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POLICY BRIEF

The EU money-go-round

Negotiating the 2021-27 multi-annual financial framework

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THE PROBLEM TO BE SOLVED

The European Union invariably has immense difficulty in agreeing the multi-annual financial framework (MFF), the long-term basis for its public expenditure. Although the headline total is a large number, at some €1,000 billion over the seven year duration of the MFF, it is small as a proportion of the EU economy, at barely one percentage point of gross domestic product.

Moreover, the negotiations typically only turn on a small fraction of this amount: for a deal to be struck, as little as a few hundred million euros have to shift from one heading of expenditure to another, or be allocated to a particularly obstinate member state at the expense of others. Nevertheless, 'money from Brussels', can be important for many recipients, more so at a time when national budgets have been under pressure.

The usual sequence is for the European Commission to publish proposals, triggering a lengthy period of sparring by the member states which then seek to reach a compromise. Formally, the European Parliament (EP) co-decides the MFF with the Council of Ministers, but once the member states reach agreement, past experience suggests the EP only makes marginal changes. It is also able to exert an influence at an earlier stage. The main result of the MFF agreement is funding ceilings on broad categories of policies, such as subsidies for farmers, economic development, external action and administration.

The Commission published its proposals for the 2021-27 MFF on the 2nd of May 2018, building on the 2017 White Paper on the Future of Europe and an accompanying 'Reflection Paper'. Although the start of the new MFF is still over a year away, there are good reasons for seeking early agreement. In particular, regulations for some of the bigger pots of money can only be finalised once the deal is done. They include research funds and money for Cohesion Policy, most of which goes to support economic development in poorer regions.

KEY INSIGHTS

NEGOTIATING THE EU'S MULTI-ANNUAL BUDGET FRAMEWORK IS NEVER EASY OR QUICK, BUT NEEDS TO BE SPEEDED-UP

TO EXPEDITE AGREEMENT IT WOULD BE BETTER TO LEAVE THE REVENUE SIDE UNCHANGED

COMMITMENTS FROM PREVIOUS MFFs – "RAL" – ARE INCREASINGLY PROBLEMATIC AND NEED A NEW APPROACH

THE TIME HAS COME TO ALIGN THE BUDGET AND POLITICAL/INSTITUTIONAL CYCLES IN THE EU

The timetable is now becoming tight and it needs to be accelerated. This policy brief examines some of the more intractable facets of the MFF negotiations inhibiting a deal, and puts forward a number of recommendations for reaching a viable, timely agreement and reforming the process.

WHAT IS AT STAKE?

Unsurprisingly, there are disparate and mutually exclusive views on how the MFF should evolve, and on which spending priorities to favour. High profile speeches by, among others, Emmanuel Macron (notably in his 2017 'Sorbonne' speech) and Jean-Claude Juncker sought to shift the debate to enable the EU budget to play a different role in EU economic governance.

These were countered by stern calls for restraint from the finance ministers of a group dubbed the 'frugal four' (Austria, Denmark, the Netherlands and Sweden).

The consequences of Brexit add to the complexity, not least because the loss of the sizeable UK net contribution leaves a potentially large hole in the EU's finances. The resulting challenge is how to reconcile reasonable demands for the EU to do more to fund emerging policy priorities, while avoiding push-back by current recipients or antagonising net contributors reluctant to pay more: a classic 'trilemma'.

The Commission's initial proposals were an attempt to square the circle by boosting funding for a number of policies regarded as responses to what citizens want the EU to do. Examples include proposals to double the amount available for the ERASMUS programme, which provides mobility grants for young people. It was part of a wider emphasis on supporting youth which encompasses a proposal to subsidise inter-rail passes. There would also be a significant boost for managing migration, albeit from a low base, and funds for control of the EU external border.

The Commission was reluctant to disclose publicly the extent to which the amounts allocated for the principal headings of spending would change under its proposals, and direct comparison with the 2014-20 MFF was complicated by some changes of definition. However, a European Parliament study let the cat out of the bag by releasing data the Commission hoped would not be circulated, although even these figures have to be treated with some caution. Despite some of the claims, the overall structure of the EU budget will still be dominated by subsidies for agriculture and support for regions.

SLOW PROGRESS

The Commission proposal called for 'an agreement before the European Parliament elections and the Leaders' Summit in Sibiu on 9 May 2019', a schedule long since abandoned. At the end of August 2018, Günther Oettinger, the EU Budget Commissioner, already put the chances at 50:50, but it became clear later in the second semester of 2018 that much more time would be needed.

Finland took over the rotating Council presidency in July 2019 and set finalising the next MFF as one of its key priorities. Now, according to the 'timeline' posted by the Council, 'EU leaders will hold an **exchange of views in October**, aiming for **an agreement before the end of the year**' [emphasis in original]**.** If past experience is a guide, it could easily slip into 2020, providing a tough challenge for Croatia when it takes over the presidency (for the first time) in January. As reported by the 2019 Romanian Presidency, a number of chapters had been agreed by mid-June. However, with a new European Parliament now starting, and manoeuvring for the key posts in the European Commission in full swing, there is likely to be a pause.

The procrastination does at least have one advantage: obviating a legitimacy worry. Had the outgoing Parliament and Commission concluded the deal, it would have meant their successors would have no say on the MFF they inherited, nor any opportunity to shape a future one during their five year mandates, given the seven-year span of the MFF. But this could come at a cost, if the new incumbents take time to master the dossiers, put forward different demands and struggle to resolve political differences.

In its work programme, the Finnish presidency presented a series of aspirations for what should feature in the agreement, but this adds little to what has been discussed since May 2018, although 'enhanced conditionalities' and 'profitable agriculture' are stressed. As a first stage, the Presidency prepared a questionnaire for member states to respond to over the summer and plans bilateral meetings aimed at establishing areas where there is scope for compromise. This is all very well, but largely replicates what the Austrian Presidency did a year earlier.

FUNDING EU SPENDING

The EU budget today is funded by what are known as 'own resources', revenue streams formally assigned to the supranational level. They comprise 'traditional' resources – all but a tiny fraction of which are customs duties – reflecting decisions made even before the UK joined the EEC in 1973, and national contributions. The latter are made-up of a share of the proceeds of national VAT, adjusted to harmonise coverage, and a much larger amount linked to the gross national income of each member state. The national contributions accounted for an average of 85.4 per cent of total EU revenue for the five years 2014-18.

Long-time observers of the EU budget have become accustomed to two hardy perennials regarding the revenue side of the budget: proposals for new means of raising revenue for the EU and calls to end the various rebates ('corrections' in EU-speak) through which the net contributions of a handful of member states are abated. Neither has found much support and, despite some changes over successive rounds, the revenue mix is broadly unchanged, and the system of corrections has become more complex and opaque.

The options for own resources to fund the EU budget are numerous and have been extensively studied, including by a High-Level Group chaired by former Italian Prime Minister and European Commissioner, Mario Monti. Oft-proposed instruments for new EU resources range from variations on carbon taxes, through other forms of environmental taxes, to profits taxes or levies on financial transactions.

Although many potentially viable instruments can be identified, any new EU tax will have pros and cons, and the distribution of the tax among member states will not necessarily be equitable. Thus, a carbon tax would penalise countries relying on fossil fuels to generate electricity, while favouring those relying on the natural endowment of water (Austria, with its sizeable share of hydroelectric) or on nuclear (France).

To simplify somewhat, there are three sets of options.

- First, instruments reflecting relative national prosperity, with the current VAT and GNI resources both essentially falling into this category, because a small, poor country will pay little, while a large, prosperous one pays a lot. Others which might fall into the same category include personal or corporate income taxes, though as with the current VAT instrument, only a portion of the yield from the tax would be needed for the EU and they would require some adjustment to correct for coverage or country-specific rules on exemptions. A proposal to assign central bank monetary income to the EU sounds appealing, but in practice proxies national prosperity.
- Then there are levies associated with EU policies, such as the customs duties currently assigned to the EU level. In this category, receipts from the EU's emissions trading scheme (suggested by the Commission in its 2018 document) could be defended as an EU resource and it would not be hard to identify others.
- Third, there are what are known as Pigouvian taxes, deliberately imposed to alter behaviour. A new plastics tax, also proposed by the Commission, is an exemplar.

Turning to corrections, they arose from Margaret Thatcher's relentless demands in the early 1980s for 'my money back', leading to the concession of the British rebate at the 1984 Fontainebleau European Council. At the time, Germany was the only other net contributor to the EU budget and, while not explicitly given a rebate, obtained the concession of being asked to pay proportionally less towards the UK rebate, the burden of which then fell on the other member states.

In subsequent rounds, an assortment of mechanisms was devised to abate the net contributions of Austria, Germany, the Netherlands and Sweden, followed in the 2014-20 round, by those of Denmark.

All sorts of formulae have been put forward over the years to massage net contributions, but however clever they look, they unavoidably boil down to a simple political question: how do you rob Peter to pay Paul? The Commission's solution is to do so by stages, gradually phasing out corrections over five years. Even though the UK's departure removes one ardent supporter of rebates, it is hard to see the more robust net contributors, such as the Dutch, accepting an end to corrections.

THE PROBLEM WITH REBATES IN THE EU BUDGET SYSTEM IS THEY MEAN ROBBING PETER TO PAY PAUL

ANOTHER TRICKY QUESTION: THE 'RAL'

Another feature of EU finances that has led to disputes is the overhang of spending commitments, not just from one year to the next during a MFF, but from one MFF to its successor. In the EU system, commitments made in advance are expected to become actual spending. Amounts committed but not yet paid are known by the French expression *reste à liquider* (RAL). What is known as 'decommitment' can occur, but only a small proportion of spending commitments is cancelled – estimated at around 2% by the European Court of Auditors (ECA) between 2007 and 2017.

RAL has been increasing to the point where it now approximates two full years of EU spending. A recent ECA *Rapid Case Review* highlighted the problem, noting 'the cumulative size of these commitments and their constant rise in value'. The biggest share of the increase in RAL stems from Cohesion Policy spending, and arises for two main reasons: first, delays in starting operational programmes, partly because the agreement of the MFF itself was late; and second, the extension of the time allowed to complete projects, from two to three years.

RAL results principally in technical, rather than political or policy problems, because it affects the timing of paying for spending decisions, not the decisions as such. Part of the explanation is the requirement to cover the costs of spending decisions as and when they arise. With multi-annual spending programmes, commitments can be far in the future, for example a big infrastructure project or a five-year research grant awarded late in an MFF. The result can be demands for payments at times determined by the progress of projects, not budgetary plans. Yet the annual budget has to balance and respect ceilings for headings of spending under the MFF, both of which could be compromised by an unforeseen need for payments.

Even so, RAL can become political, not least when the membership of the EU changes, or when the scale of legacy commitments crowds out other spending. Newly acceded countries become liable for commitments hanging over from previous MFFs and, as the saga around the Brexit 'divorce bill' demonstrated, leads to liabilities beyond membership for a country exiting. But even if there were no membership complications, the ECA argues that a focus on completing spending from a previous MFF distracts the attention of policymakers in the early years of a later one. It may also increase the scale of RAL in what becomes a circular process.

CONCLUSIONS AND RECOMMENDATIONS

There is an urgency to settling the MFF if major spending programmes are to start promptly. Yet even more than most EU policy decisions, as the June 2019 [Romanian Presidency overview]() reasserts, an agreement on the MFF is 'guided by the principle that nothing is agreed until everything is agreed'.

MFF NEGOTIATIONS EXEMPLIFY THE APHORISM "NOTHING IS AGREED UNTIL EVERYTHING IS AGREED"

Nevertheless, there has clearly been progress since the beginning of 2019 in gravitating towards an agreement. However, predictably,few of the more contentious problems have been resolved. This is typical of EU brinkmanship and is unsurprising, but it does mean a significant acceleration is now needed.

Net contributions and receipts are trickier, because they derive predominantly from the decisions on spending, whereas the *ex-ante* amounts countries are obliged to pay are reasonably close to one percentage point of GDP. Corrections are, by any rational standard, a bizarre way of dealing with imbalances and have had a pernicious effect on discourse about EU budgetary priorities, because member states look at policies as much through the lens of their net positions as their value for the EU. Yet, the genie of corrections is out the bottle and will not easily be pushed back, and national parliaments and public opinion constrain governments disposed to be flexible.

All sides know the most difficult decisions concern the headline total for the budget, the amounts to be allocated to different headings of expenditure and the net positions of member states. The following recommendations are therefore put forward.

First, the headline total ought to be easy and it can seem bizarre to devote so much effort to agonising over the second decimal place of a percentage point of GDP. In addition, the outturn is often quite different compared with the MFF headings agreed several years earlier. The EU should settle on a headline figure no later than the October European Council, leaving the detail for later if need be.

Second, with limited negotiating time – and, often more tellingly, capacity for compromise –the current mix of own resources should be continued, except for the obvious simplification of abolishing the current VAT resource and weaving it into the GNI contribution.

Third, in the longer term, the EU should seek a degree of politicisation of the EU's finances by aligning the budgetary and political cycles, working towards a five-year MFF.

- The optimal timing in relation to the electoral cycle for the European Parliament would be for the new MFF to start thirty months after the EP elections, providing the opportunity for parties to put forward budgetary proposals as part of their election manifestoes and for the incoming Commission to build on proposals initiated by its predecessor.
- With EP elections due in 2024 and 2029, engineering a start to a follow-on MFF would mean a shorter MFF, ending in 2026 instead of 2027 for the next period, with five-year cycles thereafter.
- Rather than another sterile discussion prompted by Commission proposals for this or that new 'own resource', political parties contesting the European elections should explicitly propose revenue packages, thereby rendering them more accountable for the balance of spending and revenue decisions. Doing so would imply a limited Treaty change, but should not be precluded for this reason alone.

A fourth recommendation is to enhance the legitimation of EU spending from the perspective of citizens. While perhaps obvious, it implies better communication of the nature, value and effects of the public goods supported by EU funding. Money for Brussels is a hard sell, but transparency can help to convince citizens it is worthwhile.

FURTHER READING

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