CHARACTERISTICS, FUNCTIONS AND CHANGES (?) OF EU BUDGET

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ABSTRACT: *Every chance that you get is a chance that you seize – every crisis is a chance.[1] Due to the economic depression the supervision and evaluation of governmental roles is surfacing not only at national but also at EU governmental level. The crisis and the debate of the next (2014-2020) multiannual financial framework (MFF) have given an opportunity to the revision of EU governmental methods and functions. The question is whether the EU and the MemberStates have made the best of this opportunity or not.*
For the purpose of analysing the functions at EU governmental level, the first part of the study focuses on the theoretical background of intergovernmental fiscal relations, on the theory of fiscal federalism in general. Afterwards the special characteristics of the EU budget and EU finances will be defined from the viewpoint of fiscal federalism. In the framework of our study, the present (2007-2013) MFF will be thoroughly evaluated and compared to the next (2014-2020) MFF. The final version of the next MFF and the detailed rules have not been adopted until the time of writing (November 2013), though the proposals of the Commission and the conclusions of the European Council clearly show the direction – or the lack – of changes.

KEY WORDS: *Fiscal federalism, allocation, redistribution, stabilisation, EU budget, multiannual financial framework*
JEL CLASSIFICATION: K 34

1. FISCAL FEDERALISM – GOVERNMENT FUNCTIONS IN GENERAL

The theory of fiscal federalism focuses basically on the distribution of tasks and competences between the public and private sector, the roles of different governmental levels, the optimal level of providing public goods and services, and the fiscal resources and tools for the effective and efficient achievement.

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The first generation of fiscal federalism (the so called TOBM model)[2] examined the federal financial system of intergovernmental levels (typically in the USA). Later the researches related to the fiscal decentralisation expanded to the unitary states and to the Member States of the EU.[3] In connection with this trend the Council of Europe and the OECD also carry out researches into this topic.[4] The recent studies of fiscal federalism analyse the roles and functions of the EU governmental level and the intergovernmental fiscal relations in the framework of the European economic field.[5] In consequence, the theory of fiscal federalism can be examined in the following territorial units:

a) at national governmental level (between central and sub-national governmental levels):
   - in federal states,
   - in unitary states;

b) at international governmental level:
   - fiscal relations between countries,
   - fiscal relations in economic integrations.

The functions of the different governmental levels are central issues of fiscal federalism. The types of functions are classified in several ways. The most frequently used classification was defined by Musgrave,[6] who distinguished the allocation, redistribution and stabilisation branches.

By studying the roles of the public sector the *allocation function* is the limitation of public from private goods and services (e.g. education, health care, public transportation, public utilities). After the determination of the scope of public goods and services the government has to distribute the competences and power to the optimal – the most efficient – governmental level(s) and regulate the provision (directly by public bodies or indirectly involving the private and civil sector) and finance (taxes, fees) of public goods and services. The economic policy (e.g. liberal or welfare state) of the state significantly determines the quantity and quality of public goods and services.

The *redistribution function* aims to reduce the differences caused by primary allocation. According to the governmental preferences, the redistribution can be realised between social groups, generations, economic sectors, territorial units or governmental

[2]Tiebout, C. M., 1956, ‘A Pure Theory of Local Expenditures’, *The Journal of Political Economy*, vol. 64, no. 5, pp. 416–424. Oates, W., 1972, *Fiscal Federalism*. Harcourt Brace Jovanich, New York.. Buchanan, J. M., 1950, ‘Federalism and Fiscal Equity’, *American Economic Review*, vol. 40, no. 4, pp. 583–599. Musgrave, R.A., 1959, *The Theory of Public Finance*, McGraw-Hill, New York.

[3]The connection literature e. g.: Bosch, N–Durán, J. M., 2008, *Fiscal Federalism and Political Decentralization,* E. Elgar, Cheltenham, UK; Northampton, MA, USA. Fossati, A.–Panella, G., 1999, *Fiscal Federalism in the European Union*, Routledge, London. Rattso, J. (ed.) 1998, *Fiscal federalism and state-local finance: the Scandinavian perspective,* E. Elgar, Cheltenham, UK; Northampton, MA, USA.

[4] With the acceptance of the European Charter of Local Self-Government and the operating of the European Committee on Local and Regional Democracy, the Council of Europe committed itself to the research of the modernisation of financing local governments. Besides, in 2003 the OECD established a network of professionals dealing with the operation of fiscal relations across governmental levels.

[5] See especially: Molle, W., 2011, *European Economic Governance*, Routledge, London, New York. Begg, Iain, 2009, *Fiscal Federalism, Subsidiarity and the EU Budget Review*. SIEPS Report, no. 1. Vaneecloo, C.–Badriotti, A.–Fornassini, M., 2006, *Fiscal Federalism in the European Union and Its Countries*, P.I. E. Peter Lang, Brussels. Baimbridge, M.–Whyman, P., 2004, *Fiscal Federalism and European Economic Integration*, Routledge, London.

[6] Musgrave, Richard A., 1959, *The Theory of Public Finance*. McGraw-Hill, New York.

levels. There are more financial techniques that facilitate the play of redistribution role: tax allowances, support, regulation of minimum level of public services, etc.

The aim of *stabilisation function* is to minimize the economic cyclicality and the various types of macroeconomic failures. To tackle macroeconomic failures the state can reduce the rate of inflation and unemployment, manage economic depressions and promote economic growth, strengthen the fiscal discipline and the positive trade balance (to avoid twin deficit), etc.

According to Bailey,[7] the functions of allocation, redistribution and stabilisation can be completed by *the function of regulation*, which is not just the system of laws, but is a much wider phenomenon containing the techniques of indirect regulation.

With regard to the abovementioned functions, I highlight some of the essential features:

- According to the theory of fiscal decentralisation, the redistribution, stabilisation (and the regulation) functions shall be accomplished primarily (but not exclusively) at central governmental level – though there are several studies which prove that sub-national levels are also capable of stabilizing the economy,[8] redistribution and regulation. The local employment programs and development policy, the local regulation of municipal solid waste management or the regulatory role related to the fees of public utilities are typical examples of local functions.
- The allocation function shall be divided between national and sub-national governmental levels, so the allocation function shows the most obvious transfer of tasks and duties and division of power. The principle of subsidiarity and the different local needs also justify the role of local units.
- In many policy areas, the combination of functions is present (every function appears in the case when the rail service is provided by a public company that gives some fee allowances and – due to the liberalisation of rail transportation market – at the same time the state regulates the conditions of entry and operation in the market).

The governmental functions help to answer the questions: what are the roles of the state and why should it intervene? Then another question may arise: what methods of intervention?[9] In our study – with regard to the topic of our research, the EU governmental level – we will apply three main governmental methods: the regulation, coordination and finance. The *regulatory method* may take the form of prohibition, limitation and other obligatory decision and can be connected to the abovementioned regulation function defined by Bailey. The *financial or budgetary method* can be manifested in different kinds of subsidies, taxes and allowances. The *coordination method* is not associated with obligatory decisions but may take different forms of cooperation such as discussing, exchange of experience, recommendations, etc.

Finally, the research of the optimal level, size and method of providing public goods and services shall cover the issue of *multi-level and multi-sector governance*, the participation of non-government organisations.

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[7]Bailey, Stephen J., 1999, *Local Government Economics: Principles and Practice*, Palgrave Macmillan, Houndmils, p. 6.

[8]Pauly M.V., 1973, 'Income Redistribution as a Local Public Good', *Journal of Public Economics*, no. 2. pp. 35–58. Head J.G., 1976, *Public Goods and Public Welfare*. University Press, Duke.

[9]Molle, Willem, 2011, *European Economic Governance*. Routledge, London, New York, pp. 16–27.

2. CHARACTERISTICS OF THE EU BUDGET

After the Lisbon reforms, the Treaty on the Functioning the European Union (TFEU) regulates the division of power between the EU and its MemberStates (MSs). Even in cases of exclusive competences[10] the EU has exclusive regulatory power, most of the powers are shared between the EU and the MSs. I am convinced that although the roles and the competences of the European Union are expanding and the principle of primacy and pre-emption, the elastic clause[11] give the opportunity of deeper cooperation, the limitation of competences, the principle of subsidiarity, proportionality and the principle of conferral result in a special, *inverse federation system* within the EU.

The fiscal policy of the EU is also limited. Below I mention the special features of EU budget, EU finances:

- According to the present rules[12] the total amount of own revenues of the EU budget shall not exceed 1.24% of the sum of all the Member States' GNIs.[13] If you take into consideration the centralisation rate of MSs (approx. 30-60% of the GDP), the EU budget is *relatively small*. On the other hand, if you compare the EU budget (150.9 billion euro in 2013)[14] to the budget of international organisations – the total budget of Council Europe (307.23 million euro)[15] in 2013 – it can be concluded that the EU budget is *more considerable* than budgets of "traditional" international organisations.
- The *main welfare tasks remained the competence of Member States*. According to the Treaty on European Union (TEU), the EU respects essential State functions[16] and acts in accordance with the principle of subsidiarity and proportionality.[17] It can be the basis of the argument that emphasizes the sufficient size of EU budget.
- The EU budget plays *unorthodox roles* (see later). While the biggest part of the budget of MSs finances the social expenditures, on the contrary, 70% of the EU budget supports the agricultural and cohesion policy. According to the Commission,[18] the EU budget is a *development budget* as a significant part of it subsidizes investments, development. The administration costs are only 5% of the EU budget, though the bureaucracy of support system is significant – they are the *opportunity costs of confidence*. The expenditures of the EU budget are spent on special priorities, but on the other hand, not every important

[10] Art. 3 TFEU: customs union and common commercial policy, competition rules for the internal market, monetary policy for EMU members, conservation of marine biology under the common fisheries policy.
[11] Art. 352 TFEU.
[12] 2007/436/EC, Euratom Council decision of 7 June 2007 on the system of the European Communities' own resources OJ L 163, 23.6.2007, p. 17–21.
[13] In view of preparatory documents and the ongoing debate related to the next budget the centralisation rate will not increase. As the EU budget must be in balance, the redistribution rate (ratio of public expenditures to GNI) is the same as the centralisation rate.
[14]http://ec.europa.eu/budget/library/biblio/publications/2013/budget_folder/KV3012856ENC_web.pdf (25.11.2013)
[15] Also involving the expenditures of Development Bank. http://www.coe.int/t/budgetcommittee/Source/BUDGETS/Table_Contributions_to_CoE_Budgets_en.pdf(25.11.2013)
[16] Art. 4 (2) TEU.
[17] Art. 5 (1), (3), (4) TEU.
[18]SEC(2011)867 p. 2.

EU policy (e.g. exclusive or shared competences of the EU) is supported by the EU budget at the same level – it also depends on their nature.[19]

- The regulation, surveillance and control of national fiscal policy shall be distinguished from the *fiscal policy of the EU*. According to the structure of the TFEU the fiscal policy of the EU covers only the revenues and expenditures of the EU budget and the multiannual and annual procedures of budget cycle. In a wider context certain regulations of economic policy cooperation, customs union, the support system of policies, the European Investment Bank and the European Development Fund, etc. also connect to the fiscal policy of the EU – even if they are not regulated under a common title of the TFEU. As examples: in the framework of economic policy cooperation the EU can provide support with economic policy conditions[20] to certain Member States, the Maastricht Treaty set the delimitation of liability of EU budget for commitments of public authorities (governmental levels) of MSs ("no bail out rule").[21]
- The *fiscal policy remained basically the competence of Member States*. The EU budget is relatively small (as we mentioned) and *the EU is not entitled to levy any taxes on EU citizens* except for the personal income tax of eurocrats[22] (bureaucrats working for the EU bodies). Therefore, the lack of tax administration is also a specific feature of the EU budget. Even if the EU has tax (value added tax) revenue, the VAT revenue is the Member States' contribution depending on their national value added tax.[23] The harmonisation of national tax system, typically the indirect taxes is based on the regulation of internal market and not on the right to levy any taxes, though the directives limit the fiscal sovereignty of Member States.
- The *procedures related to the EU budget* have already progressed, but still have deficiencies from the viewpoint of reducing *democratic deficit*. The decision about the system of own revenues is adopted unanimously by the Council after consulting the European Parliament and approval of Member States. This unique decision-making process is similar to an international agreement. The multiannual financial framework, as another strategic decision about EU finances is also adopted by a special legislative procedure of the Council and the Parliament and requires unanimity from the Council. Though the Union's annual budget is set up under a special legislative procedure, the Parliament's role has become wider,[24] in certain cases[25] stronger than the Council's vote.

[19] The establishing of competition rules related to the internal market and the common commercial policy are exclusive competences of the EU but they do not require so much financial support than agricultural or cohesion policies (agricultural and cohesion policies are shared competence of the Union though 80% of the EU budget is spent on these policies).

[20] Art. 122 (2), 136 (3), 143 TFEU.

[21] Art. 125 TFEU.

[22] 260/68/EEC, Euratom, ECSC Council regulation laying down the conditions and procedure for applying the tax for the benefit of the European Communities. OJ L 56, 4.3.1968, p. 8–10.

[23] The European Commission proposed a new harmonised tax, the financial transaction tax as a new possible tax contribution to the EU budget. See details: COM(2013) 71 final Proposal for a Council directive implementing enhanced cooperation in the area of financial transaction tax.

[24] Before the reforms of Lisbon Treaty there were two types of expenditures: expenditures necessarily resulting from the Treaty or from acts adopted in accordance with it (like agricultural support) and other expenditures (such as regional support). The maximum rate of increase in expenditures not necessarily resulting from the Treaty was regulated and within this framework the Parliament had the final word in the vote of such expenditures (Art. 272 of Treaty establishing the European Community).

[25] Art. 314 (7) d) point TFEU.

On the other hand, the own bodies and rules of budget procedure can be mentioned as results of integration. Otherwise, the decision of the annual budget does not appear in a legal obligatory act.

- The accounting method related to the *strategic* financial planning of EU budget is *baseline budgeting,* focusing on the functions / policies of the EU. As the Commission is responsible for the implementing of EU policies, the biggest part of the annual budget is connected to the budget of the Commission.
- The *subsidy system* of the EU budget consists of mainly earmarked, non-repayable grants (except for the direct payments of common agricultural policy that are general, non-matching and basically unconditional grants). Besides, outside the EU budget considerable amount of repayable grants are ensured for microeconomic (development) and macroeconomic purposes in the framework of European economic integration. Grants with microeconomic purposes are development grants given by the European Investment Bank Group and the Euratom. Macroeconomic grants are financial assistance for imbalances of payment (Macro-Financial Assistance to third countries, Medium-term Financial Assistance and European Stability Mechanism to Member States). Financial assistance takes the form of repayable grants with economic policy conditions.

According to the theory of fiscal federalism, the EU budget should play more dominant roles and should (at least tenfold) increase the size of EU budget. Therefore, significant reforms are needed, zero-based thinking would be useful. Besides, the willingness to cooperate and change would be also necessary... From the viewpoint of fiscal federalism the present financial system of the EU is an undeveloped system with overweight national middle-level.[26]

3. GOVERNMENT FUNCTIONS IN THE EU

In the framework of the abovementioned theories and budgetary features, in this part of the study the functions of the EU budget will be analysed.

3.1. Allocation function at EU governmental level

The fiscal policy of the EU fulfils allocation function whereas not in a decisive manner. In the research of allocation function, the theory of market failures and the principles of subsidiarity and proportionality provide orientation to us.

There are some public goods that can be tackled more effectively at regional/international level as they have cross-border effects. The more open economy a country has, the bigger is the spill-over effect. As a result of internal market the interdependency is growing among MSs and the EU shall play a greater role in handling territorial externalities and providing European public goods.

According to the competences of the EU and the principles of subsidiarity and proportionality, the Union determines European public goods mostly by its agricultural and fisheries, environmental, research and development policies while the social policies remained mainly the competence of Member States.

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[26] Vigvári, András–Vigvári, Gábor, 2008, 'Az Európai Unió fiskális rendszere', in Blahó András (ed.), *Nemzetgazdaság – integráció – világgazdaság. Tanulmányok Palánkai Tibor akadémikus 70. születésnapja tiszteletére*. Aula Kiadó, Budapest, pp. 301–310.

The *common agricultural policy* represents most significantly the allocation function. European agricultural public goods (e.g. the availability of supplies at reasonable price), as market failures are handled by the regulation of European market organisation and extensive agricultural support system (e.g. direct payments) at the European governmental level. Although the financial system of the agricultural policy has already changed and become more comfortable to the market relations, the high level of the agricultural policy expenditures is still a controversial issue. From the beginning (establishing the European Economic Community) the agricultural support system has been a significant part in the EU budget even though from the second half of the seventies the regional policy appeared in an increasingly proportion and the rates of the agricultural and regional support have been getting closer to each other (see table 1).

Table 1 - Proportion of agricultural and regional support of the EU budget (1975-2020; %)

EU policy	**1975**	**1980**	**1985**	**1989**	**1993**	**1994-1999**	**2000-2006**	**2007-2013**	**2014-2020**
Agricultural policy	70,9	68,6	68,4	57,7	52,4	47,8	44,1	42,96	38,87
Regional policy & *Competitive-ness*	6,2	11,0	12,8	18,8	30,7	33,7	36,9	35,64 *(8,57)*	33,87 *(13,1)*

Source: own compilation

If you want to consider all angles of the issue, it must be noted that the amount of agricultural policy expenditures has never been decreased. Besides, the next (2014-2020) multiannual financial framework will bring changes as the annual average of agricultural and regional expenditures will be less than in 2013.

Table 2 - Proportion and amount of agricultural and regional expenditures of the EU budget (1994-2020)

EU policy	**1993-1999**		**2000-2006**		**2007-2013**		**2014-2020**	
	billion ECU	%	billion EUR	%	billion EUR	%	billion EUR	%
Agricultural	220.3	47.8	329.2	44.1	366.6	42.43	373.2	38.87
Regional	155.1	33.7	275.0	36.9	308.0	35.65	325.1	33.87
Total amount	460.4	100.0	745.5	100.0	864.1	100.00	960.0	100.00

Source: own compilation

In my view, the internal structural reform of the agricultural subsidy system (like increasing earmarked support and role of rural development, etc.) could strengthen the reason for the relatively high level of agricultural expenses and for the maintenance of public interest in common agricultural policy. It is also justified by the multifunctional agriculture and the Engel's Rule.[27]

Due to the Lisbon Strategy[28] and the Europe 2020,[29] in the long-term economic strategic plans of the EU, more and more attention is placed on the environmental, research and development and employment policy. It is the reason why a separate budget line, the Heading 1.a ("Competitiveness for growth and employment") appeared in the 2007-2013 MFF and it shows the most significant, positive change in the next, 2014-2020 MFF.

The *research and development policy and environmental policy* also appears both directly and indirectly in the EU budget expenditures. Compared to one another, the direct expenditures of research and development policy (approx. 50 billion euro)[30] are much larger in the 2007-2013 MFF than the direct sources of environment policy in the framework of common agricultural policy (approx. 3.66 billion euro).[31] Nevertheless, the indirect expenditures of both policies are more considerable, however, difficult to quantify.

As an example we take the support of environment.[32] The funds of regional policy[33] shall be pursued in the framework of sustainable development[34] in the framework of which the Cohesion Fund gives support to investments for environment and transport infrastructure[35] and the European Regional Development Fund also supports projects related to the environment protection.[36] Improving the environment is an objective of the fund of rural development (European Agricultural Fund for Rural Development, EAFRD)[37] and a part of the sources Heading 1.a also supports the environment protection (like Competitiveness and innovation framework programme 2007-2013 and Trans-European Networks related to transport, energy and telecommunication). In the

[27] Engel's Law is an economic theory that the percentage of income spent on food rises slower that the percentage increase in income. Therefore one of the main objectives of the common agricultural policy is to ensure a fair standard of living for the agricultural community (Art. 39 (1) b) TFEU).

[28] The Lisbon Strategy for growth and jobs was launched in 2000 by the European Council.

[29] The Europe 2020 was launched in 2010 by the European Council.

[30] The support of 7th Framework Programme for Research and Technological Development (approx. 50 billion euro) is a dominant part of Heading 1.a Competitiveness for growth and employment (78.9 billion euro). Sources: http://ec.europa.eu/research/fp7/index_en.cfm?pg=budget (26.11.2013). Annex 2009/1005/EU European Parliament and Council decision of 17 December 2009 OJ L 347, 24.12.2009, p. 26–27.

[31] The support of environmental policy is 1% of the Heading 2 (preservation and management of natural resources). Financial instrument of environment programmes are the Life+ programme and Natura 2000 programme though the Natura 2000 sites can be also granted by the ERDF.

[32] According to the Commission a broad range of funding tools help to realise the knowledge economy. The most relevant are: the Structural and Cohesion Funds, the Competitiveness and Innovation Framework Programme, the Education and Training Programmes, Trans-European Networks (such as Galileo) and the European Agricultural Fund for Rural Development. COM(2005) 118 final p. 3.

[33] European Regional Development Fund, the European Social Fund and the Cohesion Fund.

[34] Art. 17, 1083/2006/EC Council regulation of 11 July 2006 OJ L 210, 31.7.2006, p. 25–78.

[35] Art. 2, 1084/2006/EC Council regulation of 11 July 2006 OJ L 210, 31.7.2006, p. 79–81.

[36] Art. 4 (4), 5 (2), 6 (2) b) 1080/2006/EC regulation of the European Parliament and of the Council of 5 July 2006 OJ L 210, 31.7.2006, p. 1–11.

[37] Art. 4 (1) b) 1698/2005/EC Council regulation of 20 September 2005 OJ L277, 21.10.2005, p. 1–40.

framework of the 2014-2020 MFF the support of EAFRD will increase, furthermore the other common agricultural fund (European Agricultural Guarantee Fund) will enhance the greening of direct payments (support agricultural practices and require ecological focus areas on each agricultural holding).[38]

Besides, the research and development funds for research, development, innovation (FP7, contributions to the European Institute of Innovation and Technology) will be merged from 2014 and under the Horizon 2020 programme will allocate 70.2 billion euro[39] – that is also a positive change in amount of support.

Additionally, other expenditures of Heading 1.a (like energy and education policy, partly the Progress programme for employment and social affairs) and Heading 3 (like culture, consumer protection, media, health, drug prevention, protection of civil rights, etc.) also contribute to serve common interest, provide common public goods and services even if they can also be connected to other functions (such as the employment policy basically contribute to redistribution). The proportion of Heading 1.a (9.1% of 2007-2013MFF total commitment appropriations) and Heading 3 (1.25%) are low[40] even though they are increasing. The newest Heading (1.a competitiveness for growth and job) shows the most significant, positive change in the next, 2014-2020 MFF[41] and Heading 3 shows the second biggest growth.[42]

To conclude, the allocation function of the EU budget – compared to the traditional and social tasks of Member States – is not decisive but appears in certain areas with respect to some EU policies. On the one hand, the agricultural support has been decreasing, on the other hand, the grants of environmental, research and development policy have been increasing that is why the policy mix of allocation function at EU level has been changing.

3.2. Redistribution function

The redistribution function is basically realised by the cohesion and development support of the EU budget.

The subsidy system of the EU *regional policy* is a *dominant part* of the EU budget (see table 1) aiming to reduce not just the territorial but also the economic and social disparities. According to the theories of economic integration,[43] the common market can

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[38]In order to finance those practices, Member States will use 30 % of the annual national ceiling. European Council conclusions (Multiannual financial framework), Brussels, 8 February 2013. Point 67.

[39]In constant (2011) prices and including the 2.3 billion euro contribution of Euratom. http://www.sciencebusiness.net/news/76337/New-Horizon-%E2%82%AC79-billion-for-R-and-D-as-Parliament-approves-EU-budget-for-2014-2020 (20.11.2013)

[40] Annex 2009/1005/EU European Parliament and Council decision of 17 December 2009 OJ L 347, 24.12.2009, p. 26–27.

[41] The amount of Heading 1.a support was 78.94 billion euro (9.1% of total commitment appropriations) between 2007-2013 and 125.61 billion (13.1% of total commitment appropriations) between 2014-2020, that is a +37,16% increasing in support system of competitiveness for growth and job.

[42] The amount of Heading 3 supportwas 10.77 billion euro (1.25% of total commitment appropriations) between 2007-2013 and 15.69 billion (1.63% of total commitment appropriations) between 2014-2020, that is a +31,4% increasing in support system of 'Security and citizenship'.

[43]Ishiyama, Y., 1975, 'The Theory of Optimum Currency Areas: A Survey', *IMF Staff Papers*, vol. 22. pp. 344–383. Koczkiczky, György, 2008, *Regionális integrációk gazdaságtana*, Miskolci Egyetemi Kiadó, Miskolc. Palánkai, Tibor, 2004, *Az európai integráció gazdaságtana*, Aula Kiadó, Budapest. Studies connected to the theory of divergence: Hallet, M., 1997, ‚Wirkungen wirtschaftlicher Integration auf periphere Regionen – Eine Untersuchung anhand der Integration Griechenlands und Portugals in die Europäischen Gemeinschaften', *Triere*

lead to growing inequalities, therefore the negative externalities of the common market can be handled at EU governmental level by cohesion funds. Based on this theoretical approach, from 1975 to 2006 the process of the deepening and widening of the integration was parallel to the extension of regional support – even if the last two MFF show different direction...

The redistribution function of the EU budget is *limited*. First of all, the low centralisation and redistribution rate of the EU budget are absolute limits to increasing the sources of redistribution. Secondly, the amount of regional policy seems to hit the ceiling as the earlier spectacular growing stopped and the last two multiannual financial frameworks show decreasing proportion of cohesion support (see table 1).

Additionally, the *correction mechanisms* and their changes also reduce the redistribution function of regional policy. The UK rebate negotiated by Margaret Thatcher in 1984 – on the basis that the UK benefits much less from the common agricultural policy than other countries –still exists even if the subsidy system of the EU significantly has been changed, the proportion of CAP expenditures has been reduced (see table 1) and the relatively prosperity of the UK has risen. In 2014-2020 the UK rebate remains, on the basis of it Austria, Germany, the Netherlands, Sweden are still – and from 2014 Denmark is also – entitled to correction related to their payment to the EU budget. It must be also emphasised that not just the less developed regions are supported in the framework of regional policy but every region (even if not in the same proportion). The maximum level of transfer to each MemberState is also a limitation of redistribution function. In the last three MFF the capping (maximum limit) has been reduced from 4% to 2.35% of the GDP. From 2014 the earlier (2007-2013) 3.24-3.79% capping will be reduced less (2.59%) in Member States which acceded to the EU before 2013 and whose average real GDP growth in 2008-2010 was lower than -1%. Nevertheless, from 2014 the minimum level of support will be also regulated both at regional and national level.[44]

The *European Investment Bank* (EIB) also contributes to the cohesion as one of its main priorities is addressing economic and social imbalances between the regions. The credits and loans that pay attention to the cohesion take approx. one-third of the total EIB repayable grants.[45]

Not just the regional but also the *international development and cooperation policy* of the EU provides subsidies for development, performs redistributive function in the EU. Related to the trade and cooperation agreements between the EU and third countries, the EU operates a complex support system through the method of multi-channel funding. This multi-channel financing system consists of: the repayable grants of European Investment Bank, non-repayable grants of European Development Fund (EDF) outside the EU budget, and non-refundable grants of the multiannual financial framework.

Approximately 10% (53.93 billion euro in 2012)[46] of the total EIB support is given to third countries. The period of the EDF budget (2008-2013) and the MFF (2007-2013) is

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Schriftenreihe zur Wirtschaftstheorie und Wirtschaftspolitik. Band 6. Trier. Krugman, P., 1991, ‚Increasing Returns and Economic Geography’, *Journal of Political Economy*, vol. 99. pp. 483-499. Martin, R.-Straubhaar, T., 2001, ‘Regional Effects of EMU’, in: Caesar, R.–Scharrer, H.E. (eds.), *European Economic and Monetary Union: Regional and Global Challenges*,Nomos, Baden-Baden.

[44] European Council conclusions (Multiannual financial framework), Brussels, 8 February 2013. Point 45–52.

[45] European Investment Bank: Financial Report 2012. p. 17.

[46] European Investment Bank: Financial Report 2012. pp. 42–46.

different, they do not overlap completely but there was a chance to merge them in the framework of the next MFF. It has not happened, although the Commission intends to propose the budgetisation of the EDF as of 2021 (regarding that the Cotonou agreement due to expire in 2020).[47] If you compare the annual average amount of EDF support (3.78 billion euro)[48] to the annual average amount of the Heading 4 of MFF (approx. 7.9 billion euro), it can be stated that the subsidies of the EU budget are twice as large as the EDF, although the repayable grants of the EIB are the most significant sources. It must be also noted that the subsidies of third countries are given not just in the framework of the Heading 4 but also from some reserves of the EU budget (but rather with stabilisation purposes). Finally, not every support to third countries realises redistribution function, typically those that are given to underdeveloped areas (the EDF supports only underdeveloped countries, the other two just mostly).

As the budgetary volume of EU regional policy support is more significant than the amount of development subsidies to third countries, it is proved that the cohesion policy of the EU realises mostly the redistribution function in the EU.

3.3. Stabilisation function

As a matter of fact, nowadays the most vital topic is the *stabilisation role* of the EU. In view of governmental methods, coordinative and regulative governmental methods are used generally with the object of stabilisation in the EU, the financing governmental method has firewall role and designated for ultima ratio cases. The *coordinative and regulative governmental methods* related to economic governance usually have precautious function (like preventive arm of multilateral surveillance and alert mechanism of macroeconomic imbalances; corrective arm of excessive deficit procedure and excessive imbalance procedure). The financial method with stabilisation function handles emergency cases (like natural disasters, depressions of economic sectors, economic crises, etc.). It has two parts: the EU budget with non-repayable support and guarantees[49] and repayable financial assistance outside the EU budget.

The EU budget cannot play significant stabilisation function because of the limitation of EU revenues. Among budgetary expenditures only a few and scattered financial instruments play stabilisation role[50] (EU Solidarity Fund, European Globalisation Adjustment Fund, etc.).[51]

European Union Solidarity Fund was established in 2002[52] to give non-repayable, rapid financial assistance to a MemberState or a candidate country in the event of major natural disasters occurring in one or more regions or one or more countries. In 2007-2013 (outside the MFF) there is a 1 billion euro ceiling on the annual amount available for the fund, but from 2014 it will be cut in half. Otherwise, from 2014 a new reserve for crises in

[47] European Council conclusions (Multiannual financial framework), Brussels, 8 February 2013. Point 108.

[48] Kengyel, Ákos (ed), 2010, *Az Európai Unió közös politikái*, Akadémiai Kiadó, Budapest, p. 106.

[49] Guarantee Fund for external actions (such as credit and loans of Macro-Financial Assistance and European Investment Bank) is financed by the Heading 4 of the EU budget in cases of default or late payment on a guaranteed loan.

[50] Regional funds are not taken into account as they have strategic, long-term perspective and support structural reforms not emergency cases, therefore they primarily have redistributive function even if they also have stabilisation effect.

[51] Interinstitutional agreement between the European Parliament, the Council and the Commission OJ C139, 14.6.2006, p. 1–17. European Council conclusions, Brussels, 8 February 2013.

[52] Art. 2, 2012/2002/EC Council regulation of 11 November 2002 OJ L 311, 14.11.2002, p. 3–8

the agricultural sector in case of major crises affecting agricultural production or distribution will be included under Heading 2 with an amount of 2.8 billion euro (400 million euro pro year). Crisis in agricultural sector could have been also granted under Heading 2 earlier, though the negative externalities as risks are increasing in the sector because of environmental changes – so the new reserve is reasonable. The cases (natural disaster – crisis in agricultural sector) and the beneficiaries (candidate and Member States – producers and traders in the EU) supported by the Solidarity Fund and the new reserve also differ, so the parallel process with opposite directions is remarkable.

Another reserve fund is the *Globalisation Adjustment Fund* that provides additional support for workers in the EU who suffer from the consequences of major structural changes in word trade patterns, to assist them with their reintegration into the labour market. The fund may not exceed a maximum annual amount of 500 million euro in 2007-2013 and 150 million euro in 2014-2020 (less than one-third of the earlier limitation).

The *Emergency Aid Reserve* ensures capacity to respond rapidly to specific and unforeseeable aid requirements of third countries (humanitarian operations, civil crisis management and protection, migratory pressures) with a maximum annual amount of 221 million euro in 2007-2013 and 280 million euro in 2014-2020.

Afterwards, the EU has a general reserve, the so called *Flexible Instrument* that is also outside the MFF and is intended to allow the financing of clearly identified expenditure of MFF which could not be financed within the limits of the ceilings available for one or more other heading.

To summarise, we can distinguish special and general reserves (providing non-repayable grants) getting outside the MFF, remaining a possible expenditure of the EU budget that are not significant and the next budgetary period mainly brings negative changes in the amount of them.

Financial assistance outside the EU budget consists of fundamentally repayable support (credits, loans). It can be divided into two groups: financial assistanceto third countries and financial assistance to Member States. All of them are balance-of-payment support and given with macroeconomic conditions defined by the EU (and the IMF, if it also contributes to the financing).

The support of the *Macro-Financial Assistance* (MFA) to third countries can take the form of medium or long-term loans, grants or a combination of these. The non-repayable part of subsidies are given from the Heading 4 of the EU budget, the repayable grants are based on back-to-back operation (the given loan is borrowed by the Commission from the financial market on the same amounts due, currency, payment date)[53] and guaranteed by the Guarantee Fund for external actions (financed by the EU budget). The amount of MFA is much less than the financial assistance to Member States even if it has also increased due to the crisis. From 2009 until August 2013 the Council and (from 1 December 2009) the Parliament decided about 1.536 billion euro disbursement to six countries (Bosnia and Herzegovina, Serbia, Armenia, Georgia two times, Ukraine and Moldova) of which only 148 million euro were non-repayable grants, the others were credit lines.

The Treaty of Rome already made it possible to give financial support in order to handle imbalances of payment in the framework of mutual assistance. According to the

[53]COM(2010) 709 final.

regulations of the Treaty the instrument of *Medium-term Financial Assistance* for Member States' balances of payments was established.[54] The Treaty of Maastricht and with respect to the primary law the 332/2002/EC regulation has carried out an important change: excluded the euro area Member States from the Medium-term Financial Assistance. The legal basis of the Medium-term Financial Assistance is not the present Art. 143 TFEU[55] though it regulates the financial assistances for non euro area Member States in the framework of mutual assistance. The present Treaty (TFEU) makes financial assistance grants possible in cases of supply difficulties, vis maior (Art. 122) and payment difficulties (Art. 143). Due to the crisis more Member States met financial difficulties and required financial support. Non-eurozone Member States – like Hungary, Latvia, Romania – could get loans from the Medium-term Financial Assistance (cooperated with the IMF and the World Bank), but euro area Member States could not. Responding to the imminent threat of Greek insolvency, euro-area Member States set up an ad hoc mechanism on 2 May 2010 to provide, together with the IMF, €110bn[56] of financial assistance to Greece in the form of bilateral loans.[57]

After this fire-fighting a *temporary three-pillar financial construction* was created. To start with, on 11 May 2010 the European Financial Stabilisation Mechanism (EFSM)[58] was established based on guarantees from the EU budget up to 60 billion euro. The primary legal basis of EFSM is only the Art. 122 TFEU that I consider controversial as wasteful management and the indebtedness that lead to financial difficulties in certain Member States were taken into consideration as exceptional occurrences beyond their control. Secondly, on 7 June 2010 the euro area Member States as shareholders and guarantors established the European Financial Stability Facility (EFSF) and finally the IMF decided to complement these mechanisms with a potential financial support to euro area countries of up to €250billion.

On 2 February 2012 the final Treaty establishing the *European Stability Mechanism* (ESM) was signed by the 17 euro-area countries.[59] The ESM (based in Luxembourg) is an intergovernmental organisation and a permanent crisis resolution mechanism under public international law, which shareholders are the 17 euro area Member States (until 1 July 2013 it functioned parallel with the EFSF).The ESM has an effective lending capacity of €500bn (total subscribed capital of €700 billion, with paid-in capital €80 billion and committed callable capital €620 billion).[60] In order to finance loans and other forms of financial assistance the ESM is entitled to issue debt instruments. Additionally, the lack of

[54] The present rules of Medium-term Financial Assistance were adopted in 2002 by 332/2002/EC Regulation in connection with the primary law rules (Art. 143 TFEU) of mutual assistance even the Regulation refers to another Art. of the Treaty (Art. 352 TFEU)

[55] The legal basis of the 332/2002/EC Regulation is the Art. 308 of the Treaty (the present Art. 352 TFEU).

[56] Of this amount the IMF contributes €30billion.

[57]On 14 March 2012, the euro-area MemberStates and the IMF committed the undisbursed amounts of the first programme (Greek Loan Facility) plus an additional €130 billion for the years 2012-14. Whereas the financing of the first programme was based on bilateral loans, the second programme is financed by the European Financial Stability Facility (EFSF).
http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm(20.12.2012)

[58]407/2010/EU Regulation.

[59]The decision leading to the creation of the ESM was taken by the European Council in December 2010. The first version was signed on 11 July. The ESM was inaugurated on 8 October 2012.

[60]http://www.esm.europa.eu/about/index.htm (18.11.2013)

adequate primary legal basis for financial assistance with regard to euro area Member States has been tackled by the *amendment of the Art. 136 TFEU* (entered into force on 1 May 2013).[61]

Credits for EU Member States (billion EUR)

Donated state (year of decision)	Donor						Total
	BoP*	EFSM	EFSF	ESM	IMF+ World Bank	Other	
Hungary (2009)	6.5	–	–	–	12.5+1.0	–	20.00
Latvia (2009)	3.1	–	–	–	1.7+0.4	2,3**	7.50
Rumania (2009)	5.0	–	–	–	12.95+1	1.0***	19.95
Greece (2010)	–	–	–	–	30.0+0	80.0	110.00
Romania (2011)	1.4	–	–	–	3.5+0	–	4.90
Ireland (2011)	–	22.5	17.7	–	22.5+0	(4.8)**** 22.3	(67.50) 85.00
Portugal (2011)	–	26.0	26.0	–	26.0+0	–	78.00
Greece (2012)	–	–	(110.2)*** 144.7	–	28+0	–	(138.2) 172.70
Spain (2012)	–	–	–	100.0	–	–	100.00
Cyprus (2013)	–	–	–	9.0	1.0+0	–	10.00
Total:	*16.0*	*48.5*	*188.4*	*109.0*	*138.15+2.4*	*105.6*	*608.05*

* Medium-term Financial Assistance

** Sweden, Denmark, Finland, Norway and Estonia ensured 1.9 billion euro and further 0.4 billion euro was made available by the European Bank for Reconstruction and Development, the Czech Republic and Poland.

*** EIB, EBRD

**** Bilateral loans of MSs: UK (3.8 billion euro, Sweden 0.6 billion euro, Denmark 0.4 billion euro). Second line: additional 17.5 billion euro contribution of Ireland.

***** With deduction of the remaining 34.5 billion euro from the first credit line.

Source: own compilation

The crisis pointed out the insufficiencies of financial assistance system (the financing governmental method related to stabilisation function of EU). The revision of financial assistance is a positive result of the crisis, though the process also shows the growing necessity of crediting (market and governmental failures) and in the system of stabilisation support still remained inconsequence (e. g. the contradiction of adequate primary legal basis for financial assistance related to non euro area Member States and the insignificance of the regulations of mutual assistance, the inadequate legal basis for ESFM).

[61] 4. Point of the Preamble of the 2011/199/EU European Council decision also confessed it with the followings: The "European Council agreed that, as this mechanism (the European Stability Mechanism) is designed to safeguard the financial stability of the euro zone as whole, Art. 122(2) of the TFEU will no longer be needed for such purposes."

In my opinion, the structure and regulation system of funds and financial assistances providing subsidies with the object of stabilisation needs an overall revision. Within the framework of this overall reform it would be worth differentiating and regulating them as a separate group of subsidies as follows:

-according to the source of grant: non-repayable subsidies from the budget, repayable support outside the budget;

-according to the beneficiary of grant: subsidy to MemberStates or third countries (the latter could be differentiated: candidate, neighbouring, developing and other countries)

-according to the function of extraordinary grants:

a) vis maior subsidies (natural, industrial disasters, other cases of force major, for example terrorist attack)

b) subsidies for economic difficulties (grants for imbalance of payments, macroeconomic imbalances and crisis of certain market sectors). Within this type of support, the primary rules of mutual assistance (Art. 143 TFEU) could be modified, so it would not be a transitional but a common provision for all Member States. Besides, I reckon that according to the present rules of the financial assistances the EU can affect on the economic policies of Member States.

I am fully aware of the fact that the abovementioned overall reform would require the amendment of the Treaty and a long-term strategic approach of decision-makers. In my view – assuming unchanged political process – it is unlikely in the near future. Unfortunately, the secondary legislation related to the existing funds and reserves of EU budget have not been reviewed and modified by the 2014-2020 MFF either.

The most significant change of the next (2014-2020) multiannual financial framework will be resulted in a stronger relationship between governmental (coordinative, regulative and financial) methods and functions. In 2007-2013, only the subsidies of Cohesion Fund were connected to the excessive deficit procedure. From 2014 the distribution of the Common Strategic Framework Funds (European Agricultural Fund for Rural Development, European Maritime and Fisheries Fund, and the Structural[62] and Cohesion Funds) will be based on macro-economic conditionality – establishing *a closer link between cohesion (redistribution) and agricultural (mainly allocation) policies and the economic governance (stabilisation function) of the EU*. If a MemberState fails to take effective action in response to a request from the Commission to review and propose amendments to its Partnership Contract and the relevant programmes, part or all of payments may be suspended. The request of the Commission can be made to support implementation of multi-pillar European economic surveillance (broad guideline of the economic policy, employment recommendations and specific measures addressed to euro area MSs, recommendations under the excessive deficit and excessive imbalance procedure, moreover financial assistances under the BoP, EFSM or ESM). Not just the payments but also the commitments may be suspended if it is concluded that a MS has not taken sufficient action under the abovementioned procedures related to multi-pillar European economic surveillance except for the non-obligatory recommendations of multilateral surveillance (broad guideline of the economic policy and employment recommendations).

[62]European Regional Development Fund, European Social Fund.

CONCLUSIONS

The EU has taken advantage of the crisis, even if not at the maximum level. Due to the crisis the strengthening and changing of the stabilisation function of the EU (outside the budget) and the allocation function of the EU budget is the most significant, but – according to the theory of fiscal federalism – not sufficient feature at EU governmental level. On the basis of fiscal federalism, the EU should strengthen further the tools of economic governance to be able to tackle asymmetric economic shocks, on the basis of theories related to economic integration the cohesion support shall be increased parallel to the deepening of integration (such as economic governance). In fact, the changing of the next (2014-2020) multiannual financial framework shows the reducing of redistribution function and the more restrictive conditions of subsidy system, the unchanged volume justifies the limited role of the EU budget related to the governmental functions.