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395 Report by Kristina van Deuverden

EU Commission proposal for 2021–2027 budget: lost opportunities

- Budget draft does not meet upcoming challenges
- Proposal relies mainly on increases in member contributions and avoids saving
- Limited leeway for future-oriented areas and reforms

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AT A GLANCE

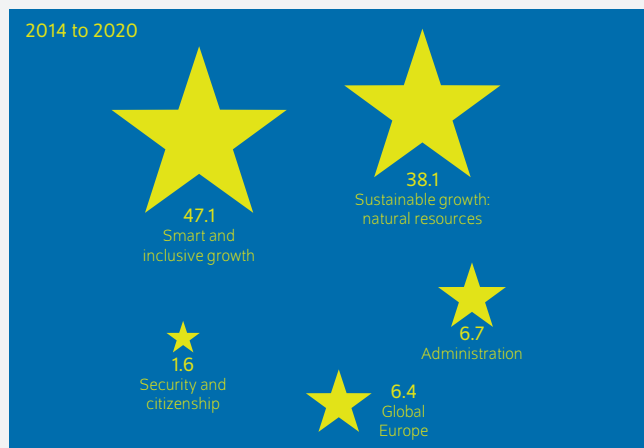
EU Commission proposal for 2021–2027 budget: lost opportunities

By Kristina van Deuverden

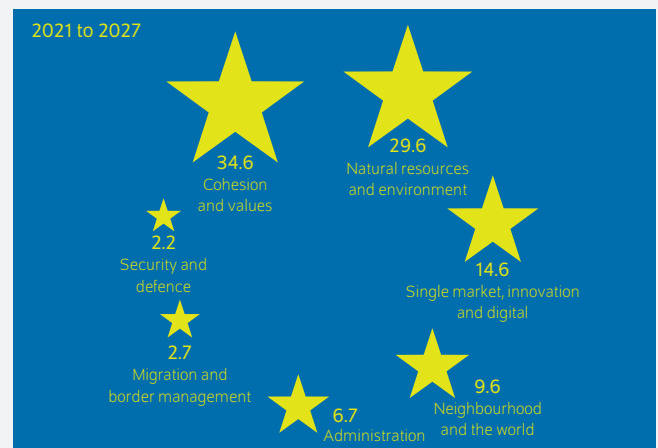
- The EU Commission's proposal for the multiannual financial framework does not meet upcoming challenges like Brexit or investment needs
- For the years 2021–2027 financial resources are budgeted without any underlying political agenda
- The proposal relies on significant increases in member contributions, avoids saving in traditional areas, and upholds the status quo
- It permits only limited leeway for funding growth in future-oriented areas and little money will remain for necessary, pending reforms

Large fraction of EU-expenditure is still going to agriculture

Share of total in percent



Sources: European Commission; author's own calculations.



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FROM THE AUTHOR

“The proposal for the multiannual financial framework is more reactionary than future-oriented. It upholds the status quo and gives little margin to new investments.”

— Kristina van Deuverden, study author —

EU Commission proposal for 2021–2027 budget: lost opportunities

By Kristina van Deuverden

ABSTRACT

In May, the EU Commission presented its proposal for the EU budget for 2021 to 2027—a period of change for the EU. Not only will Great Britain's exit from the Union leave a significant hole in the budget, but at the same time the budget must cover a vast range of additional requirements. Current international policy developments are already demanding the EU acting as a community, and the European project will continue to require a high level of investment. For managing this balancing act expenditure cuts in traditional areas are indispensable. But the Commission's lopsided proposal relies on higher revenue. Currently, the Commission is planning fund allocations in the absence of a policy strategy for the years after 2020.

The current multiannual financial framework (MFF) for the European Union will expire at the end of 2020. In the first round of negotiations, the EU Commission presented its proposal for the next budgetary period—for which again seven years are scheduled. The proposal is entitled “A modern budget for a Union that protects, empowers, and defends.”¹

This time around, drawing up the MFF is a special challenge. First, developments in recent years have shown that for more and more tasks it would make sense if the solutions were implemented on the European level: take refugee and migration policy or security issues, for example. This will inevitably mean increasing spending levels. Second, Brexit will leave a significant hole in the EU's income. Finance requirements are high.

But raising contributions will probably encounter stiff political opposition, particularly since the pressure to consolidate is still quite high in many member states. It is just as difficult to save on the expenditure side. Since the 1980s, three-quarters of the EU budget has been tied to the traditional areas of agriculture and cohesion policy, and inertia in those areas is high.

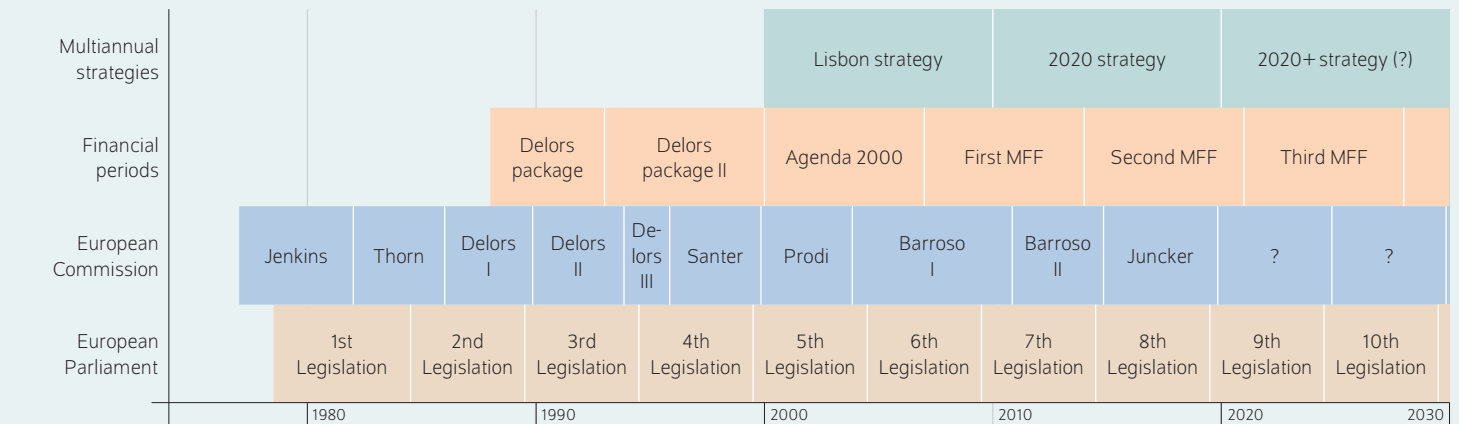
The decision on the MFF will not be made in a vacuum: it is foreseeable that some of the EU member states will be assigned further tasks in the near future. Basic reforms are pending for the euro area countries. The financial architecture in particular must be adjusted to meet the requirements of a currency union.² Reforms like these require investment. But the euro states' willingness to provide funds to implement them will probably also depend on the final terms of the MFF. Even if the EU budget's volume is comparatively low, the MFF will establish general conditions that will influence the EU's policy leeway for the next ten years.

¹ European Commission, A Modern Budget for a Union that Protects, Empowers and Defends (2018) (available online, accessed August 28, 2018; this applies to all other online sources in this report unless stated otherwise).

² See Jean-Claude Juncker et al., Completing Europe's Economic and Monetary Union (2016) (available online).

Figure 1

Timeline European Union



Source: Author's own depiction based on European Court of Advisors, extended

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Yet no strategy had been decided on for the years 2020 plus.

Given this situation, the EU Commission's proposal will subsequently be subjected to close examination. The focus will be on planned expenditure.³

The European Union's multiannual financial framework

Special features of the EU budget

The EU budget process is aligned to the institutional realities of a confederation of states and differs significantly from the process on the national level.⁴ For example, the European Commission's proposal for the first round of negotiations on the budget plan must be unanimously approved by the Economic and Financial Affairs Council (ECOFIN) and by a majority of the members of the European Parliament. If there is disagreement between the Commission and ECOFIN or the European Parliament, protracted negotiations could be the result. In this case, a budget plan might not be agreed until the fiscal year is underway and policy would no longer be constant and predictable.⁵ Conflicts like these used to repeatedly call into question EU policy's capacity for action—particularly in the 1980s. For this reason, since 1988 multi-annual agreements have been adopted.⁶

To make it easier to achieve compromise in the political process, the MFF contains expenditure ceilings (in relation to gross national income (GNI)) in the form of a maximum annual appropriation for commitments and for payments of funds to be provided) and for income (own revenue). The latter primarily consists of contributions, and since the EU budget is subject to a strict prohibition on debt, it must be sufficient to cover expenditure.

In principle, public budgets can be interpreted as a government agenda cast in numbers. After all, they represent policy plans for which funds must be made available. This makes it essential to have a policy agenda before a budget can be created and agreed. However, on the European level this is not always the case and when it is, it applies only partially. Currently, there is no political strategy for the years after 2020 (see Figure 1), but the financial framework for 2021 to 2027 is already on the negotiating table. The present financial negotiations will have a decisive influence on EU expenditure for approximately the next ten years.⁷ Although each year's MFF is adjusted in timely manner, the adjustment is primarily a technical one. The course that EU finances will take is set only once in seven years.⁸

Due to the length of the financial period, budgetary management flexibility is significantly constraint. Since the beginning of the current financial period, a countermeasure has been in effect: to a limited extent, funds that are not used can be transferred to other budget years. And creating funds external to the EU budgets ("special instruments") has been

³ The implicit assumption is that the ECOFIN council will agree to the Commission's proposal and raise the ceiling for EU's own resources.

⁴ See for example, Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, Ein Haushalt für Europa. Stellungnahme zum neuen mehrjährigen Finanzrahmen der EU 2014–2020 (2012) (available online).

⁵ Until a consensus has been reached only provisional budget management is possible, and expenditure is limited to one-twelfth of the funds available in the previous year.

⁶ The first "inter-institutional" agreement was concluded in 1988 (Delors Package 1). In 2007, the first multiannual financial framework was adopted. Since then, the financial period has been at least five years and in practice, has always been seven years.

⁷ As a rule, MFF negotiations start two and a half to three years before the new financial period begins. The individual EU programs are gradually starting after a new period begins, and therefore involve payment terms of several years.

⁸ According to the official schedule, the new MFF will be adopted in May 2019. In this case, fundamental consultations on financial policy will not be pending during the legislative period of the European Parliament, which is also up for election next May.

common practice for many years. Maximum amounts are specified for special instruments, but the annual expenditure ceiling in relation to GDI does not apply to them.⁹

When funds are apportioned parallel to the core budget, transparency is heavily reduced and the large number of programs in EU finances obscures budget transparency even further. Moreover, changes are constantly being made both to the budgetary system and to the classification of programs by individual headings. This makes it difficult for the general public to consistently assess European budgetary policy.

Special features regarding financial negotiations

The shift to multi-annual financial periods has successfully prevented binding budgets from being adopted in ongoing budget years, but negotiations are still rife with conflict, typically taking two to three years until resolution. The growing number of member states and the required unanimity of the European Council on financial matters made consensus difficult to achieve. A change in majority rules could not only make it easier to create consensus, but also reinforce European policy makers' responsibility to national voters. However, reforms like this do not seem likely, as they require an unanimous vote of the European Council

Policy adjustments, such as changing the qualifying criteria for funds or specifying new areas of activity, and therefore changing the expenditure structure, tend to leave some member states better off while others will lose. This is why budget cuts often cannot be unanimously agreed and the workaround is to request extra funds for new tasks. Member states that in net terms receive EU funds would probably be in favor of granting requests for additional expenditure, but states that are net contributors would not.¹⁰

Being a net recipient or net contributor does not reveal much about the actual benefits of being an EU member state for a given country, but it is a readily available statistic—for the voters back home as well. For this reason, it plays a significant role during financial negotiations. Breaking up the traditional front between net contributors and net recipients could considerably simplify future negotiations. The Commission would like to accomplish this by levying an own tax for which it is not possible to determine on first sight in which country it is paid. Given the institutional circumstances, however, a right of taxation for the European Union remains a difficult issue—and not only because the European Parliament's participation is still weak. It has had full powers of co-decision in tandem with ECOFIN in some areas since 2009, but the Commission—an administrative body—still retains the power of initiative in many areas. Voters often do not know whether national policy makers or their elected member of

EU Parliament is responsible for a decision on the European level. But if areas of responsibility are not clearly defined, the probability that decision-makers will be held accountable and voted out of office is not very high. Under these circumstances, the fiscal burden will generally be higher than otherwise. However, individual citizens have a fine sense of their fiscal burden. If it rises due to the implementation of a European tax, an already widespread Euroscepticism could run rampant. If the EU had its own source of tax income, the discussion would likely shift to other levels. Member states' net balances would not be directly available in the statistics in that case, but could be calculated for regional tax revenue estimates. And a different statistic—gross expenditure, for example—could also trigger a national signal that impacts the financial negotiations.¹¹

The EU Commission's proposal for the 2021–2027 financial period

The EU Commission presented its ideas in the MFF proposal for the 2021–2027 period. The Commission uses the words “modern,” “protect,” “empower,” and “defend” to crystallize the claims they are making for their proposal. They intended it to be future-oriented and apart economic cooperation—historically the sphere of European action—other objectives are formulated. However, the Commission indicates the pragmatic character of the proposal at the same time, emphasizing that it “responds to this twin challenge [of Brexit and new tasks] through cuts to expenditure and through fresh resources in equal measure.”¹²

And it is intended to “focus” the budget. To the Commission, this means that revenue is increased while expenditure in traditional areas is decreased. The Commission is also targeting a budget with more transparency and flexibility. Grants within EU programs are intended to be more efficient and target-oriented, which should be supported by a standardized set of rules.¹³ When it comes to allocating tasks to the European level, extra care is intended to be taken in determining if they can be performed more efficiently, that is, whether or not “European added value” is present.¹⁴

The Commission's proposal at a glance

As usual, the Commission presented its proposal in base-year prices. In 2018 prices, it appropriates funds in the amount of 1,134.6 billion euros for commitments (see Table 1). The current MFF allocates commitment appropriations of 960 billion euros in 2011 prices. To compare both, the two MFFs have

⁹ If they are used, they are subject to the own resources ceiling.

¹⁰ Currently, not all net contributors are rejecting increases in expenditure. Germany has indicated that it can envisage a higher level of expenditure. The high level of willingness to pay more can be explained in the context of the European roadmap. If the target milestone for passing a resolution is not met, the heated phase of negotiation could fall in the period of Germany's EU presidency.

¹¹ For a discussion of possible own resources, see Mario Monti et al., *Future Financing of the EU* (2016) (available online).

¹² European Commission, *EU budget: Commission proposes a modern budget for a Union that protects, empowers and defends*, (May 2, 2018) (available online).

¹³ See European Commission, “A Modern Budget.”

¹⁴ This is already becoming apparent at an early stage. See for example European Commission, *Reflection Paper on the Future of EU Finances*, (2017) (available online); European Court of Auditors, *Future of EU finances reforming how the EU budget operates*, (February 2018) (available online); and European Court of Auditors, *EU budget: time to reform? A briefing paper on the mid-term review of the Multiannual Financial Framework 2014–2020* (available online).

been converted into current prices by using an inflation rate of two percent, the rate used for technical adjustments. A comparison shows that the currently valid MFF has commitment appropriations in the amount of 1,082.6 billion euros, while the MFF for the period beginning in 2021 plans for the expenditure of 1,279.4 billion euros. This equals an average annual increase in commitment appropriations of 2.7 percent distributed relatively evenly across the entire period.

But this comparison is lopsided because the current MFF applies to the 28-member EU. The new MFF is tailored to the post-Brexit EU. To be able to compare both financial periods, the numbers must be adjusted by the expenditures attributable to Great Britain.

Based on the funding flows between 2014 and 2016 by country and program MFF (MFF EU-27) had been adjusted.¹⁵ Compared to this adjusted MFF EU-27, the commitment appropriations in the proposal for the next financial period are a total of 252 billion euros higher (see Table 2). At the beginning of the next financial period they will rise sharply and in 2021 will be 7.6 billion euros higher than in 2020 (see Table 3). The rate of increase in commitment appropriations picked up momentum in comparison to previous decades as well. This shows a strong expansion in expenditure in an era in which the budgets of individual member states clearly still need to consolidate.

The funds for special instruments have also increased exponentially (see Table 4). This is partly because facilities for current challenges and those that are increasing in importance are planned outside of and not inside the EU budget. This adds to overall flexibility, but the ceiling for commitment appropriations no longer reflects the actual agreements entered into. It also diminishes transparency, as do the reestablishment of external budgets or reintegrating existing special funds into the core budget.

The Commission's proposal in detail

The Commission emphasizes that in the future it would like to take on more of the tasks that can be more efficiently solved on the European level. Climate protection, for example, does not stop at national borders. And some events on the global stage of recent years have provided the occasion to call national solutions into question in many areas. Much speaks in favor of creating a joint policy for accepting refugees or making a joint effort to better protect external borders against terrorism. In light of the apparent shifts in the world order, a discussion has arisen about further fortifying collaboration on defense policy on the EU level.

¹⁵ For 2017 to 2020, there is still no information (estimate) on distribution by member state. The approach selected here permits to adjust commitment appropriations for each individual budget year. The European Court of Auditors applied a different approach and presented its first assessment of the EU Commission's proposal in July. Referring to the EU Commission's proposal, it adjusted a cumulative amount of expenditure within the entire financial period by 52.8 billion euros. See European Court of Auditors, The Commission's proposal for the 2021–2027 Multiannual Financial Framework (July 2018) (available online).

Table 1

Decision on multiannual financial framework 2014–2020 and draft for the years 2021–2027¹

Different price indices, in billion euro

	MFF 2014–2020 (prices from 2011)	MFF 2014–2020 (current prices)	MFF 2021–2027 (current prices)	MFF 2021–2027 (prices from 2018)
Commitment appropriations	960.0	1,082.6	1,279.4	1,134.6
in percent of GNI ²	1.00	1.04	1.11	1.11
Payment appropriations	908.4	1,024.0	1,246.3	1,104.8
in percent of GNI	0.95	0.99	1.08	1.08
Own resources				
in percent of GNI	1.23	1.23	1.29	1.29
Margin (percent of GNI)	0.24	0.24	0.21	0.21

¹ State of planning in the years 2013 and 2018 respectively.

² Gross national income.

Sources: European Commission; author's own calculations.

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Table 2

Multiannual financial framework for EU-27¹

Current prices in billion euro; percent

	MFF 2014–2020 (EU-27)	MFF 2021–2027 (EU-27)
Commitment appropriations	1,027.6	1,279.4
in percent of GNI ²	1.12	1.11
Payment appropriations	962.4	1,246.3
in percent of GNI	1.05	1.08
Own resources		
in percent of GNI	1.23	1.29
Margin (percent of GNI)	0.18	0.21

¹ August 2018.

² Gross national income.

Sources: European Commission; author's own calculations.

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The Commission's proposal also allocates funds for tasks like these, pooling programs in the headings of "migration and border management," "security and defense," and "neighborhood and the world." Not all of the programs carried here are new, but the changes in the budget classification system make it difficult to compare the new MFF to the current one. Funds in the amount of 185.4 billion euros have been allocated to the headings listed above. In the currently applicable MFF, only 82.8 billion euros were allocated to the "security and citizenship" and "global Europe" headings. At first glance, this looks like a sharp rise. These headings' proportion of total expenditure is 14.5 percent and therefore significantly higher than the 8.1 percent of the current financial period. But cohesion and agriculture (see Figure 2) are still the EU's focal areas.

A solid 29 percent of EU funds are being made available for cohesion policy. In the previous financial period it was 34.6 percent, but contrary to the EU Commission's statements, the level of funding will be continuously increased in

Table 3

Adjusted multiannual financial framework for EU-27 in the years 2014–2020 and the EU Commission's draft for the years 2021–2027¹

	Commitment appropriations, in billion euro	in percent of GNI ²	Compared to previous year, in percent	Payment appropriations, in billion euro	in percent of GNI	Compared to previous year, in percent
2014	135.3	1.15		127.0	1.08	
2015	139.0	1.14	2.8	133.0	1.09	4.7
2016	142.6	1.14	2.6	137.0	1.10	3.0
2017	146.6	1.13	2.8	134.2	1.03	–2.1
2018	150.3	1.11	2.6	140.1	1.04	4.4
2019	154.7	1.10	2.9	144.2	1.03	2.9
2020	159.1	1.09	2.8	146.9	1.01	1.9
2021	166.7	1.12	4.8	159.4	1.07	8.5
2022	173.7	1.13	4.2	164.0	1.07	2.9
2023	179.4	1.13	3.3	177.4	1.12	8.2
2024	182.9	1.12	2.0	180.9	1.10	2.0
2025	187.0	1.11	2.3	184.5	1.09	2.0
2026	193.7	1.11	3.6	188.2	1.08	2.0
2027	195.9	1.09	1.1	192.0	1.07	2.0

¹ August 2018.

² Gross national income.

Sources: European Commission; Eurostat; author's own calculations.

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Table 4

Special instruments outside multiannual financial framework In billion euro

	2014–2020 in total	2021–2027 in total
Emergency Aid Reserve	2.17	4.73
European Globalisation Adjustment Fund		
European Union Solidarity Fund	2.41	1.58
Flexibility instrument	3.87	4.73
Agricultural Crisis Reserve	3.64	7.89
ITER	3.09	
Copernicus (before GMES)	2.56	
Global Climate and Biodiversity	3.13	
European Investment Stabilisation Function	p.m.	
European Peace Facility		p.m.
Total	20.86	29.43

Sources: European Commission; author's own calculations.

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the new financial period.¹⁶ Cohesion policy, that is directed toward smoothing over socio-economic imbalances is as such an important task. But a major portion of EU expenditure has gone to this area since the 1980s, while the disparities among member states appear to be rather permanent—including in countries that have received funding for 30 years. This is why cohesion policy regularly comes under criticism.¹⁷ For example, critics claim that the administrative costs are too high, the criteria for different programs are not standardized,

an expenditure-driven approach is being followed instead of a results-oriented one, or the programs are not harmonized and insufficiently oriented toward growth and employment. In addition, they frequently demand that the classification of assisted regions—which is solely based on GDP per resident—be supplemented by further indicators.

The portion of the budget that is spent on agricultural policy is significantly diminished in the commission's proposal, but this is because Great Britain, which received a high proportion of funding for agriculture, will be leaving the EU. And overall expenditure is rising much more than the level of expenditure for agriculture. In current prices, agriculture expenditure is foreseen also to rise—not sharply, but stronger than it currently does. Despite the modest rise, nearly 30 percent of funding is still going to a sector in which EU-wide only 1.5 percent of gross value added is generated.

Agricultural policy is also the target of frequent criticism:¹⁸ many of the expenditures for agriculture resemble subsidies. A large proportion is direct payments, which establish false incentives and reduce self-responsibility. Further, critics often say that the programs are insufficiently harmonized and do not take other goals of European policy into consideration. Many suggestions for improving this area are on the table as well.¹⁹ Above all, measures that lead to more self-responsibility—on the part of recipients and nation states alike—are desirable.

¹⁶ Also see European Court of Auditors, "The Commission's proposal." The Commission's statement is correct when the cohesion fund is examined exclusively. But other funds are also active in that area.

¹⁷ For example, see European Court of Auditors, Simplification in post-2020 delivery of Cohesion Policy (May 2018) (available online).

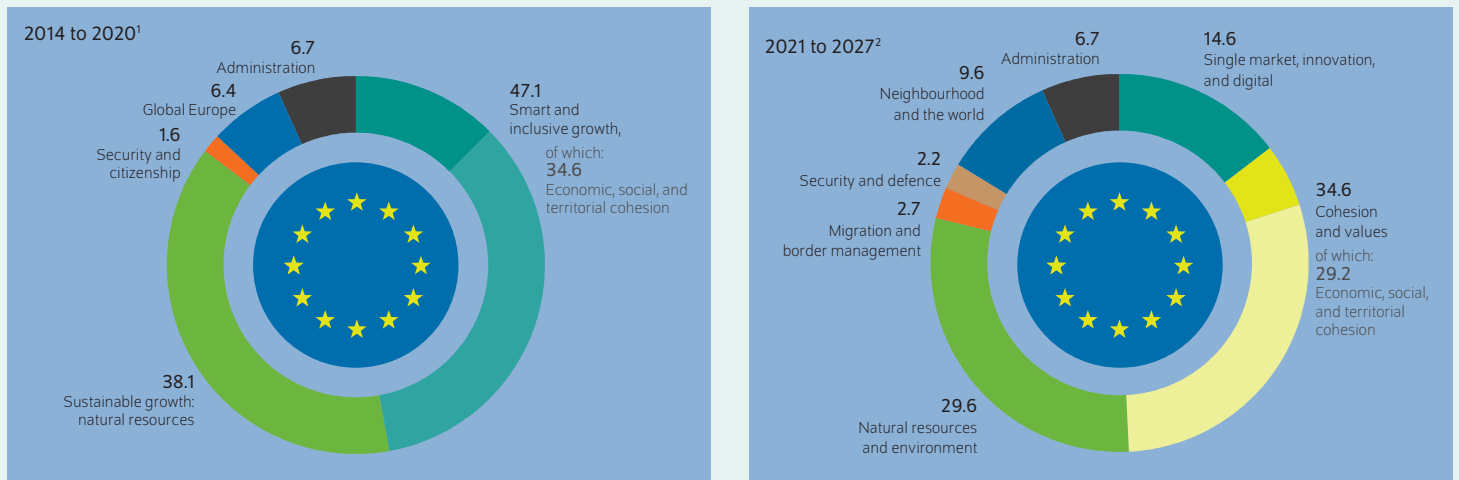
¹⁸ See for example European Court of Auditors, Future of the CAP (March 2018) (available online).

¹⁹ Also see European Commission, Modernising and Simplifying the CAP: Economic challenges facing EU agriculture, (2018) (available online); European Commission, Modernising and Simplifying the CAP: Socio-Economic challenges (2018) (available online); and European Commission, Modernising and Simplifying the CAP: Climate and Environmental challenges (2018) (available online).

Figure 2

Expenditure by financial framework headings

Share in Total, adjusted for EU-27

¹ August 2018.

Sources: European Commission, author's own calculations.

² European Commission's proposal.

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Expenditure on cohesion and on agriculture (in natural resources) still are biggest spending items.

Brief recap

The proposal presented by the EU Commission emphasizes four goals: focusing the budget, increasing transparency and flexibility, and defining the EU's responsibility more precisely in terms of "European value added."

- Tasks that are most efficiently carried out on the outer border of the EU can be assumed to deliver "European value added". The Commission proposes to increase funding for areas like these. However, the totality of money going to these tasks is too small to assume this increase to be connected with systematic transfer from national to the EU level.
- The Commission warns that budget management on the European level must become more flexible—a reasonable requirement considering the overall spending horizon of ten years. However, reallocating larger funding volumes always has to be legitimated by political decision. The minor influence that European voters have on budgetary policy decisions establishes a natural boundary for pragmatic solutions. The coming years will show whether or not the proposed extension of the transferability of funds increases the EU's capacity for action for implementing the budget sufficiently.
- The EU Commission also intends to increase transparency. In general, the new budget classification provides a clear overview of the EU's policy priorities. Integrating certain special instruments of the current financial

period to the headings supports this aim. But the re-posting required by the new system will make comparative analysis more difficult—at least during the transition phase. To make longer-term analysis possible, the classification system should be somewhat more finely divided and remain in place for a longer period in the future.

- The Commission emphasized that the budget must become more focused so the EU will be in a better position to meet the twin challenges of future orientation and Brexit, and can successfully master this balancing act by cutting funding to traditional areas in addition to increasing its revenue. These requirements are not actually met by the proposal. While there is only a limited amount of re-funding revenue is increased significantly, and in all headings, expenditure in current prices will rise; in most of them, sharply. The orientation toward new challenges will be inadequate and there will be little leeway for revenue increases.

Outlook: Budget policy in the new financial period is more reactionary than future-oriented

This conclusion is regrettable, because some member states are faced with a much larger challenge than financing traditional expenditures. The currency union must be made more crisis-proof because the survival of the common currency will be further on at risk due to diverging economic development on the national level in an environment of comparatively low employment mobility. Proposals for suitable preventive instruments have been presented and

some are the subject of heated debate.²⁰ Although the oft-repeated official line is that permanent transfers to the benefit of one particular member state must be excluded, funds of sufficiently large volume must be provided to absorb diverging business cycle trends or asymmetrical shocks—preferably in the form of spending money on investment. Some of the funds for the currency union could

have been raised by cutting spending on smoothening socio-economic imbalances within the European domestic market—even if the group of countries is not completely identical.

Funding EU and funding euro area do belong together. The measures must be pooled and the fundamental decisions to be made now must be aligned. However, this requires a policy strategy and the EU has not yet agreed on one for the post-2020 period. If the multiannual financial framework eliminates all financial leeway now, it will be difficult to reach a consensus that sets the Union's basic course in coming years.

20 See Agnès Bénassy-Quéré et al., "Reconciling risk sharing with market discipline: A constructive approach to euro area reform," *CEPR Policy Insight*, no. 91 (2018) (available online); Marius Clemens and Mathias Klein, "Ein Stabilisierungsfonds kann den Euroraum krisenfester machen," *DIW Wochenbericht*, no. 23 (2018) (available online).

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