

European Union budget review: An Austrian perspective
Lessons for the Union of South American Nations

Auke R. Leen

Faculty of Law, Department of Tax Law and Economics
Leiden University, The Netherlands

Thematic areas: Economics/Political Philosophy

Abstract

Constitutions should say no. The Treaty of Lisbon (2007), though no real constitution, definitely says yes to almost all spending and taxing of the European Union (EU)¹. There are almost no limitations to the tasks of the EU; subsidiarity and proportionality, the criteria to determine the added value of EU spending, are no effective constraints. In a public call, the European Commission asks for ideas how to reform the budget. The challenge of our paper is to give from the point of view of Austrian economics a novel angle to revise the budgetary powers made available. With the budget restrictions, we suggest, on specific outcomes, the procedure for reaching outcomes, and the pattern of allowable outcomes, the Leviathan can be trusted.

Background: EU-budget review

After the rejection of the Treaty establishing a Constitution for Europe (2004) in 2005 by French and Dutch voters, the Treaty of Lisbon (2007) is put up for ratification. A revision, however, of the budgetary powers of the EU is a priority. For, if the ‘no’ of the French and Dutch was a revolution, the truth is that, as has

been said, at least half of all historic revolutions were fiscal revolutions. The EU should remember Machiavelli's warning. '[T]o avoid being hated, a ruler must keep his hands off the property of others, because men more quickly forget the death of their father than the loss of their patrimony'. Citizens want to be protected from an 'automatically' expending budget. If the budget expands, it should be by the explicit consent of the citizens. Afterwards to curtail (see the discussion re the curtailment of the agricultural expenses) is almost impossible.

The discussion, invited by the consultation paper of the European Commission (2007),---just as that after the rejection of the Constitutional Treaty---can be a toilsome process inside the realm of partisan (Member States') advocacy. Also, the discussion often applies ethical norms in a vacuous (without a model of governmental-political behavior) institutional setting. Solidarity, however, has to be bought. In the end, 'competition between political agents for constituency support through the use of promises of discriminatory transfers of wealth' (pork-barrel politics) will prevail. For James Buchanan, 'politics without romance' is the proper attitude (2003, p 15).

Moreover, budgetary decision-making is often based on the rule that policies have to pose as little resistance as possible for the majority that must decide. The feeling dominates that someone else pays (Hayek, 1982, Vol. 3, p. 127). To trust on goodwill to constrain the budget is no solution either. At least in the U.S. in the four years before 2005, no Member of Congress voted on total for a reduction in spending. Though the rhetoric of fiscal discipline was strong (Dirksen, 2005).

For a real budget review, we have to improve rules and institutions. For Thomas Sowell, this improvement was also the essence of the American Revolution of 1776. The essential point was not a change in false to true doctrines or leaders but a change in the process 'by which whoever occupied the places of power could be restrained and replaced' (1999, p. 146; cf. Hayek, 1960, p. 155).

Approach to the problem: Constitutional and Austrian economics

Our paper gives a fundamental review: it focuses on the choices among quasi-permanent constraints. Within which constitutional alternatives, rule-based perspectives---or whatever political correct name we choose after the demise of the Constitutional Treaty (2004)---should budgetary powers be exercised? We take literally Dalia Grybauskaites (European Commissioner for Financial Programming and Budget) remark about the review as a ‘unique, may be once-in-a-lifetime possibility’. We choose rules that, once selected, stay over time. Member States cannot predict their future position. In particular, they are presumed to be unable (a veil of ignorance) to identify their position either as payer or as spending beneficiary. We deliberately make ‘the outcome unpredictable in order to make agreement on the procedure possible’ (Hayek, 1982, Vol. 2, p. 4). History shows that debates about a framework for political action have been possible and fruitful (Elster, 2000)

The Treaty states individual freedom as a core value. It is a value in itself; it coincides with human nature. Man is first-and-for-all a unique spiritual being. We can develop our unique potentialities if our choices are based on individual freedom. Freedom is also essential to develop our spiritual (moral) site. If not leading to the extinction of all moral responsibility, we must make choices to help others in freedom. Individual freedom, however, is also a necessity for a market economy. Not only, quite visible, do the climate and the physical characteristics of countries differ. Less visible, though of more importance, as just-said, men in their preferences and knowledge do. Decentralized (market) decision-making, as has been emphasized by the Austrian-born economist Friedrich Hayek, makes optimal use of differences in knowledge. The market uses unique knowledge of local circumstances and preferences that do differ in time. Knowledge that is difficult or even impossible to centralize. Most importantly, the market unleashes ‘the creative powers of a free civilization’ (1960, p. 21). Often knowledge grows at the moment

individuals seek to discover facts that may be to their advantage. Government can never duplicate the variety of individual action and experimentation. The problem in a market economy is not to give the authorities all the extra knowledge they need to pursue policy. The problem is to give each individual all the extra knowledge he needs, mostly in the form of price (profit) signals, so he can decide how to pursue his goals.

In sum, the paper evaluates budgetary rules. The emphasis is not, as is usually the case, based on a benevolent EU, to enhance economic efficiency (making the EU 'work better') and/or to increase equity. Our analysis is defined by the limits it places on the powers of Brussels, an egoistic despot, to tax-and-spend'. Though the model of a budget-maximizing Leviathan-like bureaucracy, a discretionary agency, may seem extreme, the norms laid down may prove acceptable as to ensure that the best remains a possibility by guarding against the worst.

Political economy: Hayek

For Hayek (1986), democracy can only under restricted conditions be transposed to a supra-national organization. We can hardly expect concrete policies from the European parliament---the most democratic institution of the EU. Of course, general objectives (prosperity for all) will be easy to agree on. For concrete objectives, however, this will be hard. Countries differ in culture, history and economic development. Every choice, e.g., to equalise standards of living, supposes a balancing of the pros and cons (o.c., p. 168). The revised Services Directive of 2006, for instance, is supposed to show the human face of the EU. No worker from Eastern Europe, however, will be glad with the social protection of the revised directive or the social clause in the new Treaty. Within a relatively homogeneous country, however, the original directive, or a measure to support a national pride is no problem. In the Union, however, the solidarity and trust that is

necessary for policies is tenuous. Even within one country if things differ: language (Belgium), religion (North-Ireland), or economic development (North and South-Italy) solidarity is hard.

Besides that, large countries will never transfer power to Brussels. The watered-down version in 2005 of the original rules of the Pact on Stability and Growth, in the early years of this century, is an example. It is naïve to have expected the same reforms if small countries had broken the rules. We can expect similar for the new rule, to be effective in 2014, for a qualified majority in decision-making. A double majority is required: 55% of the Member States representing at least 65% of the Union's population. Probably, if it is of a disadvantage to large countries, it will be violated.

Hence, if the parliament cannot agree on policy objectives, the European Commission remains *de facto* the administration. Often below the guise, that it concerns only a technical point. That is hard to maintain. Over a change in policy, no matter how technical, the parliament belongs to decide too. Moreover, also the Commission has to do with the conflicting wishes of the Member States.

Constitutional political economy: Buchanan and Hayek

For the EU, constitutional economics is largely uncharted territory and a road abandoned. For Buchanan, however, it is an opportunity---EU citizens need to grasp---for going back to constitutional basics (1991). The constitutionalist mindset that says that persons owe loyalty to the constitution rather than to the government has become foreign to Europe. The idea that there are, or should be, limits on the powers of the government has largely been forgotten. Freedom, however, means exemptions from the power (the ability to restrict options) of the Union. As Hayek said, 'the most important outcome of the socialist epoch has been the destruction of the traditional limitations upon the powers of the state' (1960, p. 223). Constitutionalism defines the rules of the socio-economic-political game. Equal

processes (rules and institutions) for all, not equal results, are the focus of policymaking (Sowell, 1999, p. 152). Constraints and the consent of free individuals (and hence trust) are important. For some, real equality should supersede (be a prerequisite) or be an alternative to formal equality. Freedom of speech, for instance, should include the means of making speaking heard. Whatever is the merit of this idea, it is, as just shown, hard to apply for the Union.

We have to make two sorts of decisions. First, we choose constitutional (higher law) rules. No one knows his future position. (Ironically, of all the Member States, Germany broke the rules of the Pact on Stability and Growth. Though beforehand Germany was a most unlikely candidate.) It is at this stage, where we choose the basic arrangements, citizens really control the state and widespread public agreement is possible (Brennan and Buchanan, 2000). The prospect for agreement changes dramatically if we allow for the introduction of ignorance and/or uncertainty into the calculus. Agreement relates directly to the predicted length of life of the reform. If we take a long-term perspective, we opt for fair rules. Besides, it is always easier to agree on rules than on a certain policy. The tone of the discussions is theoretical and argumentative. Gains for all members are real.

Second, we have, within the framework, to state rules for day-to-day policies. Majoritarian rule ensures workability. The tone of the discussions is one of weighting up interests and bargaining; ordinary politics, post-constitutional choice, tends to be conflictual (Elster, 2000).

The Treaty of Lisbon gives unanimity a smaller role. It, however, does not make the distinction between the two sorts of decisions. For this reason, in the old Treaty, rule (policy) making implicitly had constitutional characteristics. In the new Treaty, rule making becomes more conflictual and is without effective constraints. '[M]ajoritarian rule,' as Brennan and Buchanan do say, 'can best be modeled as if it embodies *no effective constraint on the exercise of government power at all*' (2000, p. 10).

There is a difference between Buchanan's more radical approach to constitutional reform and Hayek's cautious approach. Nevertheless, for Hayek too, especially if we have to start from scratch, to create supra-national institutions, an analytical map is worthwhile (1982, Vol. 3, p. 108). 'Societies form but states are made' (o.c. p. 140). For societies, however, abstract (impersonal) rules of conduct, '[t]he basic tools of civilization [...], are all the result of spontaneous growth and not of design' (o.c. p. 163).

Three principles to constrain the Leviathan

After a wide consultation for each project, subsidiarity and proportionality should constrain EU expenditures. Subsidiarity says that 'in areas which do not fall within the EU's exclusive competence the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States but can, by reason of the scale or effects of the proposed action, be better achieved at the Union level.' Proportionality says that 'the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties' (2007). The principles, however, are too vague and arbitrary to constrain. It allows the EU to stimulate the sale of flowers by subsidizing a lottery attached to each sale and the plan to subsidize fruit for schoolchildren. As far as the provision of a wide consultation goes, at least in the U.S., in hearings of the Congress with a balance of 145 to 1, witnesses arguing in favor of programs compared to those who spoke against them (Payne, 2006).

In constitutional economics, there are no unique solutions; several combinations of institutions and rules are possible. Certain general principles, however, can be part of an effective constraint. Though, constraints that are more specific are possible, e.g., revenue-rate limits, revenue-base constraints, aggregate revenue and outlay constraints (cf. Brennan and Buchanan, 2000). Like this, the EU budget is not allowed to have a deficit, and the amount of money, which can

be made available to the Union, is limited by agreement of the Member States for a seven-year period.

We learn from the American Constitution (Friedman, 2002; Hayek, 1960 and 1982; Sowell, 1999). We have to be protected against that instrument of power: legislation that has been described ‘as among all inventions of man the one fraught with the gravest consequences, more far-reaching in its effects even than fire and gun-powder’ (Hayek, 1982, Vol. 1, p. 72). If we have to carry over tasks to supra-national authorities, we feel protected if one or more, of the following provisions is present. Provisions that, state the activities that can be undertaken, disperse fiscal power, and prescribe nondiscriminatory taxing and spending rules.

EU tasks

In the American Constitution the central authorities do have little and limited and the States do have many and large competences. The former has powers related to foreign policy and national defense. The latter has powers related to the criminal justice system and the protection of the family. In the Treaty, however, almost everything is the competence of Brussels. It has exclusive competence on certain areas (customs, competition and monetary policy, fishing, and common commercial policy). It shares competence on other areas (e.g., economic, social and territorial cohesion, the environment, energy, consumer protection) and it supports still others (e.g., industry, tourism, education).

Power, however, wants more power, all to the good or to the bad. ‘The whole history of the development of popular institutions is a history of continuous struggle to prevent particular groups from abusing the governmental apparatus for the benefit of the collective interest of these groups’ (o.c., Vol. 2, p. 6). To require national co-financing for a project might be no good idea. The pressure to accept, with the strings attached to it, is enormous. Matching grants do unlock an acute gold rush---for the authorities the benefit of the project has to be only halve of the costs (Sowell, 1999, p. 181).

Even if the tasks of the central authorities are limited, the pressure for an ever-growing budget is great. The Treaty says, 'The Union shall offer its citizens an area of freedom [...] the Union shall establish an internal market'. That, however, is a license for government involvement in almost everything. Look at the results of the infamous 'commerce clause' in the U.S. Constitution. This authority to regulate interstate trade is a license or defense for almost all policies from quota for planting wheat to the possession of handguns.

What should be the tasks of the EU? As 'an area of peace, freedom, and justice', the classical tasks of the minimal state are first. Since absolute freedom is impossible (not all men are angels), the tasks (coercive measures of government) of the protective state are internal order, the enforcement of rights and contracts, and external order. Some supplementary or subsidiary pure service activities and public goods are second. They are usually not undertaken by the market because it is not possible to confine the benefits to those prepared to pay for them, such as a reliable monetary system, the setting of standards, and statistics. Third, tasks based on individual expediency are necessary. Precluded, since they are virtually impossible at a central level, are tasks re the basic economic functions: setting the scale of values; organizing production; and distributing the product.

In sum, the tasks should be limited to the protection of mainly negative values. To limit tasks is one of the fundamental protections of individual freedom.

The institutional structure of decision-making

Hayek (1982, Vol. 3) splits fiscal functions and hence power. At present, the functions of stating rules and of directing particular activities are confounded. The solution is to create a Legislative Assembly (upper house) that states the fiscal rules and a Governmental Assembly (ordinary legislature or parliament) that administers within the rules. The assembly that draws up semi-permanent budgetary rules should not be confused with that body that is set up to enact or amend a constitution. The last defines what can be substantive law; the first

develops its content. As far as voting procedures go, at the legislative (just as at the constitutional) level, unanimity (or at least a super majority) is required. It, for one, tends to minimize wasteful investment of resources in majoritarian rent seeking. For ordinary politics, majority rule will do (Buchanan, 2003, p. 15). To provide an effective check, we elect the Legislative Assembly in a different way from the Governmental.

How should the institutional structure of the EU change? Next to the idea behind subsidiarity that power should be split and exercised at an as low institutional level as possible. Since, in a world of jealous Member States, if I do not like what my country does, I can always move to another. The mere possibility, though few take this step, acts as a check upon power (Friedman, 1982, p. 3).

Presently a trilateral agreement of Commission, Council and Parliament decides. All of whom state the budget and make policy within it. For the positive this means, 'Two powers will fight until one of them has crushed the other. But three will maintain themselves in a perfect equilibrium [...] when two are fighting each other, the third, being equally interested in maintaining the one and the other, will join the oppressed against the oppressor, and thus restore peace among all' (Elster, 2000, p. 135). For the negative, however, there is no, government-under-the-law: the Union is 'free to give itself currently whatever laws help[s] it best to achieve the particular purposes of the moment' (Hayek, 1982, Vol. 3, p. 101). A split in the level of law making is necessary; a sort of 'double' European Commission is an option.

In sum, splitting up fiscal powers (bicameralism) in two levels constrain outcomes indirectly by modifying the decision process. Splitting up political power is one of the bulwarks of individual freedom.

Budgetary rules

Given our limited knowledge, discrimination in taxing and spending has unforeseen consequences. Besides, at the Union level, no agreement, except for the most

general goals, is possible. The market, however, can handle decisions when knowledge is dispersed and general agreement is impossible (Friedman, 2002, p. 24). The market is ‘a method of collaboration which requires agreement only on means and not on ends’ (Hayek, 1982, Vol. 2, p. 3). The market makes the EU a viable possibility. It allows the EU to do what it can do: to state nondiscriminatory broad-based taxation and spending policies. The EU should centralize activities with homogeneous preferences and high externalities and/or economics of scale. Besides, if it wants to create trust, the EU should be more than countries seeking to further particular interests. The ultimate justification of collective action is the persuasive force of nondiscriminatory objectives (Hayek, 1960, p. 198).

We extend the legal tradition of nondiscrimination. The rule of law: ‘no power should be arbitrary and [...] all power should be limited by higher law’ (o.c., p. 155) should be applied to ordinary politics: not limiting benefits to identified groups or countries. The principle, for Hayek, as cited by Buchanan (2005), would make all other rights unnecessary. It disqualifies programs that qualify persons in accordance with identification by ethnicity, location, occupation, or industry. Just as it rules out all discrimination on taxation by special exemptions or deductions.

In sum, just as Justice, the EU should be blindfolded. Discrimination implemented through politics (the method of specific orders and prohibitions) is just as immoral as implemented in the private sector. Though generality is more or less the (implicit) rule on revenues, politics has lagged behind law in its incorporation for expenses. The principle of nondiscrimination limits the EU budget by the allowed pattern of outcomes.

Conclusion

The EU budget is the cause of bitter arguments. It is said, the budget has never been used as a means to meet objectives but rather as a negotiating tool. Changing majority coalitions do have the political authority and the opportunity to finance

their interests. There is another possibility. The Treaty of Lisbon misses rules and institutions that constrain whoever has the power. ‘The effective limitation of power is the most important problem of social order’ (Hayek, 1982, Vol. 3, p. 128). If, as the Treaty says, the Union is an area of ‘freedom, security and justice’, the basic values of the EU are negative: they assure, ‘the individual of the right within a known domain to pursue his own aims on the basis of his own knowledge’ (o.c., p. 130).

For the Austrian constitutional economist there are three basic constraints. One, to limit budgetary tasks. Second, to split budgetary powers. And, third, not to limit benefits to specific groups or countries.

Instead of the present approach, the guidelines of this analytical blueprint of quasi-permanent constraints can become an agenda-setting focal point for the budget review. They are means proportionate to the problem at hand, since (1) they create trust (social cohesion) between the states. A shared framework facilitates a robust democratic debate. (2) They make the aims of subsidiarity and proportionality a real possibility. The goal that EU policies should add value is applied effectively. Moreover, (3) they substitute agreed on rules for (instead of) improving the morals between Member States. Just as the market does the same by steering self-interested human behavior within an order of private property. Finally (4) they are a real possibility. In history, debates on rule-based frameworks have been possible and fruitful.

Because of their voluntary consent (an internal criterion based on the desires of the States) the reforms are acceptable to the Members. No external criteria are necessary; no agreement is needed over the goodness or badness of the criteria, e.g., allocative efficiency or equal treatment for equals.

To conclude, constraining rules facilitate a democratic debate within a transparent and reliable policy and legislation framework. ‘Politics by Principle, Not Interest; Toward Nondiscriminatory Democracy’ (The title of a book by Buchanan and Congleton; cf. Hayek, 1960, p. 193).

References

Brennan, G. & J.M. Buchanan (2000). *The Power to Tax, Analytical Foundations of a Fiscal Constitution*. Indianapolis: Liberty Fund.

Buchanan, J.M. (1991). 'An American Perspective on Europe's Constitutional Opportunity.' *Cato Journal* 10 (3): 619-629.

Buchanan, J.M. (2003). 'Public Choice. Politics without Romance.' *Policy* 19 (3): 13-18.

Buchanan, J.M (2005). 'Three Amendments: Responsibility, Generality, and Natural Liberty,' *Cato Unbound*.

Dircksen, J. (2005). Vote Tally Report 108-2. *NTUF Policy Paper* 156.

Elster, J. (2000). *Ulysses Unbound*. New York: Cambridge University Press

European Commission (2007). Reforming the Budget, Changing Europe. A public Consultation Paper in view of the 2008/2009 budget review.

Friedman, M. [1962] (2002). *Capitalism and Freedom*. Chicago: University of Chicago Press.

Hayek, F. A. [1944] (1986). *The Road to Serfdom*. London: Ark.

Hayek, F.A. (1960). *The Constitution of Liberty*. London: Routledge.

Hayek, F.A. (1982). *Law, Legislation and Liberty*. London: Routledge & Kegan Paul.

Payne, J.L. (2006), 'Budgeting in Neverland. Irrational Policymaking in the U.S. Congress and What Can Be Done about IT,' *Cato Institute, Policy Analysis*, July 26.

Sowell, T. (1999). *The Quest for Cosmic Justice*. New York: Touchstone.

Treaty establishing a Constitution for Europe (2004). *Official Journal of the European Union* C-310, Volume 47, 16 December.

Treaty of Lisbon (2007). *Official Journal of the European Journal* C-306, Volume 50, 3 December.

¹ EU facts: 27 Member Countries with almost half a billion inhabitants; GNP 11.000 billion Euro (17.000 billion U.S. Dollar); 30% of world income; 15 countries do have the Euro; EU (balanced) budget: 130 billion (293 Euro per head); expenditures structure: 45% agricultural policy, 45% cohesion policy, 5% foreign policy, 5% administration; maximum spending limit 1.24 % of total EU GNI; revenues structure: customs duties 15%, share of national value added taxes 15% (about 0.3% of national VAT's), Member States contributions based on GNI 70%.