 2011).

2.2 Revenue structure

Federal-revenue regimes are characterized by their use of three major elements: own-source revenues for each order of government, shared revenues, and federal transfers. There are important differences among federations regarding how they organise and reform their revenue structure, added to which revenue functions are best performed at a centralized level and which are best done at a decentralized level. The lack of the ability of a federal government to raise revenues from its own sources has been identified as the main factor for the lack of sustainability of a federation (Riker, 1975:111, Kincaid, 2014). Federalist 12 and 30–36 describe the benefits of a national fiscal system with independent revenues, arguing that a strong national government cannot exist for long without the means to raise revenues on its own. Hamilton argued that the union will be much more efficient than the states at collecting revenue.

In this sense most federal governments raise a high percentage of the total revenues, but there are also examples (Canada and Switzerland) where the federal revenues are less than half of total government revenues (Anderson, 2010:21).

The allocation and management of taxing and other revenue powers within multi-level systems are linked to the system for tax sharing and effecting fiscal transfers from the federal government to the constituent units. There are different models regarding the allocation of tax powers, because of different constitutional arrangements, histories of revenue raising and political culture. But there is no consensus about the effective allocation of tax powers. On the one hand according to normative considerations decentralised tax and spending incentives reinforce the direct relation between the administration and the electorate, as well as increase the accountability of public spending. On the other hand, different funding arrangements create different incentives for constituent units to expand or curtail their public sector. While revenue

sharing or intergovernmental grants create incentive to overfish the common pool, horizontal tax autonomy increases tax competition among constituent units (Obinger, Leibfried, 2005). The comparative analysis of federal countries show that fiscal autonomy for all tiers of government is not very frequent. (Groenendijk, 2011) Not all levels of government which are tasked with the provision of public goods, have revenue-raising power in order to be able to provide those goods.

With a view to ensuring the financial autonomy of the Union, article 311 of the Treaty on the Functioning of the European Union (TFEU) states that the Union shall provide itself with own resources necessary to attain its objectives and carry through its policies. (Blanchard, et al. 2015; Calmfors, 2015) Although this is a clear statement for fiscal autonomy, there is no consensus on what kind of own resources (Alfonso, 2014:36). In this sense the debate about the EU revenue system is an issue dating back to the EEC Rome Treaty of 1957, but during the past decades the system has not been static and there have been some important reforms and the proportions of revenues have altered considerably. Revenue coming from the 'GNI resource' and the weight of this resource has increased over the last few years, while the traditional own resources³ have lost importance. In 2015 more than 85% of EU financing was based on statistical aggregates derived from GNI and VAT. Since the GNI resource cannot be characterized as a true 'own resource', the EU remains in a situation of very limited financial autonomy (Cieslukowski, Alves, 2006; Alves, Afonso, 2008). In recent years several studies have been carried out on the financing system of the EU budget demanding financial autonomy and less dependence on the GNI-based resource. The ongoing revision process on the EU own resources, agreed on in the final agreement on the Multiannual Financial Framework (MFF) 2014-2020⁴, is an important occasion to reform the financing of the budget. The Commission already proposed to introduce a Financial Transaction Tax and to develop a new VAT resource. Also the European Parliament repeatedly called for genuine own resources for the EU, proposing revenue sources like an EU emissions trading System, charges related to air transport or an EU wide corporate income tax. In 2014 a High Level Group on Own Resources has been established with the former Italian Prime Minister Mario Monti as a chair. The Group will deliver its final recommendations on transparent ways to finance the EU in 2016.

³ Own resources are of three kinds: traditional own resources (import duties and agricultural levies); the resources based on VAT; resources based on GNI. In 2013, total EU revenue amounted to €149.5 billion, which came mainly from three categories of own resources: 9.38% from traditional own resources, mostly customs duties; 10.28% from a resource based on value added tax (VAT); and 73.71% from a resource related to member states ' GNI, which plays the budget-balancing role, by financing that part of EU expenditure not covered by the other resources and revenue.

⁴ Article 2, Mid-term review/revision of the MFF, Council Regulation, No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020.

Every reform of the revenue side will change the budget fundamentally, however this will be a slow process. Member states are traditionally reluctant to accept any form of direct fiscal taxation and financial autonomy for the EU and the Council's main interest seemed to be not to lose its veto power over EU financing arrangements. Nevertheless there are some governments supporting these proposals since financial autonomy of the EU could reduce the burden of national budgets and increase the flexibility of the EU budget. In recent years, measures oriented towards common challenges e.g. the economic crisis, the migration and refugee crisis, as well as the Fight against terrorism, underlined the need for more flexibility and increased the demand for more funding. In his intervention in the EP plenary in October 2015 President Juncker underlined that "extraordinary measures require extraordinary funding". Moreover national transfers will continue since genuine own resources need to guarantee sufficiency and stability of EU finances to cover expenditure and to avert the risk of sudden financing difficulties.

2.3 The Expenditure structure

There are also important differences regarding how multi-level governments organise their spending structure, added to which spending programmes are best performed at a centralized level and which are best done at a decentralized level. Most federal constitutions assign legislative responsibilities explicitly and expenditure responsibilities only implicitly. According to Musgrave there are different aspects regarding the objectives of federal spending: firstly, the supply of public goods and services; that are common to all regions, such as research, infrastructure, diplomacy and defence. Secondly, federal budgets should contribute to the redistribution of income and finance transfers between regions to correct geographical or historical disadvantages and maintain national cohesion. And, thirdly, the macroeconomic stabilization function to keep economic growth stable, along with price levels and unemployment (Musgrave, 1959).

With regard to the later, the literature on fiscal federalism points towards the importance of a significant central budget for the purposes of macroeconomic stabilization. Transfer mechanisms to the constituent units undertaken by the federal government produce stabilization in situations of asymmetric shocks. Taking the EU, this is the most evident difference between the EU budget and the budget of federal countries. According to recent figures, member states accounts for 98 % of total public expenditure, whereas the Union level accounts for only 2 % of total public expenditure, which means that in the multi-level EU system, the public expenditure is highly decentralized (Barbier Gauchard, 2014). In contrast, public expenditure in federal countries is much more centralized. The central level in the US accounts for 64 % of total public

expenditure and in Canada for 37%.⁵ As already suggested by the 1977 MacDougall report, a budget of 2% EU GNP would have an effect in reducing the inequalities of living standards, and an increase to 5-7% of GNP would be necessary in order to give the budget a stabilisation role (European Commission, 1977)⁶. In this sense the EU budget has marginal growth effects and lacks of resources to respond to macroeconomic challenges (e.g. only a Union wide Basic unemployment insurance would require 1% of the EU GDP)⁷.

With regard to the second aspect of a federal budget highlighted by Musgrave, federal budgets may carry out transfers between regions to correct geographical or historical disadvantages and maintain national cohesion. All federations have some sort of vertical and horizontal transfer and equalization programmes. Moreover the issue of sharing wealth within a federation is closely tied to citizens' sense of solidarity with the federal and regional communities (Hueglin, Fenna, 2015). According to recent research taxes and transfers in federal countries reduce income inequality. However the redistributive effects are frequently reduced through re-ranking effects. (Hungerford, 2010)

The European Union is confronted with large disparities in wealth which, to a certain level, increased by the functioning of the EU. Moreover during the past decades the disparities have not only been growing among member states but also within member states (European Commission 2014). Already in 1957, the Treaty of Rome enshrined the objective to promote harmonious economic development and help less favoured regions close the gap they experience. Cohesion has become increasingly one of the main objectives of the EU budget. While until the eighties 69% of the EU budget was spent on agriculture, since the beginning of the nineties there have been a significant increase in the resources assigned to cohesion policies⁸. Although some analysts consider that overall the EU budget has rather modest redistributive effects, due to the role of agriculture spending, negotiation procedure and correction mechanisms, for some countries (Heinemann, et al, 2010), the EU budget represents a significant source of resources for investment. In this sense redistributive effects of the EU budget are partly explained by differences in countries' relative economic prosperity and partly

⁵ If social protection and health are excluded respectively around 51 and 35 %. (Barbier Gauchard, 2014)

⁶ The long-term objective being "a Federation in Europe in which federal public expenditure is around 20-25 percent of gross product as in the USA and the Federal Republic of Germany" (European Commission, 1977:10-11). In December 2012, Herman Van Rompuy and the presidents of other EU institutions (Van Rompuy et al, 2012) further proposed to introduce a "fiscal capacity" in the euro area, in order to "improve the absorption of country-specific economic shocks, through an insurance system set up at the central level". In June 2015, the Five Presidents' Report (Juncker, et al, 2015) noted that "all mature Monetary Unions have put in place a common macroeconomic stabilisation function to better deal with shocks that cannot be managed at the national level alone".

⁷ See proposal by László former European Commissioner for Employment, Social Affairs and Inclusion on "Basic European unemployment insurance: Countering divergences within the Economic and Monetary Union".

⁸ EU agriculture spending had redistributive effects that did not appear necessarily to be related to countries' relative prosperity.

by institutional features that systematically favour smaller EU Member States (Mattila, 2004). However analysing only spending on Cohesion policies the redistributive effects are clearer. During the financing periods 2007-2013 and 2014-2020 in central and eastern European member states investments from the EU budget have been corresponding to between 2% - 4% of their GNI leading to convergence patterns in the EU.

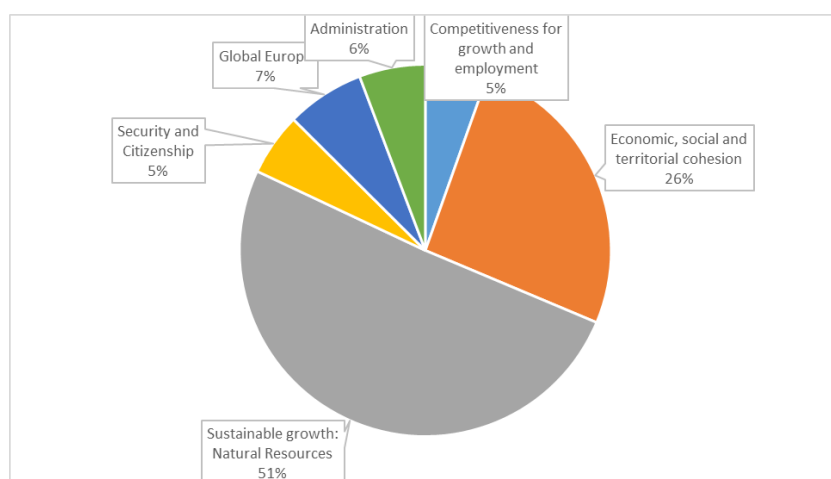
Thirdly, according to Musgrave, federal budgets should finance those public goods that are common to all regions, such as research, infrastructure, diplomacy and defence. As already mentioned the expenditure structure of the EU budget is different in nature and function from national budgets, since most powers transferred to the EU do not include what would be considered the core elements of public goods. However the spending structure of the EU budget has evolved according to the EU integration process and subsequent treaty reforms, as well as according to specific challenges. In other words, while the EU budget has grown up over the years as bargaining tool, aggregating numerous but uncoordinated spending programmes, the budget has become more coordinated and focused on the delivering of public goods. (Hagemann, et al. 2012; Cipriani, 2014).

The negotiation of the MFF have been traditionally interrelated with treaty negotiation. Compensations for losings in treaty negotiations were locked into the EU budgetary structure. Together with the unanimity rule for budgetary decisions, the evolution of the budget limited a policy-driven debate on the budget (Sapir, et al. 2003). The first MFF for the period 1988-1992 (Delors I package) was negotiated in parallel with the Single European Act. The MFF 1993-99 (Delors II package) contained a significant increase of structural and cohesion funds as a basis for the preparation of member states for the Maastricht Treaty. In 1999 the MFF for the period 2000-2006 (Agenda 2000) secured the necessary resources to finance the enlargement process. Since the negotiation of the MFF 2007-2013, the link between treaty and redistributive negotiations disappeared and there have been attempts to redirect the EU budget to more specific policy goals. Moreover, besides the traditional objectives of EU spending policies laid down in the EU treaties, policy strategies determined increasingly the EU spending priorities and budget implementation. In this sense the Lisbon Agenda added a new dimension to the MFF. The EU budget should provide adequate financing for initiatives in support of the goals of the Agenda. In this sense, the Cohesion Policy 2007-2013 was designed towards the goal of achieving economic and social cohesion but also for the delivering of public goods that are common to all regions. "Rather than an instrument to reduce regional disparities, EU cohesion policy started to be portrayed as a delivery vehicle to achieve the Lisbon goals of competitiveness, growth and jobs all over the EU territory" (Rubio, 2011). The Lisbon Treaty

increased the role of the cohesion policy and introduced a third dimension: territorial cohesion (Article 158 TFEU). The cohesion policy also played a further role beyond its traditional objectives related to the response to the economic and financial crisis within the framework of the European Economic Recovery Plan. (European Commission, 2010) Additionally, within the EU sovereign debt crisis a debate came up related to the fiscal stabilization function of the EU budget. In this context it was proposed that structural funds should have a secondary purpose of stabilizing national or regional business cycles. However the majority of member states decided not to reorient the EU budget towards a crisis resolution tool but to exploit flexibility within the traditional spending objectives (Núñez Ferrer, 2014).

Finally the MFF 2014-2020 established a clear link between the budgetary headings and a policy strategy, e.g. the Europe 2020 Strategy. The MFF “provides a long term vision of the European economy [the] budget is invested in the Member States in order to produce benefits for the European Union and its citizens. It helps to deliver the EU's growth strategy.” Analysing the different budget headings we can confirm the shift from traditional spending towards spending on specific policy goals related to the Europe 2020 Strategy. While during the nineties the EU targeted over 80% of its budget in favour of structurally weak and agricultural members states, this percentage has been reduced. This is not only due to budgetary constraints but also because of the growing importance of policy strategies and there interlink with the EU budget⁹.

Figure 1: Distribution of spending headings 2000 - 2006¹⁰

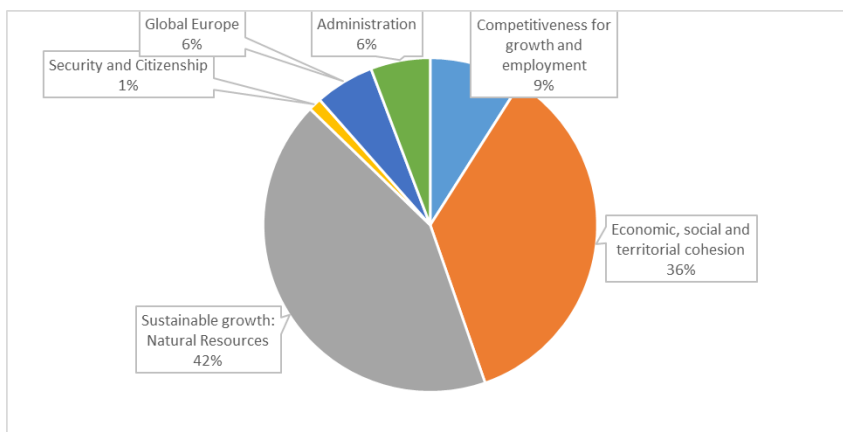


⁹ This is notably the case for: ‘Competitiveness for growth and jobs’ (+37%); ‘Economic, social and territorial cohesion’ (-8%); ‘Sustainable Growth: Natural Resources’ (-11%) and ‘Security and citizenship’ (+27%).

¹⁰ This table provides the distribution of the spending period 2000-2006 based on the headings of MFF 2007-2013 in order to provide an overview of the evolution of EU policies. There have been mayor changes in the EU, mainly in relation to the number of member states.

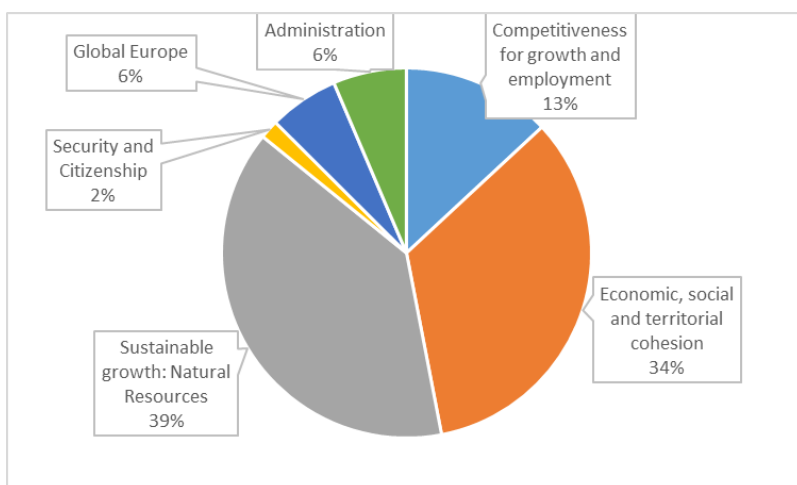
Source: Own elaboration, European Commission (2009), EU budget 2008, Final report, Luxembourg: publications office of the European Union.

Figure 2: Distribution of spending headings 2007 - 2013



Source: Own elaboration, European Commission (2009)

Figure 3: Distribution of spending headings 2014 - 2020



Source: Own elaboration

The MFF 2014-2020 contains specific instruments to respond to emerging challenges that call for a common, pan-European approach, as well as deliver mutual benefits across the European Union (European Commission 2011).

Furthermore new target spending criteria increased the trend towards public goods. In the sense that specific indicators verify the fulfilment of common objectives. Since 2014 cohesion funds are not only linked to specific indicators of the Europe 2020 strategy, but also to

macroeconomic criteria. Recent attempts to link the EU budget to whether member states adopt economic reforms or accept refugees confirm this trend.

Target spending also increases the role of the European Commission and the EP. In this sense the EP demanded that the EU budget priorities should continue addressing the migration and refugee crisis while at the same time investing more and better to accelerate today's slow economic recovery. The mid-term review of the Multiannual Financial Framework, scheduled for the end of 2016, is envisaged to orient the EU budget further towards jobs, growth and competitiveness.

There is a further element which underlines the evolutionary character of the EU budget. Within the current MFF we can confirm an increased flexibility within the budget both related to the temporal dimension but also among budgetary headings. The increasing flexibility of the budget has increased the discretionality of budgetary actors.¹¹

2.4 The budgetary decision making process

Budgetary negotiations are even in well studded democratic federal countries characterised by strong tensions. However budgetary negotiations are crucial for arrangements for making joint decisions on joint problems (Friedrich, 1955). The EU has only recently moved to a more communitarian approach in the decision making process regarding both the budgetary procedure and the use of the instruments of fiscal policy related to taxation and transfers. In general terms the budgetary procedure at the EU level consists of the annual budgetary negotiation and the negotiation of the MFF. While the annual budgetary negotiation comes close to the budgetary process in a federal country, the negotiation of the MFF has been traditionally an intergovernmental negotiation.

However, the European Commission and the EP also took advantage of openings in the political opportunity structures to capitalise on new opportunities. The control mechanisms for budgetary discipline introduced by Delors I and the control of EU spending according to policy objectives had been included by the European Commission and strengthened afterwards the position of the EC in the budgetary process. (Laffan, 2000:729). But more important has been the increasing role of the European Parliament.

The Lisbon Treaty gives the European Parliament a new formal role in the adoption of the regulation which sets up the MFF. The EP has the right of consent over the spending side, e.g. a majority of MEPs can approve or disapprove the agreement reached by the European Council,

¹¹ The Commission requested twice the mobilisation of the Flexibility Instrument, as well as the deployment of the Contingency Margin, in order to cover pressing and unforeseen needs that could not be financed within the existing MFF ceilings.

although formally it cannot negotiate it. But the EP has not only a new formal role in the final phase, since it has already been one of the major players from the very beginning of the negotiation process of the MFF 2014-2020. The new “informal” procedure enabled the MFF 2014-2020 to be “negotiated” between the Council and the EP. “It is only since the Lisbon Treaty that the European Parliament has fully deserved to be called a parliament. It now has all the budgetary powers a parliament in a federal system has. It is the first time that these new powers can be exercised on a multiannual financial framework.”¹²

Taking into account the long term development of the EU budget we can see a continuous but slow evolution with incremental modifications. There is still high political resistance in many countries to the sharing of fiscal resources and political sovereignty. The lack of support in Council for a series of reforms proposed by the Commission and the EP resulted in a prolongation of the current system, which is plagued by conflicts between net payers and net beneficiaries.

It will need to shift to a system of further sovereignty sharing within common institutions. Member states have to increasingly accept joint decision-making on elements of taxation. This would pave the way for some degree of public risk-sharing, which would at the same time have to be accompanied by stronger democratic participation and accountability both at national and European levels (Juncker, et al. 2015).

3. The EU budget beyond Fiscal Federalism - Models for an EU Federal budget

Following the three aspects of federal budget discussed above there are three models of fiscal integration which take into account the specificities of the EU budget and which could offer a road map for further integration: The “classic fiscal federalism model”, the “surveillance and regulatory model” and the “surveillance and investment model” (Hinarejos, 2013).

According to the “classic fiscal federalism model”, the EU will acquire fiscal authority and own fiscal tools in order to raise revenue resources. Taking into account considerations from fiscal federalism several categories of revenue models could be envisaged. However, an explicit fiscal source should have a broad base and be levied at a low rate, to minimise allocative distortions. Moreover the tax should be collected by a European treasury authority (Iozzo, et al. 2008). The establishment of own resources would provide the justification for giving the European

¹² “If we abdicate our powers, we no longer deserve our name” - Interview with Alain Lamassoure, European Parliament’s chief MFF negotiator, Europolitics, 01 March 2013.

Parliamentary budgetary powers. This financing system based on “real” own resources would increase the financial autonomy and accountability of the EU and introduce a direct link to citizens.

According to the “surveillance and regulatory model”, member states would continue to maintain all taxing powers. The EU would enforce fiscal discipline. This model could be considered the natural progression of the current status quo. The financing of the EU would be maintained through member states’ contributions based, for example, on the GNI resource without a specific European tax or tax sharing. The GNI resource has been considered a flexible and cost-efficient revenue type with reasonable statistical reliability, and moreover it is a transparent indicator for national contribution capacity. The GNI resource stresses the relative size or prosperity of member states as the variable to determine the revenue burden, under the equivalence principle, a country contributes in proportion to its benefits from membership. In this context only member states will have instruments and resources to deliver solidarity-based social, pension and health systems, and the EU’s role is a regulatory one. The EU will increase its role in the surveillance of national budgets, in line with the “European semester”, by which the EC is overseeing and commenting on individual member states budget plans.

The “surveillance and investment model” foresees a slow but gradual introduction of fiscal power at the EU level but also the reinforcement and parliamentarisation of the control mechanism for budgetary stability. There will be some own resources established, but the financing of the EU would still be mainly through member states’ contributions based. In general, the EU would have the necessary resources to address economic and social inequalities through fiscal instruments, while at the same time using these instruments for policy objectives. The EU may be empowered to achieve those objectives through specific policy reforms such as reforming the national pension systems, or even the tax system. This scenario would include some kind of “transfer union” similar to the equalisation systems used in federal countries. Evolution towards further integration could take place through more detailed prescriptions and recommendations from the centre, and through the use of fiscal tools together within the surveillance procedures, as well as increasing conditionality in spending programmes.

Independently of which kind of model that would be considered as the most appropriate, the decision making process has to be reformed to improve transparency and democratic legitimacy. The European Parliament should ensure further democratic scrutiny of the budgetary measures taken. Firstly there are proposals to align the next MFF with the political cycles of the Commission and EP. This would offer the opportunity to “politicise” the discussion on the MFF and present differences before the electorate on the occasion of European elections. According to

the elections result the European Parliament should have a mandate to negotiate the MFF, which would be applied during its mandate. Secondly, a shift towards a qualified majority voting for the MFF would be in line not only with the ordinary legislative procedure, used for the adoption of virtually all EU multiannual programmes, but also with the annual procedure for adopting the EU budget. And thirdly, the EP should have a similar input in the MFF decision making like in the annual budgetary process. In this sense it has been put forward that the MFF should be prepared in co-decision of the Council with the EP (Padoa-Schioppa, 2013).

5. Conclusions

The economic and financial crisis highlighted the need that the EU should become to be sustainable as a multilevel system of fiscal and economic governance. But how large does a federal budget have to be in a system where spending and revenue raising are highly decentralised? The size of the EU budget is too small for macroeconomic stabilisation functions. In fact the EU budget is small in size as a share of GNI (1%) or of national public expenditure (2%).

In many respects, the EU institutional structure is unique, being neither an inter- governmental organisation nor a federal State. In this text we have been using the term federal budget not as a normative term but as a descriptive term and an explanatory tool applying it to particular forms of budgetary organization and evolution.

Briefly analysing the underlying principles of federal arrangements around the raising, sharing and spending of money, we studied different elements of the EU budget. The scope of this contribution was limited to demonstrate some evidence that we can speak about the federalisation trends regarding the EU budget. At a first glance, according to the classical fiscal federalism criterias: revenue and spending power, budgetary autonomy, the EU budget could not be considered as a federal budget.

Conserving the general principles, the EU budget faces similar challenges that all federal, multilevel or fiscally decentralized systems face when allocating fiscal power to different levels of government. Especially, the need for transparency and efficiency, along with the balance between spending obligations and the adequate revenue-raising powers to meet these obligations in addition to the respect for subsidiarity are crucial issues.

Regarding the revenue structure, the comparative analysis of federal countries show that fiscal autonomy among the different tiers of government is not very frequent. In most federal countries exist different models regarding the allocation of tax powers, because of different constitutional arrangements, histories of revenue rising and political culture.

Regarding the spending structure, existing mechanisms may not overcome the structural inequalities between rich and poor countries or prevent and tackle asymmetric shocks in an efficient manner. There is an important gap between the present EU framework with regard to the performance in the field of macroeconomic stabilization and what should occur in the context of a true Federation. However the EU budget contributes to finance public goods and to maintaining cohesion and on balancing economic integration with regional economic development. Since the Sapir report in 2003 famously dubbed the EU Budget as a historical relic, (Sapir, et al., 2003), there have been some important steps forward. Especially the new MFF 2014-2020 and the ‘emergency’ atmosphere of the past years allowed some important reorientations. In this sense the EU budget is moving from a budget as a bargaining tool to a budget based on the rational that all member states and the Union have common objectives rooted in common values.

Finally we should not underestimate the effect of EU initiatives on the budgetary priorities of member states. The symbolic role of funding decisions and spending are key to understanding why they are. According to Alexander Hamilton, there is, perhaps, nothing more likely to disturb the tranquillity of nations than their being bound to mutual contributions for any common object that does not yield an equal and coincident benefit. For it is an observation, as true as it is trite, that there is nothing men differ so readily about as the payment of money. Referring to the US example, it should be underlined the complicated and long process which had to be passed before the US-federal budget reaching a widely accepted but still imperfect balance between the allocation of spending and revenue power among the different levels of government.

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