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**Article**

## Editorial: Towards a Reform of the EU Budget

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# Towards a Reform of the EU Budget

Twenty years ago, the Sapir report famously defined the EU budget as a “historical relic”. Today, the EU budget remains outdated and unfit to face current EU policy challenges. Over the years, priority has been given to stability and budgetary peace, with limited attention paid to more strategic goals linked to the EU’s domestic and international agenda. The size of the EU budget (€160-€180 billion annually, 1% of the EU GDP) remains inadequate. Importantly, as a response to the pandemic, the budget has been supplemented by NextGenerationEU (NGEU) with the Recovery and Resilience Facility (RRF) at its heart, but this programme is set to expire in 2026. Given its composition, the EU budget cannot credibly deal with the green and digital transition, preparedness in case of a resurgence of the pandemic, the fallout of the war in Ukraine and in the Middle East, and ongoing migration inflows. Such a state of affairs could have been acceptable in a relatively stable environment, but it has become increasingly costly in uncertain times. Unless the EU budget is reformed in earnest, the forthcoming enlargement – that will bring the EU to over 35 members – might lead to a breaking point. To live up to expectations and effectively tackle these challenges, the EU budget needs to be radically reformed both on the revenue and expenditure side.

The spending side of the EU budget has evolved at a glacial pace. While the share of the Common Agricultural Policy and the Cohesion Funds has shown a gradual erosion, the composition of the budget has remained broadly unchanged, thereby increasingly diverging from what the new European priorities dictate. A reformed EU budget should embrace a European public goods (EPGs) approach, meaning that it should focus on matters where the EU can bring real added value. In line with this approach, the expenditure side of the EU budget could be divided into two main categories: RRF-type programmes and genuine EPGs.

The first category represents those expenses involving transfers to member states. These are financed at the EU level but delivered at the national level. Here, a rethinking should exploit the advantages of the experience with the RRF. Two innovative aspects of the RRF are its focus on both reforms and investment in exchange for financial support, and its performance-based approach. Hence, EU programmes involving transfers to member states should be designed by considering these two aspects.

The second category, genuine EPGs, represents those projects financed and delivered at the EU level to directly tackle EU challenges. These projects should in principle be politically less contentious compared to other forms of central fiscal capacity as they weaken the *juste retour* (or net balance) narrative and, by doing away with the risk of moving to a “transfers union”, they should lessen the tensions between “creditor” and “debtor” countries. Identifying genuine EPGs is easier in practice than in theory. The areas where EPGs remain under-supplied are digital transition, “green” transition and energy, social transition, essential raw materials, security and defence, and health. These broadly correspond to the European priorities identified in the informal European Council meeting in Versailles in March 2022.

A pragmatic idea to ensure the delivery and financing of genuine EPGs would be to rely on the “vehicles” offered by existing EU programmes that should be revamped and refocussed on cross-country projects. Some parts of the REPowerEU could support common initiatives at the EU level; the same applies to other programmes of NGEU such as Connecting Europe Facility, InvestEU and Horizon. European initiatives are also the core of the Innovation Fund. Moreover,

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if reformed to allow financing via EU resources and devoted to genuinely EU-wide interventions, the Important Projects of Common European Interest would offer a very useful tool.

The credibility of such a spending programme relies on the robustness of the EU revenue. Although politically difficult, the issue of ensuring adequate own resources cannot remain a residual item. Currently, the EU can count on several own resources, in particular the customs duties, the value added tax own resource, a contribution based on the amount of the non-recycled plastic packaging waste, and a resource based on Gross National Income (GNI, this last one is not really “own”). Traditionally, spending has driven revenue: when new priorities arose, additional spending was agreed upon and the necessary revenue was procured, most frequently through the adjustment of the “fourth resource”, i.e. the GNI resource. However, a reformed EU budget supplying EPGs cannot rely on such an approach: new and permanent revenue, however difficult to identify, needs to be part of the equation from the beginning.

A number of future own resources are on the table, including resources from the EU carbon border adjustment mechanism, revenues from the emissions trading system, a statistical contribution on corporate profits, a temporary own resource from 2024, revenue from the implementation of the OECD agreement on a re-allocation of taxing rights. These proposals should be adopted as a matter of priority. Looking forward, a promising option appears to be a resource based on corporate income taxation, building on the recent proposal by the Commission on corporate taxation (the so-called BEFIT). The other side of the financing coin is represented by the issuance of EU bonds by the Commission. Their amount has grown exponentially since 2020 with SURE and NGEU reaching a stock of over €400 billion. The two sources of financing are inextricably linked: credible own resources are necessary for the market attractiveness of bonds issued by the European Commission. The key issue is that investors and markets penalise bonds issued by the Commission since they do not see the EU as a permanent player in the securities market with its bonds backed by a credible stream of revenue. Hence, agreeing on robust, permanent own resources is essential whether one envisages financing the larger budget directly via revenue, or as a fiscal backing for the issuance of EU bonds.

I have argued for refocussing the EU budget on EPGs, that is, on projects addressing EU priorities, financed and delivered at the EU level. What are the political conditions that would make such an ambitious reform a reality?

First of all, trust has to be rebuilt among EU members and between the latter and EU institutions. Credible, enforceable and enforced fiscal rules as well as an effective implementation of the RRF are conditions *sine qua non*. Furthermore, national and European authorities should strive to lengthen the time horizon of policymakers in order to internalise the advantages of supranational solutions, such as the creation of a more ambitious common budget. This requires that national governments find a way to shield their EU decisions from short-term political fibrillation, thereby being able to apprehend the medium- to long-term benefits of a reformed EU budget.

That is difficult but not impossible. During the global financial crisis, the moral hazard paradigm dominated and the policies were characterised by short-term bias. In contrast, the response to the pandemic was better suited as the palpable concerns over EU dissolution had countries gone on separate tracks led national governments to cross “deep red lines”. The response was large and decisive, although cautious due to the temporary nature of NGEU and focus on transfers rather than on common projects. The new institutional cycle after the next European elections should acknowledge the geopolitical threats surrounding the EU and build trust, starting from the agreement on a new fiscal framework. A sufficiently low “political discount rate” will be needed to embody the structural priorities of the Union and the future pattern of risks.

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