The Budgetary Procedure in the European Union and the Implications of the Treaty of Lisbon

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Abstract

The Treaty of Lisbon reformed the budgetary procedure of the European Union (EU). This paper describes the key changes and presents a game-theoretical analysis of the annual budgetary procedure. Our focus is on the implications of these changes for the budgetary powers of the European Parliament (EP). Against the common belief that the budgetary powers of the EP were strengthened as a result of the Lisbon Treaty, our analysis paints a somewhat more sober assessment of its budgetary empowerment as a result of the reform. We find that the budgetary procedure operates much like the codecision procedure does in the legislative process. Compared to the budgetary procedure used prior to the Lisbon Treaty, it has become more difficult for the Parliament to pass amendments, if it wants to affect what used to be referred to as non-compulsory spending or decrease compulsory spending. The EP's ability to pass amendments that increase compulsory spending is mostly unaffected. The configuration of preferences and bargaining powers in the Conciliation Committee determine whether on balance the EP is better off under the new procedure.

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1 Introduction

The Treaty of Lisbon introduced a number of important changes to the budgetary process in the European Union (EU). First, the multiannual financial framework shall now be adopted unanimously by the Council after obtaining the consent from the European Parliament (EP). This consent shall be given by an absolute majority of its members. There is also an opening for the European Council to unanimously authorize the Council to act by qualified majority when adopting the multiannual framework (Article 312 (2)). Second, the annual budgetary process was restructured and simplified. The distinction between compulsory and non-compulsory spending was removed, and a conciliation process was set up similar to the one used in the legislative arena under the codecision procedure, now renamed the ordinary legislative procedure (OLP).

The budgetary reforms were introduced with the support of the EP, and initially thought to strengthen its hand in the budgetary process. A number of studies have since questioned this and found that the EP loses power under some circumstances. Benedetto and Høyland (2007) argue that the EP already had significant power to reduce compulsory spending under the Pre-Lisbon budgetary procedure. Benedetto (2011) concludes that the Lisbon-reforms weaken the EP's ability to reform the budget. Giuriato (2009) also questions the EP's gains under the new procedure.

In this paper we develop a spatial, game-theoretical model to assess the impact of the Lisbon reform of the annual budgetary procedure on the institutions' powers. Spatial models have been used extensively to study the EU's legislative process, but have so far not been used to analyze the budgetary process.[3]

The paper is organized as follows. The next section presents the Lisbon version of the multiannual financial framework and the annual budgetary procedure, and compare them with the regime that were in place prior to the Lisbon treaty. The third section describes our model. The fourth section solves the model and derives equilibrium

[3] See, for example, Steunenberg (1994), Tsebelis (1994), and Crombez (1996, 1997) for early spatial models of the EU legislative process.

strategies and budgets. In the fifth section we compare the equilibrium budgets under the old and new procedures. The sixth section presents the conclusions.

We find that voting rules on EP amendments render it more difficult to amend the draft budget under the new annual budgetary procedure. However, amendments are now compared to the joint text that is expected to emerge from the Conciliation Committee rather than the draft budget. Whether the new procedure leads to budgets the EP prefers to the budgets that would have been set under the old procedure depends on the configuration of preferences and the bargaining powers in the Conciliation Committee.

2 The Multiannual Financial Framework and the Annual Budgetary Procedure

This section presents the multiannual financial framework and the annual budgetary procedure embedded in it following the Lisbon Treaty, and compares this setup with how the multiannual budget was decided prior to the treaty change and the annual budgetary procedure that was in operation prior to the treaty change. While our game-theoretic model focuses on the annual budgetary procedure, it may be useful to describe the multiannual financial framework in order to give the reader an idea of the scope of negotiations within the annual budgetary procedure. We focus our discussion on the differences in the actual procedures, readers interested in the process can consult (Benedetto and Høyland 2007). The financial provisions of the EU are regulated under Title II, Articles 310–316 of the Treaty of Lisbon. Article 312 sets out the multiannual financial framework, while Article 314 provides the procedure for adopting the annual budget. It is worth noting that the EU operates under a balanced budget rule, set out in Article 310 (1).

The multiannual financial framework

The purpose of the multiannual financial framework is to control the development of the EU's expenditures. The framework is in place for at least five years, and, crucial for our analysis, the annual budget must comply with the limits set in it. The multiannual framework is adopted by unanimity in the Council following the consent from an absolute majority in the EP. However, there is an opening in the Treaty to allow the Council to adopt the framework by qualified majority. This opening is

subject to a unanimous decision in the European Council (article 312 (1)). The framework sets annual ceilings on the different budgetary categories, corresponding to the EU's major sectors of activities.

Prior to the Lisbon treaty, the financial framework that set the limits for the annual budget was an inter-institutional agreement without any legal basis in the treaty, beyond the fact that it was negotiated by institutions that were allowed to undertakelegal obligations. This agreement between the Council, the Commission and the EP was established in 1988. Under it, the EP was given the power to veto the agreement reached by the Council under unanimity on the basis of a proposal from the Commission. If the EP vetoed the budget, it would operate on the basis of annual budgetary procedure. The consequence would mean that it is harder to plan long-term spending programs (Heinemann, Mohl, and Osterloh 2008, 15).

The annual budgetary procedure

The annual budgetary procedure is set out in Article 314. Under this procedure the Commission proposes a draft budget to the EP and the Council. Then, the Council adopts its position by qualified majority. If the EP approves the budget set by the Council, or fails to reach a decision within forty-two days, the budget is adopted. If the EP, by an absolute majority amends the budget, the Conciliation Committee convenes. Within twenty-one days a qualified majority in the Council and a simple majority of the representatives of the EP need to reach an agreement. If they fail to reach an agreement, the Commission shall submit a new budget. If no budget is adopted by the start of the next financial year, provisional twelfths of the previous year's budget will be allocated unless this sum is higher than the sum in the draft budget (Article 315).

If however the Conciliation Committee does agree, the EP and the Council have fourteen days each to adopt the joint text. Failure to do so is regulated through a series of possible scenarios in the Treaty (Article 314, 7 a-d). As we will see below, and in line with the analysis in Benedetto and Høyland (2007), these arrangements are unlikely to change the outcome. We will nevertheless present them in the interest of completeness.

First, if the EP and Council both approve or fail to take a decision (one of them or both), the budget will be deemed adopted. Second, if the EP, by an absolute majority rejects the budget, the Commission shall submit a new draft budget. Third, if the Council rejects, but the EP approves the budget, the EP may within fourteen days, by an absolute majority and three-fifths of the votes cast, confirm some or all of its amendments. For those amendments that not confirmed, the position agreed in the Conciliation Committee is maintained.

Prior to the Lisbon treaty, the annual budgetary procedure distinguished between "compulsory" and "non-compulsory" spending. "Compulsory" expenditure included areas the typical intergovernmental areas, such as agriculture, fisheries, development and common foreign and security policies. These areas were called compulsory as the EU was under a constructional obligation to provide this funding. All other areas were "non-compulsory". The "non-compulsory" part of the annual budget grew from 8 per cent in 1975 to 58 per cent in 2003 (Benedetto and Høyland 2007, 571).

Under the old budgetary procedure (Article 272 in the Nice Treaty), the Commission presents a draft budget to the Council. The Council adopts the budget by QMV. The Parliament can, by an absolute majority modify "compulsory" expenditure and by simple majority amend "non-compulsory" expenditure. If the EP has not amended or modified the draft budget from the Council within 45 days, the budget will be deemed adopted. If the EP does amend the budget, the Council may, after consulting the Commission, modify any amendments to "non-compulsory" expenditure by QMV.

For "compulsory" expenditure, the majority required in the Council differs with the effect of the EP proposal. For modifications that have no effect or reduced the total amount of expenditure of an institution, the Council can *reject* by a qualified majority. If not rejected, the modification from the EP is deemed adopted. If the modification increases the expenditure of an institution, the Council can *accept* the modification by qualified majority. If not accepted, the modification falls. If the Council has rejected a modification, it can re-propose the amount in the draft budget, or any other amount by QMV.

By an absolute majority and 3/5 of all votes casted, the EP can amend or reject modifications to its amendments of "non-compulsory" expenditure. If the EP does not act, the budget is adopted. However, the EP can then reject the budget as a whole by

an absolute majority and 2/3 of votes. If the annual budget is rejected, the previous year's budget is voted through on a monthly basis.

3 The Model

To study the annual budgetary process, the new and the old procedures, we use spatial models. Alternative budgets are represented by points in an *n*-dimensional policy or budget space. Each dimension stands for a specific budget item, and different locations on a dimension denote different spending levels on the corresponding budget item. Setting the budget can then be thought of as choosing a point in the budget space. We present game-theoretical models with complete and perfect information: the political actors know the structure of the budgetary process, each other's preferences and the actions taken. We use the subgame perfect Nash equilibrium concept.

3.1 Actors and Preferences

Political actors are considered to have Euclidean preferences. That is, they have ideal budgets and prefer budgets that are closer to rather than farther away from their ideal budgets. Thus, the actors can be represented by points in the budget space.

There are three main institutions involved in the budgetary process: the Commission, the Council, and the EP. The *Commission* currently consists of 27 members, one per Member State (MS). Its role in the budgetary process is to propose a draft budget. In particular the Budget Commissioner proposes the draft. For that reason the Budget Commissioner represents the Commission in our model. In reality the Commission votes on the Budget Commissioner's proposed draft by simple majority, before submitting it to the other institutions, and allows for amendments in its internal deliberations. The Commission's votes and deliberations are not the focus of this paper, however. Moreover, any draft budget would need to satisfy the same conditions as the Budget Commissioner's proposal to get adopted and become the EU budget. So, our conclusions hold, even if we consider Commission votes and deliberations.

The *Council* consists of representatives of the 27 MS governments. The analysis of policy making can be simplified by focusing on the MSs that are pivotal under the Council's qualified majority voting (QMV) rule. Under QMV 255 votes out of a total of 345 are currently needed to defeat the status quo.[4] In a one-dimensional setting there are thus two pivotal MSs. The MS *a* that is pivotal for a rightward move has an ideal policy to the left of the MS with the median vote. In particular, MS *a* is the MS with the 91st vote (from the left). Similarly, the MS *b* that is pivotal for a move to the left is the MS with the 255th vote. In a multi-dimensional setting more MSs may be pivotal, depending on the direction of policy change.

The *EP* typically uses simple majority rule, but in some instances a stricter rule is used. This is particularly true in the annual budgetary process. The EP uses a stricter decision rule at three points in the new process. First, an absolute majority of its members is required, rather than a simple majority of the votes in favor and against, for the EP to pass amendments. Second, the EP also needs an absolute rather than simple majority to reject a joint text. The absolute and simple majority rules differ from one another, because MEPs may abstain or choose not to participate in a vote. We assume there is no cost to voting, however, in this paper. As a result MEPs have no incentive to abstain or not participate, and the absolute majority rule is equivalent to a simple majority rule. In reality participation has increased over the years, and as this trend continues an absolute majority does indeed become equivalent to a simple majority. Third, the EP can confirm its amendments at the end of the process by a majority of its members and three-fifths of the votes cast. In our model this is equivalent to a three-fifths majority requirement.

Similarly, the EP used a stricter voting rule at three points in the old budgetary procedure. First, it required an absolute majority to pass amendments on non-compulsory spending. Second, to reject Council modifications to its amendments on non-compulsory spending, it needed an absolute majority and three-fifths of the votes

[4] The MSs' vote numbers depend on population size: the largest MS, Germany, has 29 votes; the smallest, Malta, has three. There are two additional requirements for a coalition of MSs to constitute a qualified majority: they need to consist of a majority of MSs, with at least 62 percent of EU population. The QMV rule will be adapted when Croatia becomes an EU MS on July 1, 2013, and will undergo further changes on November 1, 2014.

cast. Third, it could reject the budget by an absolute majority and two-thirds of the votes cast.

In practice the two-thirds and three-fifths majority requirements imply that the support of the two principle political groups, the Christian-Democratic/Conservative European People's Party (EPP) and the Socialists and Democrats (S&D), is needed.[5] At the points in the process where a simple majority suffices, a coalition of the largest group and other smaller groups may also yield a majority. We do not consider these smaller groups and represent the EP by its two main groups. The approval of the largest group, assumed to be the EPP, as has been the case in recent years, then suffices to win a simple majority vote.

In sum, there are thus five potentially relevant actors in policy making in a one-dimensional model: (1) the Commission *C*, as represented by the Budget Commissioner; (2, 3) the pivotal political groups in the EP, the EPP and S&D; and (5,6) the pivotal MSs *a* and *b*. In a multi-dimensional setting more MSs may be pivotal.

3.2 The Annual Budgetary Process

This section presents the stages in our model of the budgetary process under the new and old set of rules.

3.2.1 The New Procedure

The annual budgetary procedure resembles the codecision procedure in the legislative process, with some marked differences that we will point out.[6] The Commission

[5] The EU budget is typically approved by a broad coalition of these two groups, and possibly other groups. The coalition often also includes the centrist Alliance of Liberals and Democrats for Europe (ALDE), the third largest group. An average of 99.4 percent of voting EPP MEPs, 90.7 percent of voting S&D MEPs, and 97.04 percent of voting ALDE MEPs approved the most recent three budgets. See www.votewatch.eu for more information on the votes. We do not focus on decision making within party groups, and represent the party groups as unitary actors. The numbers above show that they are cohesive in votes on budgetary issues, as they are on other issues.

[6] See Crombez (1997, 2001) and Tsebelis and Garrett (2000), for example, for analyses of codecision. See also Crombez (1996), Moser (1997), Steunenberg (1994) and Tsebelis (1994) for

formulates a draft budget that is sent to the Council and the EP for adoption. The Council and the EP can each amend the draft, and if they approve different versions, a Conciliation Committee is convened to find a compromise, as under codecision. If the Council rejects the compromise, however, the EP can confirm the budget it passed earlier by a three-fifths majority, unlike under codecision.

More specifically, the new annual budgetary procedure consists of the following eleven steps, as illustrated in Figure 1. Let the budget b_s be the budget that emerges from step s of the process. In the first step the Budget Commissioner formulates a draft budget b_1 that is sent to the Council and the EP.

--- Figure 1 about here ---

The Council gets to consider the draft budget first, as shown in steps two through four in the Table. We assume that MS k gets to propose an amendment b_2 in the second step.[7] In the third step the MSs vote on the amendment, if one was indeed proposed.[8] The (amended) draft budget b_3 is subsequently submitted to a vote for approval in the fourth step. If it is approved, the process moves on to the next step. Otherwise the Commission needs to start its work over again and propose a new draft budget. The previous year's status quo budget then holds as long as no new budget is approved. As the budgetary process takes several months, we assume for simplicity that the status quo prevails if the process needs to start anew. The budget b_4 is thus the (amended) draft budget or the status quo.

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more game-theoretical analyses of the legislative process. Thomson (2011) and Thomson et al. (2006) present tests of these theories.

[7] In reality all MSs can propose amendments. This simplification does not affect our conclusions however.

[8] Council amendments of Commission proposals usually require unanimity for adoption. Article 293 of the Treaty on the Functioning of the European Union (TFEU), however, states that this requirement does not hold for Article 314, the article that describes the annual budgetary procedure. Therefore, the Council's standard decision rule, QMV, applies, in accordance with Article 16 of the Treaty on European Union (TEU). This is different from codecision in the legislative process.

In step five the EP considers the (amended) draft budget b_3, referred to as the Council's position. In particular, the EP, as represented by its largest group, the EPP, can either approve the position or propose an amendment. If the EP approves the Council's position, it becomes the EU budget $b^*=b_4$. If the EP proposes an amendment, the amendment is sent back to the Council.

Subsequently the Council gets a chance to vote on the amended budget $b_5 \neq b_4$ in the sixth step, if the EP did indeed amend the budget. If the Council approves the amended budget, it becomes the EU budget $b^*=b_6=b_5$. Otherwise the Conciliation Committee meets to work out a compromise.

The Conciliation Committee consists of the members of the Council and an equal number of representatives of the EP. The actions of the Conciliation Committee are represented in steps seven and eight in Figure 1. In the seventh step the EPP proposes a joint text b_7, and in the eighth step the members vote on it.[9] The proposed joint text requires support from a qualified majority of the members of the Council, as represented in the Conciliation Committee, and a majority of the representatives of the EP for approval. If the joint text is not adopted, the status quo prevails. If the joint text is adopted, it is sent to the Council and EP for final approval.

In steps nine and ten the MSs and the MEPs then vote on the joint text. If neither the Council nor the EP rejects the joint text, it becomes the EU budget $b^*=b_7$. If the EP, as represented by the largest group, the EPP, rejects, the status quo prevails, whatever the result of the Council vote may be. If the Council rejects the joint text and the EP approves it, the procedure moves on to the eleventh and final step.

In the final step the EP can confirm the amendment it approved earlier by a three-fifths majority, which means the two largest groups need to confirm it. If the EP confirms, the amendment b_4 becomes the EU budget. If the EP fails to confirm, the

[9] We assume for simplicity that the EPP is the only actor who can propose an amendment. This does not affect our conclusions, because other amendments would need to satisfy the same conditions to be adopted and become the EU budget.

joint text b_5 becomes the EU budget. The possible outcomes in the last steps of the procedure are represented in Figure 2.

--- Figure 2 about here ---

3.2.2 The Old Procedure

The old annual budgetary procedure consists of the following steps, as illustrated in Figure 3.[10] The first four steps are as in the new procedure: the Commission formulates a draft and the Council determines its position on it. However, unanimity is required for Council amendments.

--- Figure 3 about here ---

Step five is also similar to the old procedure: the EP, as represented by its largest group, the EPP, can either approve the draft or propose an amendment b_4. If the EP approves the Council's draft, it becomes the EU budget $b^*=b_3$. If the EP proposes an amended version b_4, the amended version is sent back to the Council. Unlike the new procedure, however, the old procedure does not require an absolute majority, but a simple majority, for the approval of amendments to compulsory spending, referred to as modifications. As mentioned above, we do not consider costs of voting, and the simple and absolute majority rules are thus equivalent in our model.

Subsequently the Council gets a chance to vote on the amended budget b_4 in the sixth step. The Council can accept modifications that increase spending by a qualified majority. It can reject modifications that do not increase spending by a qualified majority. That is, modifications that do not increase spending can be approved by a blocking minority. The Council can amend EP amendments to non-compulsory spending by a qualified majority. If the Council approves the modifications and the EP amendments are not amended, the amended budget becomes the EU budget $b^*=b_4$. Otherwise, the Council sends its amended version back to the EP for consideration. Step 6 is thus similar to the new budgetary procedure. However, the

[10] The old budgetary procedure was outlined in TFEU Article 272.

Council can approve EP amendments to non-compulsory spending and non-spending increasing modifications to compulsory spending by a blocking minority rather than a qualified majority.

In step seven the EP can confirm its amendments to non-compulsory spending by a three-fifths majority. In the eighth and final step the EP can reject the budget by a two-thirds majority.

4 The Equilibrium

4.1 The New Procedure

When going through the annual budgetary process the actors look ahead and consider what consequences their actions will have in subsequent steps in the process. Therefore, we use backward induction and start by studying the last steps of the process. A more formal proof can be found in the Appendix.

4.1.1 Post-Conciliation

We distinguish two post-Conciliation scenarios depending on whether the EPP prefers the joint text to the status quo.

Scenario 1. Suppose first that the Conciliation Committee approved a joint text that the EPP prefers to the status quo. In the final step of the procedure the EP chooses between its amendment b_4 and the joint text b_5. The amendment is confirmed and becomes the EU budget, if the EPP and S&D prefer it to the joint text. Since the EPP prefers the joint text to the status quo, this implies that it prefers the amendment to the status quo. If the EPP or the S&D prefer the joint text to the amendment, by contrast, the joint text becomes the EU budget.

In the penultimate step the EP votes on the joint text. If the Council did not reject it in the prior step, the EP gets a choice between the joint text and the status quo. The EPP then votes in favor of the joint text and it becomes the EU budget. If the Council rejected the joint text in the previous step, the EP chooses between the status quo and

the budget that will be set in the next step, which is either the joint text or the amendment. The EPP then votes in favor of the joint text and the process moves on to the last step.

In the ninth step the Council votes on the joint text. If the Council does not reject the joint text, the joint text becomes the EU budget. If the Council rejects the joint text, the joint text also becomes the EU budget, unless the EPP and S&D prefer the EP amendment. **Thus, the joint text becomes the EU budget, unless a qualified majority in the Council, the EPP and S&D prefer the amendment to the joint text. In that case the amendment becomes the EU budget. In either case the EPP prefers the budget to the status quo.**

Scenario 2. Suppose that the EPP prefers the status quo to the joint text. In the final step of the procedure the amendment is confirmed and becomes the EU budget, if the EPP and S&D prefer it to the joint text. If the EPP or the S&D prefer the joint text to the amendment, the joint text becomes the EU budget.

In the penultimate step the EP votes on the joint text. If the Council did not reject it in the prior step, the EP gets a choice between the joint text and the status quo. Since the EPP prefers the status quo, the joint text is rejected and the status quo prevails. If the Council rejected the joint text in the previous step, the EP chooses between the status quo and the budget that will be set in the next step, which is either the joint text or the EP amendment. Since the EPP prefers the status quo to the joint text, it votes in favor of the joint text only if it prefers the amendment to the status quo and the S&D prefers the amendment to the joint text. As a result the status quo is maintained, unless the EPP prefers the amendment to the status quo and they both prefer the amendment to the joint text.

In the ninth step the Council votes on the joint text. If the Council does not reject the joint text, the status quo prevails. If the Council rejects the joint text, the status quo is also maintained, unless the EPP prefers the amendment to the status quo and the S&D prefers the amendment to the joint text. **Thus, the status quo prevails, unless a qualified majority in the Council and the EPP prefer the amendment to the**

status quo, and the S&D prefers the amendment to the joint text. In that case the amendment becomes the EU budget.

4.1.2 Conciliation

In the eighth step the MSs and the EP vote on the joint text in the Conciliation Committee. The MSs and the political groups vote in favor only if they prefer the resulting policy, whether it be the joint text or the EP amendment, to the status quo. If a qualified majority and the EPP prefer the resulting policy to the status quo, the process moves on to the next step. Otherwise the status quo prevails. Thus, **the policy that results post-Conciliation is preferred to the status quo by a qualified majority and the EP, as represented by its largest group the EPP**.

Since the policy that results post-Conciliation is preferred to the status quo by a qualified majority and the EPP, the EPP has no incentive to propose a joint text in the seventh step that does not satisfy these conditions. If it did, the resulting policy would either be the amendment or the status quo. So, it would propose the amendment or status quo instead. Therefore, we can disregard post-Conciliation scenario 2.

Thus, the EPP proposes a joint text in the seventh step that is preferred to the status quo by a qualified majority and itself. Specifically, it wants to propose the policy it prefers most from among the policies that are preferred to the status quo by a qualified majority and itself. This joint text becomes the EU budget, unless a qualified majority in the Council, the EPP and S&D prefer the amendment to it.

If the amendment is also preferred to the status quo by a qualified majority and the EPP, the EPP prefers the joint text, because otherwise it would propose the amendment as the joint text. If, by contrast, the amendment is not preferred to the status quo by a qualified majority and the EPP, the EPP only considers joint texts that are preferred to the amendment by a blocking minority or one of the two main groups, because other joint texts would be equivalent to the status quo.

Thus, **the EPP proposes as a joint text the budget that is (1) preferred to the status quo by a qualified majority and the EPP and (2) preferred to the**

amendment by a blocking minority in the Council or one of the two main groups. In particular the EPP successfully proposes the budget it prefers most from amongst these budgets.

4.1.3 The EP Amendment

In the sixth step the Council votes on the EP amendment. If a qualified majority accepts it, it becomes the EU budget. If it is rejected, the process moves on to the Conciliation Committee and the EPP proposes the policy outlined above. The amendment is thus rejected if a blocking minority prefers the EPP's optimal joint text proposal to the amendment. In that case the joint text becomes the EU budget.

In the fifth step the EPP can propose an amendment. For it to become the EU budget, it needs to be preferred to the joint text by a qualified majority. If the EPP proposes an amendment, it thus proposes as an amendment the budget b_4 it prefers most from among the budgets that are preferred to the joint text by a qualified majority. This amendment is different from the joint text, only if there are budgets a qualified majority and the EPP prefer to the joint text. This can only hold for budgets that are not preferred to the status quo by a qualified majority, for otherwise such a budget would be proposed as a joint text. In any case the amendment is preferred to the status quo by the EPP.

The EPP proposes the amendment b_4, if it prefers it to the draft budget. If it does not, it does not propose an amendment and the draft budget b_3 becomes the EU budget. Since the EPP prefers the optimal amendment to the status quo, the draft budget also needs to be preferred to the status quo by the EPP for it to become the EU budget.

4.1.4 The Draft Budget

In the fourth step the MSs vote on the (amended) draft budget b_3. If they reject the draft, the status quo prevails. If they approve it, the process moves on to the next steps. In the next steps the draft budget, EPP amendment or joint text become the EU budget. The MS thus vote in favor of the draft, if they prefer the draft, the EPP amendment or the joint text, whichever of these three budgets becomes the EU budget

in equilibrium, to the status quo. We pointed out earlier that an amendment that is different from the joint text is not preferred to the status quo by a qualified majority. As a result, such an amendment does not become the EU budget in equilibrium.

In the third step the MSs vote on MS *k*'s amendment. The amendment becomes the draft budget if a qualified majority prefers the budget that results from it to the budget that results from the Commission draft.

In the second step MS *k* can propose an amendment. It considers the optimal joint text, the EPP's optimal amendment to it, and the Commission's draft. We distinguish four scenarios.

Scenario 1. Suppose the EPP prefers the Commission's draft to its optimal amendment, and a qualified majority prefers the draft to the status quo. The draft then becomes the EU budget unless MS *k* amends it. MS *k*'s optimal amendment, the budget it prefers most from among the budgets that a qualified majority prefers to the draft and the EPP prefers to its own optimal amendment, is then preferred to the status quo by the EPP and a qualified majority.

This budget is equal to the joint text. Since the EPP prefers MS *k*'s optimal amendment to its own optimal amendment and its own optimal amendment to the joint text, it prefers MS *k*'s optimal amendment to the joint text. Both these policies are preferred to the status quo by a qualified majority and the EPP, and the joint text is the budget the EPP prefers most from among the budgets a qualified majority and the EPP prefer to the status quo. As a result MS *k*'s optimal amendment is equal to the joint text.

Scenario 2. Suppose next that the EPP prefers the Commission's draft to its optimal amendment, but a blocking minority prefers the status quo to the draft. The status quo then prevails unless MS *k* amends the draft. For the Commission proposing a draft that no qualified majority prefers to the status quo is equivalent to proposing the status quo.

MS k successfully amends the draft, if there are budgets that a qualified majority prefers to the status quo and the EPP prefers to its optimal amendment. As in scenario 1 only the joint text can satisfy these requirements. If it does not, the status quo prevails. In any case the resulting budget is preferred to the status quo by the EPP and a qualified majority.

Scenario 3. Suppose now that the EPP prefers the optimal amendment to the Commission draft, and a qualified majority prefers the EPP's optimal amendment to the status quo. For the Commission this is equivalent to proposing the EPP's optimal amendment as draft budget. Scenario 3 is thus equivalent to scenario 1.

Scenario 4. Suppose finally that the EPP prefers the optimal amendment to the Commission draft, but a blocking minority prefers the status quo to the EPP's optimal amendment. For the Commission this is equivalent to proposing the status quo. Scenario 4 is thus equivalent to scenario 2.

In the first step the Commission realizes that whatever budget it proposes the Council will successfully propose the joint text as an amendment, unless the EPP prefers its own optimal amendment to the joint text but a blocking minority prefers the status quo to the EPP's optimal amendment. In that case the status quo prevails. The equilibrium budget is thus either the joint text or the status quo. The Commission can do no better than propose the joint text.

The equilibrium budget is the budget the EP prefers most from among the budgets that the EP and a qualified majority prefer to the status quo, unless there are policies that the EP and a qualified majority prefer to it but are not preferred to the status quo by a qualified majority. In that case the status quo prevails.

3.2 The Old Procedure

In this subsection we investigate the equilibrium outcomes of the old budgetary procedure. As above, we rely on backward induction. Our analysis hence starts with the last stage of the game and move backwards to the first stage.

3.2.1 The Final EP Vote

In the eighth and final step of the old procedure the EP could reject the budget by a two-thirds majority. For a budget to be adopted it thus had to be preferred to the status quo by one-third of the EP. For this reason we can disregard budgets that do not satisfy this requirement.

3.2.2 The EP Amendments and Modifications

In the fifth step the EP can amend and modify the draft budget. As a result of the Council voting rules in the sixth step and the EP's voting rule in the seventh step, the amendments and modifications need to satisfy the following requirements for adoption. (1) Amendments to non-compulsory spending need the support from a three-fifths majority in the EP or a blocking minority in the Council. (2) Non-increasing modifications to compulsory spending need the support from a blocking minority in the Council. (3) Increasing modifications to compulsory spending need the support from a qualified majority in the Council. Amendments and modifications that do no satisfy these requirements are voted down in favor of the draft budget provisions. Thus the EP amends or modifies the draft budget if there are amendments and modifications that it prefers to the draft and that satisfy these requirements.

3.2.3 The Draft Budget

A qualified majority can vote down the draft budget in the fourth step. In the second and third steps the Council can unanimously amend the draft. For these reasons the Commission proposes a draft budget in the first step that is preferred to the status quo by a qualified majority and such that no other budget that can be adopted is preferred to it by all member states.

Moreover, because of the EP's right to reject the budget in the last step the Commission only considers budgets that are preferred to the status quo by a third of the MEPs. Furthermore, the Commission wants to avoid that the EP amend or modify its budget. The Commission proposes as a preliminary draft budget the budget it prefers most from among the budgets that satisfy these conditions.

4 Comparing the New and the Old

As outlined above the first five steps of the old and new procedures are largely similar. The main differences in the procedures are to be found in the later steps. The two main differences that have an important impact on the resulting budget are the following.

First, the majorities required for adoption of EP amendments are different. Under the new procedure amendments need the support of a qualified majority in the Council, whereas in the old procedure this was true only for modifications to compulsory spending that increased the budget. Modifications to compulsory spending that were not budget-increasing required support from a blocking minority only. Amendments to non-compulsory spending could be passed even more easily: with support from a blocking minority or three-fifths of the EP. It thus seems to have been easier for the EP to pass amendments to non-compulsory spending and non-budget-increasing modifications to compulsory spending prior to the Lisbon Treaty. Moreover, the EP now needs an absolute majority to propose amendments, whereas in the past this was only required for amendments to non-compulsory spending, with modifications to compulsory spending requiring a simple majority only.

Second, what happens when EP amendments are rejected is different. Since Lisbon a Conciliation Committee is convened under such circumstances. As a result MS now compare EP amendments to the joint text that will emerge from the Conciliation Committee. Prior to Lisbon the draft budget was the reversion policy. Depending on the configuration of preferences and the bargaining powers of the institutions and MSs in the Conciliation Committee the new procedure may thus lead to budgets that are closer to the EP's preferences even if the majorities required to pass its amendments are stricter.

5 Conclusions

In this paper we study the Lisbon Treaty's reform of the annual budgetary procedure. We present spatial, game-theoretical models to analyze the impact of the reform on the institutions powers and equilibrium budgets.

We find that voting rules on EP amendments render it more difficult to amend the draft budget under the new procedure. However, amendments are now compared to the joint text that is expected to emerge from the Conciliation Committee rather than the draft budget. Whether the new procedure leads to budgets the EP prefers to the budgets that would have been set under the old procedure depends on the configuration of preferences and the bargaining powers in the Conciliation Committee.

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Figure 1: The New Annual Budgetary Procedure.

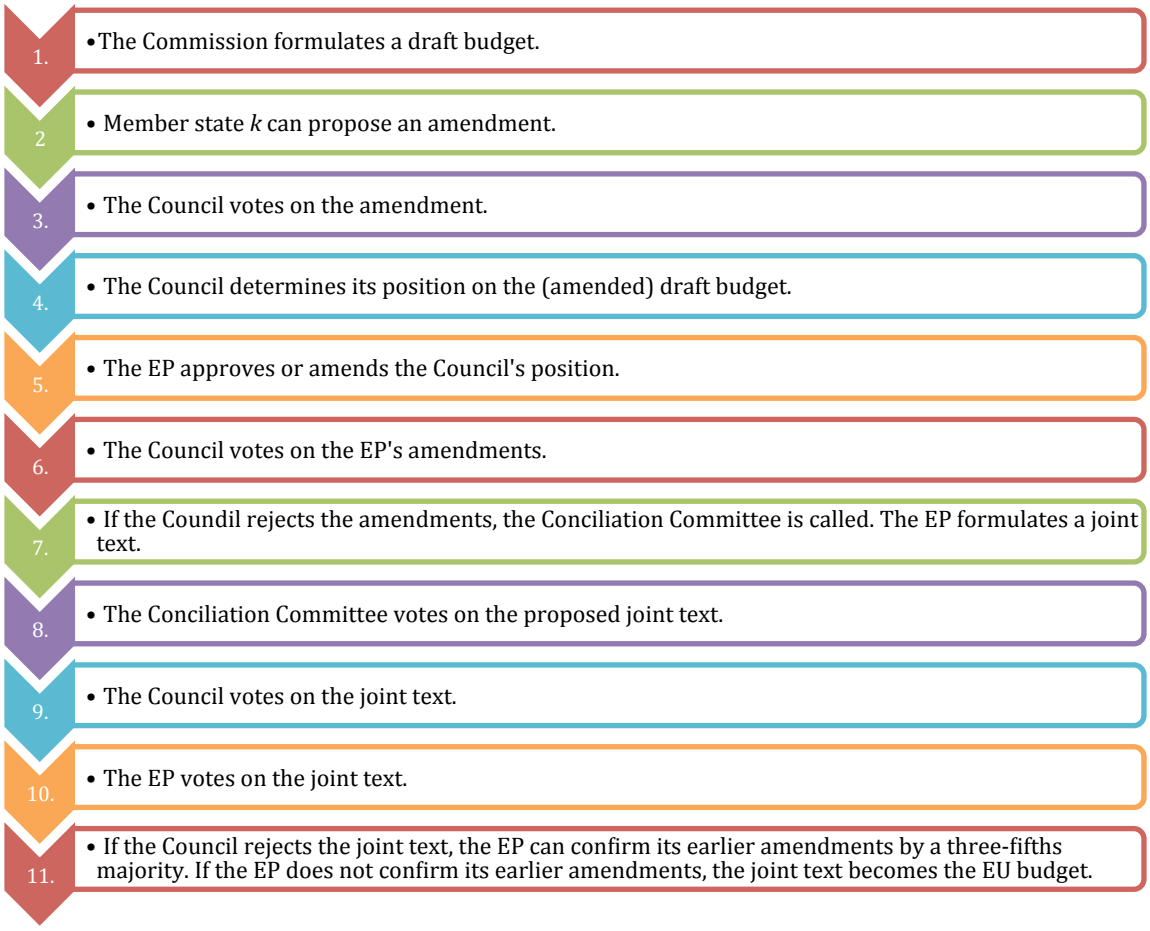

Figure 2: Post Conciliation.

		Council		
		Approves	No Decision	Rejects
EP	Approves	JT	JT	JT/AM
	Rejects	SQ	SQ	SQ

JT = joint text; SQ = status quo; AM = EP amendment

Figure 3: The Old Annual Budgetary Procedure.

Appendix

The Model

- The budget space $B \subseteq \Re^n$ consists of n dimensions, each corresponding to a budget item.
- The political actors are: the member states in the Council; the Members of the European Parliament (MEPs); and the Commissioners.
- They have Euclidean preferences over EU budget $b^{EU} \in B$. That is, actor j has the following utility function: $U_j(b^{EU}) = -(x_j - b^{EU})^2$, where $x_j \in B$ is actor j's ideal budget.
- The MEPs are partitioned into political groups. We assume that they behave as unitary actors.
- When the European Parliament (EP) uses simple majority rule, support from the largest political group suffices to win a vote. Since 1999 the European People's Party (EPP) has been the largest group. For that reason we will refer to the largest group as the EPP, with an ideal budget x_{EPP}.
- We assume there is no cost to voting. Thus MEPs have no incentive not to participate in a vote. The absolute majority requirement is therefore equivalent to the simple majority requirement.
- When a three-fifths or two-thirds majority is required, the support of the two largest groups is needed, the EPP and the Socialists and Democrats (S&D).
- The Commission is also represented as a unitary actor with ideal policy x_C equal to the ideal policy of the budget Commissioner.
- The Council uses qualified majority rule (255/345 votes). In an n-dimensional setting the pivotal member states depend on the direction of the change proposed.
- The member states and an equal number of representatives of the EP form a Conciliation Committee. As we focus on the two largest groups, we assume that the EP members of the Committee represent those two groups.
- The structure of the new annual budgetary procedure is as follows. Let budget b_s be the budget that emerges from step s of the process.

1. The Commission formulates a draft budget $b_1 \in B$.
2. MS *k* gets to propose an amendment b_2.
3. The MSs vote on the amendment. The amendment is approved if and only if it obtains the support of a qualified majority. The (amended) draft budget $b_3 \in \{b_1, b_2\}$.
4. The MSs vote on the (amended) draft budget b_3. It is approved if a qualified majority supports it. The process then moves on to the fifth step. Otherwise the status quo budget *q* prevails. The budget b_4 is thus the (amended) draft budget or the status quo. That is, $b_4 \in \{b_3, q\}$.
5. If the (amended) draft budget is approved, i.e., $b_4=b_3$, then the EPP chooses budget $b_5 \in B$. If $b_5=b_4$, it becomes the new budget $b^*=b_5=b_4=b_3$. Otherwise the process moves on to the sixth step.
6. The MSs vote on the EPP amendment. The amendment becomes the EU budget, i.e., $b^*=b_6=b_5$, if and only if it obtains the support of a qualified majority. Otherwise the budget $b_6=b_5$ is sent to the Conciliation Committee.
7. The EPP proposes a joint text b_7.
8. The MSs, as represented in the Conciliation Committee, vote on the proposed joint text. It is approved if a qualified majority supports it. The process then moves on to the ninth step. Otherwise the status quo budget *q* prevails. The budget b_8 is thus the joint text or the status quo. That is, $b_8 \in \{b_7, q\}$.
9. The MSs vote on the joint text by qualified majority. Whatever the outcome of the vote, the process moves on to the tenth step, with $b_9=b_7$.
10. The EPP votes on the joint text. If neither the Council (by qualified majority) nor the EPP reject the joint text, it becomes the EU budget $b^*=b_{10}=b_9=b_8=b_7$. If the EPP rejects, the status quo prevails, $b^*=b_{10}=q$. If the Council rejects the joint text and the EP approves it, the procedure moves on to the eleventh and final step, with $b_{10}=b_9=b_8=b_7$.

11. The EPP and S&D vote on the EPP amendment b_5. If they both approve it, it becomes the new budget, $b^*=b_5$. Otherwise the joint text becomes the budget, $b^*=b_7$.

The Equilibrium

The equilibrium under the new annual budgetary process can be derived as follows.

11. In the final step the EPP and S&D compare the joint text b_7 to the EPP amendment b_5. The EPP amendment becomes the EU budget if it is closer to the ideal policies of the EPP and S&D than is the joint text: $b^* = b_{11} = b_5 \Leftrightarrow [-(x_{EPP} - b_5)^2 \geq -(x_{EPP} - b_7)^2 \wedge -(x_{S\&D} - b_5)^2 \geq -(x_{S\&D} - b_7)^2]$. Otherwise the joint text becomes the EU budget: $b^*=b_{11}=b_7$.

10. Suppose the EPP prefers the joint text to the status quo: $-(x_{EPP} - b_7)^2 \geq -(x_{EPP} - q)^2$. Then the EPP approves the joint text ($b_{10}=b_7$), because the resulting budget b^* is the joint text or its amendment ($b^*=b_{10}=b_7$; $b^*=b_{11}=b_7$ or $b^*=b_{11}=b_5$) and in either case the EPP prefers it to the status quo ($b^* \in W_{EPP}$, with W_{EPP} the set of budgets the EPP prefers to q).

    Suppose, by contrast, that the EPP prefers the status quo to the joint text, $-(x_{EPP} - b_7)^2 < -(x_{EPP} - q)^2$. If it approves the joint text, the resulting budget is the joint text or the EPP amendment. So, it approves the joint text only if the resulting budget is the EPP amendment and it prefers the amendment to the status quo. This requires that the S&D prefers the EPP amendment to the joint text, for only then can it become the EU budget in the 11th step. The process then moves on to the 11th step and the EPP amendment becomes the EU budget: $b^*=b_{11}=b_5$. Otherwise the status quo prevails: $b^*=b_{10}=q$. In either case the EPP (weakly) prefers the resulting budget to the status quo ($b^* \in W_{EPP}$).

9. Suppose the EPP prefers the joint text to the status quo. The resulting budget is then the joint text or the EPP amendment. It is the EPP amendment only if a qualified majority of MSs vote against the joint text and the EPP and S&D prefer the EPP amendment to the joint text. The

MSs then reject the joint text if a qualified majority, the EPP and S&D prefer the EPP amendment to the joint text. The EPP amendment then becomes the EU budget in the last step ($b^*=b_{11}=b_5$). Otherwise the joint text becomes the EU budget ($b^*=b_{10}=b_7$).

Suppose, by contrast, that the EPP prefers the status quo to the joint text. Then the status quo can be defeated only if a qualified majority rejects the joint text. The MSs reject the joint text if a qualified majority and the EPP prefer the amendment to the status quo, and the S&D prefers the EPP amendment to the joint text. The EPP amendment then becomes the EU budget in the last step ($b^*=b_{11}=b_5$). Otherwise the status quo prevails ($b^*=b_{10}=q$).

8. The MSs approve the joint text by qualified majority ($b_8=b_7$), if a qualified majority prefers the resulting budget ($b^*=b_{10}=b_7$; $b^*=b_{10}=q$; $b^*=b_{11}=b_7$ or $b^*=b_{11}=b_5$) to the status quo. Otherwise the status quo prevails: $b_8=q$. In any case a qualified majority prefers the resulting budget to the status quo ($b^* \in W_{QM}$, with W_{QM} the set of budgets a qualified majority prefers to q).

7. Whatever joint text the EPP proposes, the resulting budget b^* is preferred to the status quo by a qualified majority and the EPP ($b^* \in W = W_{EPP} \cap W_{QM}$). Therefore the EPP proposes as a joint text a budget that is in the set W. It wants to propose the budget it prefers most from among these budgets. However, not all budgets in W become the EU budget if proposed: the EPP amendment would become the EU budget in the last step if a qualified majority, the EPP and the S&D prefer it to the joint text.

   This can only happen if the EPP amendment $b_5 \notin W$, for otherwise the EPP would have proposed it as a joint text. A joint text that would be beaten by the amendment $b_5 \notin W$ in the last step, would not be approved

by a qualified majority in the eighth step, however, because a qualified majority prefers the status quo. The status quo would then prevail.

For that reason the EPP proposes as a joint text b_7 the budget it prefers most from among the budgets (1) that are preferred to the status quo by a qualified majority and the EPP, and (2) preferred to the EPP amendment by a blocking minority, the EPP or S&D. A qualified majority votes in favour in the eighth and ninth steps, as does the EPP in the tenth step. This proposal then becomes the EU budget: $b^*=b_7$.

6. A qualified majority votes in favour of the EPP amendment if it prefers the amendment to b_7. The amendment then becomes the EU budget: $b^*=b_5$. Otherwise the process moves on: $b_6=b_5$.

5. If the EPP proposes an amendment, it proposes the budget b_5 it prefers most from among the budgets that are preferred to the joint text by a qualified majority. The amendment then becomes the EU budget: $b^*=b_5$. The EPP proposes b_5, if it prefers b_5 to the draft budget. Otherwise the draft budget becomes the EU budget $b^*=b_4$. Since the EPP prefers b_5 to the status quo, b_4 also needs to be preferred to the status quo by the EPP for it to become the EU budget.

4. The MS vote in favor of the (amended) draft b_3, if they prefer the draft or the EPP amendment, whichever becomes the EU budget in steps 5 or 6, to the status quo. The process then moves on to the fifth step. Otherwise the status quo prevails: $b_4=q$. In any case the EU budget is preferred to the status quo by a qualified majority. (We pointed out earlier that an EPP amendment that is different from the joint text is not preferred to the status quo by a qualified majority. As a result, such an amendment does not become the EU budget in equilibrium.)

3. The amendment proposed by MS k becomes the draft budget b_3 if a qualified majority prefers the budget that results from it, whether it be the amended draft or the EPP amendment, to the budget that results from the Commission draft.

2. We distinguish four scenarios. **Scenario 1.** Suppose the EPP prefers the Commission's draft b_1 to the EPP amendment b_5, and a qualified majority prefers b_1 to q. The draft then becomes the EU budget unless MS k amends it. MS k's optimal amendment b_2, the budget it prefers most from among the budgets that a qualified majority prefers to the draft and the status quo and the EPP prefers to its own amendment, is then preferred to the status quo by the EPP and a qualified majority. This budget is equal to the joint text.

   Scenario 2. Suppose next that the EPP prefers the Commission's draft to its optimal amendment, but a blocking minority prefers the status quo to the draft. The status quo then prevails unless MS k amends the draft. MS k successfully amends the draft, if there are budgets that a qualified majority prefers to the status quo and the EPP prefers to its optimal amendment. As in scenario 1 only the joint text can satisfy these requirements. If it does not, the status quo prevails. In any case the resulting budget is preferred to the status quo by the EPP and a qualified majority.

   Scenario 3. Suppose now that the EPP prefers its optimal amendment to the Commission draft, and a qualified majority prefers the EPP's optimal amendment to the status quo. For the Commission this is equivalent to proposing the EPP's optimal amendment as draft budget. Scenario 3 is thus equivalent to scenario 1.

Scenario 4. Suppose finally that the EPP prefers the optimal amendment to the Commission draft, but a blocking minority prefers the status quo to the EPP's optimal amendment. For the Commission this is equivalent to proposing the status quo. Scenario 4 is thus equivalent to scenario 2.

1. The EU budget is either the joint text ($b^*=b_5=b_6=b_7$) or the status quo q. The Commission can do no better than propose the joint text. Thus, b^* is the budget the EP prefers most from among the budgets that the EP and a qualified majority prefer to the status quo, unless there are policies that the EP and a qualified majority prefer to it but are not preferred to the status quo by a qualified majority. In that case the status quo prevails.