The future EU budget

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Every seven years, the EU engages in one of its more difficult negotiations, namely seeking to agree the medium term plans for its budget, known as the Multi-annual Financial Framework (MFF). Following the publication on the 2nd of May 2018 by the European Commission of its MFF proposals[1] for the period 2021-27 and initial skirmishes over the summer of 2018, the negotiations are set to intensify. An agreement will set out the broad headings of EU spending, leaving more detailed allocations of money to be determined in annual budgets, but it is the MFF which represents the main political bargain on the future spending of the EU level of governance.

Formally, the Council of Ministers (representing the Member States) and the European Parliament (EP) co-decide EU spending, whereas the EP is only consulted on the revenue side of the EU budget. Because the MFF has to be agreed unanimously, the veto power of smaller Member States is greater than in many other EU decisions. As a result, there is inevitably extensive horse-trading about the amounts for specific headings of spending.

Who wants what from the MFF?

As always, the demands and expectations of different interests are often incompatible. For a start, the EU institutions have distinct preferences. The Council of Ministers, as the voice of the Member States, has traditionally sought to dominate the decisions, with the final say having gravitated over the years from Finance Minsters to the heads of state and government meeting as the European Council. On balance, the Council tends to prefer a lower overall budget, often conceives of the EU budget as a zero-sum game in which the objective for individual Member States is to maximise the net financial gain (or minimise the cost), and wants to retain control over how the EU's revenue is generated.

The European Parliament, in contrast to most legislatures, is in the unusual position of not having to worry about how to raise the revenue needed: a clear incentive to spend more because it does not need to take the hard decisions on which taxes to impose. The Commission, with its significant agenda-setting power, is able to shape the debate on spending priorities and tends to argue for expenditure supportive of EU policy goals, and exhibiting EU added value. The issue of what constitutes EU added value has been prominent, yet hard to agree. From an economic standpoint, added value can be achieved if spending at EU level is more cost efficient than at national level, if there is a clear spillover across borders in the incidence of the spending and if there is a strong connection to EU policy priorities.

Three distinct member state positions colour the current debate – see figure 1. First, there is an insistent political demand for the EU (reinforced by the Commission and certain factions within the EP) to do more to deal with major contemporary policy challenges. These include: border security and management of migration from third countries; supporting the development of the digital

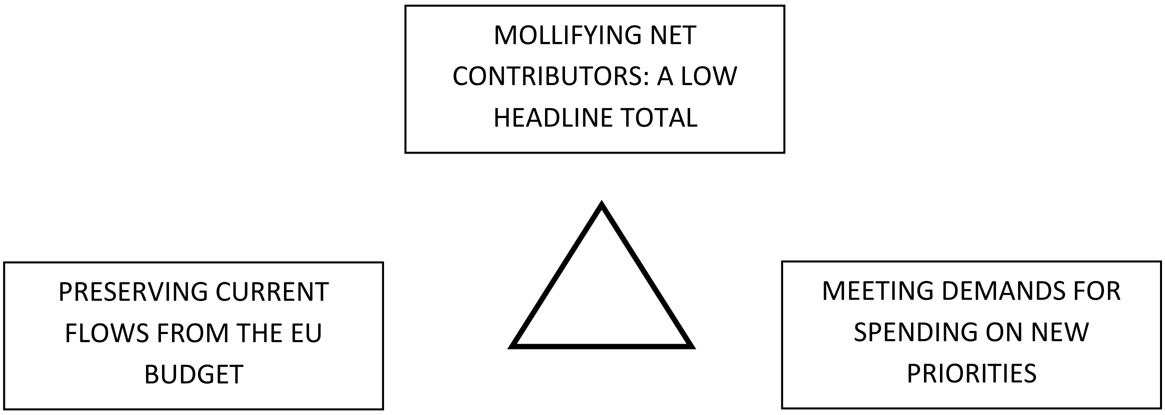
[1] https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0023.02/DOC_1&format=PDF

economy; mitigating the social consequences of the years of crisis; and enhancing the Eurozone's macroeconomic stabilisation capacities. All these can be justified as meeting an EU added value test.

Second, the conjunction of the forthcoming loss of the UK contribution and pressures for further fiscal consolidation in so many Member States imply a collective reluctance to increase the flow of cash to the EU. Although Emmanuel Macron and jean-Claude Juncker, among others, have argued for a bigger EU budget, the Commission proposal of a slight increase to 1.11% of EU gross national income (GNI) is, realistically, a maximum. If past experience is repeated it will be whittled down.

The third element is the desire of current beneficiaries from EU spending to keep what they have. Throughout the last three decades, some three quarters of EU spending has consistently gone on the combination of direct payments to farmers and (a little) the fishing industry, and to cohesion policy, including rural development. The share for direct payments has declined and that for cohesion has increased, but the consequence has been to leave all other EU spending scrabbling for the remaining quarter of the EU budget. In other words, funding for all other EU policies has had to compete for a quarter of a percentage point of EU GNI. In successive MFF rounds, these existing beneficiaries have been adept at maintaining their share of EU spending and will want to do so again.

Figure 1 The EU Budget Trilemma



The commission proposal: a basis for negotiations

This is a classic 'trilemma' in which only two out of three positions can be sufficiently satisfied. The question then is which loses most. The Commission proposals, summarised in table 1, can be interpreted as an attempt to mediate between the three points of the trilemma, but also establish the battle-lines for the negotiations. The headline total is marginally higher than was proposed seven years earlier, but on a like-for-like basis the difference is less than a twentieth of a percentage point of GNI. The Commission has, to date, been unwilling to publish precise comparisons of proposed amounts under the various headings and has re-assigned some of the detailed spending lines between broad headings of expenditure.

There are some eye-catching proposals. The Commission proposes to double the amount available for the ERASMUS programme, which provides mobility grants for young people, and there is even a proposal to subsidise inter-rail passes. There would be a significant boost for managing migration, albeit from a low base, and new money for control of the EU external border.

One of the emerging priorities of the Commission is a renewed push to advance ‘social Europe’ through the European Pillar of Social Rights (EPSR) to which Member States committed themselves at the 2017 Gothenburg social summit. The main instrument for funding the EPSR is to be the ‘European Social Fund plus’ (ESF), a gathering together of the ESF and linked initiatives, such as those covering youth employment and health. According to the Commission the share of ‘social’ in cohesion policy will increase, but in practice there is unlikely to be much new money. It may be, however, that the higher profile of ‘social’ will mean regional economic development priorities figure less within cohesion policy, to the benefit of social objectives.

Conditionality and proposals on earmarking of funds for specific policy objectives are sensitive issues, but can be expected to be more extensive than in previous MFFs. Cohesion Policy has been at the forefront of efforts to use EU spending to achieve both governance and policy objectives, for example with obligations to spend minimum proportions of receipts on projects to counter climate change. There has also been much debate around coercive measures. An especially tricky issue will be the proposed conditions on ‘rule of law’, seen as a warning to Hungary and Poland.

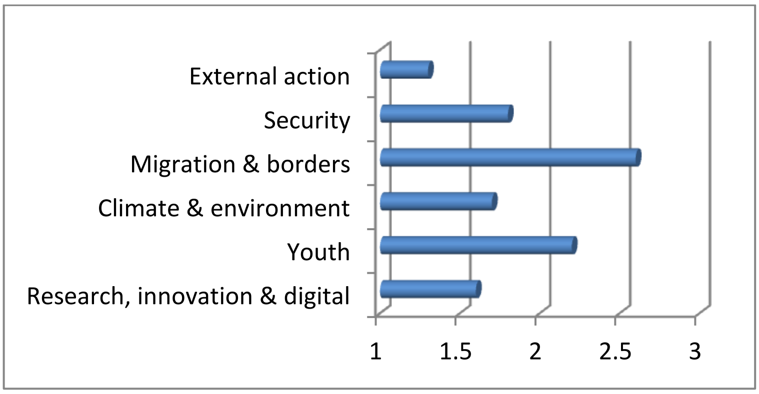
Table 1 Overview of European Commission proposals for next the next MFF

Feature of MFF	Commission proposal	Extent of change	Comment
Headline total	1.11% of EU27 GNI	Close to status quo for EU 27. Open to differing interpretations (e.g. amount, share of GNI)	Likely to be edged downwards in negotiations
Duration	Seven years, 2021-27	No change	Exceeds five year mandates for Commission and EP
Structure	Increase to seven headings; European Development Fund brought into MFF	Marginal changes, but similar broad shape	Not very contentions; some pressure to bring globalisation adjustment fund into MFF
New priorities	Increases for migration, border security, Euro-zone stabilisation and ERASMUS programme	Significant, but most from quite low base	Will face pressures to lower some of the amounts
Traditional policies	Some decrease	Still well over 60% of aggregate spending; some ‘old’ spending shifted to other headings	Objections to implied loss of receipts could lead to political pressures for more on these policies
Own resources	Proposals to introduce three new resources: plastics tax, eco-tax and share of corporate tax	Will only yield 12% of revenue requirement; national contributions will still dominate	Current VAT resource may be discontinued; agreement on new resources doubtful
Rebates (‘corrections’)	To continue, but be phased out over 5 years	Departure of UK removes primary reason for corrections, but still demand for rebates	Although an oddity, need for unanimity expected to see indefinite retention of corrections
Governance	Range of proposals for conditions on receipt of EU expenditure. 20% share of budget for climate change initiatives	More extensive than in the past with links to European semester and to adherence to ‘rule of law’	Conditionality was already controversial in 2014-20 MFF. Will be a source of friction.

Source: elaborated from Commission (2018)

The Commission proposal emphasises the effort to be made to respond to new priorities, and, as figure 2 shows, the extent of the increases looks impressive. Spending on migration is to be 2.6 times the level in the previous MFF, while that for youth is to be 2.2 times what was spent before.

Figure 2 Increase in scale of spending on new priorities (times previous amount)



Source: Commission (2018)

The aggregate increase in outlays for the new priorities is computed by the Commission to be €109 billion. However, to put this in perspective, it is only 9.6% of the total. As figure 3 shows, spending on 'Cohesion and values' – most of which is for economic development of poorer parts of the EU – and for 'Natural resources and environment' – three-quarters of which goes to direct payments to farming and fisheries – remain the two dominant blocks of spending. It is also noteworthy that, despite the proposed multiplication of spending on migration and border management, it will account for just over 3% of EU spending over the 2021-27 period.

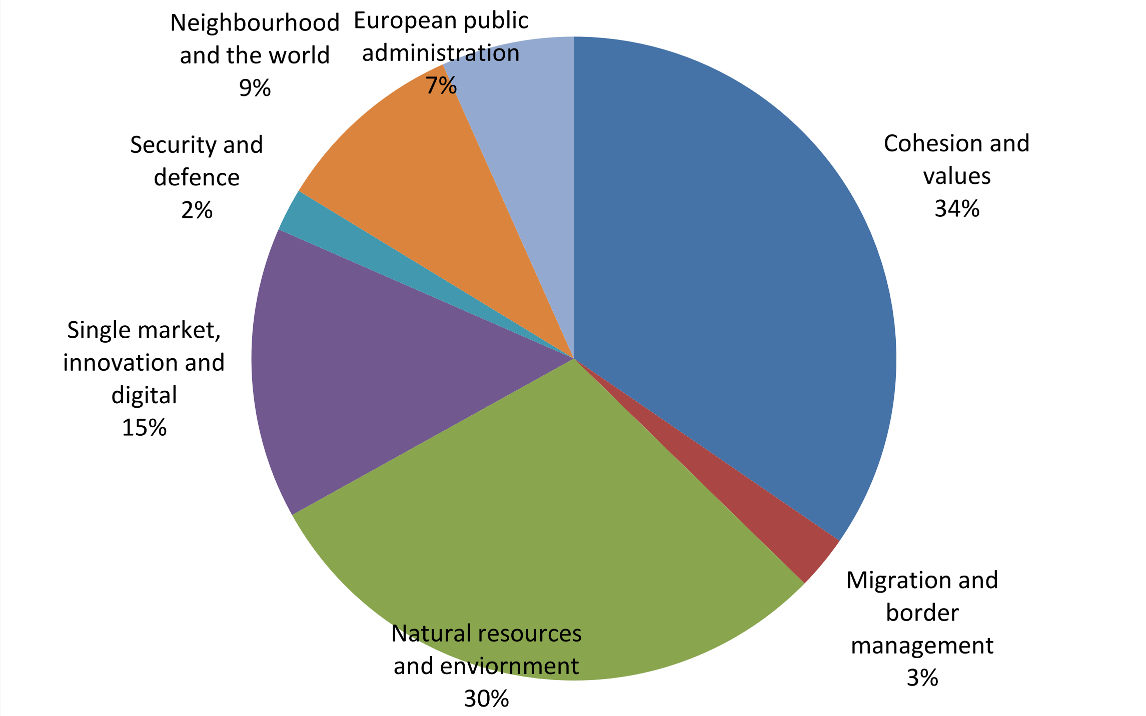
There is some sleight of hand in the proposals around whether or not the Commission proposals maintain the level of the budget. As a proportion of GNI, the headline figure is higher than at the equivalent stage prior of preparations of the 2014-20 MFF. However, including the European Development Fund within the MFF inflates the figure by some €30 billion over seven years, because it was previously outside the MFF.

Because of the way expenditure plans (known as 'commitments') typically exceed actual payments made when the budget is implemented, the headline total presented in the MFF also tends to overstate the true level of the budget. Figure 4 shows how these two series differed in the plans[2] for the 2007-13, 2014-20 and the forthcoming MFFs. The bars in the figure show the outturn for the period up to 2017 for which firm data are available.

The Commission proposals for the 2007-13 MFF were for a significantly higher budget than was eventually accepted, whereas in advance of 2014-20 and again in the proposals for 2021-27, the Commission opted for more modest headline totals. But as the bars on the chart show, outturn data show actual spending is systematically lower still. This happens, in part, because some EU budget allocations underspend.

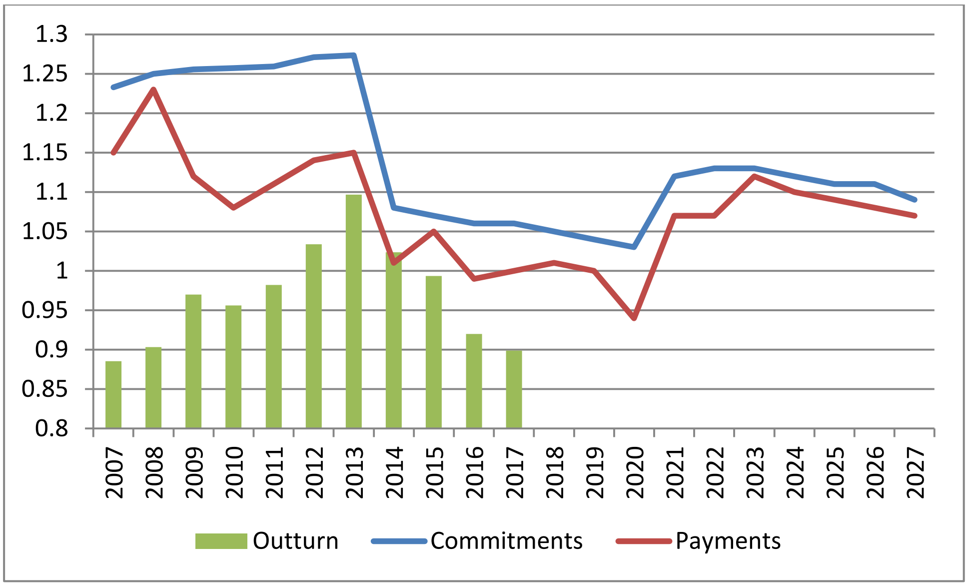
[2] These planned amounts were revised between the original Commission proposals and the eventual decisions; for consistency with the current Commission proposals, the equivalent figure from what was originally planned are shown, not the outcomes.

Figure 3 Share of seven main heading of expenditure in proposed 2021-27 MFF



Source: European Commission (2018)

Figure 4 Total EU spending as a proportion of Gross National Income, %



Timing

The Commission and the European Parliament would like to reach an early settlement for practical, institutional and political reasons. Whether a deal can be achieved before the EP election is in doubt.

Günther Oettinger, the EU Budget Commissioner, speaking at the end of August[3] put the chances at 50:50. Although the start of the next MFF is more than two years away, an important practical concern is that regulations covering major EU programmes can only be definitively settled once the size of their budgetary envelopes are known. Substantial preparatory work for the next round of Cohesion Policy and the Horizon Europe research programme has been undertaken, but past experience has shown how late changes or switches of headings can alter the parameters, affecting what is possible.

If there is delay, as happened with the current MFF, which was only formally approved early in 2013, its knock-on effect on finalising regulations means prospective beneficiaries from EU programmes cannot, in turn, submit their proposals for funding soon enough for projects to start in a timely manner. The upshot was that the launch of many major projects in support of the economic development of poorer regions – for example in Poland and Romania – only began two or three years into the 2014-20 MFF. A further consequence is spending commitments lasting well beyond the end of the MFF, a concern already prominent in 2013.

A major institutional consideration is that the term of the current European Parliament (EP) will effectively end in the spring of 2019 – around the time the withdrawal of the UK is due to happen. With elections to be held late in May 2019, there is a gap from mid-April until early July during which there will be no plenary sessions of the EP, nor are any scheduled during August 2019. Since the EP is (with the Council of Ministers) one of the two arms of budgetary authority in the EU, it has to approve the MFF. If it is unable to do so by April 2019 at the latest, there could be several months of hiatus, unless there is resort to the highly unusual option of an extraordinary plenary session.

Politically, there are two concerns. On the one hand, the EU has to be seen to respond to the many demands for it to address the key challenges facing the Union. Apart from the forthcoming European Parliament elections – likely to see the arrival of more euro-sceptical and populist members – and the aftermath of Brexit, the EU has to impart a sense of direction to its citizens. The leaders' meeting to be held in Sibiu on the 9th of May is, therefore seen as an important date in the political timeline for the next MFF. While the budget, in purely quantitative terms, lacks the scope to be a major 'game-changer' the political signal that would be sent by delay and an outbreak of acrimony would be damaging.

On the other hand, a new Commission will be appointed in the autumn of 2019 and, by late summer, the identity of the next Commission President will be known. Whoever it is may want to promote different priorities, including for EU spending. Similarly, a new EP with a different political complexion (and, perhaps, also keen to flex its muscles) might want to re-open the budget debate. From a legitimation perspective, there is a dilemma: early settlement of the MFF will bind reconstituted institutions with potentially different ambitions into their predecessors' decisions.

EU revenues after Brexit

The future budget will be affected in diverse ways by Brexit, not least because of the loss of the UK's payments. In recent years, the UK net contribution (the difference between the amount of money the UK pays into the EU budget and spending from EU programmes in the UK) has been some €10-12

[3] https://www.politico.eu/article/gunther-oettinger-50-50-chance-of-a-budget-deal-before-2019-election/

billion per annum. Because of the way the EU raises its revenue, through a formula that adjusts national contributions to meet agreed spending, Brexit will not mean a financing problem in the narrow sense of an inability to raise revenue. But what it necessarily implies is a redistribution of the burden among the EU27.

Although France and Germany have signalled a willingness to pay more to offset the UK net contribution, other net contributors have been more reluctant. One group of opponents of a larger EU budget – dubbed the 'frugal four', comprising Austria, Denmark, the Netherlands and Sweden – have already been vocal, with Denmark's finance minister, Kristian Jensen, prone to say 'not a Krone more'. The combination of the expected Brexit 'divorce' payment by the UK – worth at least two year of the UK net contribution beyond 2020 – and the possibility that the UK may continue to contribute indefinitely if it remains in certain EU spending programmes would ease these tensions.

As for how to fund the EU, proposals for changes to the 'own resources' assigned to the EU have been a perennial item on the agenda for every MFF round, yet have just as regularly made no progress. This is despite the clear commitment that revenue from any such new instrument would reduce the current national contributions, rather than be a net increase in taxation. The simple reason is that any plausible instrument – and there are many reasonable contenders – is inevitably going to be more attractive to some countries or interest groups than to others. For example, a country with low dependence on fossil fuels, like France, which has a substantial nuclear electricity generation capacity, or Austria with its hydro-electric and wind power, will be much more amenable to a carbon tax as an instrument to fund the EU budget than others (Poland is a prime example) where coal is still prominent.

'Corrections': an EU oddity

One of the odder features of the EU's budgetary regime is the various rebates accorded to selected Member States, known as 'corrections'. These started with Margaret Thatcher swinging her handbag to great effect in support of her demand 'I want my money back', culminating in the 1984 agreement at the Fontainebleau European Council to grant the UK a rebate of two-thirds of its *ex-ante* net contribution to the EU budget. This meant all other Member States had to pay proportionally more, although Germany – the only other net contributor at the time – was accorded a rebate on its share of the UK rebate. Subsequently, as net positions evolved, Austria, Germany, the Netherlands and Sweden negotiated a variety of other corrections, with Denmark also joining the rebate club during the last MFF.

The departure of the UK is therefore seen as an opportunity for reform leading to the end of corrections, with many Member States keen for this to be implemented at the start of the next MFF. However, there is little chance of those currently benefitting from corrections agreeing, for the simple reason that they would then face a higher contribution burden. The Commission answer is to maintain corrections for five years, but with their value progressively falling: it is an astute idea, although because of unanimity in decision-making for the MFF, it will struggle to be accepted.

By any objective standard, corrections are a bizarre way of organising the EU's public finances, not least because they distort incentives by pushing Member States to focus more on net positions (sometimes referred to by the French expression *juste retour*), rather than genuine EU added value, and are so opaque that they undermine transparency. Nevertheless, they became politically necessary because the mix of EU spending – above all the distribution of direct payment to farmers – led to systematic gains and losses.

Indeed, the original UK rebate, known in France as *le cheque britannique*, was arguably a Faustian pact between the UK and France, enabling French farmers to continue to receive substantial subsidies, while the UK secured its money back. Despite the accession of countries with much larger agricultural sectors (as a proportion of GDP), France continues to receive the largest share of these direct payments – see figure 5. In 2017, direct payments to French farmers were €7.34 billion, well above the two next largest recipients, Spain (€5.09 billion) and Germany (€5.05 billion), and more than double what UK farmers received (€3.08 billion). The total for all eleven Member States from central and eastern Europe was €9.84 billion, just €2.5 more than France on its own. In the period 2014 to 2017, the UK 'correction' averaged €5.74 billion and the difference between French and UK direct payments to farmers was €4.54 billion.

What to expect

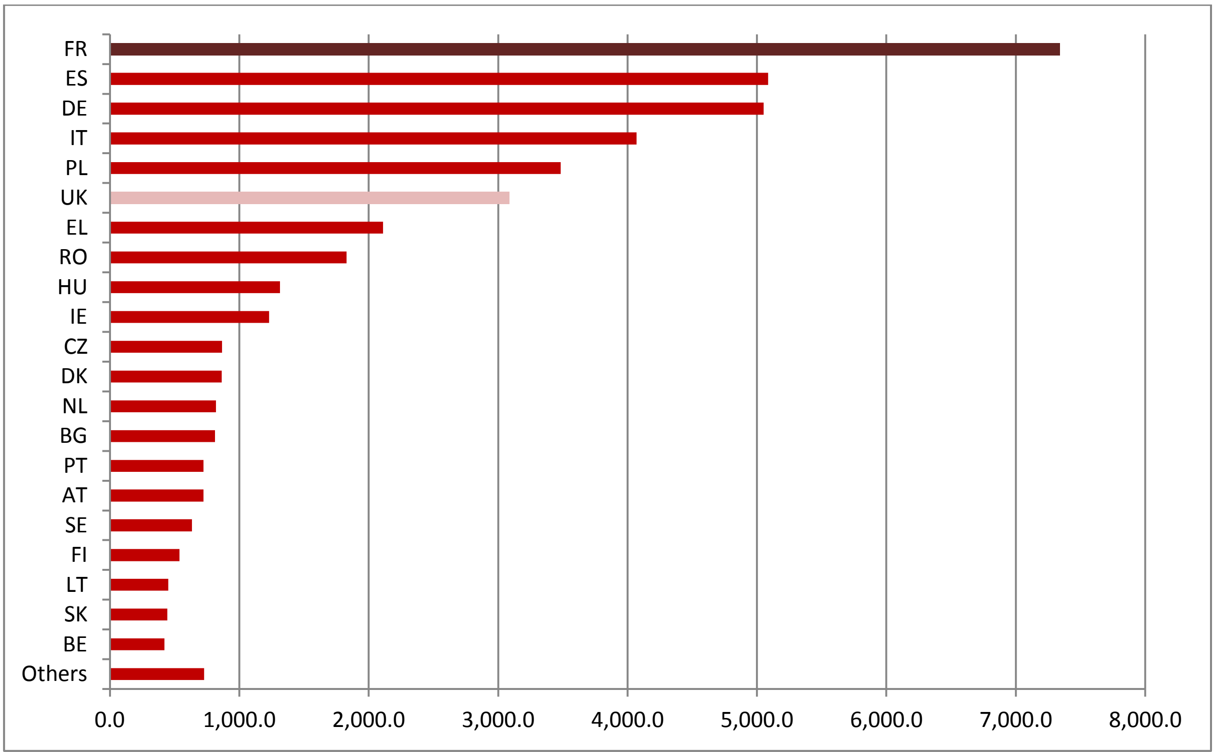
The doubts over what proposed innovations, such as the ESF plus budget, can plausibly achieve illustrate a more general characteristic of the EU scope, as a budgetary actor, to make a difference. What has been referred to in relation to EU foreign policy as the 'capability-expectations gap' is arguably an apt description. With no realistic prospect of expanding beyond 1.1% of EU GNI, the EU budget is mainly targeted at selective interventions on the supply-side of the economy, but can have only a minimal role in macroeconomic stabilisation or inter-personal redistribution.

Predictably, the positions of Member States remain quite divided on the more contentious issues. A stock-taking by the Austrian Presidency[4], prepared for the September 18th General Affairs Council, highlights a number of dividing lines. These divisions again reflect the three points of the trilemma set out above, with the Presidency noting concern to preserve the traditional Treaty-based policies (Cohesion and Agriculture) because of their crucial role in promoting EU objectives.

On certain other issues, there is more of a consensus among the Member States. There is no obvious appetite, for example, for moving away from the seven year MFF cycle, despite the fact that this is at odds with the five year political cycles of both the Commission and the European Parliament. In part, this reflects the inter-institutional balance of power in which the Member States (the Council of the EU) want to retain the dominant say in setting the EU budget. A strong argument for retaining the seven year term is to ensure predictability, although it should also be recalled that multi-annual frameworks were originally introduced to end what had become – in the mid-1980s – an annual battle over the budget between the EU institutions.

[4] http://data.consilium.europa.eu/doc/document/ST-11871-2018-INIT/en/pdf

Figure 4 Direct payment for farmers in 2017 by member state of the EU (€ millions)



Source European Commission

Some friction has surfaced, as was to be expected, around the Commission proposal to include Eurozone stabilisation instruments in the EU27 MFF. While the Commission has been artful in also proposing a new budget line to assist non-Eurozone members to converge towards membership of the euro, the underlying question of why all should contribute towards spending for a sub-set of members was always going to be tricky.

EU spending on research, while generally endorsed by the Member States and seen as able to generate added value, nevertheless attracts criticism about the modalities of distributing the budget. In successive rounds of EU research programmes, the guiding principle for allocating money has (rightly) been excellence: proposals for EU funded projects are assessed by standard peer review procedures and grants awarded only to the best. However, with many of the most successful research universities located in richer Member States, the outcome tends to be a net fiscal transfer from poorer to richer Member States, with North West Europe doing well at the expense of the southern, central and eastern countries.

This prompts calls for a more balanced geographical distribution of funding, but leads to the dilemma that greater spatial equality risks eroding research quality. A partial solution is for other EU budgets, notably cohesion policy, to support the building of research capacity, but this does not necessarily overcome the disparities in capability.

Unsurprisingly, there seems to be only lukewarm support for new revenue instruments to fund the EU budget, despite the best efforts of the High-Level Group on Own Resources chaired by Mario

Monti[5] to identify new options. However, many Member States would be keen to see corrections abolished more expeditiously than the Commission proposes.

One element of the Commission package likely to receive a more positive reaction is the proposal to build on the perceived success of what became known as the 'Juncker Plan' – the initiative to stimulate private investment using guarantees. It reflects something of a trend in recent years to shift from grants to loans (and other so-called 'financial instruments') in EU public finances. The logic is that such instruments enable a smaller amount of tax-payer money to achieve a greater impact. It was also supported by the Monti group, although estimates of the likely macroeconomic effect have to be treated with some caution. The evolution of the European Fund for Strategic Investment (to give it its formal title) into a new 'InvestEU' fund is likely to be widely supported, although some reservations have been expressed about the risks that it would accrue disproportionately to richer and financially more sophisticated Member States.

Conclusions

Fifteen years ago, the EU budget was castigated – in the 'Sapir' report[6] – as a 'historical relic' for having spending and procedures 'inconsistent with the present and future state of EU integration'. It has evolved, but to a much lesser extent than would be needed to counter this criticism, and now seems set to retain many of these features for much of the 2020s. In what is now on the table, there are fewer radical developments than had been hinted at in the more ambitious of the five scenarios set out in the *White Paper on the Future of Europe*, published in 2017[7], or in what Commission President Juncker described as his 'scenario 6' in his 2017 *State of the Union* address.

This outcome is easily explicable, because the MFF is inherently difficult to shift, whether in size priorities or procedures and has so many veto-players. Although a minority of Member States have argued that the loss of the UK net contribution must mean a smaller budget, the reported willingness of the Germans and the French to pay more suggests that the next MFF will have aggregate resources similar to the current period. It can also safely be concluded that spending on agriculture and cohesion policy will still account for comfortably the largest share of spending.

In reconciling demands for EU spending on new priorities with the insistence that traditional spending must not be cut, the probable compromises will please neither side. New budget lines for managing migration and enhanced border security have found favour, but judging by reports of the divergent positions of Member States, the most likely outcome will be closer to status quo in the MFF than more radical change.

There is an urgency to settling the MFF if major spending programmes are to start promptly. Those who hope to see new resources being created or rebates disappearing are likely to be disappointed, and it may therefore be sensible not to lose time negotiating them. In the same vein, it ought to be possible to reach early agreement on the headline total for the budget, before embarking on the horse-trading needed to mollify all sides.

[5] http://ec.europa.eu/budget/mff/hlgor/library/reports-communication/hlgor-report_20170104.pdf
[6] https://global.oup.com/academic/product/an-agenda-for-a-growing-europe-9780199271498?cc=gb&lang=en&
[7] https://ec.europa.eu/commission/sites/beta-political/files/white_paper_on_the_future_of_europe_en.pdf

After all, the amounts at stake are fractions of a percentage point of GNI. Yet, as Voltaire put it ‘In general, the art of government consists of taking as much money as possible from one class of citizens to give to another’.