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Plus ça change... the Commission's budget proposals for 2021-27

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Key insights

- The EU budget is always an uncomfortable compromise between pressures to spend more and to support new priorities, to maintain support for particular budget lines (such as Cohesion Policy), and to respect overall fiscal discipline.
 - The Commission's proposals are not especially ambitious or radical, but go some way to meet the conflicting demands.
 - However, the new budgets for managing migration and for completing the Economic and monetary union are moderate in scale.
 - Although the overall Cohesion Policy will be cut and this is expected to include initiatives traditionally covered by the European Social Fund, the total available for social objectives, including support for youths, will not change much.
- A likely outcome is that there will be some reduction in the amounts proposed by the Commission.
- Despite the solid analytic cases for funding the EU budget from new revenue instruments and (taking advantage of the exit of the UK) for ending the various rebates, it is unlikely that these aims will be achieved and futile attempts to do so may hold up agreement.

Introduction

On the 2nd of May, the European Commission published its proposals for EU spending for the next seven-year Multi-annual Financial Framework (MFF)¹, firing the starting pistol on what are invariably acrimonious negotiations among the Member States. Although many in Brussels are keen to conclude a deal as quickly as possible, previous experience suggests the horse-trading is likely to continue until well into 2019, with the added spice that this timetable coincides with the Brexit negotiations. Moreover, the shadow of Brexit hangs over the MFF in another very obvious way because of the expected hole in the budget once the UK ceases 'sending money to Brussels'.

The political and policy challenges

As always, the proposals for spending over the seven years from 2021 to 2027 are a compromise between three competing sets of demands:

- Mollifying the net contributors who want to keep EU spending as low as possible;
- Avoid upsetting (too much) the powerful interests used to benefiting from EU spending, from the farm lobby to the regions receiving economic developments support;
- Responding to diverse pressures for spending on new priorities, such as dealing with asylum seekers and migrants, securing external borders and countering terrorist threats, enhancing the resilience of the Eurozone, and promoting the digital economy.

¹ European Commission (2018) A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, COM(2018) 321, Brussels, 02.05.2018 https://eur-lex.europa.eu/resource.html?uri=cellar:c2bc7dbd-4fc3-11e8-be1d-01aa75ed71a1.0023.02/DOC_1&format=PDF

Part of the challenge is that Brexit will mean the sizeable UK net contribution will have to be accommodated. In recent years, this has been of the order of €12-14 billion, while the UK gross contribution has been higher than the aggregate of all thirteen 'new' EU members acceding from 2004 onwards. Predictably, the Commission proposals elicited immediate, if contradictory, criticisms from Member States. Austria, Denmark, the Netherlands and Sweden, apparently dubbed the 'frugal four', were quick to reject the Commission proposals. Thus, Dutch Prime Minister Mark Rutte complained that 'the burden of funding the budget is not shared fairly' and Lars Lokke Rasmussen of Denmark said 'a smaller EU should mean a smaller budget'. Farmers were quick to object to the proposed reduction in real terms support for direct payments under the Common Agricultural Policy (CAP), while the ETUC deplors the cut of 10% in real terms foreseen for Cohesion Policy funding and expressed fears about potential cuts in the allocation for the European Social Fund (ESF).

However, EU Budget Commissioner Oettinger commented: 'a large majority haven't criticised it'. The Commission will have noted, too, that Germany and France are prepared to contribute more, while eight of the countries of central and eastern Europe (though not the three Baltics) had previously signalled their willingness to increase their gross contributions. Despite these positive noises, a strong bias towards maintaining the status quo is likely and the title of a comment from former Commissioner Laszlo Andor sums up the reaction of the policy community: 'A budget without lessons learned'.²

The size of the budget

There can be a surreal character to disputes around the budget which often concern small fractions of a percentage point of gross national income (GNI – a measure of aggregate well-being closely related to GDP). The Commission proposals at the same point in the budgetary cycle seven years ago were for spending totalling 1.04% of GNI for the period 2014-20. This time, the Commission has proposed 1.11%, but a direct comparison is potentially misleading for two reasons. First, because UK GNI is a little higher than the EU average and is no longer included in the denominator of the ratio, a given level of EU spending means a higher ratio. Second, certain elements of EU expenditure previously outside the MFF have been brought into it, raising the headline total. In particular, the European Development Fund (EDF, which accounts for around 0.03% of GNI) has been renamed and will be inside the MFF.

The usual pattern, seen over successive MFFs, is that the Commission proposal is whittled down in the negotiations among the Member States. For 2014-20, this reduced the total by some 0.04 of a percentage point of GNI. Cuts were also made in two of the main budget line outside the MFF: the European Union Solidarity Fund, halved from €1 billion per annum to €500 million, and the European Globalisation Adjustment Fund (EGF), cut from €500 million to €150 million per annum.

In practice all Member States have vetoes and part of the art of reaching a deal is concessions aimed at satisfying national 'red

lines' so as to forestall vetoes. Rebates of various sorts, tweaking of programmes, specific items of expenditure and – by no means insignificant – the scope for favourable headlines in the domestic media are all means to this end. These adjustments and caveats are a normal part of the process, but while allowing those involved to claim victories and, on occasion, altering the amounts accruing to certain interests, they do not make a great difference to the outcome in macroeconomic terms.

New priorities and old favourites

Expectations had been raised prior to the publication of the Commission proposals of a pronounced shift towards new priorities in the mix of EU spending. The most striking initiatives in what the Commission proposes are to provide significantly more money than in the past (albeit from a low base) for border security and 'managing migration'.

New funding lines are also proposed under a heading of 'Completing the Economic and Monetary Union' – in effect instruments aimed at providing macroeconomic stabilisation. These are a response to the extended debate stretching back to the Four Presidents' Report of 2012 on how to enhance stabilisation, and are arguably long overdue after years of vacillation. However, the moderate amounts proposed are unlikely to be transformative in the governance of the euro. Although the Commission has been canny in offering a new instrument to non-members of the Eurozone to assist them to make the economic adjustment needed to accede to euro membership, having spending lines for which only euro members are eligible is bound to attract criticism from those excluded.

Despite these novelties, direct payments to farmers and funding for regional economic development will remain easily the biggest components of the next MFF, still accounting for over 60%: the cuts proposed are less dramatic than had been foreshadowed earlier in the year by Jean-Claude Juncker and Günther Oettinger. Proposals for national co-financing of direct payments under the CAP budget have quietly been dropped, although the Commission suggests higher co-financing of the rural development pillar of the CAP.

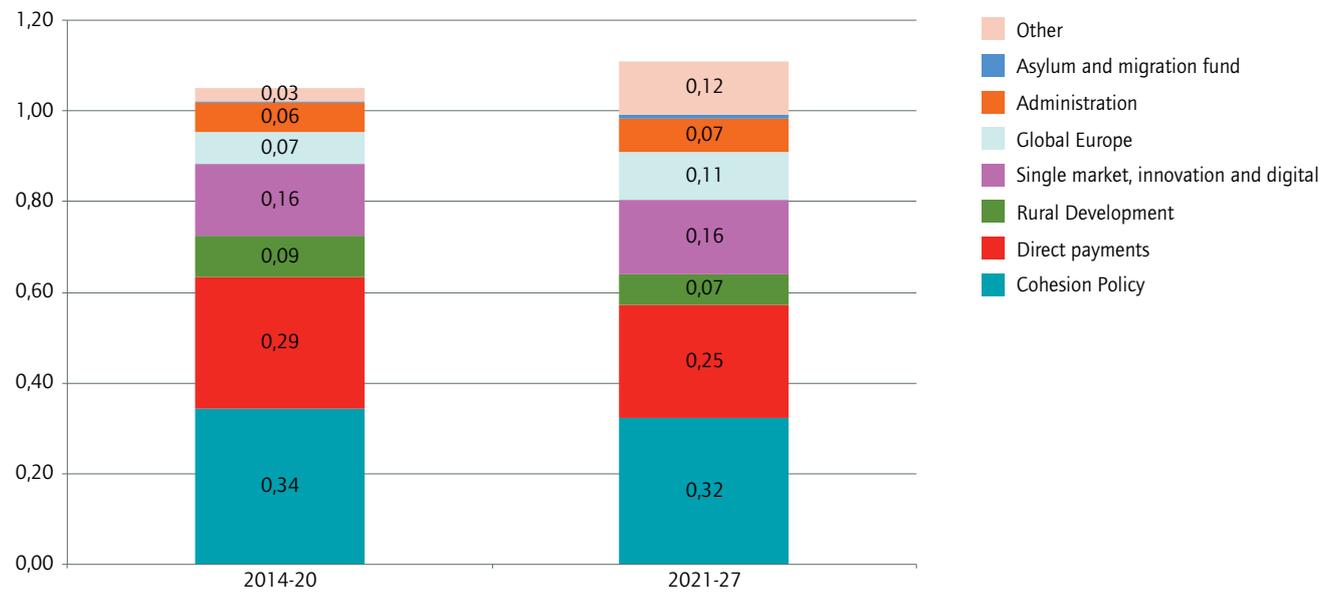
The Commission has not yet released comprehensive like-for-like comparisons of the new proposals and the current MFF, hence only a crude comparison can be presented. Figure 1 shows what the Commission proposed at the same point in the MFF cycle in 2011 (which was amended in the subsequent negotiations), alongside the new proposals.

What about Social Europe?

The Commission makes much of its commitment to following-up on the Gothenburg Social Summit, held in November 2017. It is less obvious that genuine new money will be on offer. The proposed budget for the European Social Fund (ESF) will be €100 billion, equivalent to 27% of the Cohesion budget which, because the overall share of Cohesion Policy in the proposed new MFF has been cut, will be a little bit less in real terms (after allowing for inflation) than for the previous period.

² <http://www.dahrendorf-forum.eu/a-budget-without-lessons-learned/>

Figure 1 Proposed EU spending commitments as a proportion of EU GNI, 2014-20 and 2021-27



Note: 'Global Europe' for 2021-27 includes the renamed European Development Fund, previously outside the MFF, explaining most of the increase.
 Source: European Commission

However, the intention to pool it with other funds, notably the Youth Employment Initiative, may prove to be unpopular, even though there is supposed to be earmarking of money for youth initiatives. Elsewhere, the Commission stresses its commitment to youth through the proposed doubling of funding for the Erasmus programme and a proposal to spend €700 million on Inter-rail passes for young people. The latter may struggle to escape the attention of gimlet-eyed finance ministers looking for cuts.

Despite its record of persistent under-spending, the European Globalisation Adjustment Fund (EGF) is to continue outside the MFF, with an annual budget of €200 million at 2018 prices. While the higher amount proposed for 2021-27 might seem to be in the interests of workers, examination of applications to the EGF makes dispiriting reading, especially given the new goal of managing the digital transition. According to a table published on the Commission web-site³, since 2007 the average annual level of total funds successfully requested has been just €55 million, with a peak in the crisis years of 2009 and 2010 of around €120 million. The number of persons affected by EGF applications attained 28,680 in 2010, but was just 5,060 in 2016.

Hard choices

An inevitable question is what sort of compromises might be struck and which actors will be pivotal. In the past, the main deal has eventually been achieved at the European Council and, although its members may think otherwise, the European Parliament has had only a marginal influence. After the Commission published its proposals for the current MFF in 2011, the bargaining process led to a number of changes in the spending ceilings. Direct payments

(nearly all to the agriculture sector) and administration were cut least, followed by Cohesion Policy, while the biggest cuts were to the 'security and citizenship' and 'global Europe' headings. Overall, the cut for commitments was from 1.05% to 1.00% of GNI.

This prompts the obvious question of what might be targeted in the coming negotiations and this, in turn, will reflect the power of different constituencies. The farm lobby has long been effective in this regard whereas the proponents of some of the 'new priorities' tend to be more diffuse and may struggle to maintain the levels proposed by the Commission.

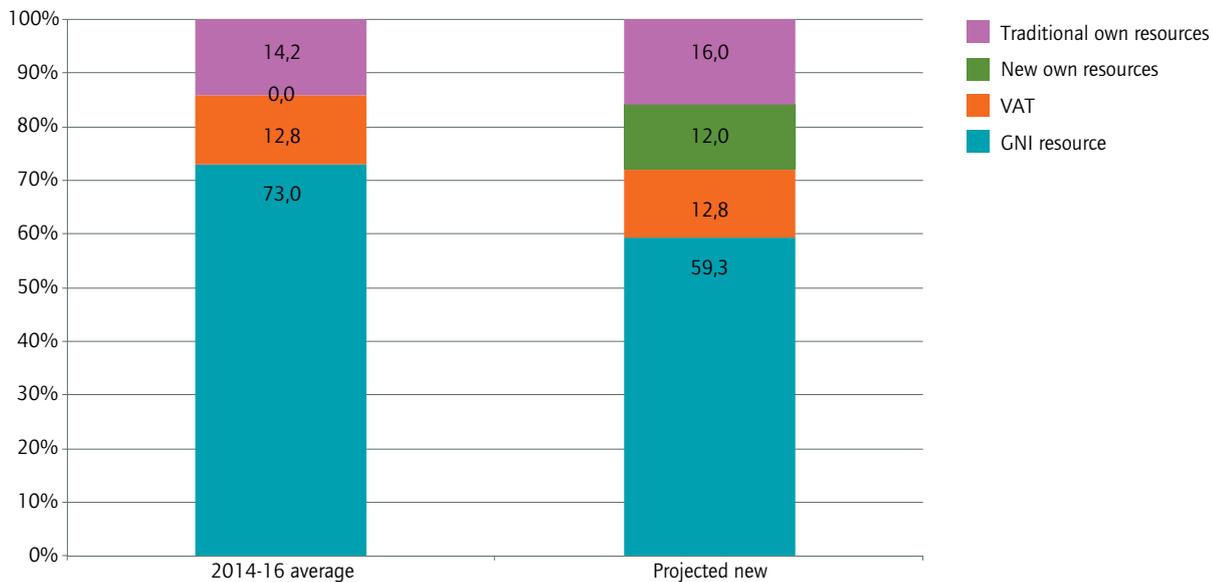
The revenue side

On the revenue side, the proposals are for three main changes. The first is to introduce new own resources equivalent to around 12% of the total revenue required, with the Commission arguing (rather oddly, given there has never previously been hypothecation of revenue to specific tasks) that new priorities should be funded by new resources. This will be achieved by assigning three distinct revenue streams to the EU: a share of corporate income tax; a fifth of the revenue generated from auctions of permits to emit carbon under the EU's Emissions trading scheme (ETS); and an unspecified tax on non-recycled plastics.

Second, the Commission advocates keeping the existing own resources, but making some changes in the detail of how they are calculated. In particular, the 'collection fee' paid to national customs administration will be halved from 20% to 10% of the revenue generated. The EU budget has to balance and this is achieved through the functioning of the GNI resource which rises or falls to match the spending in a particular year. This key role of the GNI resource was

3 <http://ec.europa.eu/social/main.jsp?catId=326&langId=en>

Figure 2 Shares by resource of EU revenue



Source: European Commission

recognised in the report of the high-level group chaired by Mario Monti and it is therefore no surprise to see it being retained in the Commission proposals. Figure 2 shows how these two proposals would change the composition of revenue, by comparing actual revenue raised over the period 2014-16 with a simulation of how the new system would look (actual data are not available because the amounts for each resource are not known in advance).

Unsurprisingly, a third plan is to eliminate the various rebates currently applied to the gross contributions of a handful of Member States (see below), albeit over a five-year period to prevent an excessive jump in what they have to contribute.

There is also a proposal to increase what is known as the own resources ceiling – the maximum that the EU can spend, enshrined in a formal legal agreement known as the own resources decision – from 1.23% of gross national income to 1.29%, although this will have little impact so long as planned spending is well below even the existing ceiling.

These proposals are likely to encounter considerable resistance for a number of reasons, echoing objections expressed in previous MFF rounds. Shifting to true own resources, rather than what have been known as national contributions, might be regarded as more in keeping with the spirit of Treaty article 311 which states ‘without prejudice to other revenue, the budget shall be financed wholly from own resources’. However, the Member States have consistently favoured national contributions and several of them are reluctant to concede a ‘power to tax’ to the EU.

Even the small proportion envisaged could be seen as the thin end of the wedge and will face the further criticism that three new resources for a relatively small aggregate yield will be unduly complicated. In addition, the incidence of new resources could be

uneven as between sectors, social groups or Member States, and the reliability of yield may be dubious. For example, corporate income tax tends to fall in periods of economic slowdown, such that the aggregate funding required has to come from other sources. Carbon taxes, of which (effectively) the ETS is one, obviously hit emitters of carbon. While this is precisely their purpose, it can mean that Member States with economic systems more dependent on carbon will pay more towards the EU budget. This might be regarded as a ‘good thing’, but could also have social impacts, for example by penalising poor households or making industrial jobs more precarious.

Ending rebates is widely agreed to be a laudable aim. The various rebates are complex, opaque and hard to explain to citizens, yet they have been an essential lubricant of previous budget settlements. Certainly, removing the UK from the equation presents an opportunity, because the UK rebate required all other Member States to increase their gross payments, although the infamous ‘rebate on the rebate’ meant that Austria, Denmark, Germany, the Netherlands and Sweden paid proportionately less than all the others, while also having additional rebates. For the Dutch in particular, lowering the collection fee for customs duty will also be seen as reducing their aggregate rebate. For all these reasons, eliminating rebates – even gradually – will be a very hard sell.

Governance changes and political economy challenges

There are proposals for altering the governance arrangements for the MFF, some of which will prove to be contentious, as the Commission surely knows from similar debates seven years ago. One is linking Cohesion Policy spending more closely to the ‘European semester’ process, including offering guidance to Member States through the

country-specific recommendations. How much attention Member States pay to these recommendations is a moot point, but many are likely to regard this additional mechanism as an unwarranted intrusion on their competence. Similarly, the attempt to link EU expenditure with adherence to the rule of law, while reflecting a moral position, is fraught with dangers. Defining the circumstances in which EU money will be withheld – in other words, financial sanctions – will be tricky enough, but implementation will be harder still.

More positively, linking Cohesion Policy to the proposed new 'Invest EU' fund – in effect the continuation of the European Fund for Strategic Investment – makes sense and will reduce the potential confusion between the instruments.

The Commission proposals, while mentioning several times the consequences of the loss of the UK net contribution, do not refer explicitly to the Brexit divorce bill and how it will be used. In round numbers, if the UK makes a payment of around €45-50 billion, as is being assumed, it would be equivalent to the current UK net contribution for the remainder of the 2014-20 MFF and for up to two years of the next MFF. This could ease the forthcoming negotiations among the EU27, although the complexities of the settlement may mean that the actual cash flow from the UK is only paid in instalments over many years.

In conclusion

The Commission, as always in presenting its plans for the next MFF, has had to walk a tightrope between satisfying demands for change and avoiding alienating current beneficiaries from EU spending. There will be a little less for direct payments to farmers and for regional development. A boost is envisaged to spending on the control of borders and on managing migration and there are some pots of money for the Eurozone, albeit not on a scale likely to be transformative in relation to macroeconomic stabilisation. But in other areas, such as the proposed European Social Fund Plus and other social policies, the changes are relatively limited and there is a dearth of genuinely eye-catching new initiatives. In short, the Commission has not been radical.

Even so, it can expect hard battles to secure agreement. Existing beneficiaries from EU programmes, such as those receiving direct payments, must be expected to resist cuts. Other likely flashpoints include:

- **The headline total:** if past experience is repeated, this will be eased downwards from what the Commission proposes. Pressures for a lower total will, unavoidably, be accentuated by the loss of the UK's net contribution, although the UK 'divorce' payment could ease the tensions, at least in the early years of the next MFF.
- **The desire to end corrections:** here, the obvious difficulty is that many of the current net contributors are likely to face even higher bills than when the UK was a member of the Union and will be looking closely at their net balances. The EU institutions can repeat endlessly (and not unreasonably) that these 'accounting balances' do not reflect what Member States gain from EU

membership and that other benefits greatly outweigh a moderate fiscal cost, but they rarely convince finance ministers.

- **Conditionality:** imposing conditions on entitlements to receive EU spending appears a beguiling way of securing compliance with EU objectives, including the 'rule of law'. But when pushed, Member States not only resent the implied intrusion in their autonomy, but also struggle to enforce the conditions. This implementation challenge is greatly under-estimated, despite the many examples of the ineffectiveness of conditionality. There are also issues of fairness to consider, particularly where the delinquent authority (for example, a government failing to abide by macroeconomic conditions or rule of law provisions) is different from the one penalised (a regional government).
- **New instruments associated with completing EMU:** while consistent with the political goals articulated by, among others, French President, Emmanuel Macron and Commission President Jean-Claude Juncker, objections from non-participants in the euro must be expected.
- **New own resources:** an attempt has been made in advance of every MFF since the first starting in 1988 to introduce additional sources of EU revenue, yet without success. What the Commission now proposes is, arguably, even less likely to succeed because it is complicated and would only make a marginal difference. It may therefore not be worth expending political capital on it.

With so many interests to balance and limited political capital, the Commission has little room for manoeuvre, and that is before the Member States start unpicking what has just been proposed. An inherent paradox is that one of the most contentious set-piece EU disputes concerns an ostensibly very large amount of money, but is of such limited economic significance. Expect the outcome to be more status quo than radical change.

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This policy brief is the first in a series which will address the different challenges linked to the Multi-annual Financial Framework (MFF).

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