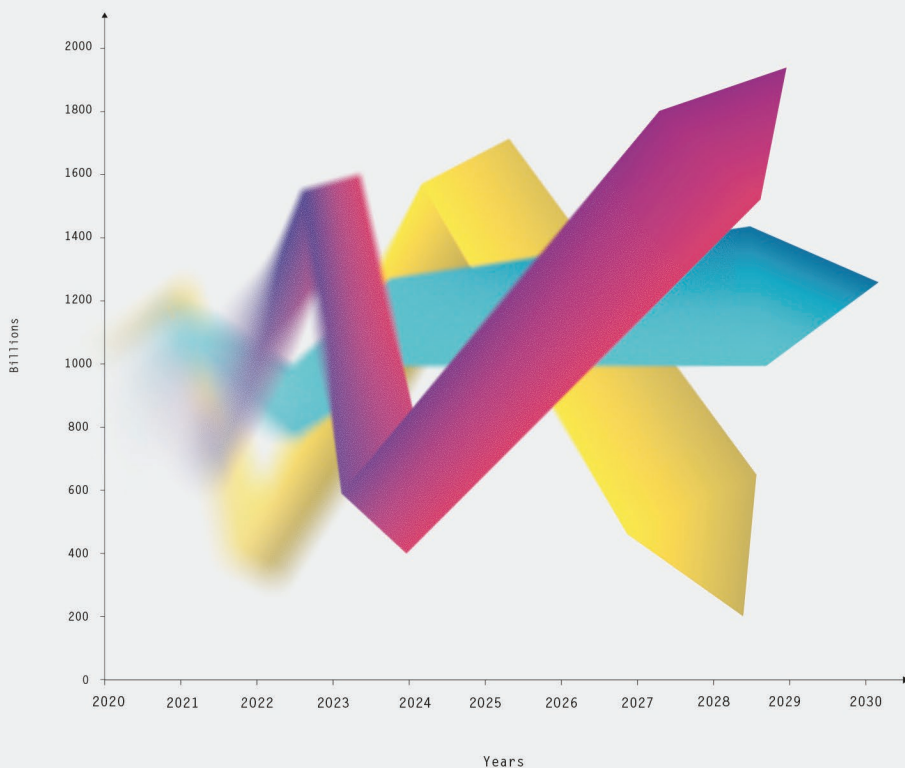




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EU Financing for Next Decade

Beyond the MFF 2021-2027 and the Next Generation EU

Editors: Brigid Laffan & Alfredo De Feo



EU Financing for Next Decade Beyond the MFF 2021-2027 and the Next Generation EU

EDITED BY

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Abstract

This edited volume on the EU Multiannual Financial Framework 2021-2027 is the outcome of an initiative by the Robert Schuman Centre for Advanced Studies at the European University Institute of Florence. In mid-October 2019, academics, think tankers, practitioners and experts in European finance and politics discussed how to improve the Multiannual Financial Framework for the next decade. The discussion was both conceptual and policy-relevant. It was therefore not limited to the MFF but also reflected on the objectives and needs of major EU policies. This discussion was timed to coincide with the renewal of the 2021-2027 MFF, which was being negotiated by the EU institutions. Subsequently, events changed the timeline. The arrival of the Von der Leyen Commission added a new dimension to the initial proposal (May 2018) by adding the Green Deal, and later, following the pandemic crisis, another new layer: Next Generation EU, which created the exceptional opportunity for the Commission to borrow capital on the financial market and offer it to the Member States partly in grants and partly in loans.

The contributions gathered in this edited volume go beyond the situation in mid-October and take into account the severe impact that Covid-19 has had on the European economies, and in particular the new proposals by the Commission of May 2020 and the European Council agreement of July 2020.

Therefore, the present volume offers a global comment on all the issues touched by the MFF and Next Generation EU (NGEU), highlighting the potentialities of the new situation. It provides insights into the ideas of key actors and experts on the practical functioning of the MFF and their reflections on its future development.

A common thread links all the chapters: how the MFF and NGEU can drive reform to make the European Union more resilient to face the new challenges of the next decades. The reader can navigate through the three

sections of the book. The first is rich in ideas on how to enhance the MFF as a governance tool which could drive reforms of the EU. The second part focuses on the impact of long-term planning on the most relevant EU policies. The authors highlight current challenges and offer their views on how to make policies more efficient. Finally, the third part presents ideas on how to introduce innovation in the financing of the European Union with additional creative financial tools.

Foreward

Brigid Laffan¹

The EU is frequently classified as a regulatory state and there is no doubt that law and regulation plays a central role in EU governance. That said, the budgetary politics of integration have been vital in promoting and sustaining European governance. The internal market project was accompanied by a major change in the EU budget with a doubling of funds destined for Europe's poorer regions. The budgetary bargain of 1988, known as the Delors 1 package, initiated a Multi-annual Financial Framework (MFF) that persists to this day. This volume analyses the MFF for the forthcoming period 2021-2027. The analysis began with a Workshop at the European University Institute (EUI) in October 2019 on the MFF and the funding demands of big EU programmes. No-one at the Workshop could have envisaged how quickly the budgetary politics of the Union would change in the first half of 2020.

Covid 19, which hit Europe in February 2020, dramatically altered the conditions and outcome on the next funding period. In February 2020, the European Council struggled to agree a financial framework but by July was agreement on the MFF and a Recovery Fund, Next Generation Europe. The agreement included the issuance of common debt to support economic and social recovery and build a post-Covid political economy. This was a seminal moment, a game changer, in the finances of the European Union. This edited volume provides an in-depth assessment of the MFF and the major policy fields and provides a framework for thinking about reform and innovation in the EU budget.

The next decade will be pivotal for the finances of the Union as the potential for enhanced budgetary resources and common debt will depend on how effectively the resources of Next Generation EU are used

¹ Director Robert Schuman Centre for Advanced Studies

to invest in Europe's recovery and future. In addition to the question of the effective use of EU funding, the issue of rule of law breaches in a number of member states became part of the political agenda. The Council and European Parliament finally reached agreement in November 2020 on this highly divisive and contested issue, the conditionality that should be attached to EU funds in the member states. The Union has struggled to find effective mechanisms to counteract the deterioration of the rule of law in a number of member states, notably Hungary and Poland. Given the increase in financial resources it is imperative for the legitimacy of the process that the Union has a robust mechanism to enable it to cut EU funding in the event of breaches of the rule of law that might affect the financial interests of the Union.

I would like to thank all of the authors for their participation in the October 2019 Workshop and their contributions to this volume. A special thanks to Alfredo De Feo, a Fellow of the Schuman Centre, without whom the Workshop and book would not have materialised. My thanks also to the staff of the Schuman Centre, especially Giorgio Giamberini who formatted the volume.

Introduction

This edited volume on the EU 2021-2027 Multiannual Financial Framework is the outcome of an initiative by the Robert Schuman Centre for Advanced Studies at the European University Institute of Florence. It gathered a mixture of academics, think tankers, practitioners and experts in European finance and politics.

The workshop was held in mid-October 2019, about 18 months after the 'outgoing' Commission had presented its proposals for the MFF and the accompanying legislation and about three months after the appointment of the new president of the Commission and before the entire college formally took office on 1 December.

The workshop therefore took place in the middle of the political debate on financing and policy choices, and the participants' contributions were rich in ideas, suggestions and criticisms that go well beyond the current debate and will continue to be a source of inspiration for the future. The participants in the workshop were then invited to send a written contribution, all of which arrived at the EUI by the end of February, just a few days before 9 March, when Europe entered a new phase in its history with the exponential expansion of the pandemic, with the lockdown, the two-digit fall in the Member States' GNI, the economic recession and the need to revamp public spending.

The MFF was certainly one of the tools to support the MS economies, and on 27 May the Commission presented innovative proposals, which included Next Generation EU.

On 21 July the European Council reached unanimity to accept the 2021-2027 MFF with modifications and Next Generation EU.

In mid-June, RSCAS organised a web-discussion among the authors to assess the situation. This discussion concluded with a confirmation that the book would reflect the content of the workshop held in October, but at the same time some authors preferred to adapt their chapters to the new and unexpected situation.

The present volume intends to offer a global view of all the issues touched by the MFF with the aim of highlighting the potentialities that it could develop. Scholars, students and practitioners looking for ideas, visions for a renewal and how to relaunch the European project can find food for thought in this book for years to come.

It is not an exaggeration to say that the Multiannual Financial Framework (MFF) is the main procedure where the Member States and the EU Institutions decide the direction of Europe: the responses to its challenges and expectations. The negotiation on the MFF is one of the rare moments in EU life attracting the attention of national media.

The MFF negotiations have a quite consolidated pattern in which all the actors play their roles, sometimes with dramatic tones, but in which at the end there is a conclusion, one of the classic Euro-compromises where everyone is equally unhappy.

This year the process was destined to go unnoticed, at least outside the EU bubble, with every actor defending its own negotiating script. The Commission presented a relatively ambitious proposal, the main defect of which was that it had been prepared too long ago, in May 2018, by a Commission that was no longer in office.

With its 2018 proposal, the Juncker Commission struggled to present an ambitious proposal and at the same time face the consequences of the loss of the UK contribution. After the confirmation vote by the EP, the Von der Leyen Commission made the Green Deal its political flagship, but at the same time the college did not propose revising the Juncker proposal but preferred to attach the Green Deal label to a number of existing policies.

As in the past, the Council did not want to rush into the negotiation and preferred to follow more traditional paths.

Several Member States made their positions clear concerning the total budget to devote to European affairs (the frugal four). Some other Member States were less frugal and some more ambitious. With these differences, it was difficult to prepare a compromise in the Council to get the unanimity of the 27 Member States. The first attempt by the Finnish

Presidency in December 2019 failed, as did the attempt in February 2020 by President of the Council, Charles Michel.

The European Parliament also followed a well-known model: ambitious resolutions with direct and strong wording about a possible rejection of any compromise that did not include its detailed requests.

Then suddenly the scenario changed, and it was no longer possible to refer to the well-established 'déjà vu' pattern. The Covid pandemic progressively invaded all the European countries. Although health was not one of the EU competences, voices were raised to have greater European coordination. The Commission was relatively ill-equipped to organise a common response at the medical level, but under pressure from a number of Member States it took the lead to intervene in the economic domain to alleviate the dramatic economic consequences of the virus. The corona virus pandemic suddenly changed all the economic and political agendas.

The structure of the book

This book is divided in three parts. The first is devoted to the MFF as a driver of reforms. The second focuses on the most relevant EU policies. Finally, the third part considers the most innovative proposals to enhance the role of the MFF. The three parts nevertheless have a common thread: how the MFF and European policies can drive a reform of the European Union.

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The following short presentation of each chapter is not a summary but just an appetizer to encourage and stimulate the reader to go more deeply into the individual chapters.

The first part has a horizontal view of the MFF and the role which this mechanism can play to direct and monitor EU policies. The last two chapters are devoted to the own resources, as expenditure cannot exist without the revenue side of the budget. In more detail:

Alfredo De Feo gives an overview of EU financial planning since 1988. The chapter also suggests five structural modifications of the MFF mechanism which could enhance the accountability of each future Com-

mission and EP and the role of the MFF as a driver of reform of EU policies.

Alain Lamassoure¹ comments on the electroshock that the pandemic gave to the ‘*sleeping beauty*’, which broke three solid taboos in the EU narrative. The chapter concludes by presenting seven “provocations, which show that there is still a long way to go.”

The provocations are followed by a more institutional chapter, by Stefan Lehner,² which frames the MFF in a historical perspective and offers a very interesting view of the dual nature of the MFF and the EU budget. The budget is squeezed between two contrasting finalities: a budget for Europe, to enhance the European public good, and a budget for the Member States. Without the balance between these two elements, the MFF and the budget would not exist. Lehner also draws the reader’s attention to the risks linked to the future implementation of the Next Generation EU programme. The chapter suggests a change of procedure to reduce the impact of national interests that do not contribute to genuine European added value.

Pier Carlo Padoan³ takes a wider approach to the MFF which is conditioned by economic, geopolitical and technological challenges. The ideal MFF should provide resources for global governance and European public goods, but no single policy tool could effectively deal with these challenges on its own. To conclude, the chapter offers five functions that should be assigned to the EU budget: competitiveness, convergence, stabilisation, inclusiveness and EU public goods. These elements will make the MFF more resilient, but can all this be achieved without a substantial increase in resources?

Wilhelm Molterer⁴ presents the crucial role of private funding complementing the EU budget. He points out that to achieve the EU commitment to CO2 neutrality in 2050 investments of more than €1 trillion only for climate (estimation by the European Court of Auditors) will be necessary by 2030. Public funds, national or European, do not have

1 Alain Lamassoure, Former French Minister and MEP.

2 Stefan Lehner, Former Director of the Commission.

3 Pier Carlo Padoan, Member of the Italian Parliament and Former Finance Minister.

4 Wilhelm Molterer is Director of the European Fund for Strategic Investments (EFSI), former Vice Chancellor and Federal Minister of the Austrian Government and Vice President of the EIB.

the capacity to support these targets. The chapter describes how in the future the new InvestEU programme can build on the EFSI experience. The involvement of private capital (through commercial banks/capital markets) should complement the public efforts to support the required investments. The chapter concludes with a number of provocative questions to stimulate further reflection.

As we cannot have a budget without resources – revenue and expenditure are two faces of the same coin – two chapters in Part I concern own resources.

Ivailo Kalfin⁵ describes how a budget can only fulfil its functions of redistribution, allocation and stabilisation if revenue and expenditure are managed as a whole. In the decoupling of revenue from expenditure he sees one of the weaknesses of the MFF mechanism. After analysing the advantages and disadvantages of the current system he presents five weaknesses, which, if addressed, could open the way to a successful reform of own resources with a blend of tasks involving the Member States, European national parliaments and EU institutions framed with a more transparent procedure.

Anne Vitrey⁶ highlights the history of the financing of the European budget, underlining the efforts made by the European Parliament to make own resource decisions more transparent and accountable. She presents four reasons – budgetary, macro-economic, political and institutional – which could make a reform of EU financing happen in the next decade. She also analyses the systemic changes in the new Commission proposals and identifies four obstacles to their implementation

In the last chapter of Part I, James McQuade⁷ explains how the audits by the European Court of Auditors (ECA) have raised awareness of the quantitative and qualitative performances of EU policies.

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The second part of the book concentrates on the financing of major European policies. After two chapters analysing the two horizontal issues of conditionality and flexibility, which apply to most of the policies, there are a number of chapters covering the main policies, such as cohesion,

agriculture, climate, migration and external relations. In more detail:

Viorica Viță⁸ analyses conditionality, a horizontal theme applying to a good number of external and internal policies. She draws our attention to how the implementation of conditionality is a growing tool in the Commission's proposals. She also argues that the sanctions attached to conditionality are not a guarantee of improved Member State performance and warns about the possible negative effects on public opinion and beneficiaries.

Without any doubt, agriculture is the policy that has absorbed more European resources and it continues to be closely monitored by both the 'friends of agriculture' and by those that consider agriculture expenditure an old policy that is no longer necessary. The downward trend in agriculture expenditure is continuing and Alan Matthews's⁹ chapter analyses the impact of reductions in Pillar I (income support and market measures) and Pillar II (rural development) and their implications for environment and climate objectives and for Member State co-financing. The chapter concludes by mentioning the impact that decisions on financing will have on reform of the Common Agriculture Policy.

Cohesion policy is the second biggest MFF expenditure and Laszlo Andor¹⁰ argues for continuity of cohesion and social policy but also for enhanced effectiveness, which should be measured beyond GDP. He also underlines the role of cohesion policy in completing EMU, addressing not only structural gaps and discrepancies but also cyclical fluctuations.

Reimer Böge¹¹ stresses the necessity to continue to support less favoured areas and to respect and recognise farming's struggle to deliver sustainable public goods. He concludes that the Commission proposals are an optimal balance between the different interests.

The financial impact of climate change is presented by Alessandro D'Alfonso.¹² This chapter underlines how climate mainstreaming will incorporate climate considerations in all major EU spending, but it

8 Viorica Vita serves as a European integration officer at the European Commission. She holds a PhD from the European University Institute (2018).

9 Alan Matthews, Trinity College Dublin, Ireland.

10 László Andor, Secretary General of the Foundation for European Progressive Studies (FEPS) and Former EU Commissioner.

11 Reimer Boege, Former Member of the European Parliament.

12 Alessandro D'Alfonso, Policy analyst at the European Parliament Research Service.

should also leverage public and private funds. The chapter concludes with the key role of climate spending in raising the European public good in the next MFF.

Three complementary chapters cover the themes of migration and foreign policy. Nelli Feroci's¹³ chapter presents the Commission's proposals for migration and foreign policy and the main reactions by stakeholders and Member States. The chapter also offers considerations of a more general nature to enhance foreign policy and migration management in the EU.

After giving an overview of the proposed budget for migration management after 2020, Florian Trauner¹⁴ highlights the main controversial points such as a switch of funds from east to south, relocation and, last but not least, conditionality.

Myriam Goinard's chapter¹⁵ presents the debate about the governance of external financing instruments concerning the monitoring of legislative authority over delegated acts. The chapter offers ideas on how to overcome institutional divergences regarding the two main external financing instruments, NDICI and IPA III.

.....

The third part of this book is devoted to innovations which could raise the profile of the MFF. After a chapter underlining the importance of private capital to support investments in climate change, two chapters are devoted to the stabilisation of the eurozone budget, four to different forms of innovation and the last two to own resources.

In more detail:

The first two chapters focus their attention on the eurozone and the reinforcement that the MFF could give it in terms of stabilisation with a dedicated budget.

13 Ferdinando Nelli Feroci, President of the Istituto Affari Italiani and former Ambassador to the EU.

14 Florian Trauner holds a Jean Monnet Chair at the Institute for European Studies of Vrije Universiteit Brussel (VUB).

15 Myriam Goinard is member of staff of the European Parliament, DG for External Policies.

Johannes Lindner¹⁶ and Sander Tordo¹⁷ analyse the role that the EU budget can play in euro area macroeconomic stabilisation. The political agreement reached on the post-Covid MFF unexpectedly gives a new role to the EU budget, now equipped with a novel one-off ability to borrow on a large scale to hand out recovery grants through the Next Generation EU programme. This chapter also looks at the contribution the EU budget can give to euro area macroeconomic stabilisation and proposes five mechanisms with which the EU budget can have a counter-cyclical impact.

Gregory Claeys's¹⁸ chapter investigates (seven) essential reasons for establishing a budget for the euro area. In particular, it explores the benefits and drawbacks of establishing this euro-area specific instrument within the EU budget. The chapter then analyses whether the Budgetary Instrument for Competitiveness and Convergence (BICC) agreed on by the Eurogroup in 2019 could serve the needs of the euro area and it concludes that such an instrument is most likely to be inadequate to meet the most important challenges facing the euro area.

Pilati and Zuegg¹⁹ give a very realistic and crude analysis of the risks of a business as usual approach. In spite of the European Council agreement of July 2020, the MFF remains rooted in the past. The chapter offers realistic ideas to “evade the rigidities of MFF negotiations and deliver an EU budget better fit for purpose.” Developing financial instruments, match funding and fiscal flexibility for investment priorities are innovations which are within reach and do not need a change in the current structure.

Eulalia Rubio²⁰ argues that in the future the different EU sources of innovation funding should be better articulated to contribute in a complementary way to tackling the major innovation challenges facing the EU. The cuts by the European Council to the Horizon 2020 budget will

16 Johannes Lindner is Head of the EU Institutions and Fora Division (since 2012), which coordinates the relations of the European Central Bank with the EU institutions.

17 Sander Tordo is an Economist at the European Central Bank.

18 Grégory Claeys is a research fellow at Bruegel (since 2014) and an associate professor at the Conservatoire National des Arts et Métiers in Paris.

19 Fabian Zuleeg is Chief Executive of the European Policy Centre (EPC). Marta Pilati is a Policy Analyst in Europe's Political Economy programme at the European Policy Centre (EPC).

20 Eulalia Rubio, Senior Research Fellow Jacques Delors Institute.

reduce the impact on innovation. The chapter concludes with four policy recommendations to mainstream innovation through the EU budget.

Magdalena Sapala's²¹ chapter underlines the importance of flexibility measures to allow the EU to react to unexpected circumstances or to new political priorities to balance the rigidity of the multiannual financial planning. The flexibility 'toolbox', composed of special mechanisms and instruments, has expanded with each new MFF, and the chapter mentions seven areas where flexibility could also expand. The chapter shows how the relevant flexibility mechanisms have allowed the achievement of policy goals and adequate reactions to a number of unexpected events. Sapala concludes by underlining how a better decision-making process and an expanded role of flexibility could be two of the keys to reach a final agreement on the future MFF.

The chapter by Leena Sarvaranta²² continues in the same vein, focusing on innovations in science and research to support industrial development and technology infrastructure. She makes the distinction between 'spending' and 'investment' and underlines the great opportunity offered by the Green Deal. Sarvaranta concludes by highlighting five factors which could enhance and mainstream innovation in the EU budget.

Carla Montesi²³ analyses how the EU can reach the Sustainable Development Goals together with the objectives of the Paris Agreement. Her evaluation of needs, especially in the post-Covid-19 period, encourages the EU to go beyond official development assistance and to stimulate private capital to invest in sustainable development with the guarantee of EU funds. The new Multiannual Financial Framework complemented by Next Generation EU offers a unique opportunity to boost sustainable investment in growth and job creation in developing countries. The paper highlights how pilot instruments in the current MFF will be improved and scaled up in the next financial framework.

The following two chapters concentrate on own resources.

Giacomo Benedetto's²⁴ chapter evaluates the ingredients for a package to achieve a reform of own resources. It does this by analysing what we

21 Magdalena Sapala is a policy analyst at the European Parliamentary Research Service.

22 Leena Sarvaranta is Head of EU Affairs at the Technical Research Centre of Finland (VTT), Helsinki.

23 Carla Montesi, Director at the European Commission.

24 Giacomo Benedetto, Royal Holloway, University of London.

know already about package deals in the EU in which the main actors are able to gain more than they lose. The chapter presents four scenarios of package deals on the revenue side of the budget which could facilitate a reform of EU policies reducing the need for instruments outside the EU budget, which could reach, in the case of crises, larger amounts of the annual budget.

Perspectives on own resources are also in the chapter by Margit Schratzenstaller and Alexander Krenek.²⁵ This chapter analyses several options for sustainability-oriented own resources and provides estimates of their potential revenues. Each of the potential taxes is evaluated against a number of sustainability criteria, concluding that all the options considered are in principle well-suited candidates, while none can be identified as the ‘perfect’ candidate. All the candidates could be introduced within the existing legal framework so that no Treaty changes would be required.

In the last chapter, Alfredo De Feo discusses how the agreement of the European Council of 21 July might change the approach of the MFF and whether it could constitute a change in the construction of European integration. The chapter concludes with a recognition of the importance of the measures proposed but also focuses on some of their shortcomings.

25 Margit Schratzenstaller is working as an economist at WIFO (Austrian Institute of Economic Research), where she was Deputy Director until 2019. Alexander Krenek is a junior researcher at WIFO (Austrian Institute of Economic Research).

Part 1

The Multiannual
Financial Framework:
a driver of reform

The Multiannual Financial Framework 2021-2027: Ambition or Continuity?

Alfredo De Feo

Abstract

This introductory chapter outlines the general evolving context in which the Multiannual Financial Framework is situated. A brief excursus of EU financial planning will end in this period when the MFF negotiations are in their last mile. Events since February 2020 have given a different profile to the MFF, which will now have, at least in the Commission proposals, a central and new role in the EU's contribution to the Member States and to the reconstruction of the EU economy.

The chapter suggests how the role of the MFF can be enhanced as a driver of EU political reform and also offers some suggestions for improvements of the mechanisms and procedures. It concludes with a general assessment of possible renewals of financial frameworks, evaluating if, generally, they are more dominated by continuity or by ambition. The chapter focuses on MFF discussions until April 2020, while the new Commission proposal, the Next Generation EU and the European Council decisions will be discussed in the last chapter. Ambition and continuity will be a thread running throughout the volume.

Keywords: MFF, EU Reform, EU Policies

Introduction

In the early years, the EU annual budget was the main arena for institutional conflicts. It was the place where the European Parliament had some power and it used the annual budget procedure to exert its influence on the political priorities and legislation to come. The situation has evolved in recent decades. The annual budget has been framed in multiannual planning and the EP has increased its legislative power.

Before entering into the meanders of EU finance and policies, I will give a short overview of EU multiannual planning of expenditure and policy.

Before 2009, the date of entry into force of the Lisbon Treaty, the repartition of budgetary competences between the two arms of budgetary authority, the Council and the Parliament, was based on a classification of expenditure. The 1970 Treaty split the competences into compulsory expenditure¹ (mainly agriculture), which was decided by the Council, and non-compulsory (all other expenditure), on which the Parliament had the final say (with a number of limitations). In the 70s and early 80s, compulsory expenditure was between 70% and 80% of the total. The ambiguity of this definition and the Parliament's firm will to expand its competence gave rise to many interinstitutional conflicts during the period 1970-1988.

In 1988 the budgetary structure changed with the introduction of the first multiannual plan (Financial perspective).² Multiannual planning of the EU budget was part of a wider package proposed by Jacques Delors. This package included the launch of the internal market, support for structural measures in the less developed regions by doubling the funds available for this purpose and, last but not least, a global ceiling on own resources, which would guarantee the Member States an orderly evolution of payment appropriations.

Multiannual planning consisted of binding annual ceilings and sub-ceilings established for the different categories of expenditure. EP influence over the annual budget was then limited not only by the classification of expenditure, but also by categories of expenditure. Neverthe-

1 Art. 203 of the 1970 Treaty defined compulsory expenditure as "expenditure necessarily resulting from this Treaty or from acts adopted in accordance therewith."

2 The first financial perspective (also called Delors I) went from 1988 to 1992.

less, the EP accepted this self-limitation as the Member States accepted the increases in the resources available each year in the annual budget.

No change of Treaty was necessary for this important change of procedure, but all the various elements were included in an interinstitutional agreement on financial perspectives, the first of which in 1988 covered five years while from 1992 onwards each multiannual financial framework lasted seven years.

There was another novelty in 1988 which would have a strong influence on European politics: the introduction of the so-called fourth resource. This was a GNI-based contribution by the Member States to cover the difference between the revenue deriving from the traditional own resources,³ the trend in which was declining, and the financing needs of the annual budget. This decision gave the European budget stability and it was welcomed by the EP and the Commission. At the same time, it put the Member States in full control of European finances and opened the door for the infamous calculation of the so-called ‘juste retour,’ the balance between what Member States paid into the Union budget and what they got back. Over the years the impact of this form of (GNI-based) financing on European politics was similar to that of the gentlemen’s agreement of 1965 which informally introduced the unanimity vote in the Council whenever an individual Member State claimed ‘vital interests.’⁴

In the first years, the share of revenue financed by the Member States through the GNI-based resource was marginal but it has steadily increased and nowadays is more than 70% of EU budget revenue. The Member States are in full control of the revenue side of the budget.

The experience of interinstitutional agreements (IIA), which started in 1988, has been positive. Conflicts between the two arms of the budgetary authority have continued but have been framed in a procedure that favours dialogue and solutions.

The Lisbon Treaty incorporated into law the main elements of the

3 The traditional own resources are customs duties, agriculture levies and a percentage of VAT.

4 The Gentlemen’s agreement of 1965 introducing the unanimity vote ended the empty chair crisis of 1965 when France suspended its participation in all Community activities. In spite of the fact that this ‘informal’ rule is incorporated in no legal act, it has been present in all the negotiations.

IAs, in particular the Multiannual Financial Framework, which is now a Regulation to be adopted unanimously by the Council with EP consent.

These short introductory remarks in this volume dedicated to the Multiannual Financial Framework and EU policies aim to provide the context in which the current debate on the MFF is situated.

The Multiannual Financial Framework

The preparation, negotiations and approval of the Multiannual Financial Framework (MFF) are one of the crucial moments in the life of the European Union, if not the most. Before the entry into force of the Lisbon Treaty, these negotiations only had a political relevance, as no mention of a multiannual financial framework was made either in the Treaty or in any other legal act. When the MFF procedure was then embedded in the Lisbon Treaty, a legal and institutional dimension was added to the political relevance. Its approval is now crucial for the smooth functioning of the European Union.

The MFF is not only a single technocratic act; it is the procedure which sets the direction of the European Union for the years to come. The proposal for the regulation of the MFF is complemented by several regulations establishing the policies with a financial impact that will come into force in its period of application. Budgetary and legislative procedures are closely linked: legislation can only be adopted after a financial framework has been approved. The MFF procedure sets the direction of the EU.

Concerning the repartition of competences (art. 312 TFEU), the MFF regulation is adopted unanimously by the Council (with a ‘passerelle’ to a qualified majority which has never been activated) after the consent of the European Parliament. The procedure in the Treaty hides the reality. The established practice is different: the European Council is the real master of the procedure, contradicting the functions attributed in the Treaty:⁵ to give impetus to the development of the Union and to formally prohibit its exercise of legislative functions. In reality, the European Council sets in stone its unanimous decisions, not only at the level of own

5 Art. 15, TEU: “The European Council shall provide the Union with the necessary impetus for its development and shall define the general political directions and priorities thereof. It shall not exercise legislative functions.”

resources and the ceilings on the headings in the financial framework but also on details of many legislative procedures, mainly deciding the repartition of expenditure (national quotas) and the key elements in a number of legislative acts. These concessions made by the Council to one or another Member State are simply the result of the unanimity procedure and the need to ‘buy’ the votes necessary to reach a unanimous vote of the Council.

The decision by the European Council is therefore the architrave of the whole procedure, even though afterwards the formal procedure with consent or co-decision starts. However, the room for manoeuvre is limited as the European Council has democratic legitimacy in the national parliaments and also in the European Parliament.

In this context, the preparation of the proposals for the 2021-2027 MFF already started in 2016 when President Juncker presented his vision for Europe.⁶ The formal proposals only came two years later in May 2018. The European Council adopted some general guidelines⁷ and the European Parliament did the same, adopting a resolution⁸ ahead of the Commission proposals.

European leaders were aware that a number of EU citizens had lost confidence in the European project and these ‘institutional’ declarations aimed to give an answer to regain the support of these citizens. At the same time, many European political leaders felt a need to reform the current European model.

The 2014 Commission was well aware of this crisis of confidence and had the ambition to open the way to a reform: “We need to put the wind back in Europe’s sails.”⁹ Closed in its ivory tower, the Commission did not prepare the proposals for the MFF package but it consulted not only governments, national parliaments and European institutions but also interest groups and it organised public consultations with citizens. It pro-

6 State of the Union Address 2016: “Towards a better Europe – a Europe that protects, empowers and defends.” State of the Union Address 2017: “Catching the wind in our sails.” COM(2018) 98.

7 Declarations of the European Council: Bratislava on 16 September 2016, Rome on 25 March 2017, Sibiu on 9 May 2019.

8 European Parliament Resolutions of 14 March 2018 on “The next Multiannual Financial Framework: Preparing the Parliament’s position on the Multiannual Financial Framework post-2020 (2017/2052(INI))” and on the “Reform of the European Union’s system of own resources (2017/2053(INI)).”

9 JC Juncker, State of the Union, 2017.

duced many papers with reflections, which stimulated the debate within institutions and among scholars.

Paradoxically a number of factors worked as incentives for a reform to strengthen the EU: the geo-political situation, in particular relations with the US and Russia (the latter openly against the European project and actively seeking to destabilise/destroy it) and a number of transnational challenges like migration, the situation in Libya and Syria, climate and environmental issues, trade conflicts and the (possible) end of multilateralism.

At the same time other destabilising factors obliged the MS and the EU institutions to reflect in depth: the outcome of the British referendum and the subsequent exit of the United Kingdom from the EU; the scores of nationalist parties in national, regional and local elections and, last but not least, the outcome of the 2019 European elections.

In this context, the Juncker Commission presented its proposals (2018) and those who took office in 2019 (the European Commission and Parliament and the President of the European Council) engaged in negotiations over their approval.

All the above gave the feeling that the post-2020 MFF procedure offered a unique opportunity to get out of the 'business as usual' approach and aim for ambition rather than continuity. This chapter will analyse the current situation in the light of this dual approach, ambition and continuity, and offer some ideas on how to make the MFF more ambitious both now and toward 2030.

The MFF: a driver of reform

In this context of crisis, the optimal solution would have been a radical reform but this would imply a change of Treaty, for which there is little appetite among most European Leaders. The current Treaties offer many potentialities to start a reform of the EU. The Multiannual Financial Framework is certainly one of the best instruments to set the political priorities, the financial incentives, the performance indicators and the objectives for each legislative act.

The MFF could then be the driver to initiate a reform of the European Union. This volume contains multiple options for improving/reforming

various aspects of the MFF and the policies linked to it, with the aim of starting a bottom-up reform process. The quasi totality of these proposals can be carried on without a revision of the Treaty.

Below are some introductory considerations to assess how far the current proposals innovate or remain prolongations of previous exercises.

The Commission proposals for the MFF 2021-2027 were received with mixed feelings. These proposals had some elements of continuity but also the ambition to adapt and reform European Union policies. The departure of the United Kingdom from the EU has obliged the Commission to face a reduction in funds (about €75 bn over the seven-year period) with a blend of: reducing certain programmes; increasing national contributions; and introducing new sources of financing. Overall, the legislative proposals are largely in continuity with the past but there is a real effort to focus on the political priorities of the Juncker Commission. Scholars have defined it as a glass half full. I will mention three positive and three negative elements.

Among the positive elements:

- a. a reallocation of expenditure to policies with more European added value (i.e. structural reforms, environment, climate change, defence);
- b. an aim to carry out a major reform of the CAP by: shifting the focus from compliance to results; revising direct payments in favour of medium-sized and smaller farms; and introducing reinforced conditionality with environmental objectives;
- c. a proposal to change the own resources mechanisms with a progressive abolition of rebates and the introduction of new resources.

Among the negative elements:

- i. an over-timid approach to solidarity and protection, two elements considered priorities by EU citizens;
- ii. insufficient support for macroeconomic policies (a reform support programme (RSP) and the European investment stabilisation function (EISF));
- iii. lack of a clear procedure to guarantee respect for the rule of law (primary and secondary).

The proposals both constitute a legacy from the outgoing to the incoming

Commission and present some novelties with respect to the business as usual approach. They offered Member States a positive platform with a margin of improvement.

If we look at the level of discussion in the European Council, in particular at the compromise proposals presented by the President of the Council at the EUCO on 20 February, the three positive points fade away.

Enhancing the role of the MFF

The paragraphs below outline a few areas in which the role and the coherence of the MFF could be enhanced: the priorities for the next decade, off-budget financing and the duration of the MFF.

a) The political priorities and the structure of the MFF

Who sets the political priorities to be translated into legislation and financial allocations for the next decade? The question is particularly pertinent this year as the procedure started with the Juncker Commission but will continue with the Von der Leyen Commission.

The question of who should set the priorities is central. It goes beyond the current debate but the case of the current proposal is ideal for drawing attention to the weakness of the current mechanism. In appointing Ursula von der Leyen, the European Council has sought an element of continuity with the previous Commission. In rejecting the idea of appointing one of the Spitzenkandidaten, the Council wanted, among other things, to avoid the Lead Candidate might have made promises during the election campaign without having discussed them with the Member States. Once appointed President of the Commission, Mrs Von der Leyen presented her vision for Europe stressing the priorities which will drive her political agenda. These priorities were approved by the Council and the European Parliament after hearings with the individual Commissioners.

In her investiture speech before the EP, she mentioned her determination to triple the Erasmus plus programme as a Commission priority, a commitment which did not appear to be open for negotiation.

The Communication on the European Green Deal¹⁰ indicates a total

10 Communication on the European Green Deal, com(2019) 640.

need for €1 trillion over a decade. It mostly shows the percentage of money already allocated in the MFF that has been used. The roadmap annexed to the Communication announces 51 actions, measures and proposals to be presented in 2020/2021. Commissioner Hahn was clear that the fresh money needed will be €7.5 billion (for the Just Transition Fund), provided that the Commission's MFF proposal is adopted. Johan Van Overtveldt, a former Belgian finance minister and current chair of the European Parliament's Budget Committee, commented¹¹ that "Creative accounting and financial adventures will not get the Commission very far towards finding the €1 trillion needed to fund their new climate and energy plans."

The Commission's plan could definitely have an impact on day-to-day life and citizens realise that this is a project that can only be achieved at the European level (a European public good), but there is still a long way to go to transform the ambition into reality.

b) A Wider MFF for Off-budget Financing

To face the scarcity of financial resources, the EU has reduced its direct financial support for investment projects but instead it has used the resources of the EU Budget to guarantee the EIB to collect private capital on the financial markets. This approach has been quite successful¹² and allowed the funds invested in European projects to multiply in size by 15. The European Fund for Strategic Investment (EFSI, also known as the Juncker Plan) is one of the financial instruments but not the only one.

The use of these funds has displaced the decision centre from the Commission to the EIB group. Decisions are mainly made on the basis of the return on investments more than public utility. These funds have changed the nature of EU spending.¹³

There are two possible solutions to address this situation: the ideal solution includes all the instruments in the EU budget in the community decision-making process; the realistic solution is to accept the state of play but give the institutions more transparency and control. The

11 Politico: Commission green cash credentials questioned, 14/1/2020 <https://www.politico.eu/article/european-commission-brussels-green-cash-credentials-questioned-frans-timmermans-budget-just-transition-mechanism/>

12 See also chapter by Wilhelm Molterer.

13 See also chapter by James McQuade.

‘ideal’ solution should remain an objective but in the meantime structured transparency should give a clearer vision of what Europe and the Member States do for the European economy. Regular reporting exists, but more transparency would facilitate understanding of the impact on the European economy.

The MFF should be complemented with a more complete document, a wider MFF, adding up all the measures foreseen (national co-financings, the funds leveraged on the financial markets and the funds of the European Stability Mechanism). As Benedetto¹⁴ indicates, the amounts of these off-budget instruments are potentially (in the case of crisis) greater than the MFF/EU budget (1.66% vs 1% GNI). The EU institutions should be involved in monitoring the decision-making process and the implementation of the ‘wider MFF’.

The Commission proposals of May 2020 incorporate all the Next Generation EU funds under the MFF.

c) The duration of the MFF

The time length of the MFF was a topical subject in the preparatory work at the IGC preparing the Treaty of Lisbon.

The EP insisted on a duration of the MFF and of the legislation which was aligned with the institutional timeline, mainly to enhance the democratic legitimacy of the EU. The Council has always been more inclined towards a 7-year period for two valid reasons: negotiations are usually quite long (about two years) and a five year duration of the MFF would oblige Member States to be in permanent negotiations; and a 7-year period gives more time to implement long-term projects (i.e. cohesion funds).

The compromise between these two positions was the formulation of art. 312 TFEU establishing that the MFF “shall be established for a period of at least five years,” leaving the possibility of adopting it for a longer period. With the seven-year duration, which has been applied since 1992, it has happened, and it will happen again, that a Commission and EP, during their mandates, have had no say on the priorities and have had only to implement a MFF to which they have not contributed. This certainly has a negative effect on EP elections, raising the question of how

14 See also chapter by Giacomo Benedetto.

to motivate electors to vote if they cannot influence the main decisions in EU life. A duration of the MFF and of the legislation modelled on the institutional timeline could enhance the democratic legitimacy of the EU.

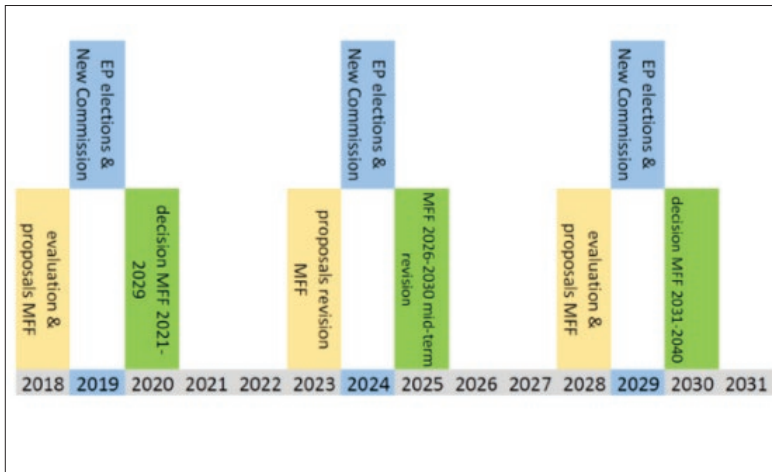
The idea of a 10-year Multiannual Financial Framework with a mid-term review by each incoming Commission/EP to highlight their own priorities and vision has been proposed. The outgoing EP has launched a request for a 10-year MFF, but only from the next one in 2028.¹⁵

A 10-year MFF would be accompanied by a mid-term review after five years, which would allow the new EP and the Commission to focus on their priorities.

Should the 10-year MFF be adopted this year, the calendar offers a unique opportunity to plan for a decade. This modification would not only be a cosmetic change but it would have high institutional significance, giving more responsibility and accountability to each Commission. Furthermore, it would enhance the democratic legitimacy of European elections. Citizens would see that their vote in a European election could influence the direction of Europe, increasing their sense of ownership.

The table below shows the junction between the outgoing and incoming Commissions.

Timeline in the case of a 10-year MFF.



d) European public goods and cross-country fairness

The EU budget has a dual nature:¹⁶ redistribution to serve national interests and investments to develop activities with higher European added value. A balance has to be struck between these two pillars. To make the debate more transparent, the structure of the MFF needs to be divided into two wide categories with the idea of keeping these categories as separate as possible. Should rebates not be abolished, a clearer distinction between redistribution and investment could open the door to a revision of the calculation of rebates. Rebates could be applied only to the portion of revenue allocated to redistribution. Jean Pisani-Ferry¹⁷ goes even further, suggesting setting each country's net balance in advance so as to simplify the negotiations on the expenditure side.

Concluding remarks

Ambition or continuity is in the background of all the chapters in this volume. Probably Louis Michel, President of the European Council, had the same question in mind when preparing the European Council's meeting of 20 February 2020. But the answer from the heads of states and governments was clear: more continuity and less ambition. All this was true until the explosion of the Covid-19 pandemic in European countries and around the world.

The last modest compromise proposal put forward in the night of 20 February by the President of the European Council foresaw an increase in funds for policies with pre-allocated national quotas and a reduction in ones with more European added value.

The lockdown of world economies in the second trimester of 2020, the uncertainty about the second semester of 2020 and the drop in GNI worldwide have pushed European leaders to articulate a strong European answer. The Franco-German initiative and the Commission proposals of 27 May 2020 offered a new and untested solution to respond to the challenges that Covid has imposed on the European economies. The compromise reached in the European Council decisions of 20 July 2020 authorising the EU Commission to borrow on the capital markets to invest in

16 See also the chapter by Stefan Lehner.

17 Jean Pisani-Ferry, A Radical Way Out of the EU Budget Maze, Bruegel, 2020. <https://www.bruegel.org/2020/02/a-radical-way-out-of-the-eu-budget-maze>

loans and grants to the Member States is a radical new step and of a size never practised before.

Even if these decisions still need the approval of the European and national Parliaments, and in spite of many criticisms on a number of details, the temporary and exceptional nature of these decisions changes the role of the EU. The decision on the Next Generation EU is the most important one taken by EU Institutions since the launch of the single market in 1985.

To conclude, the decisions of the European Council change the nature of the EU. The Member States are aware of the interconnections among their economies and show solidarity. While regrettable, this ambition was not part of a vision but the outcome of the very profound crisis which hit the European economies, a crisis the contours of which are not yet defined. The 2021-2027 MFF and the Next Generation EU represent at the same time (MFF) continuity as no serious reform has been introduced with only some funds cut with the only logic of a compromise, and ambitions to launch a new financial instrument which when operational will reinforce the role of the EU and its Member States in the world.

The Awakening of the Sleeping Beauty?

Alain Lamassoure

Abstract

This chapter highlights the immobility of the EU budget, which has remained stable in size and procedure in a fast-evolving EU and world. The pandemic has shaken the EU (the sleeping beauty), breaking the wall of indifference and neglect and opening the way for a true revolution, at least on three major points: the own resources ceiling, the borrowing ability of the EU and, last but not least, opening the Pandora's box of new own resources.

The chapter concludes by offering seven 'provocations,' which indicate the long way to go.

Keywords: EU reform, own resources, EU budget

The black hole of European politics

My first European Parliament election took place in 1989. Thirty years on, Europe and the world have undergone ground-breaking changes: the 12 Member States have grown to 27, four treaties have widely extended the Union's competences and we have witnessed the demise of communism and of the Soviet bloc, the bloody end of Yugoslavia, the success of the euro, the economic emergence of China and other BRICs, new forms of massive radical Islamic terrorism, never-ending wars in Afghanistan and the Middle East, the invasion of part of Ukraine by Russia, a global financial crisis, several surges of migrants at our gates, the doubling of the African population, with another doubling pending in the next two decades, Brexit ... Everything is different everywhere.

Everything, that is, apart from the EU budget: it is the same good old tiny budget, with the same proportion of GNI and the same breakdown of expenditure: a third for cohesion, a third for the CAP and the leftovers for new priorities. Every year we have desperately tried to update and refresh a debate the terms of which have remained desperately unchanged.

Over the years, the Multiannual Financial Framework (MFF) had turned from the best means to ensure long-term funding of major policies into a straightjacket depriving the EU of any flexibility in an ever-changing world. The gap between over-ambitious announcements by the European Council and the financial means allocated for them had become unbridgeable. Budget ministers and administrations ignored European Council decisions and conversely our Olympian leaders preferred not to delve into the way they were (dis)obeyed: an in-depth discussion on the long-term financing of European policies had not taken place at summit level since the European Council in Fontainebleau in 1984. Late last year, the EU budget seemed doomed to be stuck forever at 1% of GNI, a cap the net payers deemed even more binding than the Treaty itself and that the net beneficiaries were resigned to not questioning any longer. Worst of all, among policymakers, economists, journalists and commentators, nobody cared. The budget was the black hole of European politics. This is the title I gave to my course on the subject at PSIA-Sciences Po in early 2020.

Electroshock therapy by the pandemic

All of a sudden, in spring 2020 the pandemic crisis and its apocalyptic global economic fallout created the temperature and pressure conditions required to break the wall of indifference and neglect. All the psychological and political barriers fell apart as suddenly as the Iron Curtain. Following a joint move by France and Germany, the Commission was bold enough to topple the applecart with a ground-breaking proposal. As I write this paper, negotiations are still underway among governments. However, the simple fact that all the taboo issues came out into the open at the same time is a genuine revolution. At least three of them.

1. The invisible rooftop of 1% GNI has been rocketed through. A rise to 2% of the legal ceiling of resources has been proposed. In fact, if we add the New Generation EU 750 bn and the SURE programme 100 bn, a total extra amount of 850 bn should be spent in the next

three years, which will more than double the EU budget during that period of time. Certainly, this is proposed as a one-off temporary scheme. But history abundantly shows that the force of such precedents is irresistible: when national budgets exploded during wartime, they never came back to pre-war levels afterwards. A new threshold was reached for ever. See how today everybody agrees that the European Solidarity Mechanism (ESM), once a one-off temporary device, must find a new lasting role.

2. The borrowing capability of the EU would become almost unlimited. This entails two novelties: (a) an admission that the EU budget may involve an investment section to be financed through borrowing and not taxes, including to fund grants and not only loans; and (b) power is conferred on the EU to issue common bonds and set up a common debt.
3. The EU needs new own resources, if only to service the debt. Some enthusiasts have referred to a 'Hamilton moment' of the EU. In 1790, Treasury Secretary Hamilton convinced the US Congress that public borrowing could not do without taxation power, which is the only credible guarantee for prospective lenders. The EU is now considering this quantum leap.

Still a long way to go

A Chinese proverb runs: the longest journey begins with a single step. Assuming that this first step will be taken, a lot of other questions are awaiting answers.

1. How can we find a way to compel Their Majesties of the European Council to complement each of their Olympian conclusions with a financial fiche specifying the funding for their largesse? This would prevent their finance ministries from ignoring the above decisions and, conversely, prevent the grantees from ignoring disobedience by their subordinates.
2. On own resources, if we can build on the Monti Group's recommendations, the Commission's proposals and other ideas hinted at here and there have not yet been elaborated enough to go very far. Apart from the sale of ETS rights and a tax on plastic bags, the 'candidate'

resources (a border adjustment carbon tax, a digital tax, a financial transaction tax, a common consolidated tax base) still require in-depth examination at the technical level and engagement in harsh controversies. Moreover, the final result will have to be ratified by all the national parliaments. A first step would be a formal recognition of the principle that all or some of EU-originated revenue should be allocated to the EU budget. ETS rights are the first case in point.

3. As important as the subsidiarity principle should be the neutrality principle, which is its fiscal translation. Any transfer of competence from the national level to the Union should be accompanied by a transfer of all the relevant financial and staffing means so that every extra euro spent at the EU level is offset by at least one euro less at the national or subnational level. National auditors and the European Court of Auditors could be networked to ensure a competent and unbiased implementation of this principle on a case by case basis.
4. Beyond the EU budget, we should broaden our horizon to the financing of EU policies. The EU budget has become a minor part of the public funds dedicated to these policies. For a start, we must take into account the national contributions imposed by the additionality principle. We must also add all the kinds of 'satellite' budgets created year after year to respond to unexpected events without exceeding the MFF ceilings – a facility instrument for this, a trust fund for that, fiscal capacity for something else, the Athena procedure for the military – plus the various loans and guarantees indirectly linked to national budgets: EIB, ESM, EFSI, InvestEU Aggregation of it all should come to a very sizable amount. If we are to continue to live with this sort of mixed financing for a couple of decades, we should set up a suitable decision-making process for the sake of good management, including democratic oversight. Consequently, national parliaments should be involved together with the EP. The European Semester, with the so-called European Week, should be upgraded for this purpose. So far it has only mimicked a true ministerial and parliamentary debate without being taken seriously by the participants themselves, let alone by the citizens.

5. Now is the time to engage in real coordination of national fiscal policies. This coordination has been a mantra of Ecofin and Eurogroup meetings, but a mantra as hypocritical as it is boring: nobody means business. The issue must be tackled at two levels, for different purposes: at the total level, to enable the coordination of fiscal policies in line with the Ecofin and European Semester orientations; and on specific policies, where the lack of coordination is particularly detrimental to the achievement of common objectives. Let us take two policies as different as research and cooperation and development aid. In both cases the addition of national funding is between 8 and 10 times as high as the EU funds earmarked for these policies. If we sincerely aim to reach a critical mass, we need to not only coordinate but even perhaps merge all or part of these too numerous purses. Inventing the revolutionary partnership promised to Africa or at long last boosting Europe among the global digital powers will demand that much.
6. Incidentally, this will require harmonising our national public accounting systems. Certainly, this is not a vote-catching issue. However, had we undertaken this prerequisite process in time – i.e. when the Maastricht treaty came into force – we would be in a far better position to direct a common fiscal concert with 27 instruments. Playing in tune requires the same definitions of appropriations, liabilities, commitments, guarantees and deficits in all our public books.
7. A last question worth raising: do we still need a Multiannual Financial Framework at all? Its original ambition was to match EU priorities and their funding in a procedure that kept the peace between the three institutions. Admittedly, compared to the eighties, the institutions are currently at peace. However, the procedure prevents new priorities from being reasonably funded. At the national level, we have always managed to finance long-term policies in the short-term framework of annual budgets. Why would this be impossible at the EU level? To facilitate the relationships between the Commission, the state level and the regions in charge of cohesion fund management, we can preserve a form of five- or seven-year interinstitutional commitment. This could also apply to the implementation of multiannual international programmes like the ESA and ITER. However, other policies hardly require formal multiannual commitments,

all the more so since the MMF figures are not minimum amounts ensured in favour of targeted policies. The actual fact is that they work as maximum amounts, as ceilings not floors, protecting finance ministers for seven years against frivolous initiatives by MEPs.

The Dual Nature of the EU Multiannual Financial Framework¹

Stefan Lehner²

Abstract

At the end of 2019, the negotiations on a new Multiannual Financial Framework for 2021-2027 had barely begun. The Commission proposals of May 2018 aimed to strike a balance between managing the costs of Brexit and funding new priorities with high European added value. Member States, however, took traditional positions, insisting on agricultural and regional subsidies, and on budget cuts and rebates. New priorities were in danger of being squeezed out. Finding a new financial balance in the EU after Brexit was a task comparable to the ‘Agenda 2000’ negotiations to accommodate several less developed new Member States. At that time, all ‘other’ spending was frozen, contributing to the judgement that by 2003 the EU budget had become a ‘historical relic.’ Repeating such an outcome was not inevitable. All Council declarations and agendas committed to strengthening research and innovation, digitalisation, Erasmus, security and defence, cross-border infrastructure, migration management, and neighbouring and developing countries. In 2020, the newly elected European Parliament and the new Commission had the means to confront the Member States and to seek adequate financing for the common priorities of a new European Union of 27.

1 This paper builds on a contribution to the EUI/RSCAS Workshop “The MFF and EU policies 2021-2027: the EU towards 2030,” Fiesole, 17-18 October 2019, Roundtable “Lessons learnt and expectations.” The views expressed are the author’s and cannot be attributed to the European Commission.

2 Former European Commission director “Multiannual Financial Framework and Own Resources”

Every seven years³ the European Union engages in a grand financial bargain. The centrepiece is a Multiannual Financial Framework (MFF), which sets limits on annual spending overall and on the main categories of expenditure. Furthermore, the sources of financing – the ‘own resources’ of the EU – including possible rebates for some Member States, each individual spending programme with its allocated spending amounts, and the rules and conditionalities allowing EU expenditure are negotiated in the same package. 98-99% of the financial possibilities for the EU in the subsequent seven years are thus *de facto* pre-established.⁴

While the different components of this negotiation follow different legal procedures, it is negotiated as a package. The negotiation is launched by consistent proposals from the European Commission and unfolds in a well-established pattern: a thorough assessment by each Member State and by the European Parliament, one or two leaders’ summits negotiating and eventually pre-agreeing many important elements⁵ on behalf of the Council and a negotiation between the Council and the European Parliament, formally only for the EP’s consent on the MFF, but taking other elements in the package into account.⁶

Observers of these negotiations are regularly struck by a paradox: although academics nearly unanimously recommend that the EU budget should focus on ‘European Value Added’ (EVA) and before the negotiations political leaders identify ‘challenges,’ ‘strategic action plans’ and ‘budgetary priorities,’ the actual negotiations among the Member States focus virtually exclusively on the Common Agricultural Policy (CAP),

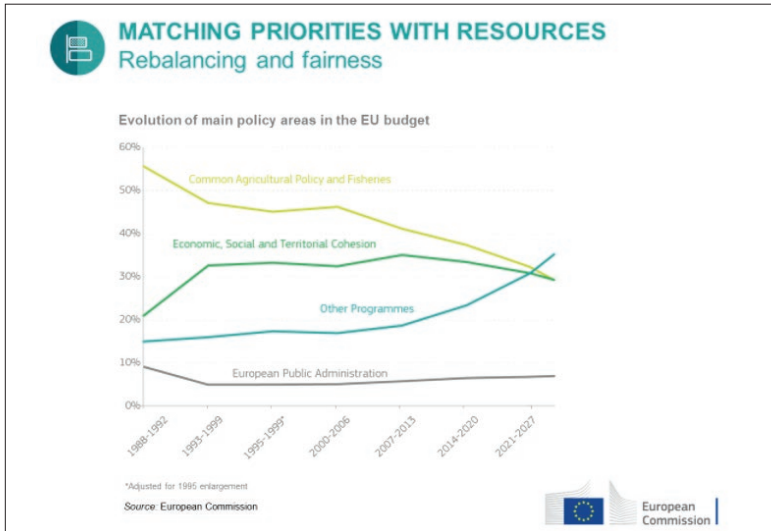
3 Currently. The duration of MFFs is regularly discussed. Arguments in favour of a return to five years – as for the very first MFF from 1988-1992 – or even an extension to 5+5 years with a review and possible revision at half time exist, but so far seven years has been retained as a compromise between predictability and flexibility.

4 Revision of the MFF remains a possibility, but it requires unanimity among the MSs and consent from the EP. The annual budget procedure may mobilise some unallocated margins and predefined flexibility instruments, but the amounts concerned regularly remain below 1% of the total annual budget. In crisis situations, however, Member States have sometimes provided additional ad hoc funding over and above the MFF, e.g. for part of the Facility for Refugees in Turkey (FRIT).

5 The European Council conclusions on the financial package regularly include more than 100 items.

6 The Own Resources still require ratification by all the Member States. While this component of the package is therefore formally adopted much later than the rest, this is compensated for by retroactive application. In substance, national parliaments have never deviated from the unanimous agreement established by their heads of state and government.

cohesion, the overall budget size and individual rebates, i.e. the directly measurable financial benefits and costs of the EU budget. EVA programmes are treated as ‘other programmes’ and are allocated whatever is left under some artificial overall limit (the infamous 1%). The Commission proposal for the 2020-2027 financial package tries again – as in previous exercises – to break the mould (see graph 1), but the negotiations so far are following the familiar pattern.



Numerous proposals have been made to get rid of the ‘juste retour’ or ‘I want my money back’ approach but without success. Instead, this contribution contends that this line of criticism fails to understand the dual nature of the EU budget⁷ resulting from its unique characteristic as **a budget for the Union and a budget for the Member States**: on the one hand, the EU budget is a vehicle for the Union to invest jointly in European Value Added projects but, on the other hand, it is also a legitimate and effective tool for the Member States to rebalance the actual and perceived costs and benefits of EU membership for each of them. In practice, the two aspects may even be inseparable for many spending policies.

For the best EU budget possible, both aspects must find their legiti-

7 Sapir (2008) talks of the “two logics of EU expenditure”: the side-payments logic and the public goods logic. Although he recognises that to some extent side-payments enable the basic public good of the EU, i.e. the Single Market, and that parts of the structural funds are distributive and nevertheless an essential part of the integration process, he advocates structural changes to much reduce the side-payments part of the EU budget.

mate space. However, given the underrepresentation of European value added at the most important negotiation table in the European Council, additional mechanisms have to be found to protect EVA from the MS bargaining. This contribution will make some proposals to facilitate this, both in the short and the longer term.

The EU budget as a tool for joint Investment

The academic verdict on the EU budget is quite unanimous. It has been most effectively summarised by Sapir (2004): “As it stands today, the EU budget is a historical relic. Expenditures, revenues and procedures are all inconsistent with the present and future state of EU integration.⁸” The criticism in the Sapir Report is mainly based on the discrepancy between the declared strategic economic goals set by the EU for the 1990s – sustainable economic growth and greater social cohesion (the ‘Lisbon Agenda’) – and the dominance of agricultural spending in the EU budget, which contributes little to either objective and should be replaced by more growth-enhancing expenditure, such as research and innovation, education and training, and infrastructure connecting national markets.

Other academics base their criticism on the theory of fiscal federalism, an economic theory on the optimal repartition of tasks between different levels of administration.⁹ Fiscal federalism prescribes that the higher political level, here the EU, should only act in situations of economies of scale (i.e. significant cost advantages of joint provision) or to internalise spill-overs across national borders. Prominent examples of economies of scale would be the Galileo project, the network effects of infrastructure investments such as the Brenner Base Tunnel and joint defence procurement. The potential spill-overs may be positive from research and development or negative from pollution. The advantages of central provision in such cases would still have to be weighed against the heterogeneity of preferences: the wider the range of preferences across Member States and regions, the stronger the argument for local provision. This position would argue for, e.g., a limited centralisation potential for defence or recommend enhanced cooperation of some like-minded

8 Sapir (2004), p. 162.

9 See, for example, a detailed explanation of the concept of European Value Added in Weiss, S. et al. (2013) and, for a very detailed application to the EU budget, ECORYS et al. (2008).

Member States, which is, however, difficult to organise in an EU budget. With the apparatus of fiscal federalism, the standard recommendation is to expand EU activities – and the budget associated with them – on research and development, the environment, networks (energy, transport, information, communication), foreign aid and neighbourhood policy, and – to a more limited extent – defence. Funding for agriculture is to be transferred to national or regional budgets. European funding for the CAP can only be justified to the extent that it provides environmental goods with cross-border benefits.¹⁰ Cohesion policy is also seen critically, at least to the extent that it goes beyond the poorest regions.

To some extent, the low score given to the CAP for EVA is exaggerated: it is typically based on a perceived heterogeneity of preferences. Some argue that decentralisation would allow each Member State to give income support to its farmers depending on national circumstances and preferences for income.¹¹ Others seem to assume away national differentiation in agricultural subsidies by invoking EU state aid control.¹² What is rarely considered is that the centralisation of a large part of public support for agriculture at the EU level represents an EVA in itself to the extent that it defines a ‘level playing field’ in a sector which is highly prone to political pressure and therefore vulnerable to subsidy competition. *In extremis*, out of control agricultural subsidies could not only represent an actually higher burden on the EU taxpayer but put into question the single market overall.

Similarly, cohesion support, which is mainly redistributive, can also be a key tool for the regional development of the EU as a whole, in particular if it is effectively combined with cross-border infrastructure investments (transport, energy). The recent reservation of cohesion fund amounts for transport projects within EU-defined corridors seems to work well in this direction. Therefore, also here, the EVA elements tend to be underestimated.¹³

With these caveats, the academic concept of EVA – which is in any case legally enshrined through the subsidiarity principle in the Treaties¹⁴

10 Heinemann and Weiss (2018), p. 10.

11 ECORYS, op. cit., p. 168.

12 Heinemann and Weiss, op. cit., p.10.

13 Also, as Ludlow (2013), p. 32 observes, “Cohesion and integration are flip sides of the same coin.”

14 Treaty on Union, Art. 5.3.

– provides valuable guidance for the development of the EU budget. It identifies the areas where joint investment can realise provisions for all Europeans which individual Member States could not realise or closes cross-border infrastructure gaps. Joint provision sometimes also has a potential for significant national budget savings.¹⁵

For the MFF negotiations, common financing should therefore be evident, possibly combined with side payments if winnings are not equally distributed across the Member States. In reality, however, European value added has no vote at the Council negotiation table. As the returns from EVA cannot be precisely allocated to individual Member States, these investments figure very low among their negotiation priorities.¹⁶ They are inexistent when heads of state and government congregate to conclude the deal for the next financial package. In fact, instead of being seen as a potential win for all, EVA expenditure is seen as a burden by everyone, and is cut down in every negotiation round.

The value of the **budget for the Union** as an instrument for joint investment is uncontested. But it needs special provisions to find its appropriate place in the negotiations.

The EU budget as a balancing mechanism between the Member States

The discrepancy between theory and negotiation reality has triggered wide-spread criticism of the ‘juste retour’ or ‘I want my money back’ approach and motivated many demands to get rid of it, but without success. This criticism overlooks the fact that the European Union is still to an important extent a union of Member States, and their motivations for EU membership are quite different: they may depend on history, geography or various economic factors – macroeconomic or based on key economic sectors (e.g. agriculture, coal and steel). In such a situation, a

15 Weiss (2013) provides detailed numerical examples of the European added value of common EU diplomacy and integrated European land forces.

16 “In a recent ECFR (European Council for Foreign Relations) survey of attitudes towards MFF negotiations among policymakers and influencers across the EU member states, only four countries said they had a strong interest in the allocation of external aid – and none said they had a very strong interest in it. (By comparison, 19 had a strong or very strong interest in cohesion funds, and 20 a strong or very strong interest in the common agricultural policy.) The EU’s global role matters to member states, but investing in it is not leaders’ top priority” (Dennison, p.3).

successful Union cannot ensure that each Member State has the same costs and benefits from every joint decision. However, overall and in the medium/longer term, the benefits must clearly outweigh the costs for each Member State, both real and perceived. The recent ‘Brexit’ is a poignant reminder.

There are a number of instruments to balance the interests of Member States, particularly if they are properly packaged. The EU budget, in particular in the magnified form of the Multiannual Financial Framework, is a crucial one among them. This was already recognised in the Padoa-Schioppa Report:¹⁷ “This is because the Community, unlike fuller political systems, is not responsible for the provision of essential ‘public goods’ such as defence, justice and social security, with the important economic consequence that distributive issues become more acute owing to the need to balance costs and benefits for members in more narrow terms than in a complete political system. Consequently, the claim of a ‘juste retour’ tends to be stronger than in other systems.”¹⁸

This can best be illustrated by the example of the very first substantial budget negotiations in the EEC in the 1960s¹⁹ ²⁰ when the founding Member States agreed to have an operational budget for the European Economic Communities.²¹ This was the result of the first serious crisis of the young Communities which culminated in the French ‘empty chair’ boycott on participating in any Community activities. The key issues at

17 Padoa-Schioppa, T. (1987), p. v.

18 Similarly, Laffan (1997), p. 15: “The public finances of the Union lie at the borderline between politics and economics, between market integration, wider economic integration and political union. Financial resources play an important role in complementing market integration and in providing sufficient cohesion to sustain economic and political integration. There is thus an important link between the finances of the Union and the process of political and economic integration.”

19 This chapter draws heavily on European Commission, “The European Commission 1958-72,” chapter 4 and European Commission “European Union Public Finance,” Part 1.

20 In their historical analysis of the EU budget Blankart and Koester (2009) show that the institutional set-up goes back to the Treaty of Rome, which indeed already included provisions for “agricultural guiding and guarantee funds (Art. 40.4)” and a “European Social Fund” (Art. 123). No funding was, however, provided for the first decade of the EEC.

21 The 1965 Merger Treaty and the 1970 Luxembourg Treaty fully incorporated the Euratom Treaty and the administrative budget of the European Coal and Steel Community (ECSC) in the EEC budget. The operational budget of the ECSC remained separate until the expiry of the ECSC Treaty in 2002. Due to its small size and exclusive sectoral focus it is not included in this analysis.

the time were:

- The completion of the common market enabling the free movement of goods across intra-Community borders required a **common agricultural policy (CAP)**, given the crucial importance of this sector in the period. Common market schemes were established for each agricultural product, including import levies.
- Revenue from external **customs duties** and **agricultural levies** could gradually be made available as EEC ‘**own resources**,’ allowing Member State national contributions to be phased out.
- As the opening of national markets would result in significant adjustment costs, probably unevenly distributed across the Member States, the **European Social Fund (ESF)** was available to provide assistance, in particular to combat resulting unemployment.
- **Research policy**, originally confined to the nuclear field through the Euratom Treaty, was gradually generalised.

The material interests of the Member States were quite different. Funding the CAP via the EEC would represent a major transfer in favour of France, but also Belgium, the Netherlands and Italy. The ESF would be most solicited by Italy, in particular for its lagging south. Most Member States would benefit from transferring customs duties to the EEC, although for a long time the Netherlands regretted losing the benefits of the ‘Rotterdam’ effect. As the difficulty in agreeing on any of these elements culminated in a major crisis, the Commission for the first time proposed to resolve these issues in a package (Hallstein proposals of 31 March 1965²²).

However, this package left Germany as the only net payer and all the other Member States as net beneficiaries. Why would Germany agree to this? Blankart and Koester (2009)²³ argue that the other Member States, in particular France, used a credible threat to withdraw from the Communities, putting into question the commercial gains for export-oriented Germany from the Common Market. A more obvious explanation can be found when widening the perspective, as the 1965 package contained two important non-budgetary elements:

22 Financement de la politique agricole commune – Ressources propres de la Communauté – Renforcement des pouvoirs du Parlement européen (Propositions de la Commission au Conseil), COM(65)150, 31 March 1965, as quoted in European Commission (2014), p. 93.

23 Op.cit, p. 10.

- An accelerated abolishment of **Intra-Community customs rates**, thus opening the national markets earlier than foreseen, which would rapidly benefit the re-emerging German export industries; and
- A gradual expansion of the budgetary **powers of the European Parliament** as first steps to establish the Parliament as a second significant centre of power at the European level, which was particularly supported by Germany and the Netherlands.

In the final stages of the negotiations, Germany also obtained agreement that the greater part of the Community's external trade was included in **external customs tariff reductions in the GATT Kennedy Round**.

Therefore, when the crisis was resolved in 1967, a pattern had emerged which *mutatis mutandis* would repeat in all the European budget negotiations until today. France would lead the 'friends of agriculture,' Italy (later joined in this role by new Member States) would lead the 'friends of cohesion' and Germany (and other commercially strong Member States) would try to limit the budgetary 'price to pay' but find its main interest in the continual deepening of the single market. The only additional element was one introduced in 1985 when the United Kingdom was not satisfied with this structure and a **rebate on its contributions** had to be introduced with 'rebates on the rebate,' initially for Germany but later also for the Netherlands, Sweden and Austria. The latter Member States – in 2014 joined by Denmark – have since also benefitted from additional time-limited rebates, which are a relatively simple mechanism to fine tune the final negotiation equilibrium.

Other prominent manifestations of this approach took place in 1988, when the ambitious '1992' programme to complete the single market could not be agreed on without it being packaged with a doubling of the structural funds and vice versa, and in 1992 approval of the Maastricht Treaty providing for Economic and Monetary Union was combined with the historically strongest expansion of the EEC budget to 1.27% of GDP.²⁴

The trend turned in 1999 at the Berlin summit in the moment in which the costs of German unification had become clear and a fear of

24 The decision of the Council of 1 February 1993 to allocate more representatives in the European Parliament to unified Germany than any other Member State and thus loosen the principle of equal representation of the 'big' Member States was also part of the package.

similar costs of enlargement dominated the discussion in Germany. “Enlargement touches key internal bargains of the Union.”²⁵ Negotiations among the existing 15 Member States and with the acceding countries for each accession agreement allowed these bargains to be rebalanced, albeit with a shrinking overall economic weight of the EU budget.

In 2005 and 2013 an ever more restricted total volume of the MFF (as % of EU GNI) was dictated primarily by the United Kingdom, which – in the light of a widening intra-EU trade deficit – felt it could not justify what was still a major net contribution in spite of its rebate.²⁶ Other net contributors happily accepted the restrictive approach as the budget negotiations stood largely alone and few other benefits for them could be brought into play.

In each exercise, the EU budget served as a key mechanism allowing the Member States to rebalance in certain time intervals their actual or perceived costs and benefits of membership of the European Union in general and so to allow the European Union at least to continue.

The case of the 2021-2027 MFF

The negotiations over the MFF for the years 2021 to 2027 again provide an illustration of its dual nature. On the one hand, the European institutions have made efforts to identify the challenges for the future. Triggered by the vote of the United Kingdom to leave the EU, a discussion process got underway among the EU27 with the Bratislava roadmap (September 2016) and the Rome declaration (March 2017). The Commission launched a White Paper on the Future of Europe,²⁷ which was accompanied by five reflection papers on key policy areas, including the future budget. The process was slow, overshadowed by the uncertainties about the form ‘Brexit’ would take. Therefore, when the Commission had to put forward its proposals for the 2021-2027 MFF in May 2018 it could only build on a vague consensus on the themes which were of common concern: security, future economic potential, social and ecological sustainability and a stronger Europe in the world. The subsequent political

25 Laffan (1997), p. 254.

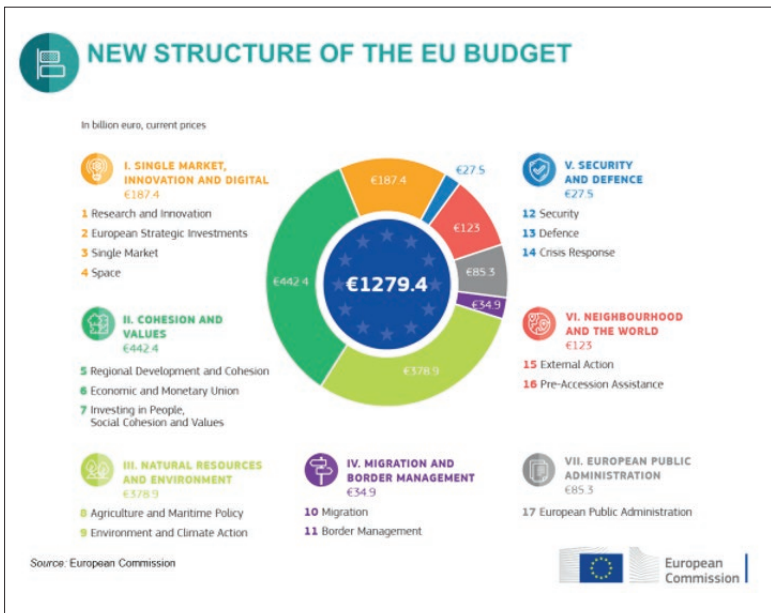
26 Not surprisingly, the net contribution to the EU budget played a major role in the ‘Brexit’ campaign. The loss of many ‘unseen’ benefits of EU membership, however, may still reveal “Brexit” to have been a major miscalculation.

27 See https://ec.europa.eu/commission/future-europe/white-paper-future-europe_en

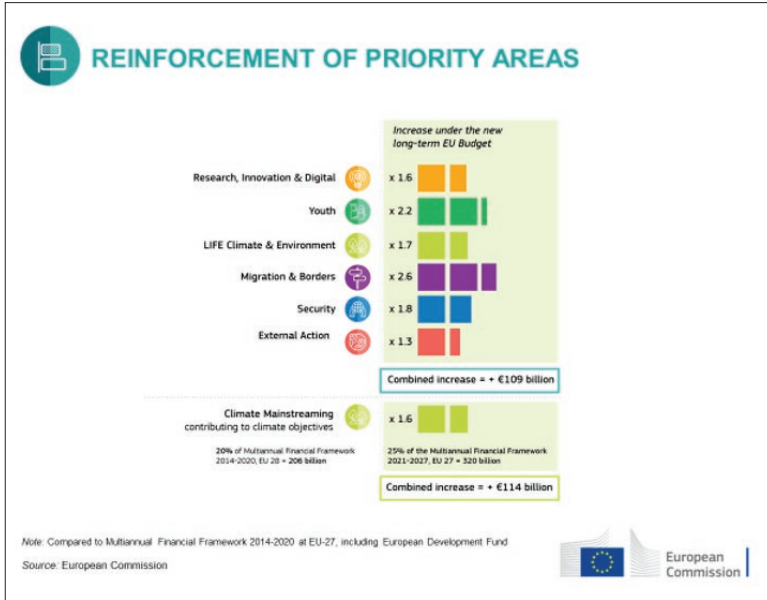
conclusions of the European Council in Sibiu in May 2019 and the European Council’s ‘New Strategic Agenda’ of June 2019 broadly confirmed the consensus. However, no consolidated operational programme for a European Union of 27 (such as a ‘Europe 2030’) emerged to anchor the budget negotiations.

On the other hand, the withdrawal of a major net contributing Member State, the United Kingdom, threw into sharp relief the need for a renegotiation of the budgetary benefits and burdens. While other main net contributors signalled their unwillingness to increase their contributions,²⁸ net beneficiaries insisted they would not agree to ‘pay the price of Brexit.’ From the outset, the redistributive issue had to be addressed.

In a “realistic and balanced” proposal of 2 May 2019, the European Commission suggested splitting the costs of Brexit between some moderate cuts in the big spending policies – the CAP and cohesion, but without putting these key EU policies into question – and some additional contributions from all the Member States. In addition, it proposed



28 Unlike in 2003 and 2011, however, no letter from the major net contributing Member States setting a 1.0% limit at the outset of the upcoming MFF negotiations was received this time. Germany even sent some signals indicating a more forthcoming position.



investing more in common key EVA priorities for the future²⁹.

The reaction of the European Parliament was mostly one of disappointment. It rejected the cuts and insisted on much more ambition regarding the EVA priorities.³⁰ It stood ready at the end of the process to confront a result from the Council which would be even more disappointing than the Commission proposal.

The deliberations in the Council developed predictably. The Member States established national positions strictly according to national preferences, focusing on the CAP and cohesion, and on the overall size and the desire for rebates. The solemnly underwritten joint priorities were quickly side-lined. In December 2019, the Finnish Presidency³¹ attempted a compromise proposal, tilting the rebalancing in favour of a somewhat reduced cut in the CAP, an additional reduction in cohesion and an overall level halfway between the Commission proposal and the

29 For a detailed presentation of the Commission proposals, see https://ec.europa.eu/info/strategy/eu-budget/documents/multiannual-financial-framework/2021-2027_en

30 For the positions of the European Parliament, see <http://www.europarl.europa.eu/legislative-train/theme-new-boost-for-jobs-growth-and-investment/file-mff-2021-2027-mff>

31 Presidency of the Council, “Multiannual Financial Framework (MFF) 2021 – 2027: Negotiating Box with figures,” 2 December 2019.

position of the most restrictive Member States.

However, remnants of the priority profile remained, safeguarding the increases proposed by the Commission for Horizon Europe: the LIFE programme, the Asylum and Migration Fund and Humanitarian Aid. For other policies (e.g. cross-border transport infrastructure, space, neighbourhood and development policy), however, the Commission proposals would be reduced, in some cases quite drastically, leaving only small increases compared to the current MFF (e.g. the proposed amount for the new defence fund was cut in half). All the Member States and the European Parliament rejected the Finnish proposal, which nevertheless, as in the previous exercise, became the reference point for the final stages of the negotiations in the European Council.

Indeed, the first proposal of the President of the European Council at the Special Summit of 20 February 2020 was largely a validation of the preceding Council discussions with some minor tweaks, e.g. introducing a 'Just Transition Fund,' which was proposed by the new Commission President, to provide additional cohesion funding for coal regions predominantly in the new Member States. It is still worth noting that the inclusion of two new own resources based on non-recycled plastic and the Emission Trading System represented the first time since 1988 that new own resources reached the final stage of European Council negotiations. The trend in the negotiations at the summit, as revealed in an informal 'Commission non-paper' distributed in the morning of 21 February, was similarly unsurprising with the CAP and cohesion reinforced, 'priority programmes' (Horizon Europe, space, military mobility and development cooperation) further reduced, the ETS dropped as a potential new own resource and the incentive aspect of the plastic-based own resource largely neutered by an anti-regressivity mechanism. Furthermore, the morning compromise attempt already went very far in reintroducing rebates. While the summit still failed to agree on these terms, it was reasonable to expect that a second summit, possibly in May 2020 – given the increasing time pressure – would succeed with some further modifications along these lines.

The massive cuts in 'priority' spending areas and the – if at all – minuscule new own resource would, however, set up a confrontational negotiation with the European Parliament, which was to be organised by the German Presidency. The possible outcome of the European Council

agreement would have been so far from the declared European Parliament positions that ideas were floated for a 'plan B' rejecting a new MFR and continuing for some time with annual extensions of the 2020 ceilings, as foreseen for such a case in Art. 312.4 TFEU. Given the particular circumstances of an outgoing framework of ceilings based on an EU28 being available for spending by an EU27,³² the spending possibilities of some 1.16% of EU27 GNI would far exceed a possible EC agreement of 1.07% and even the Commission proposal of 1.114%. These spending possibilities could be allocated to individual programmes in a revived annual budget procedure with the European Parliament in full co-decision authority. The main obstacle to this plan would have been the expiry of the current spending programmes at the end of 2020. These programmes would have to be extended and possible new spending programmes agreed by a qualified majority in the Council. Whether such a majority could have been found in the absence of an overall agreement on a new MFR remains an open question. In any case, the final stages of the next MFR negotiations would have been an interesting test of whether under current rules the European Parliament could restore the required funding for the European Value Added programmes. But then everything changed.

Next generation EU – a new (budget) world?³³

While the negotiations on the next MFR were dragging towards a predictable outcome, the world was hit by an unprecedented health crisis which quickly turned into an unprecedented economic crisis: the spring forecast of the European Commission in May feared an EU-wide loss of -7.4% of GNI for the year 2020 and the summer forecast of July had to correct this further downward to -8.4%. Although the shock was symmetric in so far as all the Member States were affected, the differing economic impacts and reaction capacities of the Member States were expected to result in income losses diverging between -4.3% and -9.7%, which were later corrected to -4.6% to -11.2%, thus risking unsustainable divergence and a damaging second round of economic – and political – effects.

32 After the de facto exit of the United Kingdom from the EU budget at the end of 2020

33 The following is a very condensed introduction to the new dimensions of the MFR negotiations under the COVID crisis. It will have to be more thoroughly discussed elsewhere.

With a real risk of the Union falling apart and the financial markets already tightening for some Member States, the Member States and the Union reacted. On 14 April 2020, the Finance Ministers agreed a package of three EU level instruments with a nominal value of € 540 billion, which reinforced the existing possibilities of the European Monetary System and the European Investment Bank and launched a new refinancing possibility for national health and employment measures (SURE). All these measures, however, would be intergovernmental, temporary and credit based,³⁴ the latter of which was considered inadequate by already highly indebted Member States.

Therefore, encouraged by a German-French initiative of 18 May 2020, on 27 May 2020 the new European Commission proposed a new recovery instrument, 'Next Generation EU', to be funded by EU loans and to be partly used for non-reimbursable grants to Member States. Given that the Treaty prescribes that the EU budget must balance (Arts. 310 and 311 TFEU), the funds raised on the capital markets would be considered 'external assigned revenue' as provided for by Art. 21 of the EU Financial Regulation, boosting the regular EU budget. The ceiling for the regular MFR would be raised to 1.4% of GNI for payments and temporarily to 2.0% to guarantee the own resources for the Next Generation loans. The repayment could be facilitated by new own resources, to be proposed by the Commission by 2021.³⁵

After a short period of examination of these new proposals by the Council and a first inconclusive virtual Special European Council on 12 June, a second physical meeting of the European Council on 17-20 July 2020 found agreement after a record four days of negotiations. The main elements of this agreement are an acceptance in principal of credit-financed grants reinforcing the regular EU budget, but with reduced amounts compared to the Commission proposal, a new own resource based on non-recycled plastic – with a work programme towards further new own resources, a new 'rule of law' conditionality for payments from the EU budget – with details still to be agreed at a further European Council meeting – and a rather unambitious traditional MFR.

In terms of structure, for the first time the EC conclusions establish cohesion policy as the dominant EU spending policy, taking into account

34 Furthermore, by July 2020 none of them had been activated.

35 Any new own resource would again require unanimity of the Member States and a second ratification process.

the fact that the Just Transition Fund and most of the ‘Next Generation’ package and the Recovery and Resilience Facility have many characteristics of cohesion policy, although the latter will be implemented at the national rather than the regional level. The CAP continues to lose ground compared to the previous period. European value added investments gain in share, but the breakthrough intended in the May 2018 Commission proposal is not achieved.

The next step will be a negotiation between the Council and the European Parliament. Given the sheer dimension of the ‘Next Generation EU’ fund and the desperate time pressure, the European Parliament may decide to accept some limited reinforcements and focus on the content of specific spending programmes rather than putting the whole package into question. Any agreement in the autumn would still have to be followed by agreement on some forty spending programmes and on the annual budget for the year 2021. Furthermore, the recovery programme cannot be activated until the own resources decision has been ratified by all the Member States. Ratification just before the end of 2021 would be a record pace and would just allow the first tranche of the national recovery programmes to be committed.

In the negotiations with the Council, the European Parliament could positively weigh the fact that the European Council conclusions already agree on issues which it has fought for for many years: the special instruments will be unambiguously over and above the MFF ceilings, in terms of both commitments and payments – these special instruments will therefore provide very valuable margins for the fully co-decided annual budget procedure; the share of climate-related expenditure is raised to 30% across the EU budget (40% for the CAP), and there is a ‘do no harm’ clause obliging *all* EU expenditure to be consistent with the Paris Agreement objectives; the decades old blockage against new own resources is broken, even if the first step – contributions calculated by means of an indicator for non-recycled plastic, largely neutralised by a non-regressivity mechanism – is materially small; and the European Development Fund is integrated in the regular EU budget with its special flexibilities preserved.

For the longer-term outlook two scenarios are possible:

- In the best case, the daring expansion of EU budgetary activities, temporarily funded with loans and then reimbursed with new own

resources, could be a success story and could become available to the EU toolbox for future needs. The Commission loans could also serve a useful purpose for European Central Bank refinancing purposes. And – across the Member States – accelerated investment in modern green and digital infrastructure along with much needed structural reforms could contribute to a successful emergence from the deepest economic crisis in the history of the EU. The 2021-2027 MFR would be truly historic, comparable to the very first Delors package. Even in this best case, it should be noted that traditional European programmes co-decided and supervised by both the Council and the European Parliament would be put in the shade by a largely Council and Member State-run recovery programme only loosely attached to the EU budget.

- In a less optimistic scenario, the boost to be provided by ‘Next generation EU’ could fail to kick in. Ratification by all relevant national parliamentary bodies of the 27 Member States may drag on; approval of national recovery plans may turn into acrimonious affairs. And there is no precedent for how to proceed if national reforms progress half-heartedly and implementation targets are missed. In that case, the EU27 may regret having left aside for another seven years the European added value investments it should have unlocked.

Outlook: securing more European value added in the EU budget

The key lesson for the future would be to accept the dual nature of the EU budget and to strengthen the budgeting of EVA programmes against the one-sided nature of Council negotiations. Several proposals exist.

Blankart and Koester (2009),³⁶ for example, suggest creating an additional ‘public good budget’ next to the ‘general budget.’ It would be financed by individual contributions from Member States willing to jointly unlock public goods. There would be no need for a unitary budget. Several sub-budgets could emerge as in the early years of the EEC, even with different sets of participating Member States on the basis of enhanced co-operation. A few such budget instruments have indeed emerged. The European Development Fund has existed in parallel with

36 Op. cit., p. 20.

the EU Budget since 1959. More recently, voluntary ‘Trust Funds’ have been set up. The new ‘Eurozone budget’ could also be seen as a manifestation of such an additional public good budget³⁷ for a sub-group of Member States. But a multiplication of EU budgetary instruments is to the detriment of the unity and transparency of the budget. In addition, Member States risk losing control over their overall exposure, which may explain why such instruments have been of limited use.

Possibilities do exist to strengthen the EVA content while maintaining the unity of the EU budget. In the short term, i.e. with the existing budgetary rules, the chances for EVA programmes could be improved from the outset of the negotiations.

- The MFF should not stand alone but should always be negotiated as part of a wider EU strategy for the future. Accompanying internal and external policy initiatives should give Member States options for wider trade-offs. Whereas in the past such wider elements of the package often focused on deepening and enlarging the internal market, other topics – e.g. tax policy, environmental regulation, migration policy – should not be too difficult to find.
- The Commission proposal for a future MFF must be consistent with a wider strategy for the development of the European Union (such as the previous ‘Agenda 2000’, ‘Lisbon’ and ‘Europe 2020’). A pre-established consensus on the most urgent challenges, the necessary measures to take and the budgetary priorities derived from them can to some extent be held over into the actual negotiations. The Juncker Commission – confronted with the early stages of ‘Brexit’ – was only able to lay the groundwork for a redefinition of the European Union as 27. But the new Commission President Von der Leyen’s ‘New green deal’ – even late in the process – has important conceptual potential.
- The Commission must give a quantitative head start to the EVA parts of a future MFF. There is path dependency in the negotiations and a seemingly overambitious Commission proposal has better chances of achieving the desired result than a ‘realistic’ one. In addition, if the European Parliament could throw its weight in these

³⁷ The emerging design of the Budgetary Instrument for Convergence and Cohesion would, however, indicate more a redistributive intention than EVA, but the two are probably again hard to separate.

negotiations primarily behind the EVA programmes, their chances of surviving the Council negotiations would be enhanced.

Procedures could also be strengthened to bolster an outcome which acknowledges the dual nature of the EU budget. One possibility would be to install a preliminary round of formal discussions before the Commission makes its MFF proposals, in analogy with the already existing inter-institutional cooperation on “priorities for the budgetary procedure” for the Annual EU Budget.³⁸ To avoid it just being a formality, such an **inter-institutional procedure for the priorities for the next Multiannual Financial Framework** could be made to have trialogues and adopt joint conclusions. Such a preliminary procedure could not discuss amounts, but – particularly if the EU has just adopted an overarching strategy for the future – it should not be too difficult to agree on the key priorities to implement this strategy and to commit to taking them appropriately into account in the upcoming MFF negotiations.

It would be a further leap forward if the institutions could even agree to set a **percentage target for all ‘other expenditure’** except the CAP and cohesion, e.g. 35% of the total operational expenditure. Such an agreement would gain muscle if the European Parliament explicitly linked its consent to the MFF to the Council ensuring the pre-agreed percentage in the final result. This would allow the MSs to negotiate their fair burden sharing through the CAP and cohesion and retain control over the total amount, taking into account that a specific amount for the EVA programmes would be added to reach the pre-agreed proportion. The sharing of the EVA amount between specific programmes would be the main substance of the negotiations between the Council and Parliament, based on a Commission proposal. This would allow the Council to negotiate a new cost-benefit balance for each Member State for the years to come, and for Europe to move forward with investments that only Europe can realise to the Union’s benefit.

Another potential step forward is actually already in the existing Treaty: Art. 312.2 TFEU provides a possibility for the European Council to unanimously authorise the Council to adopt an MFF by a qualified majority (the so-called ‘passerelle’). Such a change in the decision mechanism would reduce the individual ‘blackmail’ potential of the Member States and therefore the redistributive requirements within the financial

38 As set out in the Annex to the Interinstitutional Agreement (2013, Art. 2). Such an IIA is regularly adopted jointly with the MFF Regulation.

framework. Furthermore, individual EVA programmes could be agreed if they benefited most Member States but not each and every one.³⁹

An even better result could be unlocked in the longer term with a change in the Treaty. As Heinemann (2015) points out, the European Parliament is structurally more apt to decide EU budget priorities on the basis of European preferences rather than purely national ones. “A power shift in budgetary policy from the Council to the Parliament would diminish parochial thinking in budgetary decision-making to some extent.”⁴⁰ Fuest, Heinemann and Ungerer (2015) therefore propose that the Council should retain the ultimate authority on the spending cap and leave the decisions on the spending structure to the European Parliament. However, they focus on the Annual Budget, which is not quite suitable as all repartition decisions are already taken with the MFF package.

Instead, the desired effect of strengthening the EVA element of future EU budgets could be expected from one key change in the decision-making rules in the Treaty. While the own resources decision, including the ceiling and composition, would remain reserved for the unanimous agreement of Member States and national ratification (as today), a **Treaty reform could foresee adopting the MFF along with the multi-annual spending programmes by the regular co-decision procedure**, i.e. with a qualified majority in the Council and a full participation by the EP in the negotiations. In such a setting, Member States would still control the maximum total spending of the EU and could agree on rebates, but the co-decision rights of the European Parliament would bring a more European-minded negotiator to the actual negotiation table and should result in more appropriate budgeting for EVA programmes.

The above would require an enlightened modification of one budgetary decision rule in the Treaty. A Conference on the Future of Europe is coming up, and such a reform could be in place for the next MFF negoti-

39 One precedent exists to support such a scenario. From 1 January 2007 the Interinstitutional Agreement of 17 May 2006 for the MFF 2007-2013 allowed for the first time a limited revision of the MFF by a qualified majority in the Council (Art. 22). This came to an end with the coming into force of the Treaty of Lisbon on 1 January 2009, which restored the unanimity requirement for all modifications of the MFF. During this short window, one significant decision to fund a new EVA programme was actually taken with a qualified majority in the Council, i.e. the revision of the MFF to fund the satellite navigation system Galileo from the EU budget (Council decision of 11 December 2007).

40 Op. cit., p. 108

ations. While the EU budget is not in the limelight of European politics, it is a precious tool to rebalance the costs and benefits of the Union for each Member State and to unlock European value added which no Member State can achieve alone.

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The MFF Process and Global Challenges

Pier Carlo Padoan¹

Abstract

This chapter assesses the background against which future MFFs will have to operate, in particular the significant challenges: a) economic, with slowdown and structural impediments to growth; b) technological, with opportunities for productivity increases but also threats to social cohesion; and c) non-economic – migration, security, climate change.

The MFF may be a common framework for new tools. Monetary policy alone will not be enough. It must be complemented with structural/fiscal tools. Structural reforms increase the impact of monetary policy in terms of competitiveness and convergence. Central fiscal capacity is needed to complement national policies. Policy tools must integrate and support each other.

The chapter identifies a number of functions that could be assigned to the EU budget and which are partially on the Von der Leyen agenda: competitiveness, convergence, stabilisation, inclusiveness and EU public goods. The chapter concludes that the new MFF can enhance EU governance if it can build stronger institutions and trust.

Introduction

MFF negotiations are taking place against a background of major global and continental challenges and at a time when a new Commission is taking office, marking the beginning of a new geopolitical cycle. This

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makes the current MFF negotiation cycle particularly encompassing, also taking into account the fact that the Commission is launching a major overhaul of a number of policy issues, from the stability and growth pact (SGP) to the green deal.

This paper offers a brief overview of the challenges facing the European Union and how they translate into implications for a redesign of the EU policy process, which includes the MFF. The challenges can be organised into four groups: economic, geopolitical, technological and what I will call European public goods.

Economic challenges

Let us start with the economy. While it is positive, growth in Europe and the eurozone (EZ) is slowing as in the rest of the global economy and there is a strong suspicion that some of the drivers behind the slowdown are not cyclical but structural. If one looks at Germany, for example, (but not just Germany and not just the automotive sector), structural challenges are showing up visibly and one could go so far as to suggest that Europe, but not only Europe, is facing symptoms of secular stagnation. It may be worth recalling some evidence. The long-term performance of variables such as productivity growth, investment and real interest rates has been on a downward trend for decades, in both the global and the EU economies.

The natural rate of interest, at times referred to as the equilibrium real interest rate, reflects the marginal return on capital and is closely related to the trend growth in total factor productivity (TFP) and to population growth. While benchmarks for equilibrium real interest rates are notoriously difficult to identify empirically, given the wide range of available measures, most estimates point to a secular decline across advanced economies. For example, according to the Taylor rule,² the appropriate short-term rate is pinned down by the natural rate estimate once output and inflation gaps are closed. Estimates of the real equilibrium rate were already on a downward path before the financial crisis. In the wake of the crisis they fell precipitously. This secular decline in the equilibrium real rate is mainly, but not exclusively, linked to factors depressing trend growth. In such a framework, monetary policy can be seen as having to

2 The Taylor Rule is an interest rate forecasting model invented by the famed economist John Taylor in 1992.

‘shadow’ the secular decline in equilibrium interest rates.

Another piece of evidence is that real interest rates and growth may exhibit diverging trends but the correlation between the two has been relatively high for the last 30 years in the euro area. (Masuch et al. 2018). Divergences between growth and real interest rates may arise from saving-investment imbalances, for example as a result of demographic developments, or of portfolio shifts due to factors such as rising demand for safe assets.

The degree to which structural reforms and technological advances can reverse the downward trend in the natural rate will be among the factors determining how challenging it is for central banks to reach their objectives in the future. A low natural real rate increases the likelihood that policy rates need to turn negative or that non-standard measures need to be taken in response to adverse shocks. While unconventional policies have proven to be effective, some of them have also been met with some concerns because of potential longer-term adverse side effects

While to different degrees in different countries in Europe, structural factors hampering growth remain in place, equilibrium interest rates are further depressed by saving-investment imbalances, due in part to demographic changes, and by portfolio shifts. Structural policies can play a pivotal role in countering these forces by improving growth potential – in turn improving long-term income expectations – and by addressing saving-investment imbalances.

To sum up, against this background one should ask to what extent the MFF can add to the effectiveness of structural reforms and fiscal policies in addressing the roots of declining growth.

Geopolitical challenges

Then there are geopolitical challenges. While the European economy is mildly progressing although at a declining rate, there might be risks of significant hurdles showing up down the road. This is happening in a framework of global economic tensions, which are in many cases, including in the case of global trade wars, self-inflicted. This has economic consequences but also more broadly governance consequences as there is a shift away from multilateralism and towards bilateralism. A few years ago in the global scenario and in Europe, no one would challenge

the fact that the global system of governance would remain well anchored to a multilateral environment and cooperation among key actors. Now the scenario has changed radically and we are facing more conflicts than cooperation.

There is an urgent need to improve global governance, lower systemic risk, raise long-term growth and reverse the trends towards higher confrontation and declining economic performance (including secular stagnation). How can this be achieved? How can the MFF contribute to such a shift? What are the challenges for global economic governance? Global governance changed dramatically after the outbreak of the global financial crisis, shifting the focus from the G7 to the G20, thus recognising the rising role of large emerging economies. Over time the G20 agenda has extended to a very broad range of issues, mostly under the heading of strong, sustainable, balanced and inclusive growth. However, it is hard to claim that global governance has succeeded in achieving risk reduction and fostering growth. In the recent past, attempts to strengthen global cooperation and multilateralism seem to have been replaced by increasing bilateralism and 'sovereignties' (i.e. the view that the interests of nation states should prevail over multilateral agreements). The policy of the global hegemon, the US, has become increasingly inward-oriented, putting national interests first and contributing less to the supply of global public goods such as stability and open markets. In other words, there has been an increasing shortage of hegemonic stability as the major key player prefers bilateral relations (both positive and negative) to multilateral cooperation. In addition, other key countries have similar attitudes. Therefore, global governance needs to deal with increasing fragmentation.

Because of the absence of a global hegemon, the provision of public goods will require fundamental changes, which are unlikely in the short term. The conditions for minimising systemic risk are not at hand. Without hegemony, international cooperation is much more difficult, requiring key players to be willing to reciprocate, adjust preferences and adopt a long-term perspective. Europe could play a much more effective role from this point of view, contributing to better global governance in a multipolar world. The challenge for Europe is to have instruments fit for improving global governance. Europe needs to provide resources for global governance and global public goods. Is the MFF up to the challenge?

Technology

Third challenge: technology. We are excited about new technologies, about the digital economy, but we have to recognise that technological transformation is good and bad at the same time. It is good because it offers new opportunities, including ways to re-boost productivity growth, which is weakening. It also offers challenges as there is a risk of a digital divide, which has significant social and welfare implications.

The technological transformation generates challenges in the policy sphere, especially ones related to the digital economy. I mention two: taxation and competition policy. Both are increasingly relevant in a scenario in which the leading companies are US and Chinese and policies have to be implemented having in mind a global playing field.

European public goods

Finally, there is a fourth group of challenges, namely migration, security and climate change. All of these have social, technological and economic implications but they also have a life of their own and challenges of their own. They also have the property of being (European) public goods, the provision of which may be problematic. They are also closely related to a strengthening of global governance, to which the MFF may react.

Response to the challenges

This is the panorama which the new Commission is facing. It is well reflected in Ursula von der Leyen's opening speech, in which many of these challenges are mentioned and there is a commitment to stand up to them. While the challenges are diverse, we need a common framework to look at them. Can the MFF provide that framework, not just in terms of resources but also in terms of tools and mechanisms?

There is no single policy tool which can deal effectively with the challenges on its own. This point is clear when one thinks of growth and the role of monetary policy. Monetary policy has changed greatly over the last few years but it is reaching the limits of its transformation. The new approach to monetary policy has provided the global system with benefits by contributing to pulling the economy, both global and European,

out of recession but it is also generating undesirable consequences such as persistent negative interest rates. The new framework needs a complementary contribution by other policy tools, namely structural reforms at the national level and structural measures at the EU level, together with extensions and an upgrade of the single market project, which is Europe's big structural programme.

Fiscal policy measures are also needed. Europe needs to make a leap forward towards European fiscal capacity instruments beyond and as a complement to reforms of national fiscal instruments and the SGP. A reconsideration of the fiscal stance implies introducing instruments at the European level, including safe assets. A European fiscal stance should be understood not simply as the sum of national fiscal policies but as an independent policy stance, which requires proper instruments. To what extent, if at all, can the MFF provide a contribution to generating an EU fiscal stance?

The debate has concentrated on three functions, namely competitiveness, convergence and stabilisation. In addition, given the secular stagnation background, Europe needs competitiveness instruments and this is very much related to exploiting new technologies in terms of productivity growth. It is also related to how this function can be instrumental for growth from other perspectives, including environmentally sustainable growth. A key issue in terms of enhancing productivity is also related to resources in the MFF leveraging incentives for private sector investment.

A second function is convergence. This is as old as Europe itself. For decades, there have been convergence and divergence trends at the national, regional and global levels. There is evidence that in an economy driven by technology-induced productivity, more convergence and more technology diffusion are factors crucial to ensure that aggregate growth is maximised and well distributed. How should we upgrade convergence policies to take into account the benefits but also the challenges of new technologies? And how can we make sure that countries, regions and companies are as close as possible to the 'technological frontier,' avoiding being trapped in the backyard and remaining laggards? This is a very well-known historical challenge in Italy, a country with a very large part of its territory systematically lagging with little or no convergence towards the richer part of the country for decades.

A third function is stabilisation. Dealing with this function has

raised significant resistance reflecting the divide between those who would like more centralised stabilisation tools in the European Union and those who claim that it is up to national governments to provide stabilisation rather than generate fiscal profligacy at the European level. My view is that Europe needs an EZ-level stabilisation function. There is discussion about what form it should take, for example investment support and/or an unemployment insurance scheme. Whatever the tool, it should operate with a short-term horizon, i.e. providing cyclical stabilisation, also so as to avoid permanent transfers.

Interaction among policy instruments

Europe needs more growth, and growth that is more inclusive. There is evidence that more inclusion and more inclusiveness bring more growth. To grow more, you do not have to leave laggards behind. Instead the opposite is true.

Understanding growth mechanisms requires considering macroeconomic and structural aspects and their interaction. This implies looking at the roles of the EZ and of national policy. The issue is how different policy instruments interact. The key point can be summarised as follows. As mentioned earlier, monetary policy alone cannot bear the burden of supporting the EZ economy. It must be complemented with fiscal and structural policies. The impact of monetary policy on inflation, risk perception and structural reform efforts may have reached a limit. Progress with the structural reform agenda (Masuch et al., 2018, OECD 2018) can improve the effectiveness of monetary policy, thus providing a further element that strengthens the growth dimension of the EZ.

On the other hand, there is no agreement on the stance and design of EZ-level fiscal policies and strategies and, while there is agreement that structural reforms should be boosted, there is limited political appetite for following up as structural reforms require time to deliver benefits and may have significant distributional costs in the short term.

A proactive fiscal policy in the EZ has several dimensions. At the national level, prominence should be given to debt reduction. Hence, as long as the interest rate is higher than the nominal growth rate a primary surplus is needed in all the countries. At the same time, a reconsideration of the stability and growth pact should be initiated so as to strengthen

incentives for public and private investment, including green investment, simplify the rules and give more prominence to a debt rule.

In addition, more coordination of national policies would be welcome. More symmetry in adjustment is needed. Countries with fiscal space should use it. Those without fiscal space should try to expand it and concentrate on structural policies. The EZ as a whole would benefit from such a distribution of policy measures.

Can the MFF open the way to an EZ fiscal capacity? Steps in this direction are only moderately encouraging, if at all. On the other hand, the EU budget is the natural instrument to deal with convergence and structural adjustment. Its impact is enhanced when operating in coordination with the structural agenda. Budget resources should provide buffers favouring structural adjustment transition costs. Convergence and adjustment are considered, but on a limited scale. However, while a stabilisation instrument is needed, no progress is in sight. As mentioned, the function could be fulfilled in different ways, for instance through an unemployment insurance mechanism. Such a mechanism could improve labour market adjustment, prevent hysteresis and avoid cyclical unemployment turning structural. This could be achieved without the risk of a transfer union (Giammusso and Padoan, 2019). A fiscal policy capacity should be developed to support both stabilisation and the adjustment of imbalances, but also allocation of resources and therefore an impact on long-term growth.

Growth and European public goods

A final challenge includes a group of issues under the heading of European public goods. These include migration, security, defence and climate-related issues. This terminology begs the question of whether Europe needs to be provided with public goods. What amount of resources and mechanisms should be devoted to producing them? Let me concentrate on environment issues.

Environmentally sustainable growth, the Green Deal introduced by President Von der Leyen, involves both the availability of public goods and a new growth mechanism such as a common regulatory environment. This strategy requires a combination of policy measures, including public investment, tax incentives and a regulatory framework to boost

private investment. The 'transition fund' should provide resources to support the structural transformation in the private sector as it moves towards a carbon-free 'circular economy.' The MFF can contribute to such an ambitious strategy to the extent that it provides appropriate incentives for additional private investment and helps minimise the negative impact of 'policy uncertainty.' The question arises of whether the amount of resources that the MFF mobilises for the Green Deal will be sufficient to jump start the transition towards a carbonless circular economy. A way to enhance the impact of MFF resources would be to accelerate progress towards the completion of the internal market for services, given the service-intensive nature of environmentally sustainable systems. Ultimately, green growth will happen if private sector companies believe in it and invest significant resources and consumers are prepared to change their consumption patterns.

Conclusions. Resources and mutual trust are needed

I conclude by mentioning two issues. First of all, if the size of the budget turns out to be inadequate to meet the challenges, where do we get the money? Is a 0.1 percentage point increase in the MFF enough? Should we reallocate existing resources? Should we go down the 'own resources' alley? And what kind of own resources? In addition, is there consensus on these agendas? Second, from a political point of view, in the recent past Europe has been facing a major challenge, I would go so far as saying a threat, that Euro-sceptics might gain political support to radically change the Union. This was expected to be one of the results of the recent European Parliament elections. This scenario has materialised only to a minor extent and this is good news, but the storm is not over. There is growing evidence since the outbreak of the global financial crisis of a link between sentiments vis-à-vis European institutions and the performance of the European economy in terms of employment and job security. Europe and European institutions have been blamed for a deteriorating economic performance. While increasing dissatisfaction is driven by different elements, it has reverberated in decreasing trust in European institutions. If trust is not rebuilt and available in reasonable amounts, it is impossible to strengthen European institutions. Building trust is one of the main challenges to governments, institutions and countries and a lack of trust is one of the consequences of the global financial crisis. This drop in mutual

trust has fallen upon the European institutions. A successful MFF could go a long way towards building stronger institutions and trust. Hopefully the new Commission cycle will be instrumental in this respect.

Post scriptum

The covid pandemic has dramatically changed the EU and Global scenario, given the dimension and extension of the crisis. It has also brought up an unprecedented policy response by the EU institutions most notably through Next Generation EU and a new enhanced role of the EU budget. Obviously the original draft of this chapter could not address the issues specifically related to the covid crisis and response. However I feel that many of the challenges addressed in the chapter still stand after the crisis. A possible, serious exception is the pandemic risk and related health care challenges. Other challenges however stand out even more dramatically today, possibly with a more severe dimension, and so do some of the policy implications. For example the need to strengthen the structural reform agenda, and the suggestion to introduce a labour market stabilisation instrument, or the need to have a more effective fiscal stance. All in all the need to have in place a stronger and more diversified EU budget instrument comes out very forcefully as one of the lessons from the covid pandemic crisis.

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Innovations in Financing the EU

Wilhelm Molterer

Abstract

Ursula von der Leyen's plan for the EU to be CO₂ neutral by 2050 needs translation into legislation and then concrete investments. The investment needs are enormous, specifically for mobility, buildings, industry and agriculture. The European Court of Auditors has quantified an annual investment need of around EUR 1.115 trillion by 2030.

However, climate is only one priority – global competitiveness and cohesion are equally important. These targets can only be achieved by complementing the EU budget with private capital. There are two principal ways of channelling private money into investment: through commercial banks/capital markets; and using budget funds leveraged by promotional banks to crowd in private capital

EFSI shows how efficient and effective this is. A guarantee of EUR 33 bn leveraged by the EIB group incentivised investments on the ground of EUR 500 bn by 2020. We currently stand at EUR 430 bn in investments for SMEs, innovation, climate, energy and infrastructure. EFSI tackles the right priorities and reaches the regions with the most persistent gaps.

Some important questions for its successor, InvestEU:

- Will the guarantee be sufficient to tackle the investment needs?
- Should the possibility of using financial instruments be obligatory for all structural funds?
- How can cross-border investments be supported?
- How can fostering the blending of financial instruments with grants maximise impact?

- How can the role of national promotional banks and institutions be improved?
- How can the spirit of the Juncker Plan as a market-driven instrument be defended based on three pillars: better regulation, a strengthened advisory capacity and a strong financial arm called EFSI?

Incoming EC President Ursula von der Leyen has laid out her Commission's priorities for the period 2019-2024 and beyond. One of the most prominent initiatives is for a European Climate Law¹ to enshrine the goal of Europe becoming climate-neutral by 2050.

Other political priorities do not get as many headlines at the moment but are of equal importance for Europe's future prosperity. One could summarise them as the three Cs:

- **Climate** – becoming CO₂ neutral by 2050, but there are also other aspects of the European Green Deal, such as preserving biodiversity, introducing a circular economy and a sustainable use of resources. The European Court of Auditors has estimated that, to achieve the required reductions in CO₂ in the four key sectors of transport, buildings, industry and agriculture, investments of EUR 1.15 trillion per annum are needed in Europe until 2030.
- **Competitiveness** – closing the competitiveness gap that has opened up with international partners and competitors will require massive investment as well. The EIB estimates that investments in strategic infrastructure – such as mobility, water, energy and digital, together with increased RD&I to achieve our stated target rate of 3% of GDP – amount to an annual requirement of at least EUR 400bn per annum, not including emerging new disruptive technologies such as artificial intelligence.
- **Cohesion/coherence.** Europe has to become green and strong but also united, in its values, economic governance and democratic accountability.

These are key topics for Europe's long-term prospects, and they will have to be translated into the next MFF and wider legislation, and ultimately have to result in real investments on the ground.

1 This act aims to translate into law the goal set out in the European Green Deal: for Europe's economy and society to become climate-neutral by 2050. https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2020-119545_en

Without going into the details of the MFF negotiations, given the magnitude of the challenges one thing is clear: it will simply be impossible to finance all the required investments from public budgets, be it at the national or European levels. Irrespective of the details of how we set our targets in Europe, we will only achieve our common goals if we manage to channel private money into strategic and sustainable investments.

There are important topics that political Europe needs to tackle to facilitate this. Let us just name three: the Banking Union, the Capital Markets Union and a clear and convincing taxonomy on sustainability. All three could provide important impetus to energise private investment.

Principally there are two ways to channel private money towards the right investments:

- 1. Via commercial banks/capital markets.** A few thoughts on this: commercial banks today remain a pre-eminent source of financing for investment, but their risk capacity has been curtailed by changes in the regulatory environment. Revisions to the Basel framework and other related measures were necessary and have made the banking system more resilient. Let us hope that when the next economic shock happens the banking system will be able to withstand it better than just over a decade ago, and without the need for massive (sometime unsustainable) public support. However, the downside is that bank financing is today often constrained in tenor and risk appetite, and that sufficient alternative sources of financing have not emerged. This leads to ample liquidity for many borrowers but limited long-term financing and risk capital, especially for small, innovative and young companies, and strategic investments that do not yield quick financial results. The Capital Markets Union, which could help in opening up financing alternatives, remains as yet unfinished.
- 2. Budget funds leveraged by promotional banks** crowding in private capital. Simply put, such instruments are an alternative and complimentary way of using budget money – not as (lost) grants but in the form of loans or guarantees that provide financing for worthwhile projects and can be recycled. Also known as financial instruments, these are not new and combine the capacity of public

funds to accept high risk for targeted policy impact with the large financing capacity of private investors looking for sensible and sustainable investments.

Allow me to expand on the second channel from an inside point of view. As the Managing Director of the European Fund for Strategic Investments (EFSI) since 2015, I have first-hand experience of the largest initiative of this kind to date. It is not a panacea or an attempt to replace the use of budget funds as grants wholesale. But EFSI has proven that the concept of using budget guarantees to mobilise investment works on a significant scale for a wide range of sectors and across all of Europe. It is based on a budgetary guarantee of EUR 26bn, plus EUR 7.5bn of risk capacity provided by the European Investment Bank. With this, the EIB Group will provide EUR 100bn of additional risky financing in the period 2015-2020 for projects that are viable, feasible and in line with EU policy goals. Importantly, EFSI (or correctly the EIB Group) will never finance an entire project on its own but will systematically co-invest alongside other financiers which rely on the Bank's detailed assessment of the quality of the underlying investment.

After four years – and with approximately one year left to go – what are the results? To recap, EFSI is part of a holistic initiative started in 2014 by the then President-elect Juncker, borne out of the correct diagnosis that investment levels in Europe were critically low, and designed using the financial expertise of the European Investment Bank: the '*Juncker Plan*.' Its three pillars are (1) better legislation for an investment-friendly environment, (2) more advisory capacity for prospective public and private investors to move project ideas to become investment-ready, and (3) the EFSI as the vehicle for additional financing crowding in private investors. The stated goal of the wider initiative is to support EUR 500bn of investment across Europe by the end of 2020 in response to the situation correctly diagnosed at the time.

As of November 2019, the total investment incentivised in projects supported by EFSI has reached EUR 450bn, based on the latest approvals. Not all of these projects have been concluded, and some will take years until they are fully implemented, particularly long-term infrastructure investments. Some projects may yet fall by the wayside, but that is the nature of risky projects. However, based on the current momentum we are confident that the targeted EUR 500bn investments will be achieved

thanks to the combination of the budgetary guarantee, the financing capacity of the EIB Group and countless co-investors participating in the financing at the level of the projects.

EFSI has provided financing support across all 28 Member States. While there are explicitly no country quotas for EFSI support, it is nevertheless encouraging to see that relative to the size of the economies in terms of GDP, the countries that have benefitted most from EFSI support are Greece, Estonia, Portugal, Bulgaria and Poland. At least 4 out of 10 EFSI projects so far directly support cohesion regions.

Looking at the sectoral distribution, it is worth remembering that this is also not driven by quotas or pre-determined allocations, but by market gaps and investment needs. Interestingly, the largest beneficiary at 30% of the total is not an industry sector per se, but support for **small and medium-sized companies**. This group has special relevance in the European economy, and was also recognised in the EFSI regulation from the beginning. When EFSI was extended to the end of 2020 (EFSI 2) the importance of continuing support for this group was one of the legislators' key messages. Following this at 26% is support for **RD&I**, which is higher than originally expected. Joint next with almost equal shares of 18% are the important sectors of **energy** (renewable energy, energy infrastructure and energy efficiency), **digital** (digital services, broadband infrastructure) and **transport** (infrastructure and innovative technologies). Across all sectors, a target of 40% for support for climate action was introduced in 2018, and today EFSI is on track to achieve or even surpass this.

The results so far show that leveraging budget funds via grants and loans and crowding in private sector investments into strategic and sustainable investments works. This is not theory but has been demonstrated at scale on the ground, and it is already having a positive impact in priority sectors and regions on the ground where market gaps are real.

The implementation of EFSI has not been easy or perfect, but hardly anything in the real world is. It has taken longer than expected to reach projects in some regions more used to grant financing. There were high expectations of the benefit for cross-border projects, but few of these have materialised so far. Maybe this is an indication that there are other constraints more crucial for cross-border projects than financing which could be better addressed through the other pillars of the Juncker Plan. Some important adjustments were also made by the legislator on the

occasion of the EFSI 2 extension, such as increased transparency and the aforementioned 40% climate action target.

However, the feasibility and potential impact of an alternative use of budget funds – another tool in the public toolbox – has been proven beyond doubt. EFSI will continue until the end of 2020, and new instruments will take over with the new MFF. What appears clear is that InvestEU will continue the concept of using budget funds for loans and guarantees where it makes sense. The set-up will be different, with 25% of the guarantee available for national promotional banks and other implementing partners, and of course the political objectives of InvestEU will have to reflect the new political priorities of today, just as EFSI reflected the crisis in investment diagnosed in 2014.

Currently the magnitude foreseen is for a guarantee volume of EUR 38bn incentivising EUR 650bn of investment until 2027. InvestEU will merge previously separate instruments on the one hand and have more focused policy targets on the other – that is the prerogative of the public guarantor.

To finish, here are some thoughts on what factors may be crucial to maximise the impact of the future InvestEU over the horizon of the next MFF.

- So far ‘financial instruments’ and InvestEU are mainly tools in the centralised budget. InvestEU offers the possibility for voluntary contributions from, e.g., structural funds or the second pillar of agriculture of up to 5%. Why only voluntarily? Why only up to 5%? Why only for these sources? Should it not be possible to make the use of such instruments a common tool for all budgetary sources looking for the impact of public intervention? Why not also use this tool for strategic investments and support for projects outside the EU?
- How can we make InvestEU intervention more impactful for support for strategic cross-border projects?
- How can blending grants with financial instruments be made easier and more impactful at the level of individual investment projects?
- How can the role of national promotional banks be reinforced and also their cooperation beyond their natural home markets, and particularly in Member States without a home-grown NPB?

- How can we ensure a balance between the renewed policy focus of the InvestEU instrument with the successful market-driven approach of EFSI so that the right strategic and sustainable investments are supported where they are needed on the ground?
- How can InvestEU retain the successful recipe of three re-enforcing pillars – better regulation/legislation + strengthened advisory capacity + a strong financing capacity – across all the Member States?

The Importance of Own Resources in The EU Budget

Ivailo Kalfin

*Not everything that counts can be counted and
not everything that can be counted counts.*

Albert Einstein

Abstract

If the three main functions of a budget are the distribution of income, the allocation of resources and stabilisation of the economy, they can only be fulfilled if both the revenue and expenditure sides are considered at the same time and managed as a whole.

The practice of decoupling revenue from expenditure in the EU budget naturally leads to substantial problems in terms of effectiveness, efficiency and economy as it creates a wide gap between commitments by political leaders and delivery of them supported by the EU budget. Furthermore, this approach provokes epic political fights among the EU Member States, wrongly focusing on the *juste retour* concept. This happens at the expense of transparency and creates a negative public perception of the EU budget as a whole. In fact, if European added value exists and part of it is intangible then the *juste retour* approach is utterly wrong.

The solution is to increase transparency in the budget negotiations, to make them less dependent on procedures in the Council, to involve the national parliaments more closely and, most importantly, to increase the autonomy and flexibility of the budget by rebalancing the share of genuine own resources without limiting the sovereign right of the Member States to decide on taxation.

Financing the recovery from the Covid-19 crisis creates a rare opportunity to finance the debt repayment without imposing additional burdens on taxpayers by using new genuine own resources that directly feed the EU budget.

Why own resources?

The EU budget is a particular budget. Under normal circumstances, a public budget has three main functions – to distribute income, to allocate resources and to stabilise the economy. In the case of the EU budget, these features weigh quite differently. In fact, the main focus falls on resource allocation. This is where the visible political fights are, where the European Parliament has a more important role and where national governments proudly announce the amounts of funds they have secured in the everlasting budget negotiations. Although it has increasing importance, the stabilisation function is still not clearly visible in the EU budget. Since the 2008 crisis the EU has tended to coordinate and regulate national fiscal policies through the European Semester procedure rather than use proper funds for macroeconomic adjustments. For the last 10 years, the newly created economic governance mechanism has managed to rapidly reduce fiscal deficits but has failed to substantially decrease the debt level of the Member States. This mechanism apparently works under pressure but is quite loose when economic decisions are not so urgent. The big question of whether economic transfers in the eurozone can be replaced with policy coordination remains open.

A major shift occurred with the shock of the Covid-19 crisis. The EU had every reason to open the door to additional substantial fiscal transfers to help the national economies mitigate the social and economic consequences of the pandemic and the difficult recovery period. The European Commission is allowed to raise debt in its own name with or without government guarantees from the Member States. This created a precedent with the ESM, the SURE instrument and finally – and in massive terms – with the proposed Next Generation EU Fund. Nevertheless, these are considered ad hoc exclusive measures and the Member States do not accept a permanent functioning of a large centralised EU budget.

The core problem here is how to ensure that taxpayers will not be required to pay for irresponsible political decisions in another country where they do not have legitimate representation. The only possible

answer to this dilemma is to shift responsibility to the supranational level and entrust the existing representative institutions, such as the European Council and the European Parliament, to exercise the necessary democratic control. This is a clear but difficult move since when they lost their national currencies few citizens were taking an informed decision that it would also mean at least partially losing control of their national fiscal policies. This is why a relatively clear move from the economic policy point of view like creating an effective budgetary instrument in the eurozone is protracted and only a partial solution, including in the current negotiations on the 2021-2027 MFF.

The third budgetary function – income redistribution – is very much neglected and undervalued in the EU budgetary process. Unfortunately, the situation is gradually deteriorating on this front. The early EU leaders very intelligently decided to fund the common enterprise with the revenue it generates. If we make a parallel with a business initiative, this is the way to make it sustainable. But if we stick with this parallel, over time the shareholders decide to immediately distribute the proceeds from the functioning of the enterprise and subsequently to fund its needs. This approach is far from sustainable. It clearly incentivises a maximisation of withdrawals and a minimisation of inputs instead of focusing on common interests and the long-term goals of the entity.

The parallel with a business entity might seem exaggerated, but what we have witnessed over time in the EU is exactly the effect of a net transfer approach, bringing short-termism and national priorities to the top when deciding on the EU's future. This approach increases risks associated with a future expansion of the Union and also widens the gap between the expectations of citizens and subsequently the political commitments on one side and the financial means left at the disposal of the EU on the other. The result is an increase in the expectations gap and the appearance of bold political moves such as Brexit.

Own resources were introduced with the Treaty of Luxembourg back in 1970.¹ They were customs duties and sugar levies, which rapidly compensated the decreasing national contributions to the EU. With the partial introduction of VAT as an own source of EU financing, the national contributions ceased to exist. For several years in the first half of the 1980s, the EU was financed entirely with the so-called traditional

1 https://ec.europa.eu/commission/sites/beta-political/files/modernising-revenue-sources-eu-budget_en.pdf

own resources: customs levies and an adjusted VAT share. Further on in the late 1980s with the enlargement of the EU and the appearance of the cohesion policy, the Member States decided to introduce a new form of financing: a GNI-based national contribution. This was practically a return to national funding but in a more sophisticated manner. Over time, the Member States made the GNI-based contribution even more opaque by introducing various rebates on the national contributions. Today, 30 years later, the GNI-based contributions amount to more than 70% of the EU budget, the financing system is impossible to explain and the flexibility and autonomy of the EU to address emerging acute concerns of citizens have been nearly brought to zero.

The reason is that a net-benefit approach and a zero-sum game understanding dominate EU budget discussions. It is difficult to fully monetise and calculate the value added of the EU. The procedure for adopting multiannual budgets requires unanimity among the Member States and discriminates against the right of the European Parliament to consider both the expenditure and the revenue sides of the EU budget.

The case for change

The current system of EU budget own resources accumulates tensions which if they are not released under control might lead to far reaching negative results similar to the unfortunate budget 'argument' in the UK referendum on leaving the EU. Several flaws are apparent in the current procedure for deciding on own resources in the EU budget.

Lack of transparency. It is virtually impossible to explain the EU budget to taxpayers. The problem stems mostly from the revenue side. First, the rebates are a result of arm twisting during negotiations that does not have a logical or numerical explanation. After starting with the UK, the GNI-based contributions are currently decreased for Germany, Sweden, Denmark, Austria, Ireland and the Netherlands. The correction mechanisms actually reach beyond the GNI-based contributions. This all started with the Fontainebleau summit in 1984 when the UK Prime Minister Mrs. Thatcher secured the British rebate from the contribution due. Today, the array of corrections includes a reduction in the call rate for the VAT-based contributions, lump sum reductions, corrections related to security and citizenship opt-outs and even rebates on the payments due following the UK rebate. As a rule, corrections do not decrease the EU

budget but instead the remaining Member States proportionally compensate for every rebate. This means that Member States like France, Italy, Spain, Bulgaria and others contribute in addition to their share in order to compensate for the other countries' rebates. All this makes it impossible for citizens to properly understand how much they contribute to the common EU budget and why. In addition, the restricted role of the European Parliament – just a consent decision on the own resources – and the lasting practice of the European Council of negotiating using 'concessions' and late-night bilateral negotiations instead of an open public procedure turn the adoption of the EU budget into a secretive ritual. Then all the prime ministers declare success and that they have defended their national interests, sometimes with totally contradicting arguments. The lack of transparency undermines the public's association with the EU and makes it more difficult to create solidarity and to rally behind common goals.

Inefficient redistribution of income. The current system of revenue and especially the bulk of the corrections described result in the fact that Member States with a higher GNI per capita contribute proportionally less to the EU budget than poorer members. The race to minimise national contributions increases the gap between political commitments – citizen expectations – and the dedicated budgetary instruments. This trend inevitably leads to erosion in public trust and weaker support for the EU, especially when the Union leads on issues that require high levels of mobilisation such as fighting climate change.

The big issue with the distribution of income is related to the creation of European added value. Can we assume that there are areas where working together delivers a better effect for the Member States than working separately? If the answer is affirmative, we detect that there is an added value created by the European Union. European added value is the argument that largely explains the irrelevance of the net balances approach to calculating the net financial flows between each Member State and the EU budget. The EU budget is not about redistribution of national income but about the creation of additional value. Hence, net balances cannot be a rational measure in the course of the budget procedure. The value created by the EU cannot be measured entirely in monetary terms. Lasting peace, the far reaching results of the Erasmus programme, food standards and climate protection represent just a few examples of important EU achievements that are not usually associated with a monetary value.

It is clear that the reason for redistributing income is related to the creation of European added value. The distribution of the new value created and European public goods cannot be measured using fiscal transfers. But what is a fairer way to generate the funds needed for the implementation of EU policies? The protagonists of the current GNI-based contribution claim that it is the best approach – easy to calculate and fair. This is only partially true as the corrections system blurs the otherwise clear criteria. Furthermore, for the national parliaments and the national publics in the Member States as a whole, contributions to the EU budget clearly represent a separate line on the expenditure side of the national budget while the EU funds received and the use of European public goods as a whole are not so clear. Therefore, an appropriate approach would be to use an array of sources to finance the EU budget with an increase in the weight of traditional own resources. This would mean that the EU engine would increasingly run on the energy it produces. This makes sense as the EU is sustainable enough, generates public goods and is able to maintain a substantial part of its functioning. The genuine own resources should be tapped from the additional value created by its functioning. Consequently, the burden on national budgets will considerably decrease.

If we are neutral about the size of the EU budget, the increased share of GNI-based contributions is due to a preceding appropriation of EU value added into national budgets. This is expensive and inefficient. National parliaments have the possibility of deciding on every euro in the EU budget without doing it in an over-sophisticated manner.

Budget rigidity. The EU budget is adopted for a multiannual period. Currently, this period is 7 years and according to the TFEU the shortest period is 5 years. The logic behind this is that for an EU policy to start being financed a number of pieces of both EU and national legislation need to be adopted. This is why there is usually a lag of roughly a year from the adoption of the budget until the first projects start being realised.

Another important explanation of the need for a longer perspective is the fact that as a whole the EU budget is an investment budget. It feeds public investments and these are usually projects that require more time for planning, creating technical plans and making public tenders, etc. A budget squeezed into one year without guarantees that any particular project will be continued in the next fiscal periods would not serve the needs of public investment financing.

The downside of the multiannual budget is that it does not foresee events and processes that might unlock in the future. For example, when the current MFF was adopted back in 2013 the main concern was to bring back growth and higher employment in the EU economy. Issues like migration, security and others that appeared at a later stage were almost not provided for in the EU budget.

The way to deal with long-term uncertainty when adopting the EU budget is to leave sufficient instruments for flexibility. These instruments are not necessarily related to the use of own resources. However, as long as the Member States adopt the ‘juste retour’ approach they are not particularly willing to move from their previously negotiated positions.

If the EU institutions received increased autonomy in raising and distributing funds, new challenges could be much better dealt with. Of course, this can only be done in a framework adopted by the Member States and under strong scrutiny. There is no need to make dramatic changes requiring an amendment to the TFEU. Nevertheless if payments do not come via national budgets, where Member States consider them a use of their own revenues, there could be a faster and more effective response to migration, for example, where we see the Member States reluctant to spend much more.

A very good option is to create dedicated trust funds fed by own resources. For example, if it were considered an EU own resource the revenue generated by a border carbon tax could be channelled into a trust fund to finance the transition to a carbon neutral economy. In such a case the own resource would create more flexibility in the budget and an instrument for financing a new priority without bypassing the decisions of the corresponding national authorities of the Member States.

The case for not changing

If all the above arguments do not lead to a change in the way the EU budget is financed, there are apparently also counter-arguments for preserving the status quo.

First, there are procedural arguments. As own resources legislation requires unanimity in the Council, the procedure for changing it is highly problematic.

Second – and more importantly – the Member States traditionally consider the budget to be their exclusive prerogative. Despite the increased role of the European Parliament in the EU budget procedure, neither governments nor parliaments at the national level are ready to delegate more responsibility to the supranational level. It is no surprise that the most sensitive issue is taxation. This is widely considered an element of national sovereignty and national exclusivity in taxation is well protected in the TFEU. Paradoxically, the desire of national authorities to exercise full control over the EU budget leads to a series of national decisions on the same amounts of money, which often creates internal problems. In this context, decreasing the share of traditional own resources and the predominant role of the GNI-based contributions is considered a safe harbour by most of the national governments.

Political vs economic considerations

It is clear that an increase in the share of genuine own resources in the EU budget is well motivated from a political point of view. If properly introduced, it may contribute to increasing the efficiency of EU public funds, increase the new value created and the scope and quality of public goods and provide more flexibility and support for political decisions to address important emerging issues.

At the same time concerns about losing political control over the EU budget are also legitimate. Without responding to political considerations, any change would not be possible, despite the pressure exercised by the European Parliament, academia and many stakeholders.

It is clear that economic arguments alone will not be able to bring about a substantial change in the own resources system in the EU budget. Additional measures are needed to ensure transparency and sound management and to guarantee that national institutions will continue to sit in the driver's seat when taxpayers' money is concerned.

If the arguments for change prevail

The economic arguments for increasing the share of own resources in the EU budget are solid enough. A good summary of these arguments can be found in the final report of the High Level Group on Own Resources

chaired by Mario Monti, which was delivered in January 2017,² and also in an academic study on the potential and limitations of reforming the financing of the EU budget.³

To be successful, such a reform should address the political concerns of the Member States and generate the necessary unanimity in the Council.

Under these preconditions, there are several elements that the new own resources system should feature. First of all, there should be an absolute guarantee that EU institutions will not decide on taxes and levies without a mandate from the national authorities, i.e. the European Council. A better system for cooperation and exchange of information between the EP and the national parliaments on EU budget issues should also be established.

Second, there should be limitations, again set by the Member States, on the redistribution of income via the separate own resources. This is needed to guarantee that both the revenue and the expenditure in the EU budget are under control and directed to achieving the political priorities set by the Member States.

Third, genuine own resources should only be tapped where the EU creates added value. It is logical for part of the value created to be used to maintain the mechanism. Such areas are the single market, climate change and environment protection, security and defence, migration policy, etc. This will also respond to concerns that national income is distributed and managed at the EU level.

Fourth, an increase in genuine own resources should be coupled with an increased ability of the EU institutions to divert part of these resources to new challenges.

Fifth, the eventual decrease in the share of GNI-based contributions should be accompanied by an improved mechanism for budget management on the part of the European Commission. Measures can include allowing a treasury function, fixing in advance the annual national contributions in the framework of the agreed MFF ceilings, the possibility of maintaining reserve accounts and re-using the budget of reflows resulting from the application of financial instruments.

2 https://ec.europa.eu/info/strategy/eu-budget/how-it-works/long-term-planning/future-long-term-budget/high-level-group-own-resources_en

3 Idem.

The consequences of the Covid-19 crisis and the need for massive financial support in the recovery period open a window of opportunity to adopt new own resources that directly feed EU policies. There is a political consensus that recovery will require a substantial financial engagement by the EU. Left alone, the Member States would have very different possibilities and recovery would open wide gaps in the Union. Having decided to create a recovery and resilience fund of a very large magnitude financed by debt raised by the Commission, the Member States will have to trace the repayment path. The only feasible and publicly acceptable option will be to not charge citizens any further for this or the next generation to repay the loan. This could be done with the introduction of new sources of financing the EU budget without additional burdens on European taxpayers. The plastic levy, the carbon border tax and the digital tax are among the very good and fair options.

In conclusion – back to transparency

It is difficult but necessary to reform the own resources system in the EU budget and return to more autonomy. This will demonstrate to taxpayers that the EU is producing visible and tangible value. In order to achieve this, it is essential to ensure full transparency of both national income transferred to the EU level and EU own-generated resources. This means a better design of a system of checks and balances involving both EU and national institutions. The control mechanisms should be further strengthened with the involvement of the OLAF, the EPPO and the ECA and an increased focus on efficiency and results. Such measures may increase knowledge of and confidence in the EU institutions and allow citizens to better control the use of the public funds.

Financing the Next Generation EU Fund with new sources of revenue and without imposing a further burden on taxpayers is possible. Leaders have the rare possibility of making a huge and visionary step on the path to European integration. It is time to align the economic rationale with political arguments.

How and Why Did the European Parliament Influence the Reform of the Own Resources System?

Anne Vitrey

Abstract

The revenue side of the EU budget remains in the hands of the Member States. National contributions constitute the largest part of the so-called system of own resources (OR) which finances European policies. The European Parliament (EP), which shares budgetary power with the Council of Ministers since the Treaties of Luxembourg (1970) and Brussels (1975) and has become a full co-legislator since the entry into force of the Treaty of Lisbon in 2011, still has no say on revenue.

This paper examines why – for institutional reasons, budgetary reasons and political responsibility – and how the EP is willing to change the current system and analyses its long-standing request. The negotiations on and the outcomes of the last MFFs (2007-2013 and 2014-2021) revealed the negative effects of the EU financing system. A High Level Group on OR (HLG OR) chaired by Mario Monti was set up on the initiative of the EP and the Monti report strongly inspired the Commission proposals for the next Multiannual Financial Framework (2021-2027). Following the Covid crisis which affected the EU, the paper will also make a preliminary analysis of the proposals related to financing the recovery plan and notably the need for new own resources.

And now what? The EP has warned the Council and the MS that no agreement will be reached on the expenditure side unless significant progress is made on the revenue side. The EP must give its consent to the

revised MFF proposals without delay. Will it consider the options laid down for the creation of new OR after 2027 as a sufficient guarantee?

I. An increase in powers without the power of the purse

A. story of path dependency

While the European Coal and Steel Community (ECSC) was granted its own resources from the start, the European Economic Community (EEC) and the European Atomic Energy Community (Euratom) were initially financed by national contributions.

In 1970, the Member States decided to replace national contributions as a means of financing Community policies with a system of 'own resources' made up of customs duties, agricultural levies and a fraction of VAT receipts.¹ As a result, these resources became Community (Union) property collected on its behalf by the Member States. They were 'own resources by nature' because they corresponded to common policies.

This change paved the way for the European Parliament, described as one arm of the budgetary authority sharing this power with the Council, to acquire significant budgetary powers in relation to the use made of the revenue but it did not lead to a say on the sources of revenue.

In 1988,² a fourth resource consisting of contributions based on the Member States' prosperity or wealth (Gross National Income) was decided. Over time this resource has become the largest source of EU revenue and is at the origin of a number of derogations to the system itself. In the wave of the third enlargement and the conclusion of the European Single Act, the 1988 deep reform was driven by a double objective: a need to ensure the financing of new European policies and to cap (below a percentage of GNP/GNI) the overall amount of resources made available for Community expenses (1.15% (GNP) in 1988, 1.20% (GNP)

1 Decision 70/243/ ECSC, EEC, Euratom of the Council of 21 April 1970 on the replacement of financial contributions from Member States by the Community's own resources (OJ L 94, 28.04.1970, p. 19).

2 Council Decision 88/376 EEC, Euratom of 24 June 1988 on the system of the Community's own resources (OJ L 185, 15.07.1988, p. 24).

in 1992, 1.27% (GNP) in 1999 and 1.23% (GNI) in 2006).³ The two principles became inseparable. Based on the Member States' prosperity, the decision of 1988 definitively cut the link between financing the EU budget and EU policies.

In terms of influence, the above decision had no effect on Parliament's role in relation to revenue. On the contrary, it re-nationalised the main source of EU revenue and moved the system away from the reach of the EP with the establishment of a double lock: unanimity and ratification by national parliaments. All the further decisions adopted in 1994, 2000, 2007 and 2014⁴ confirmed the intergovernmental status of the decision-making process on revenue.

More recently, a possibility for the Parliament to influence revenue arose with the entry into force of the TFEU in 2011 and notably the provision in article 311,5 of the Lisbon Treaty, whereby its consent is required for measures implementing the own resources decision. This provision creates the opportunity for a new prerogative through implementation of future decisions

B. The success story of stable revenue has hidden the weaknesses in the system

The fact that the existing system laid down in the 70s and 80s has provided stable revenue to cover increasing needs, including those of further enlargements, the consolidation efforts made by a number of Member States during the 2011 economic crisis and the general perception that the revenue side of the budget is functioning satisfactorily have reinforced a conservative and prudent attitude towards reforming the system.

Additional competences granted to the EU in successive treaties, the development of new policies decided in a multi-annual context for a period of seven years and a significant increase in the volume of the EU budget contributed to a sort of budgetary peace for three decades. As the focus was moved to the expenditure side of the MFF negotiations, various proposals to reform the revenue side were left behind after the efforts made every seven years to get the next financial period fixed. Only

3 Council Decision 2007/436 EEC, Euratom of 7 June 2007 on the system of the Community's own resources (OJ L 163 23.06.2007).

4 Council Decision 2014/335/EU, Euratom of 26 May 2014 on the system of own resources of the European Union.

marginal adjustments were made possible.

However, it is interesting to notice that the weaknesses in the present OR system dominated by national contributions have been highlighted by the arduous and unsatisfactory MFF negotiations. The weaknesses find their roots in the complicated calculations of rebates and corrections, which reduce transparency and create unfair balance among the Member States. The predominant weight of national contributions in overall EU financing creates an expectation that the EU should return a 'fair share' of its spending to each Member State in proportion to its contribution.

In conclusion, the link established between the wealth generated by the Member States and reflected in their shares of GNI (the main resource), i.e. their capacity to pay, has fostered a focus on net balances and fair returns and hence justified the existence of rebates and corrections to alleviate their net positions (Fontainebleau logic).

II. Why should the EP be involved in the revenue side?

The Member States have been reluctant to share the sovereignty of the power of the purse with the European Parliament although they have shared the budgetary authority (over expenses) since 1988 and almost complete legislative competence since 2011.

The main architecture of the system has remained unchanged since 1988, despite six decades of increasing influence of the Parliament in the institutional, legislative, budgetary and political areas.

Three main reasons can explain the long-lasting efforts of the EP to reform the system.

The first one is of an institutional (or constitutional) nature. Recalling the American slogan of the 1700s which summarised the colonial grievances against the British Government, *No taxation without representation*, the directly elected European Parliament representing more than 450 million taxpaying citizens is deprived of the right to decide on the revenue in the EU budget. Since the first direct election in 1979, the EP has been granted a number of new prerogatives by the different Treaties, but not this one.

The imbalance between the two arms of the budgetary authority contains a democratic dimension which is in contradiction with the powers

obtained by the Parliament over the last four decades. One could reverse the slogan into *No representation without taxation*.

The second one is of a budgetary nature. The current system of EU financing is at the source of a number of distortions and deviations during annual and multi-annual debates: the logic of a fair return, compensations (gifts) for a zero-sum game, alliances between net payers and net beneficiaries, rebates and rebates on rebates, the level of payments resulting from the calculation of the GNI resource, net balances and unspent appropriations returned to national treasuries.

An EP resolution of 16 April 2014⁵ states: *amongst crippling inconveniences, the current system of Union financing has prevented a majority of MS in the Council from budgeting a sufficient level of payment appropriations in the annual budget to meet EU obligations and political commitments*.

The third reason is of a political nature. The Parliament is only responsible for the expenditure relating to the EU budget. The Parliament has been open to a charge of ‘revenue irresponsibility’ since it was not responsible for finding the money that is required to finance EU policies. However, it is the Member States which have been reluctant to see the Parliament too much involved in an area which they consider too sensitive and too close to an area of national prerogative.

III. A long-standing quest

Following the 1988 deep reform of Community finances under the Delors I package, the newly elected Parliament looked to gain legitimate powers over the revenue side of the budget. At the time, the claim focused on institutional aspects: how to be treated on an equal footing with the Council, the other arm of the budgetary authority, both on revenue and on expenditure. The other aspect of the EP’s claim was the budgetary component: how to create space for new programmes under the tight budgetary discipline and binding ceilings imposed by the 1988 Decision?

The size of the budget for the years 1988-1992 was between 45 and 50 million ECU. The battle conducted by the committee on budgets and its

5 PE 527.841 (Avril 2014) - Lessons of the past and the way forward.

chairmen⁶ and rapporteur⁷ aimed to provide more funding for ‘non-compulsory’ policies, notably internal policies emerging from the internal market and other cooperation activities. Both aspects are reflected in an April 1994 report:⁸ *[The European Parliament] calls on the Commission to submit a proposal on a new system of OR before the start of the Intergovernmental Conference of 1996 (...) [and takes] the view that the Union should have sufficient own revenue to cover the tasks transferred to it (...).*

Later, in the Agenda 2000 period, the Parliament continued to require more funding for policies resulting from the new competences granted to the EU in the treaties of Maastricht, Amsterdam and Nice.

In 2007, as a reaction to the difficult negotiations between the Member States over the 2007-2013 Multiannual Financial Framework, the Parliament pointed out again the responsibility of the current financing system which, according to the Lamassoure report,⁹ had reached its limits.

Point 6 of the Lamassoure report reads: *[The European Parliament] (...) attributes to this faulty system the inadequacies of the European Council's agreement on the new 2007-2013 MFF (...) [and] believes that the financial package agreed, with numerous exceptions on the revenue side and its compensation gifts to certain Member States on the expenditure side, is the clearest proof of the complete failure of the current system (...).*

The report stresses the complexity and the unfairness of the current system, the lack of transparency towards European citizens (implying taxpayers), a number of shortcomings which do not serve European integration and the distortion in a system where 70% of the revenue does not originate in OR any more but come directly from national contributions. From a budgetary point of view, the report highlights that if the Edinburgh decision of 1992 setting the ceiling on OR at 1.24% of EU GNI and unchanged since then had been fully applied, the EU budget would have gained 0.22% of GNI over 13 years, i.e. equivalent to approximately EUR 240 billion.

The report proposed a roadmap for a reform in two phases:

6 Jean Pierre Cot (1984-1989); Thomas Von der Vring (1989-1994).

7 Erwin Lange.

8 Resolution on a new system of Own Resources for the European Union (April 1994) A3-0228/94, OJ C/128/63 of 09.05.1994.

9 Report on the Future of the European Union's Own Resources P6_TA-PROV (2007) 0098 of 29 March 2007.

Phase one. Apply the following principles: equality between MSs, simplicity of presentation, solidarity and equal dignity among MSs, a link between a reform of revenue and a reform of expenditure.

Phase two. Lay down a new system of OR which emerged after numerous contacts with national parliaments and in full respect of the principle of sovereignty of the MSs, fiscal neutrality, no change to the order of magnitude of the EU budget, progressive phasing in of a new system and establishing a clear link between a reform of revenue and a reform of expenditure.

Finally, the report provided an optional list of candidate taxes respecting the criteria of sufficiency, stability, visibility and simplicity, horizontal and vertical equity and low operating costs.

The approach followed by the EP from there onwards marked a turning point. It became more political, more responsible and with a constructive objective that the Council and the Member States would find it more difficult to reject.

In this wave, in April 2011 and before a forthcoming Commission proposal for a new OR decision, three MEPs representing the three main political groups in the EP addressed the Member States ahead of the negotiations on the 2014-2020 MFF and presented a report¹⁰ in which they criticised the current system for being non-transparent and non-democratic. They proposed to replace the logic of 'juste retour' with a logic of 'juste niveau.' The current level of the Budget should be maintained but national contributions should be replaced with genuine own resources in the spirit of the Treaty of Rome, such as a carbon tax on imported goods, a financial transaction tax or 1% VAT on consumption and the annual reintroduction into the budget of unspent amounts.

After the (very) difficult adoption of the 2014-2020 MFF, the EP adopted another key report¹¹ in April 2014 which again pointed out the malfunctioning of the system of EU revenue as being a major cause of the difficulties and shortcomings of the negotiations and the unsatisfactory results (from the EP's point of view). Point 3 reads: *[The European Parliament] (...) is deeply concerned at the fact that budgetary debates in the Council have been for many years poisoned by the logic of 'fair returns' instead of being driven by the logic of the European added value [and] considers that (...) the situation has seriously intensified due to the current system of EU financing (...) based on GNI instead of genuine own*

resources, as foreseen in the Treaty of Rome (...).

The lengthy and arduous negotiations over each MFF reveal each time more accurately the weaknesses of the system and each time an opportunity to reform the revenue system is left aside once a deal on expenditure is finally reached.

Based on this recurrent observation, the crusade pursued by the EP in favour of a deep reform of EU financing found a new development with the setting-up of the High Level Group on OR (Monti group). Among the *sine qua non* conditions imposed by the EP on the Council before giving its consent to the 2014-2020 MFF package was the creation of a HLG on OR with a mandate to examine how the revenue side of the EU budget could be more simple, transparent, fair and democratically accountable.

The HLG-OR chaired by Mario Monti and set up in April 2014 was composed of 9 members representing the EP, the Council and the Commission and delivered its final report in December 2016.¹² The nine recommendations laid down in the report reflect intensive and collegial work which took on a number of requests and positions from the Parliament and widely inspired the proposals made by the Commission in May 2018 (see below).

EP Position (2007-2019)	HLG - OR report (2016)	Commission proposals (2018)
<p>Reform of the OR system: main requests</p> <ul style="list-style-type: none"> ▪ Simplicity, fairness, transparency as guiding principles ▪ Back to genuine OR as laid down in the Treaty of Rome ▪ Fully-fledged reform of EU's Own Resources system ▪ Link between a reform of revenue and a reform of expenditure https://www.linkedin.com/jobs/view/1664070582/. ▪ Equality between MS. Elimination of correction mechanisms ▪ Respect of MS sovereignty. ▪ Fiscal neutrality for the citizens ▪ Progressive phasing in of the new system. ▪ Balanced basket of taxes based on criteria of sufficiency, stability, visibility. ▪ Resources allocated to the EU budget should allow the financing of its policies and meet its challenges (Art. 311 TFEU). ▪ Budgeting a sufficient level of payments to cover policy objectives properly ▪ Reform of EU Own Resources system including a basket of new OR as a pre condition for consent on next MFF 	<p>Main recommendations</p> <ul style="list-style-type: none"> ▪ Reform of EU budget necessary, both on revenue and expenditure side. ▪ Abolition of all corrections mechanisms. ▪ New mix of - own resources - with a better link with policy objectives of the EU: energy, environment, transports (taxes on ETS, Co2, electricity, fossile fuels). ▪ Products generated by european policies: digital market, border controls) or deriving from compétences granted to the EU. ▪ Some elements of the current system should be maintained: equilibrium, TOR, GNI to cover spending not covered by other sources. ▪ EU budget to bring the highest European Added Value. ▪ Revenue other than own resources to be explored. ▪ Budget neutrality, no increase of the fiscal burden, synergies and coherence with national funding, subsidiarity. 	<ul style="list-style-type: none"> ▪ Modernisation of existing OR: <ul style="list-style-type: none"> - VAT: simplified - TOR: lower collection costs - GNI-based contribution: smaller share. ▪ Other revenue: <ul style="list-style-type: none"> - seigniorage - revenues of new European Travel Information and autorisation System. ▪ New Own Resources: <ul style="list-style-type: none"> - ETS (20 %) - National contribution based on non-recycled plastic packaging waste ▪ Phasing out of rebates ▪ Higher OR ceiling (1.2 % of GNI to 1.29 % GNI). ▪ New Own Resources to contribute to about 12 % of EU budget revenue (22 billion per year). ▪ Recent commitments made by Commissioner designated at the hearing

12 Future Financing of the EU. Final report and recommendations of the High Level Group on Own Resources. December 2016.

IV. A possible reform by 2030?

A number of elements could make a reform of EU financing happen in the next decade. Four types of reasons can be evoked to justify such a reform process:

- Budgetary reasons
- Macro-economic reasons
- Political reasons
- Institutional reasons

1. Budgetary and economic reasons

On 31 January 2020, Brexit became a reality. The UK's withdrawal from the EU will create a gap in the EU budget. The UK was a net contributor even when taking into account the rebate. Its average share of OR during the 2014-2016 period slightly exceeded EUR 17 billion while the share of EU expenditure (without taking into account the benefits from common EU expenditure devoted, for example, to external policy or development aid) it received in the same period was just over EUR 7 billion. Taking into account the increase in the EU budget up to 2020, the UK's withdrawal could leave a gap of EUR 12-14 billion every year.

The OR ceiling will be under a new constraint. After Brexit, the ceiling will automatically decrease by approximately 16% in nominal terms, i.e. the share of the UK's GNI, and have a major economic impact on the EU budget and its policies. In other words, if the overall budget is maintained at 1% of EU-27 GNI, it will lose EUR 25 bn each year.

The UK's withdrawal also renders the rebates and other correction mechanisms obsolete and creates a unique opportunity to put an end to these distortions.

2. Macro-economic reasons

National taxation and statistical systems are currently challenged by globalisation and technical changes which have brought important changes to the structure of firms and the localisation of production. Dematerialisation of services, online delivery and the rapid spread of e-commerce

and other digital services have changed consumers' habits and challenged the capacity of national authorities to assess taxable bases and products. A recent initiative launched by the OECD – Base Erosion and Profit Shifting (BEPS) – provides governments with tools to ensure that profits are taxed where the economic activities generating them are performed and where value is created.

Reforming the revenue side of the EU budget would entail supporting Member States in their efforts to modernise their tax collection systems to the benefit of both national and EU budgets.

3. Political reasons

More fairness among Member States will need to be considered on both the revenue and the expenditure sides ('horizontal equity'). The purpose of the EU budget is not to collect or distribute money equally across Member States according to their wealth and size but instead to finance projects with EU added value and to support and deepen EU policy objectives and cohesion.

Recent contributions to the debate – the EP persisting in its demands, the HLG report stressing that no significant reform of revenue will be achieved without a parallel significant reform of expenditure, the Commission proposals for a mix of phasing out resources and a basket of new candidates and the objective to reach a deal on the ongoing negotiations on the next MFF (2021-2027) – indicate that the case for a reform of the OR system is stronger than ever.

4. Institutional reasons

A persisting demand from both the outgoing and recently elected Parliaments for a reform of the OR system has accompanied the preliminary stages of the negotiations on the next MFF. Recalling that the Treaty (article 312) provides that the European Parliament should give its consent to a deal unanimously reached by the Council and based on previous negotiations where the Parliament imposed conditions on the agreement reached by the Member States, the 'warning' cannot be ignored.

A resolution of 14 November 2018 (para 11)¹³ reads: [*The European Parliament*] (...) recalls that revenue and expenditure should be treated as

a single package in the incoming negotiations [and] stresses that no agreement can be reached on the future MFF without corresponding progress being made on the Union's new OR (...).

A resolution of 10 October 2019 (para 5)¹⁴ reads: [*The European Parliament*] (...) *underlines that Parliament will not give its consent to the MFF without an agreement on the reform of the OR system, including the introduction of a basket of new own resources that are better aligned and incentivise progress on major EU policy priorities.*

There is historical momentum, political support and economic necessity for the EU to reform both the revenue and the expenditure in its budget progressively, in a phasing out process. A reasonable hope exists that this unique context can be built on to lift a three-decade-long lock on OR and design a new system by 2030. Could the year 2020, which sees Brexit happening and the UK rebate disappearing, new institutions in place and the beginning of a new financial period, also mark the start of a new era?

V. The EU Recovery Plan: pushing the reform ahead or a dark mirror?

The Covid pandemic of Spring 2020 has strongly shaken European economies. The deepest recession since the Great Depression, its uneven impact on economies and societies, and the large uncertainty in short- and medium-term economic forecasts call for uneven measures to face this historical backdrop. The key element in the proposals issued by the Commission and in the French and German initiative to support the recovery of EU economies is massive financing. The principle is to give the EU unprecedented borrowing capacities which can raise massive funding on international markets to finance additional policies.

Legal and financial aspects of the proposal

Borrowing is allowed in Treaty provisions, notably:

- article 122 TFEU: ... *the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation* (para 1) ... [*and*]

14 P9_TA (2019) 0032.

may grant, under certain conditions, Union financial assistance to the Member States concerned [which are] seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond their control (para 2).

- article 143 TFEU *recommends to the Council the granting of “mutual assistance” where a Member State (not belonging to the Eurozone) is in difficulties or is seriously threatened with difficulties in its balance of payments (para 1).*
- article 212 TFEU allows the Commission to grant loans (...) *to carry out macro-financial assistance to third countries other than developing countries (para 1).*

These instruments allow borrowing capacities to be cumulated at the Eurozone, national and European levels in accordance with the principle of equilibrium imposed in article 310 TFEU and article 17 of the Financial regulation.

The Recovery Plan proposed by the Commission is quite exceptional. It initiates a deep change in the use of loans: changes of scale (EUR 1100 bn plus EUR 750 bn) and a change of purpose (subsidies and loans granted to Member States to reinforce European policies (Next Generation EU).

The cornerstone of the Recovery Plan is a modification of the Own Resources Decision (ORD) provided for in article 311 TFEU. This text makes the loan possible in legal and financial terms. The introduction in the Council OR Decision of a provision allowing loans on an exceptional and temporary basis aims to secure the construction legally. Financially, the objective is to assure investors that the European Union will be able, in all circumstances, to fulfil its obligation of reimbursement. To do this, it is necessary to increase the ceiling on OR, in other words the maximum amount that the Commission can in one given year request from the Member States to finance the expenditure of the European Union. The increase in the ceiling up to 2% of EU GNI would be made in two steps:

- 1.29% (a proposal of May 2018) to cover the loss of the UK contribution and future economic uncertainty;
- An additional, exceptional and temporary increase of 0.6% to widen the room for manoeuvre of the loan capacity of ‘Next Generation EU’. This would also serve as a guarantee for investors and allow the Commission to raise funding under more favourable conditions.

An obligation to find new OR?

The Commission proposals allowing the EU large-scale borrowing capacity to finance its policies through grants and loans represent a systemic disruption of the founding principle of EU finances, which so far have been strictly based on the golden rule of budgetary equilibrium. While loans should be reimbursed by the beneficiary Member States, funding allocated in the form of subsidies should be reimbursed through forthcoming annual EU budgets after 2027 and before 2058 up to a maximum of EUR 37.5 bn. Three reimbursement options are being studied for the repayment of the market finance raised: to decrease EU expenses after 2027; to increase Member State contributions; or to create new own resources.

The Commission has identified four options for new own resources (see below).

Extension of the Emissions Trading System-based own resources to the maritime and aviation sectors to generate €10 billion per year
Carbon border adjustment mechanism to raise €5 billion to €14 billion per year
Own resource based on operations of large enterprises which, depending on its design, could yield around €10 billion annually ,
Digital tax on companies with a global annual turnover of above €750 million to generate up to €1.3 billion per year

For budgetary reasons, the Commission decided not to formally introduce new own resources in its revised Council decision on the system of OR, first to avoid a further component in the already complex package and second because the needs for reimbursement will only intervene after 2027, i.e. under the next MFF.

Such postponement could also have political (tactical) reasons since the Member States most reluctant about the loan issue are also those who traditionally oppose the creation of new OR.

Important remaining obstacles

Four obstacles to be overcome can be identified:

The first one lies in the reluctance of net contributor Member States, the so-called ‘Frugals,’ which are opposed to the principle of subsidies being allocated to the countries most impacted by the Covid pandemic while these countries cannot contract loans any more because of the state of their public finances. What proportions of loans and subsidies will be acceptable?

The second obstacle concerns the differentiated timing between the immediate decision allowing the EU to contract large-scale loans and a later decision on reimbursement modalities through new own resources to be decided in a second stage, recalling that the creation of new own resources has so far been systematically rejected by the majority of Member States and put aside in successive multi-annual negotiations. At mid-term, how can the reluctance of these Member States be reduced and how can fruitless debates on fair return be switched to a concrete demonstration of European solidarity?

The third obstacle is the calendar. The entire legal construction of the Commission proposal is based on speedy decisions, including the adoption and ratification of the new Council decision on the system of own resources. Will it be possible to finalise such complex procedures which normally last for (at least) one and half years in a few months?

The fourth obstacle is of an institutional nature. The consent of the European Parliament is required for the adoption of the revised 2021-2027 MFF. Although the Parliament has expressed its readiness to quickly enter into negotiations on the next MFF and own resources, the ‘take it or leave it’ imposed by time pressure creates a feeling of frustration, especially since the EP has been at the origin of proposals for reform of the OR system. A second concern is about being side-lined from the establishment and implementation of the recovery instrument, the architecture of which is based on article 122 TFEU, which reads: *The President of the Council shall inform the European Parliament of the decision taken* (TFEU, article 122, para 2).

The decision and control processes raise the question of democratic scrutiny.

The Recovery Package is a unique initiative, in its objective, its architecture, its amounts and its legal and budgetary architecture. The own resources decision (to increase the ceiling and possible new OR) is the cornerstone of the financing. The EU budget is at the core of European

solidarity.

Despite the innovative and ambitious objective of the proposals, challenges and risk factors exist such as a lack of democratic scrutiny: the European Parliament is not involved in the decision process on Next Generation EU based on article 122 TFEU but is a key actor in the agreement on the revised MFF; the implementation risk factors are absorption capacity, quick delivery projects and political control.

More than ever, heads of states and governments needed to overcome opposition and satisfy requests from all and every MS in the European Council on 17-18 July but the unprecedented seriousness of the situation in Europe justifies ambitious decisions, including abandoning taboos. The Recovery Plan is a turning point in the history of the European Union.

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Improving the Effectiveness of EU Policy: the Challenge of Auditing the 2021-2027 MFF

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The views expressed in this article are those of the author and do not commit the European Court of Auditors.

Abstract

The 2021-2027 MFF regulation and related legislation will largely determine the expenditure of more than €1 trillion of EU funds. The European Court of Auditors (ECA) will be responsible for auditing how the EU accounts for and spends this money. In this paper, we examine the relationship between the MFF and the ECA's auditing role and the implications of the 2021-2027 MFF for the ECA's auditing work. We consider that there will be more continuity than change in the governance, management and auditing of the EU's finances under the 2021-2027 MFF. Therefore, the ECA will continue to face many of the same auditing challenges. It will continue to provide assurance on the reliability of the EU accounts and the regularity of the underlying transactions. At the same time, it will need to take into account changes that the EU has already planned to make under the 2021-2027 MFF when determining the auditing work it will carry out and the reports it will produce on the performance of EU policies and programmes. Overall, the 2021-2027 MFF represents a missed opportunity to rethink the way the EU budgetary system operates. The Conference on the Future of Europe will present a further opportunity to set long-term objectives and to ensure the EU has the financial means to achieve them.

Introduction

The multiannual financial framework (MFF) is the long-term budget of the European Union. It sets limits on the funds available in each of the main spending categories in the EU budget and spending programmes over a seven-year period ('the MFF package'). Overall, the 2021-2027 MFF package comprises 51 legislative proposals that will largely determine more than €1 trillion of EU budgetary expenditure. The European Court of Auditors (ECA) will be responsible for auditing how the EU accounts for and spends this money. In this paper, we examine the relationship between the MFF and the ECA's audit role and the implications of the 2021-2027 MFF for the ECA's audit work. We draw on published ECA audit reports and on contributions that the ECA has made to the public debate on the 2021-2027 MFF proposals.

The role of the ECA in the audit of spending under the MFF

The MFF package does not include any proposals that directly affect the ECA's audit role or its relationship to the MFF, which are set out in the Treaty on the Functioning of the European Union (TFEU). The **ECA's role** is to audit EU revenue and expenditure.¹ The ECA is responsible for examining the accounts of all the EU bodies, unless it is precluded from doing so by their constituent instruments, and for assisting the EP and the Council in the discharge procedure of the annual EU budget. The principal way the ECA does this is by providing an annual report with a statement of assurance about the reliability of the EU accounts (financial audit) and the legality and regularity of the underlying transactions (compliance audit). The ECA also takes advantage of the opportunity provided by the TFEU to make observations in the form of special reports on the soundness of financial management (performance audit). The ECA carries out its audit work in line with international professional standards on financial, compliance and performance auditing that are established outside the EU's legal framework.²

The TFEU stipulates that *the Union shall provide itself with the means*

1 Article 287 of the TFEU.

2 IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs).

*necessary to attain its objectives and carry through its policies.*³ It provides for these ‘means’ to be determined in a **MFF regulation** that sets limits on the spending commitments and related payments that can be made during the period through the annual EU budget.⁴ It also requires the Commission to implement the EU budget in cooperation with the Member States in accordance with the principle of sound financial management. The Commission is responsible for producing annual accounts, financial statements and an evaluation report on the EU’s finances based on the results achieved. In addition, the TFEU provides that the rules for spending the EU budget are to be set out in a financial regulation and sectoral legislation governing specific spending programmes. These legislative instruments, which form part of the ‘MFF package,’ also provide the basic framework of rules according to which the ECA carries out its financial and compliance audit.

While the TFEU is relatively clear about the means to attain its objectives, it is less clear about how the EU should set its objectives and what form they should take. The EU has been developing post-2020 **strategic objectives** in parallel with developing and deciding on the next MFF. As the ECA has noted, the Commission’s MFF proposal became a vehicle for shaping the EU’s objectives after 2020 rather than a reflection of the means to attain them.⁵ This was perhaps inevitable given the lack of alignment between the EU’s 10-year strategy period,⁶ its five-year political and legislative cycles, and its seven-year financial frameworks together with the uncertainty and delay regarding the UK’s withdrawal from the EU. The Commission has proposed a public debate on EU priorities and what the Union should seek to achieve which will take place over the next two years in the context of the Conference on the Future of Europe.⁷ This means EU financial planning will need to be adjusted to reflect new strategic objectives during the 2021-2027 MFF. To some extent, the 2021-2027 MFF and the underlying programmes provide for greater flexibility with respect to the re-prioritisation of spending than was available under

3 Article 311 of the TFEU.

4 Article 312 of the TFEU.

5 ECA Briefing Paper – The Commission’s proposal for the 2021-2027 Multiannual Financial Framework, July 2018, paragraph 16.

6 Communication from the Commission – Europe 2020 A strategy for smart, sustainable and inclusive growth COM(2010) 2020 of 3.3.2010.

7 Communication from the Commission to the European Parliament and Council: Shaping the Conference on the Future of Europe, COM(2020) 27 final of 22.1.2020.

the 2014-2020 MFF.⁸ Any such re-prioritisation of spending will necessarily have implications for the implementation of the EU budget and hence the ECA's audit work.

The **key features of the 2021-2027 MFF** are broadly similar to those of the 2014-2020 MFF: its duration will again be seven years; the annual spending in the EU budget will continue to be a little over 1% of EU gross national income (GNI); and the main MFF headings will largely correspond to those in the current period. The planned changes for the main categories of expenditure are relatively modest overall. The 2021-2027 MFF provides a smaller proportion of funds for agriculture and cohesion than previous MFFs and more spending on priorities such as research, dealing with migration, defence and security. However, in the ECA's view, the allocation of resources is not supported by a systematic assessment of **EU value added** of spending programmes.⁹ The lack of a robust concept of what EU value added is risks undermining public debate on EU spending priorities and ultimately also hinders the ECA from assessing and reporting on the performance of EU policies and programmes.

Based on the existing EU legal framework, nearly all the spending that falls under the MFF regulation is implemented through the EU budget by the Commission in cooperation with the Member States, audited by the ECA and scrutinised by the EP and Council through the discharge procedure. However, as the ECA has noted, **other sources of funds also contribute to the achievement of EU objectives** but are not subject to an equivalently high level of public accountability and auditing.¹⁰ For example, during the negotiations on the MFF the ECA maintained the view that it should be mandated to audit all the EU bodies and invited to audit all bodies created through agreements outside the EU legal order to implement EU policies (including the European Stability Mechanism and the European Investment Bank's non-EU budget activities). In addition, the ECA noted that the effectiveness of the EU budget increasingly depends on its ability to mobilise other sources of funds to implement EU policies. These include national co-financing related to EU grants, public and private finance leveraged by EU financial instruments and

8 ECA Briefing Paper – The Commission's proposal for the 2021-2027 Multiannual Financial Framework, July 2018, paragraph 27.

9 ECA Briefing Paper – The Commission's proposal for the 2021-2027 Multiannual Financial Framework, July 2018, paragraph 16.

10 Annual Report on the Financial Year 2016, paragraphs 2.30 and Box 2.8.

costs and administrative burdens associated with EU legal and regulatory instruments. For this reason, the ECA called on the Commission to complement its MFF proposal with a medium-to-long-term financial plan covering the other sources of funds to be used to implement EU policies.¹¹ Such a financial plan would also provide a basis for assessing the EU's subsequent financial performance.

Challenges in the ECA's financial, compliance and performance auditing under the 2021-2027 MFF

The ECA's **audit challenges** under the 2021-2027 MFF will largely reflect the elements of continuity and change in EU policy, financial management and reporting arrangements.

Few of the changes planned under the 2021-2027 MFF will directly impact the ECA's **financial audit** of the reliability of the EU accounts, which will in any case remain challenging. Hundreds of thousands of accounting entries are generated by Commission Directorates-General each year taking information from many different sources (including the Member States). The Commission prepares the EU accounts by applying accounting rules based on international public sector accounting standards. The EU's financial position includes the assets and liabilities of its consolidated entities at the year end. The ECA checks that the accounting processes work properly and that the resulting accounting data are complete, correctly recorded and fairly presented by the Commission in the EU's financial statements (an attestation approach). Since 2007 the ECA has concluded that the EU accounts fairly present the EU's financial position. In the period 2021-2027, the ECA anticipates that the planned technical upgrades to the Commission's accounting systems will provide opportunities for it to digitalise its audit work on the EU accounts.

The ECA's **compliance audit** work to provide a statement of assurance on the regularity of the transactions underlying the EU accounts largely involves it checking samples of transactions to provide statistically based estimates of the extent to which revenue and the different spending areas are affected by error. The ECA measures the estimated level of error against a materiality threshold of 2%, above which spending is consid-

11 ECA Briefing Paper- Future of EU finances: reforming how the EU budget operates, proposal 3.

ered to be irregular. The estimated level of error is an estimate of the money that should not have been paid out because it was not used fully in accordance with EU and national rules.

The ECA's compliance audit approach and results are largely determined by the nature of spending, the type of instrument used, the financial rules that apply and the management and control procedures in place. Since the 2016 annual report, the ECA has issued a **'qualified opinion' on the regularity of transactions**. This reflects the fact that a significant part of the EU's expenditure was not materially affected by error and that errors were no longer pervasive across the spending areas.¹² The overall level of irregularities in EU spending has remained stable within the range observed during the previous two years. The ECA estimated a 2.6% error in the 2018 expenditure (2.4% in 2017 and 3.1% in 2016). Errors were mainly found in high-risk spending areas, such as rural development and cohesion, where payments from the EU budget are made to reimburse beneficiaries for the costs they have incurred. These spending areas are subject to **complex rules and eligibility criteria**, which may lead to errors. The ECA will also need to take into account changes to management and control arrangements that will be introduced in the main spending programmes, in particular those under the 2021-2027 MFF headings 'Cohesion and values' and 'Natural resources and environment.'

Improvements in management and control of irregularity and in the Commission's reporting may offer the ECA the opportunity to move towards an **attestation approach** in the compliance audit of EU accounts. So far, the ECA has followed such an approach only with respect to Cohesion. As stated in its 2018-2020 strategy, the ECA aims to apply the attestation approach to its entire statement of assurance, meaning that it will base the audit opinion on the Commission's management statement about the level of irregularity. Where the terms of the relevant international auditing standards have been met, the ECA will be in a position to review and re-perform the checks and controls carried out by those responsible for implementing the EU budget.

Experience suggests that key institutional stakeholders such as the EP and the Council will expect consistency in **the ECA's annual reporting** on the implementation of the budget under the 2021-2027 MFF. Two fac-

12 Annual Report on the Financial Year 2018, Chapter 1 – The statement of assurance and supporting evidence.

tors will make this challenging for the ECA. First, a significant proportion of the payments in the early years of the 2021-2027 MFF will relate to commitments made under the rules for programmes for the 2014-2020 period. Second, the headings in the 2021-2027 MFF – although similar – do not correspond exactly to those in the 2014-2020 MFF due to some spending programmes being added, merged, moved between headings or discontinued. That said, the EU plans to implement fewer spending programmes overall and to improve the alignment between programmes and headings, which will facilitate the Commission's reporting on EU financial management and the ECA's reporting of its audit results.

The main effects of changes in EU policies and programmes under the 2021-2027 MFF are likely to be felt in the ECA's **auditing of performance**. The ECA does not have an obligation to provide assurance on the Commission's reporting on performance. However, in practice the ECA includes a chapter in its annual report on "getting results from the EU budget" which largely focuses on the Commission's framework for managing and reporting on performance. In the ECA's view, the performance indicators currently used for the EU budget do not always provide a good picture of the actual progress made in achieving policy objectives.¹³ The ECA has also recommended clarifying the links between the Europe 2020 strategy, the 2014-2020 MFF and the Commission's priorities (2015-2019), which the Commission has done in some respects.¹⁴ The quality of the Commission's reporting on performance has proven to be a barrier against the ECA adopting an attestation-based approach to auditing EU performance.

A key challenge the ECA faces is **selecting relevant performance audit topics**. In the coming period, this will require it to continue to engage in dialogue with stakeholders at the EU and national levels, closely monitor the trends driving developments in EU policy and financial management, and assess the main risks in EU spending and policy delivery. The thematic focus areas, which were identified for the first time in the ECA's 2020 work programme, provide an indication of how EU priorities may be reflected in the ECA's portfolio audit work in the next few years. The themes are science and technology, economic competitiveness, fiscal sustainability and the eurozone, digitalisation and e-government, security threats, the rule of law and democratic values, migratory pres-

13 Annual Report on the Financial Year 2018, paragraphs 3.80.

14 Annual Report on the Financial Year 2018, Annex 3.5, Recommendation 3 from 2015.

sure, climate change and social and economic imbalances in European societies. **Sustainability** will also remain high on the political agenda in the EU and its Member States and so it is also highly likely to remain at the heart of the audit and review tasks selected by the ECA in the coming years, not least because of the EU's planned 25% target for climate mainstreaming across all EU programmes.

The ECA's portfolio of performance audit tasks is also likely to reflect a few key changes in the nature of spending. For example, the EU plans to make more use of **financial instruments and budgetary guarantees** under the 2021-2027 MFF. This continues a trend that began under the 2007-2013 MFF and continued under the 2014-2020 MFF with the establishment of the European Fund for Strategic Investment (EFSI). These instruments enable the EU budget to be used to provide loans, guarantees and equity to help encourage investments that will contribute to the achievement of EU policy goals. Under the 2021-2027 MFF, the EU plans to bring all the financial instruments managed by the Commission either directly or indirectly together in a single programme: the InvestEU programme, which will also act as the successor to the EFSI. Under the European Green Deal,¹⁵ at least 30% of the InvestEU fund is planned to contribute to climate action. However, while the InvestEU programme represents a welcome simplification, it should be noted that many of the financial instruments and budget guarantee schemes established under previous MFFs will continue to operate throughout the 2021-2027 period. Therefore, the overall challenge associated with managing and auditing these instruments will increase significantly in the coming years.

The performance of EU policies will also depend more in the future on the EU's ability to ensure the coherence of policy action. Priorities of the Van der Leyen Commission like implementing the 'green deal,' dealing with migration towards Europe and promoting gender equality cut across the EU's established policy areas and spending programmes. Such priorities require the Commission to revise legislation and re-orient existing spending. This requires cooperation across multiple Commission services and between those within the Commission responsible for regulatory policy and EU spending, which makes the associated activities more challenging to manage and their performance more challenging to assess.

15 Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – The European Green Deal, COM(2019) 640 Final of 11.12.2019.

Closing remarks

It is clear that there will be more continuity than change in the governance, management and auditing of the EU's finances under the 2021-2027 MFF. Therefore, the ECA will continue to face many of the same challenges in playing its role as the EU's independent auditor and guardian of EU finances.

Overall, the EU missed an opportunity to rethink the way the EU budgetary system operates under the 2021-2027 MFF. The Conference on the Future of Europe will present a new opportunity to consider how to make the EU budget more transparent and efficient.

In the meantime, the ECA will need to take account of the changes the EU has already planned to make under the 2021-2027 MFF when determining the audit work it will carry out and the reports it will produce in the coming years.

Part 2

Shaping EU Policies Toward 2030

The Reinforced Conditionality Approach of the 2021-27 MFF

Viorica Viță¹

Abstract

The reinforced conditionality approach in the legislative proposals for the 2021-27 MFF suggests an increased reliance by the EU on conditional spending disbursed to Member States as a lever to achieve important EU policy objectives, in particular in the areas of rule of law and economic governance. Using budget conditionality to regulate state behaviour is not new in federal systems, such as that of the US, where conditionality has been used for more than a century to advance federal policies at the state level.² Budget conditionality is also not new in the EU, where it has been continually expanding over the last decade.³ What is new and particular in this context is the EU's aim to use conditionality to address some of its most important policy objectives and values lying at the very heart of its construction.

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 - 2 V. Viță, 'The Rise of Spending Conditionality in the EU: What Can the EU Learn from the U.S. Conditional Spending Doctrine and Policies?', EUI Working Papers 16/2017, 2017 <<http://cadmus.eui.eu/handle/1814/48644>>.
 - 3 V. Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality', *Cambridge Yearbook of European Legal Studies*, 2017; V. Viță, *Research for European Parliament, REGI Committee - Conditionalities in Cohesion Policy* (2018).

Drawing on extensive research on the *law and practice* of conditionality during the 2014-20 financial period,⁴ this contribution explains the main limitations of the reinforced conditionality approach in the 2021-27 MFF, which relies predominantly on sanctions – a withdrawal of funds in the case of lack of compliance. The contribution argues for a re-balancing of conditionality towards incentives (*positive conditionality*) rather than a punitive approach (*negative conditionality*), a practice that has so far been under-developed in the EU.

I. Introduction

A reinforced conditionality approach is an essential feature of the legislative proposals for the 2021-27 Multiannual Financial Framework (MFF).⁵ This enhanced presence of conditionality suggests an increased EU reliance on spending disbursed to Member States as a lever to achieve important EU policy objectives, in particular in the areas of rule of law and economic governance but also in a large number of EU *acquis* such as environmental protection, green energy and social policies. Using spending conditionality to regulate state behaviour is not new in federal systems such as those in the U.S. and Canada, where conditionality has been used for decades to advance federal policies at the state level through conditions attached to federal funding.⁶ Spending conditionality is also not new in EU spending, where it has been present since the 1990s and has been continually expanding over recent decades, notably during the 2014-20 and the current 2021-27 MFFs.⁷ What is new in the proposals for the 2021-27 financial framework is the EU's aim to increasingly rely on conditionality in an attempt to address some of the most important policy objectives and values lying at the very heart of its construction. This development indicates a growing importance of conditionality as

4 V. Vita, *The Rise of Spending Conditionality in the EU*, EUI PhD thesis (2018).

5 See V. Viță, *Research for REGI Committee, the European Parliament - Conditionalities in Cohesion Policy* (2019).

6 V. Viță, 'The Rise of Spending Conditionality in the EU: What Can the EU Learn from the U.S. Conditional Spending Doctrine and Policies?' *EUI Working Papers 16/2017*, 2017 <<http://cadmus.eui.eu/handle/1814/48644>>.

7 V. Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU: The Case of EU Spending Conditionality', *Cambridge Yearbook of European Legal Studies*, 2017; V. Viță, *Research for European Parliament, REGI Committee - Conditionalities in Cohesion Policy* (2018).

a permanent EU internal governance tool, inviting further scrutiny of its functioning and efficiency in its continued use in the internal sphere.

This contribution argues that the predominantly punitive nature of conditionality, which remains primarily based on sanctions, is possibly its most important limitation. (1) It will show that the use of conditionality as a sanctioning tool to achieve compliance departs from the EU's enforcement template. Moreover, (2) conditionality is rarely enforced in practice and (3) the tool is seldom capable of determining compliance. At the same time (4) the continued use of the tool may have negative consequences for the EU integration process. Against this backdrop, it would be desirable to re-focus EU spending conditionality towards incentives (*positive conditionality*) as opposed to predominantly punitive sanctions (*negative conditionality*). Shifting towards positive incentives is the most promising means to ensure the effective functioning of conditionality. However, this will require a significant overhaul of the EU's current conditionality and possibly its spending policy, notably in terms of increased spending capacity, reinforced administrative resources and much more serious attention to the policy results of both conditionality and spending.

II. The limitations of conditionality as a sanctioning tool

The 2021-27 MFF distinguishes itself by taking a reinforced conditionality approach, continuing the trend of the increase in the conditions attached to EU spending during the 2014-20 MFF and further consolidating it by adding more conditional strings to EU budget expenditure.⁸ Rule of law conditionality is beyond doubt one of the most important conditionalities put forward for post-2020 spending.⁹ Other significant conditionalities are also worth mentioning. In particular, the macro-eco-

8 Viță, *Research for REGI Committee, the European Parliament – Conditionalities in Cohesion Policy*.

9 European Commission, 'Proposal for a regulation of the European Parliament and of the Council on the protection of the Union's budget in the case of generalised deficiencies as regards the rule of law in the Member States, COM(2018) 324 final 2018/0136 (COD)' (2018).

conomic conditionalities¹⁰ and enabling conditions¹¹ attached to structural, fisheries and home affairs funds require continued compliance with the post-crisis fiscal rules and an elaborate set of EU *acquis* as conditions to access and continue the use of EU budget resources. A novel infringement conditionality is also introduced authorising the Commission to suspend expenditure in cases of Member State infringement of applicable EU law relevant to the expenditure.¹² All these conditionalities are extremely complex regulatory devices with impressively wide thematic reach, sophisticated legal frameworks, intensive administrative arrangements and are often demanding for financial and most importantly political capital to reach fulfilment. Conditionalities may touch on economic, labour, transportation, education, health and administrative reforms and may easily become a regulatory universe on their own in the realm of spending rather than simple conditions attached to it.

In this context, it is important to stress that using spending conditionality to regulate state behaviour is not new in federal systems, such as that in the US, where conditionality has been used for more than a century to advance specific federal policies at the state level.¹³ By adding conditions to federal spending, the US Congress has managed to regulate important policy areas (e.g. transportation, education, labour and health) lying generally beyond the realm of the federal government's powers.¹⁴ Spending conditionality is also not new in the EU, where conditionality attached to EU funds has been present since the early 1990s and underwent massive proliferation and increased regulatory sophistication in the post-crisis MFF for 2014-20.¹⁵ What is truly new in the 2021-27 financial framework

10 European Commission, *Proposal for a regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund and the European Maritime and Fisheries Fund and financial rules for those and for the Asylum and Migration Fund, the Internal Security Fund and the Border Management and Visa Instrument*, COM(2018) 375 final 2018/0196 (COD) (2018), hereafter CPR. (Art. 15, CPR proposal) and the conditional measures related to economic governance (Art. 8 (a), Art. 9(1), Art. 18 (1) and Art. 87 (6), CPR proposal).

11 CPR, Art.11, Annexes III-IV CPR proposal.

12 CPR, Arts. 67 (3) i, 91(1) d.

13 V. Viță, 'The Rise of Spending Conditionality in the EU: What Can the EU Learn from the U.S. Conditional Spending Doctrine and Policies?' *EUI Working Papers 16/2017*, 2017 <<http://cadmus.eui.eu/handle/1814/48644>>.

14 R. Jay Dilger, *Federal Grants to State and Local Governments: A Historical Perspective on Contemporary Issues* (2015).

15 Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU'.

is a decisive move to consolidate EU conditionality policy internally. This reinforced conditionality approach is a major development and points to the conclusion that the use of conditionality towards the EU's own Member States was not a temporary policy option embraced under the tremendous pressure of the sovereign debt crisis and conditional bail-out deals. Conditionality is here to stay as a permanent EU governance tool in its internal policies. It has now been revamped to sanction deviations from its founding values way beyond its 2021-27 MFF framework. The overwhelming majority of these conditionalities are *negative*, meaning that they mandate a withdrawal of funds in the case of failure to comply with a predetermined conduct and only rarely provide positive incentives.

The present work questions how opportune it is to use conditionality as a sanction, exposing the most important limitations of this conditionality approach. In the light of these important limitations, the contribution proposes using conditionalities as incentives as a promising alternative to be further explored and expanded in the EU.

1. Sanctions and the EU's enforcement template

The expansion of conditionality meant primarily to sanction Member States deviating from EU rules and values is a very recent development in the EU *internal* legal order which departs in important ways from the EU's internal enforcement template. The deployment of economic sanctions is not a common enforcement tool in the EU internal sphere,¹⁶ as opposed to external action and international relations, where sanctions of an economic, trade or diplomatic nature are the primary and often the only available tools of state coercion.¹⁷ Within the EU, enforcement is premised on the principle of loyal cooperation and solidarity¹⁸ and is most often secured through voluntary compliance and ultimately through

16 Roland Bieber and Francesco Maiani, 'Enhancing Centralized Enforcement of EU Law: Pandora's Toolbox?', *Common Market Law Review*, 51/4 (2014), 1057-92; Wenner, 'Sanctions against Member States under Article 260 TFEU: Alive, but Not Kicking?', *Common Market Law Review*, 49/1 (2012), 145-75.

17 D. A. Baldwin, 'The Sanctions Debate and the Logic of Choice' (2000) 24 *International Security* 80-107.

18 M. Cremona, 'EU enlargement: solidarity and conditionality' (2005) 30 *European Law Review* 3-22 at 19.

impartial court proceedings.¹⁹ Economic sanctions and fines, even though they are increasingly available in the EU legal order and especially in the aftermath of the economic crisis, are rarely deployed internally.²⁰ This is not because the EU lacks the motivation, capacity or courage to deploy sanctions, as commentators have often argued,²¹ but because sanctions depart from what Bieber and Maiani call the EU's "constitutional template" of enforcement, which is premised primarily on a culture of negotiation and cooperation between the EU and the Member States with compliance (not sanctioning) at its heart.²² When sanctions have been deployed, the process has not been a success, contrary to expectations. In fact, the process has most often failed as compliance has not been achieved.

The reinforced conditionality approach in the 2021-27 MFF primarily provides for negative conditionality, which sanctions Member States for failing to comply with its code of conduct by withdrawing EU funds. The use of conditionality primarily as a sanction nevertheless departs from the above 'template,' which as scholars have argued may be a step towards opening a Pandora's box²³ in a system which has been built and developed far from a culture of coercion based on sanctions but premised on a spirit of compromise, negotiations and common solutions.

Member States' subjective perceptions of a withdrawal of funds is another important element in this discussion. The current EU disbursements to Member States bound by conditionality represent more than 80% of the entire EU budget (about 145 bn EUR annually).²⁴ Unlike external action funds promised to third countries as future rewards for performance, EU budget benefits are internally perceived as core mem-

19 Bieber and Maiani, 'Enhancing centralized enforcement of EU law,' 1068–69, 1091.

20 Bieber and Maiani, 'Enhancing centralized enforcement of EU law'; Wenneras, P. 'Sanctions against Member States under Article 260 TFEU.'

21 L. Pech and K. L. Scheppele, 'Illiberalism Within: Rule of Law Backsliding in the EU' (2017) 19 *Cambridge Yearbook of European Legal Studies* 3–47; G. Halmaj, *The Possibility and Desirability of Economic Sanction: Rule of Law Conditionality Requirements Against Illiberal EU Member States* (2018); Wenneras, P. 'Sanctions against Member States under Article 260 TFEU.' The Possibility and Desirability of Economic Sanction: Rule of Law Conditionality Requirements Against Illiberal EU Member States (2018).

22 Bieber and Maiani, 'Enhancing centralized enforcement of EU law,' 1091.

23 Bieber and Maiani, 'Enhancing centralized enforcement of EU law.'

24 European Commission, *The Multiannual financial framework 2014–2020 and EU budget 2014. The figures* (2014).

bership rights, negotiated and expected on a regular basis by Member States irrespective of their good performance. In other words, in internal finances, EU budgetary allocations are not perceived by Member States as rewards for good compliance but membership rights negotiated by national governments represented in the Council together with the European Parliament and defined by national contributions to the EU budget²⁵ dominated by the logic of *'juste retour'*.²⁶ This internalised perception by Member States of EU expenditure as an EU membership right or at times even as a 'just return' based on the national budget contribution²⁷ renders the sanctioning logic of conditionality even more difficult in practice.

2. The enforcement difficulty in practice

The practice of conditionality on the ground and in particular during the 2014-20 financial period confirms the above analysis. For structural, institutional and policy reasons underpinning the process of EU budgetary expenditure, financial cuts for failure to respect conditionality do not follow swiftly and rarely see the light of day in the case of Member States, as opposed to private individuals (i.e. farmers or fishermen).²⁸ In EU institutional practice, enforcement of conditionality against Member States follows a long and difficult process of negotiation based on an ethos of continual communication, dialogue and support directed uniquely towards compliance.²⁹ Sanctions are seen as a failure and a lose-lose scenario and are only deployed in exceptional cases, following the

25 R. Crowe, 'The European Council and the Multiannual Financial Framework' (2016) 18 *Cambridge Yearbook of European Legal Studies* 69–92.

26 R. Crowe, 'The European Budgetary Galaxy' (2017) 13 *European Constitutional Law Review* 428–52. rebates and national net balances – Convention on the Future of Europe – Comprehensible and transparent budget as a prerequisite for democratic legitimacy – Treaty of Lisbon reforms – Post-Lisbon fragmentation leading to a 'budgetary galaxy' – Differentiated budgetary integration likely to endure – Final Report of the Monti High Level Group on Own Resources – Necessity for future reforms to take account of the broader galaxy – Return to a citizen-oriented approach – 'The Union method', "DOI": "10.1017/S1574019617000219", "ISSN": "1574-0196, 1744-5515", "language": "en", "author": [{"family": "Crowe", "given": "Richard"}], "issued": {"date-parts": [{"2017", 9}]}}}, "schema": "<https://github.com/citation-style-language/schema/raw/master/csl-citation.json>"

27 Crowe, 'The European Council and the Multiannual Financial Framework'.

28 Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU,' 25–27.

29 V. Viță, 'The rise of spending conditionality in the European Union,' EUI, PhD Thesis, 2018.

general enforcement culture in EU internal affairs described above.³⁰ Even in cases of grave and systemic failure to comply with a given conditionality, suspension of funds is often not the preferred option, as suspensions are usually balanced against multiple equally compelling and often broader EU policy considerations informing the Commission's decision to enforce conditionality or not.³¹ As an example, one may particularly recall the failed attempt to enforce macroeconomic conditionality in the case of Spain and Portugal in 2016.³² An equally pertinent example is the fact that irrespective of hundreds of ex-ante conditionalities not fulfilled before the start of the 2014-2020 financial period, no suspension of structural funds followed either before or after the start of expenditure.³³ This enforcement difficulty is expected to play out exponentially more strongly in the post-2020 financial period in the case of rule of law conditionality, especially in the case of Member States where rule of law deviations have very little connection with spending irregularities (i.e. Poland) as opposed to cases where they have shown to often overlap (i.e. Romania and Hungary).

3. Sanctions and compliance

Despite widely-held views, there is very little evidence to support the claim that economic sanctions necessarily lead to compliance. In fact, the very rich literature on sanctions and compliance, together with previous experience of conditionality in the EU³⁴ and notably of conditionality

30 Id.

31 Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU,' 26–27.

32 J. Valero, 'MEPs oppose "immoral" suspension of EU funds for Spain and Portugal' (October 2016); EU Council, *Decision (EU) 2016/1222 of 12 July 2016 establishing that no effective action has been taken by Spain in response to the Council recommendation of 21 June 2013 OJ L 201, 27.7.2016, p. 19–22*; European Parliament, 'In-depth analysis: Exchange of views with Spain and Portugal on possible suspension of European structural and investment funds REGI-ECON on 8 November 2016'; 'Excessive deficit procedure: Council agrees to zero fines and new deadlines for Portugal and Spain - Consilium' (2016); 'EU Commission decides not to suspend EU funds for Spain, Portugal' (2016).

33 Court of Auditors, *Special report No 15/2017: Ex ante conditionalities and performance reserve in Cohesion: innovative but not yet effective instruments* paras. 60–62.

34 Baldwin, 'The Sanctions Debate and the Logic of Choice,' 86.

in EU external policy³⁵ point to the opposite conclusion. It is therefore worth restating that enforcement of conditionality and consequently withdrawal of EU funds are not sufficient to determine compliance – not even in EU Member States or regions most in need of EU funds.³⁶ Compliance depends on a case by case basis on a wide range of variables, including the availability of alternative financial resources, the perceived legitimacy and fairness of sanctions, the degree of domestic public support for the policy objective prescribed though conditionality, the political costs of compliance and expected spill-over effects.³⁷ Crucially, full and genuine compliance with conditionality – as opposed to formal, incomplete and partial compliance – relies dramatically on a sincere and congruent commitment of the national government to the policy goal pursued by the conditionality.³⁸ A lack of Member State genuine commitment is expected to be a strong limitation in the case of future rule of law conditionality, where the willingness of the targeted governments to embrace change is very low and much citizen support for the policy objective of the conditionality is not always present. Moreover, compliance with conditionality in many instances requires a complex process of far-reaching reforms, an incredibly laborious process which has little chance of success in the absence of full and sustained political commitment and ownership.³⁹

35 For the case of enlargement rule of law conditionality, see U. Sedelmeier, 'Political safeguards against democratic backsliding in the EU: the limits of material sanctions and the scope of social pressure' (2017) 24 *Journal of European Public Policy* 337–51 "plainCitation": "U. Sedelmeier, 'Political safeguards against democratic backsliding in the EU: the limits of material sanctions and the scope of social pressure' (2017) for the conclusion that material sanctions are insufficient, and the more serious the departure from EU values, the more inefficient sanctions are.

36 Viță, *Research for REGI Committee, the European Parliament – Conditionalities in Cohesion Policy*, pp. 22–23, 51–52.

37 Viță, *Research for REGI Committee, the European Parliament – Conditionalities in Cohesion Policy*, pp. 51–52.

38 Viță, 'The rise of spending conditionality in the European Union,' Chapter 12, Romania case study.

39 For instance, during recent years the governments of Hungary, Poland and Romania have been busy reforming judicial systems, weakening the powers of the public prosecution office and anti-corruption oversight, changing electoral laws and criminal codes. Some have even amended their constitutions. In consequence, in all these instances, compliance with rule of law conditionality requires onerous 'to do' acts to restore the rule of law status which would require important an commitment to change in the absence of which mere formal or declaratory compliance is highly likely.

4. Sanctions and EU integration

Maybe the most important limitation of conditionality relates to the long-term cost of the tool for the future of the EU integration project.⁴⁰ While conditionality has shown some – mostly limited – achievements in practice,⁴¹ and may in future perform the useful task of condemning in a more powerful manner Member State deviations from rule of law principles (arguably in the absence of other tools), the permanent transition to *internal* sanctions marked by the consolidation of conditionality policy within the EU may pose a great challenge to harmonious EU integration in the years to come.

I would like to stress the word '*internal*' because conditionality is not a traditional tool of EU integration. For decades, conditionality has been the key and often the only available instrument of EU external action, in particular in the areas of enlargement and development cooperation. Internally, conditionality used to play a much more marginal role until recently and is certainly not the only available or often the appropriate instrument to achieve change.⁴²

As pointed out in legal scholarship, the EU's model of integration is built on a non-reciprocal type of relationship between it and its Member States, grounded in a duty of loyal cooperation and solidarity from which the *quid-pro-quo* logic of conditionality departs fundamentally.⁴³ Internal conditionality to enforce EU laws, *acquis*, policies and most recently founding membership commitments by withdrawing EU funds is at the very least a significant departure from the EU model of integration, is very unlikely to achieve sustained compliance and in addition does not seem a promising enabler from the EU integration perspective.

A conditionality process based primarily on a discourse of money – as opposed to commitments and values – is expected to draw a clearer

40 See the revealing reaction of the President of the European Commission in F. Eder, 'Juncker: German plan to link funds and rules would be "poison"' (June 2017); J. Mischke, 'Juncker rejects cutting EU funds to Poland' (January 2018).

41 Court of Auditors, *Special report No 15/2017: Ex ante conditionalities and performance reserve in Cohesion: innovative but not yet effective instruments*; European Commission, *Seventh report on economic, social and territorial cohesion* (2017) pp. 171–74; European Commission, *The Value Added of Ex ante Conditionalities in the European Structural and Investment Funds* (2017).

42 Viță, 'Revisiting the Dominant Discourse on Conditionality in the EU.'

43 Cremona, 'EU enlargement: solidarity and conditionality', 19.

dividing line than ever before between Europe's creditors and debtors, and the EU's rich and poor, beyond instances of economic hardship.⁴⁴ Moreover, a top-down, highly prescriptive, input-oriented and uneven enforcement of conditionality seems more likely to aggravate current divisions between Member States and further accentuate the intra-EU asymmetries between the EU's north and south and east and west. This unintended consequence may be highly corrosive for the EU's highly inter-dependent and integrated construct, which strongly relies on constant cooperation between its Member States. From this perspective, a deployment of financial sanctions today is likely to inform not only the response of the Member State concerned today, but also its response tomorrow.

There is another aspect of the EU integration discussion which in my opinion is far more relevant than the potential reaction of Member State governments: the cost inflicted by the enforcement of negative conditionality on EU citizens who benefit directly or indirectly from EU funds and the resulting reputational damage to the EU. Enforcement of conditionality implies cutting off already relatively scarce and much needed EU financial resources from EU citizens who would be the ultimate receivers of a financial sanction, i.e. researchers, the unemployed, farmers, fishermen and women, and small and medium enterprises. In addition, enforcement of conditionality may postpone the achievement of equally important goals financed with the EU funds attached to conditionalities, e.g. road, health and education infrastructure, a clean environment, social inclusion, ICT connectivity, rural development, research and development etc. This risk has not been sufficiently addressed by the current Commission proposals and is therefore likely to continue to pose important limitations on the use of conditionality in practice.

III. Conclusion: from sanctions to incentives

So far, the EU's approach to spending conditionality has been primarily premised on the conceptual model of *negative sanctions* rather than on *positive incentives*. Negative sanctions (funding cuts, suspensions or de-commitment) create the expectation that a withdrawal of EU funds will necessarily change the behaviour of Member State governments and that they will consequently correct their deviations under the threat of a

44 D. Kukovec, 'Law and the Periphery' (2015) 21 *European Law Journal* 406–28.

spending cut-off.

This commonly held belief nevertheless departs from the reality of conditionality. As shown above, a withdrawal of already scarce EU funds departs from the EU's enforcement template, is not often ordered in practice, is not necessarily capable of determining compliance and may have unintended consequences on the EU integration process.

The expectation that spending sanctions will necessarily lead to compliance also departs from the conceptual grounding of conditionality as a tool of behavioural psychology⁴⁵ and its subsequent applications in the fields of law and economics, which point to the finding that conditioning works best when premised on positive incentives as opposed to negative sanctions.⁴⁶ Some incipient examples of the use of conditional incentives may already be observed in the 2021-27 MFF, such as the new EU values fund proposal and the funds specifically proposed to support European Semester structural reforms.⁴⁷ While they are good examples, these still represent exceptions and have a very modest budgetary envelope attached (less than 1% of the post-2020 MFF) to constitute an effective incentive for Member States to change their behaviour.

The most recent historic agreement on a significant increase of EU expenditure during 2021-27, is likely to put the necessary basis for a gradual shift towards conditional incentives in the financial periods to come. For the time-being however, and notably during the 2021-27 financial period, the conditionality process in the EU is expected to remain focused primarily on negative sanctions. This contribution con-

45 Conditionality is an application of Pavlov's and Skinner's foundational works on classical and operant conditioning in behavioural psychology concerned with the study of changes in human and animal behaviour as a result of conditioning in the form of positive or negative reinforcers in response to expressed behaviour; behavioural psychology has found subsequent application in behavioural economics and law, notably in the work of Thaler and Sunstein. See B. F. Skinner, *About Behaviorism* (1974); C. Jolls, C. R. Sunstein and R. Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 *Stanford Law Review* 1471-1550; R. H. Thaler and C. R. Sunstein, *Nudge: improving decisions about health, wealth and happiness* (Yale University Press, 2008).

46 D. A. Baldwin, 'The Power of Positive Sanctions' (1971) 24 *World Politics* 19-38; Thaler and Sunstein, *Nudge*.

47 European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on the establishment of a European Investment Stabilisation Function COM(2018) 387 final 2018/0212 (COD)' (2018); *Proposal for a Regulation of the European Parliament and of the Council establishing the Rights and Values programme for the period 2021-2027 (with a proposed budget of about 900 mn for a seven-year financial period)*.

cludes with a call for a serious reflection and consideration of the positive aspects of the use of conditionality predominantly as an incentive in the financial periods to come. As long as conditionality is favoured as a permanent internal governance instrument of EU spending, it is essential that it is conceptualised and implemented in a way that it can effectively deliver its objectives. A shift towards positive incentives is the most promising means to achieve this end. Such a reform would require much more attention to the outputs and results of conditionality and spending, as opposed to mainly prescriptive input criteria. It would also require significant change in the EU spending implementation methods, such as the management types and institutional set up. In the light of the current state of the negotiations, such a reform may not be reasonably expected in the 2021-27 MFF. Nevertheless, such a policy reform appears highly desirable in the longer run to enhance the effectiveness and impact of the ever-expanding conditionality tool.

The Budgetary Impacts of the Common Agricultural Policy

Alan Matthews¹

Abstract

This chapter discusses how disagreement over the size of the resources made available for agricultural policy is influencing the negotiations on the 2021-2027 MFF. In turn, the size of the CAP budget is likely to determine the extent to which the Council and Parliament are prepared to support the incoming Commission's European Green Deal ambitions in the agriculture sector. The delay in agreeing the next MFF has already led to postponement of the introduction of the next round of CAP reforms, which are intended both to give greater flexibility to Member States to design their agricultural policies and to raise the level of environmental and climate ambition of the CAP. At the time of writing, the eventual landing ground for these parallel and intertwined debates is still uncertain.

Introduction

The Common Agricultural Policy (CAP) has always played a vital role in negotiations on successive multi-annual financial frameworks (MFF) in the European Union. This is for two main reasons. The first is the sheer size of CAP expenditure in the EU budget – in the last year of the current MFF it will account for 33% of MFF commitments. The second is that the pre-allocated CAP envelopes under the CAP Pillar 1 (financed by the European Agricultural Guidance Fund, EAGF) and Pillar 2 (financed by

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the European Agricultural Fund for Rural Development, EAFRD) play a major role in determining the net budget transfers that Member States inevitably pay attention to during these negotiations (Matthews, 2018).

While MFF negotiations have always been contentious, the UK's final separation from the EU at the end of 2020 has intensified the traditional disagreements between net contributors and net recipients. The UK takes with it its net contribution to the EU budget, estimated at around €13 billion annually in the coming MFF period. To fill this gap the Commission's MFF proposal sought additional resources but also proposed savings in existing programmes, including both the CAP and cohesion spending. This proposed reduction in the CAP budget has been roundly rejected by both the European Parliament (which has sought to maintain the CAP budget at its 2014-2020 level in real terms) and by many Member States.

The size of the CAP budget is not only a decisive factor in reaching agreement on the next MFF but it also has a knock-on effect on the shape of the next CAP reform. In parallel with its MFF proposal, the Commission put forward sector-specific legislation for its various spending proposals, including agriculture. The Commission's draft legislation for the CAP post-2020 was published in June 2018 (European Commission, 2018b). The proposal was motivated by new international commitments under the Paris Agreement and the UN Sustainable Development Goals requiring greater environmental and climate ambition, and also a need to address a growing revolt by Member States and farmers against perceived bureaucracy and overly complex administration.

The proposal's most innovative element is to move to a new delivery model entailing greater responsibility and flexibility for Member States to design their agricultural policies, albeit still within a common EU framework. The need to shift resources in the CAP from income support to tackling environmental challenges and climate stabilisation has been further underlined in the new Commission's flagship proposal for a European Green Deal (European Commission, 2019). An important part of this proposal is a shift to a more sustainable food system, with specific targets spelt out in the Farm to Fork (European Commission, 2020a) and Biodiversity (European Commission, 2020c) strategies and in the European Climate Law (European Commission, 2020d).

In May 2020, the Commission put forward a revised MFF proposal which includes a proposal for a European Recovery Instrument (ERI) to

finance front-loaded expenditure in the next MFF plus a slightly revised 'standard' MFF (which the Commission refers to as a 'reinforced' MFF) (European Commission, 2020f). The reinforced MFF provides for commitment appropriations amounting to €1,100 billion over the 2021-2027 period, while the ERI would help to finance a further €750 billion in constant 2018 prices of spending in the 2021-2024 period. Together, they add up to a total proposed spending of €1,850 billion over the MFF period. Part of the package allocates additional funding to the CAP to reinforce the funds available to support farmers and rural areas in recovering and delivering the European Green Deal and in particular the new Farm to Fork and Biodiversity strategies. While the Parliament has welcomed the Commission initiative, some Member States are more reserved, and at the time of writing (June 2020) its fate remains to be determined.

The Council and Parliament are unlikely to finalise a deal on the CAP legislation until the size of the CAP budget in the next MFF is known. The scale of this budget may well determine how willing the co-legislature will be to support the green transition in agriculture.

The size of the CAP budget in the MFF

The debate on the 2021-2027 MFF was initiated by the Commission's *Reflection Paper on the Future of EU Finances* in June 2017 (European Commission, 2017). This paper analysed the impact on the EU budget of five different scenarios for the future of the EU in terms of overall volume, revenue sources and spending priorities. In each scenario but the most ambitious, the CAP had either a smaller share of the overall budget and/or lower resources in absolute terms. In one scenario the Commission envisaged a cut of around 30% in the CAP budget in real terms.

In the event, the Commission recommended a nominal cut in CAP spending in the next programming period of between 3-5% compared to the 2014-2020 MFF, adjusted for the UK's departure, in the context of a modest increase in the overall MFF from 1.00% to 1.08% of EU GNI (1.11% including the European Development Fund) (European Commission, 2018a). This translates into a cut in the CAP budget of around 15% in constant 2018 prices (Table 1). Most striking, in view of the expressed desire to pursue a higher level of environmental and climate ambition in CAP spending, the Commission proposed maintaining the level of direct payments in nominal terms in EAGF Pillar 1 spending and making much more severe cuts in EAFRD spending in Pillar 2. In constant prices, Pillar

1 is cut by 11% and Pillar 2 by 27%. Pillar 2 spending is co-financed by Member States. The Commission proposed that some of the reduction in EU financing of Pillar 2 spending would be offset by requiring an increased level of national co-financing by Member States.

Table 1. Comparison of CAP spending levels in different MFF proposals 2021-2027

	EU-27 2014- 2020+EDF	EU-27 2020 * 7 +EDF	Com- mission proposal 2021-2017 May 2018	Parliament proposal 2021-2027 Nov 2018	Finland Presiden- cy Dec 2019	Michel 1st MFF proposal 14 Feb 2020	Commission reinforced MFF inc. assigned revenue from ERI May 2020	% change, G com- pared to B
	A	B	C	D	E	F	G	H
Constant 2018 prices								
1. Total MFF	1,082,320	1,107,138	1,134,583	1,324,089	1,087,327	1,094,827	1,850,000	
2. In % of GNI (EU-27)	1.16%		1.11%	1.30%	1.07%	1.074%	2.00%	
3. CAP spending	382,855	367,621	324,284	383,255	334,284	329,284	348,264	-5%
4. EAGF	286,143	273,743	254,247		254,247	256,747	258,251	-6%
5. EAFRD	96,712	93,877	70,037		80,037	72,537	90,013	-4%
6. % CAP (3/1)	35.3%	33.2%	28.5%	28.9%	30.7%	30.1%	30.3%	
Current prices								
1. Total MFF	1,063,101	1,151,866	1,279,408	1,493,701			2,049,422	
2. In % of GNI (EU-27)	1.16%		1.11%	1.30%			2.0%	
3. CAP spending	375,429	382,473	365,005	431,946			391,440	2%
4. EAGF	280,351	284,803	286,195				290,702	2%
5. EAFRD	95,078	97,670	78,811				100,738	3%
6. % CAP (3/1)	35.3%	33.2%	28.5%	28.9%			30.3%	

Sources: Massot and Negre (2018) for current MFF figures and Commission May 2018 proposal; European Parliament position from Resolution of 14 November 2018 on the Multiannual Financial Framework 2021-2027; Finland Presidency proposal from Council document 14518/1/19 5 December 2019; Michel first attempt figures from Council document 5846/20 14 Feb 2020; Commission reinforced MFF figures from European Commission (2020d). MFF totals include the European Development Fund (EDF).

This proposed reduction in CAP spending was strongly opposed by many Member States (Council of the European Union, 2018, 2019b, 2020) and the European Parliament, which sought to maintain the level of CAP spending in the next MFF constant in real terms (Table 1). The Finnish Presidency's 'negotiating box' proposal to the December 2019 European Council, the first version with definitive figures, reduced the overall volume of MFF resources compared to the Commission's proposal (Council of the European Union, 2019a). However, it added €10 billion to CAP Pillar 2 commitment appropriations. The subsequent draft prepared by European Council President Charles Michel for the special European Council meeting in February 2020 stuck closely to this Finnish draft but cut in half the additional resources for the CAP included in the Finnish proposal.

The Commission's May 2020 proposal makes two significant changes. First, it adds €9 billion in constant 2018 prices to the standard MFF compared to its original May 2018 proposal, almost bringing it back to the level in the Finnish negotiating box. In addition, it allocates a further €15 billion from the European Recovery Instrument (ERI) to EAFRD Pillar 2 spending to be committed in the years 2022-2024. This total allocation can be compared to the CAP budget in the 2014-2020 MFF, deducting amounts pre-allocated to the UK for comparability. This Commission proposal, which must still be negotiated in the Council and approved by the Parliament, represents a small reduction in constant prices but an increase in current prices compared to a 2014-2020 baseline (Matthews, 2020b).

The relationship with the CAP reform proposal

The Commission's CAP reform proposal aims at a higher level of environmental and climate ambition. It proposes a new green architecture to replace the three environmental elements in the 2014-2020 CAP, namely cross-compliance conditions for eligibility for direct payments, a greening payment to farmers who comply with further environmental conditions funded from Pillar 1 national envelopes, and voluntary agri-environmental climate measures (AECMs) financed from Pillar 2 envelopes that reward farmers who commit to go beyond these baseline requirements in terms of environmentally friendly practices.

Under the Commission's proposal, the conditions farmers must observe to be eligible for direct payments under cross-compliance and the greening payment will be combined in an 'enhanced' conditionality. Voluntary AECMs will continue to be funded from Pillar 2. In addition, the Commission proposes that Member States should be obliged to introduce 'eco-schemes' in Pillar 1 that can finance interventions and practices similar to AECMs in Pillar 2. Eco-schemes would be compulsory for Member States but optional for farmers. Member States would have greater flexibility when setting the payment levels for interventions under eco-schemes than is the case for the Pillar 2 AECMs, where payment levels are limited to the costs incurred or income foregone by farmers as a result of enrolling in the scheme.

Member States would be obliged to allocate at least 30% of their EAFRD budgets to measures addressing environmental and climate objectives (although this minimum threshold will not apply to ERI spending). In addition, some proportion of the EAGF envelopes for direct payments must be allocated to eco-schemes with the same objectives. There was no minimum share of EAGF spending required to be allocated to eco-schemes in the Commission's original CAP. However, following the publication of the Farm to Fork Strategy, the Commission has indicated that it will now support a mandatory minimum threshold (European Commission, 2020b). Member States will also have the possibility of transferring resources from the EAGF to the EAFRD without a requirement for co-financing if the funds are used for AECMs.

The European Green Deal proposed by the incoming Commission in December 2019 further underlines the urgency of raising the EU's climate and environmental ambitions. The Farm to Fork and Biodiversity Strategies propose a series of headline targets as part of a shift towards a more sustainable food system aiming to reduce dependency on pesticides and antimicrobials, reduce excess fertilisation, increase organic farming, improve animal welfare and reverse biodiversity loss. Member States will be expected to show how they are addressing these targets in their CAP Strategic Plans. To achieve these ambitious targets will require significant budgetary support to assist farmers in making the transition.

The CAP budget is also expected to play a role in reaching the ambitious target of at least 25% of EU expenditure contributing to climate objectives. The Finnish negotiating box supported the Commission pro-

posal to increase the share of climate-related expenditure in the CAP in the next MFF to 40% (this compares with a 28% share in commitment appropriations in the last years of the current MFF). Thus, spending under the Common Agricultural Policy (CAP) is expected to make up a substantial share of the overall EU budget contribution to the Green Deal.

Under its Sustainable Europe Investment Plan published in January 2020, the Commission aims to mobilise at least €1 trillion in current prices over the coming decade (European Commission, 2020e). A quarter of this will come from the EU budget earmarked for climate action. Of this budget contribution, between 40% and 45% will come from measures supported by the CAP. Unfortunately, this figure currently lacks credibility due to the way the Commission counts the climate-relevance of CAP spending. Specifically, it assumes that 40% of spending on income support payments to farmers will contribute to climate action because of the enhanced conditionality that farmers must observe to be eligible for these payments. As the European Court of Auditors (2018) has pointed out, this figure is likely to over-estimate the contribution of CAP spending to climate mitigation and adaptation and it finds the figure unrealistic. A more robust accounting of the climate impacts of CAP spending in the next MFF is needed to ensure the credibility of the Commission's financing proposals for the Green Deal (Matthews, 2020a).

The Negotiating Box and the CAP

The last CAP reform in 2013 was the first in which the European Parliament had full co-decision powers with the Council in making agricultural policy. However, many detailed provisions that formed part of the CAP legislation were also included in the European Council conclusions on the MFF 2014-2020. The Council Presidency in negotiating with the Parliament's rapporteurs in the subsequent trilogues took the view that these conclusions were non-negotiable. The Parliament rejected this position in principle. When political agreement was reached in June 2013 on the substantive provisions for the CAP reform, the MFF-related issues were left to one side and not addressed until September of that year. The Parliament finally succeeded in winning some concessions from the Council Presidency but it was an uphill struggle (Matthews, 2014, 2015).

The Finnish Presidency negotiating box also covers matters that ultimately will be reflected in the CAP sector-specific legislation but covering a narrower range of topics compared to the 2013 CAP reform. These include the formula for external convergence whereby the unit value of payments per hectare is equalised across Member States; the mechanism whereby payments to any individual beneficiary of direct payments can be capped; the method of financing the agricultural reserve; the flexibility available to Member States to transfer resources from the EAGF to the EAFRD and vice versa; the pre-financing and co-financing rates for rural development measures financed by the EAFRD; and de-commitment rules.

Where these measures affect the national envelopes and levels of expenditure to be made and have clear budgetary outcomes for Member States, there is an obvious rationale for them being included in the negotiating box. However, some of these measures (for example, capping and the flexibility to move resources between Pillars) seek to determine how Member States use the resources they have been allocated and would seem to be properly subject to co-decision. There is therefore again a potential for friction in the trilogues if the Council presidency and Parliament representatives view the negotiability of these issues differently.

Conclusions

The debate on the overall volume of resources to be transferred to the EU budget in the next MFF is greatly complicated by the loss of the UK's net contribution to the budget following Brexit. The Commission's original MFF proposal sought to compensate for this loss by both increasing the resources individual Member States should contribute to the budget (as a share of GNI) and by cutting traditional programmes such as the CAP and the cohesion budget.

The economic aftershock of the lockdowns introduced to limit the spread of the coronavirus has forced a rethink of the appropriate role for the MFF in the coming programming period. The Commission's proposal for an Economic Recovery Instrument would exceptionally allow the EU to borrow and run a deficit to finance the recovery. The Commission has used this opportunity to restore some of the cuts to the CAP budget that it made in its original May 2018 proposal.

Both the AGRIFISH Council and the European Parliament have indicated that they support the Commission's objective that the next CAP should have greater environmental and climate ambition. They both insist that at least maintaining the size of the CAP budget is essential if farmers are to be asked to do more to protect the environment and contribute to climate action. The co-legislature has not been willing, so far, to support the idea of doing more with less, even though there is scope to make more effective use of EAGF funds by capping payments to the very largest beneficiaries and redirecting these savings to helping the green transition.

The Commission has accepted that the delay in finalising the MFF conclusions for the coming programming period will delay the introduction of the new CAP. It has proposed a transitional regulation based on a 'new money, old rules' principle to allow payments to farmers in the 2021 calendar year based on rolling over the rules in the current CAP. Many parliamentarians and Member States argue that this transition period should be extended to a two-year period. In any event, it is clear that there will be no final agreement on the CAP legislation until the CAP budget in the next MFF is known. The size of the agreed budget is likely to influence how ambitious the Council and the Parliament are prepared to be in supporting the Commission's ideas for the Green Deal in agriculture.

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Cohesion and Stabilisation in the Future MFF

László Andor¹

Abstract

Territorial imbalances in the single market justify the continuation of a robust cohesion policy, which in the future will need to be more effective than in the past. Cohesion policy will need new software in order to ensure that interventions deliver sustainable transformations. Success needs to be measured with indicators beyond GDP since experience shows economic growth is often possible without social convergence. Cohesion instruments will need to be linked more closely with social investment strategies and innovation-oriented industrial policies.

At the same time, proposals have been made to embed tools for stabilisation in the MFF. However, the size and nature of these proposed new instruments make it doubtful whether they can serve stabilisation in a timely and effective manner, especially in the period overshadowed by Covid-19. Timeliness, volume and a strong social dimension are critical factors in this respect.

In the future, political momentum will need to be created for serious MFF talks that can break the 1 per cent glass ceiling (*vis-à-vis* total EU GDP) and break some old operational routines for the benefit of the European economy and societies.

1 Secretary General, FEPS

Introduction

In 2018-20, the European Union has been working on its new long-term budget amidst a variety of external and internal challenges, and some of these new conditions are certainly not temporary. Political attacks from the inside and outside together with multiple imbalances require bold answers, and working out a consensual fiscal solution under strict time pressure turns out to be an illusion.

Brexit, which is a high-risk event for both sides but especially the UK itself, is making a direct impact on the EU budget with a variety of consequences. However, it should not be allowed to play a purely negative role in the processes of EU reconstruction and budget planning. It is important to rebut false and hostile critiques of the EU and address the causes of Brexit in both policy and the budget.

There have and will always be some enemies of European integration, but they will only appeal to wider audiences if the EU fails to deliver economic growth and do it in an inclusive way. Therefore, the Brussels debates in the current situation have to focus more on how to create and share prosperity and identify the relevant budgetary tools. The EU must find ways to invest more and also invest in its own better functioning.

Cohesion in the EU budget: purpose and performance

The 2014-20 Multiannual Financial Framework (MFF) was designed to boost the transformational effects of the EU budget, namely by serving the objectives of the Europe 2020 Strategy.² The first two headings in the MFF, amounting to about 90 per cent of the budget, reflected the Europe 2020 goals (Smart and Inclusive Growth; Sustainable Growth: Natural Resources). The Juncker Commission sidelined Europe 2020 and then proposed an MFF in which both cohesion and agriculture would suffer drastic reductions on the grounds of being old rather than new.

Considering instruments old or new should not be the main driver

2 The Europe 2020 Strategy was adopted by the European Council in 2020 as a replacement for the earlier Lisbon Strategy in order to achieve “smart, sustainable and inclusive growth.” Europe 2020 consisted of seven “flagship initiatives” and was supplemented with five headline targets. Member States were asked to develop their own Europe 2020 plans in order to reach their own targets, and the European Semester was used to monitor progress and provide guidance to help implementation.

of decisions on allocations. The fact that the benefits of the single market do not automatically trickle down to disadvantaged regions and social groups turned many against the EU in the UK and contributed to the pro-Brexit referendum outcome in 2016. Consequently, the lessons of Brexit actually support arguments about the need to tackle imbalances and inequality collectively in the EU and for stronger common instruments in favour of economic, social and territorial cohesion. More traditional policies should be reformed rather than automatically reduced if new initiatives also need funding. This applies to the question of cohesion in particular, but also to the Common Agricultural Policy³ (CAP).

Cohesion Policy⁴ has always been about supporting structural transformations while enhancing growth opportunities in more disadvantaged regions in the context of the single market. However, evaluation of its contribution has always been difficult. Member States are preoccupied with the speed of absorption, while in the European Parliament the focus often shifts to the 'error rate.' On the other hand, judging the quality of Cohesion Policy instruments and how strongly they actually contribute to growth is hard, since it is not redistribution alone that produces results but other factors too (private investment, access to markets etc.).

Cohesion is what the participants in the community feel, while convergence is what they can measure. Although it is imperfect, the most important indicator for measuring convergence in the EU is GDP/head. In other words, the most important expectation vis-à-vis Cohesion Policy is that it helps less developed Member States and regions achieve higher growth rates and converge to the average EU income level.

The post-2014 Cohesion Policy introduced some important novelties, like partnership agreements and a code of conduct. A new effort was made to make evaluation 'results based' and through a more objective assessment of results help planning and programming in the following period. GDP/head remained the main allocation principle (with three categories of regions eligible for structural and investment funds),

3 The main concern with the CAP should not be its size but how it affects redistribution and societal relations within the Member States. Out of the total CAP envelope, some 80 per cent goes to 20 per cent of land owners, which is not the same category as the actual farmers. Simply because land property is highly concentrated, CAP is a potentially very regressive distribution policy.

4 Here we speak about three instruments: the Cohesion Fund, the European Regional Development Fund and the European Social Fund. Together they have represented over a third of total MFF resources.

although the performance of funds has not been measured purely with their contributions to GDP growth but through their contributions to reaching Europe 2020 targets.

Whether cohesion-funded regions experience faster GDP growth than non-assisted regions is the usual basis for judging the effectiveness of this policy (see, e.g., Darvas and Wolff). On the other hand, framing the MFF in the Europe 2020 strategy invites another type of evaluation, since the question is whether lower-income regions and countries can also get closer to the Europe 2020 targets or not. Pushing aside the Europe 2020 strategy on the political agenda of the EU makes it harder to evaluate the performance of budgetary instruments (especially ESIF⁵) and returns us to the imperfect fall-back option of using GDP.

To avoid leaving the purpose of EU funds void, reference is often made to the UN Sustainable Development Goals (SDGs) and to the European Semester. Neither solutions are problem-free. For the time being the SDGs lack a particular European focus and also the political standing that would be required. This can change but not quickly enough to make a meaningful impact on the design of the 2021-7 MFF.

The European Semester is an EU-specific tool but there are widely differing opinions about whether it works at all or not. To some extent, there is a time inconsistency too, since without Europe 2020 or another long-term strategy it becomes an annual exercise, while EU funding requires a stable and longer-term framework. In order to accept a strong link between EU funds and the Semester what longer-term strategic purpose the latter serves needs to be defined.

Since Cohesion Policy belongs to the core mission of the European Union, its funding has to continue at a level comparable to the recent past. However, the effectiveness of Cohesion Policy must improve, through smart conditionality and innovation in the management system in particular. Such changes are also needed to rebuild trust in the EU budget and its modest redistributive role.

Conditionality is an important principle, but it also has limits (Viță 2017). Cohesion instruments can improve but they cannot become overly tricky so as to combine delivering economic and social conver-

5 ESIF stands for European Structural and Investment Funds. In addition to those serving Cohesion Policy, this category includes the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund.

gence, tackling business cycles, safeguarding fiscal discipline and sanctioning political degeneration too. Instead of adding new conditionalities of dubious effectiveness, the failure of some Member States to use ESIF funds properly should trigger a shifting of the boundary between direct and indirect management of structural funds. One can also consider a third way (between direct and shared management): assisted management. This operational form would not question the legitimacy and the dominance of shared management in Cohesion Policy but it would provide direct assistance if weaknesses of audit management manifest themselves in a Member State.

Strengthening the social dimension

The political process of EU integration has been stuck since the defeat of the attempted Constitution (2005) and the recent rise of EU-scepticism has created a feeling of retreat. Indeed, the 2017 White Paper was the first major document that invited stakeholders to discuss scenarios of withdrawal or even split. Nevertheless, this state of uncertainty has not blocked progress in many areas, like the development of a digital single market and a partial reform of the EMU. The implementation of an Energy Union and a Capital Market Union are going ahead and in 2016 an EU commissioner was appointed with responsibility for a Security Union. Interestingly, discussions about the need for a Social Union remain marginal, putting social policy in a Cinderella role in EU integration.

The social dimension of the EU budget, i.e. the European Social Fund supplemented with various smaller instruments,⁶ often appears to be an underestimated area. This is perhaps because of low expectations of the EU in the area of social policy in general, and also because of a bias towards legislative instruments in the EU social policy toolkit. However, if where and how EU funding connects with human capital investment in the Member States is explained, its role and significance can be better understood.

In national budgets, broadly defined welfare expenditure amounts to

6 In the 2014-20 MFF, the European Globalisation Adjustment Fund (EGF), the Fund for European Aid to the Most Deprived (FEAD), the Youth Employment Initiative (YEI) and the EU Programme for Employment and Social Innovation (EaSI) all helped to boost the more caring side of the EU and its budget.

around 40 per cent of total expenditure. Of this, narrowly defined social protection budgets receive about a third. Needless to say, the EU budget can never rival or centralise these budgetary components. However, the social compartment of the EU budget can and does provide vital contributions to social assistance and social investment programmes in the Member States. These also function as incentives to reform employment and social policies and design more effective programmes on the ground. In many countries, workforce training largely depends on ESF funding.

The European Pillar of Social Rights (EPSR) rightly identifies social divergence as a potentially destructive factor, not only at the level of Member States but also for the EU. Following a decade of devastating financial and economic crises, discussion on cohesion and convergence must be serious and avoid clichés. A genuine assessment is needed of the capacity of instruments in the EU budget to deal with the great imbalances and inequalities in the EU.

The approach of the Juncker Commission was to create a greater European Social Fund, and call it ESF+, to demonstrate a stronger commitment to social policy. However, the greater numbers largely came from following inflation and incorporating in the ESF+ a few instruments that previously had not been part of it. At the same time, important further proposals point to a greater share of ESF serving social inclusion and easier access to the European Globalisation Adjustment Fund (EGF).

What should be more important than the larger headline figure and the orchestration of the general framework is the mission of the ESF and the need to update it. Social imbalances and divergence have appeared as a major concern in times of crisis and afterwards. The potential of EU tools to improve social sustainability should be at the heart of the MFF debates.

According to Hemerijck et al. (2020), the Commission's proposal for the 2021-2027 EU Multiannual Financial Framework continues to lack an assertive and comprehensive social investment strategy based on a policy and institutional complementarity logic that would allow for a maximisation of the social and economic returns from EU social spending. Hemerijck et al. advocate a Social Imbalances Procedure (SImp) and a targeted facility to support the implementation of an EU coordinated Child Guarantee.

The apparent shift of focus by von der Leyen to demography can also

have consequences for the MFF. Due to a combined effect of globalisation, EU enlargements and the eurozone crisis, more peripheral countries and regions in the EU have experienced very significant outflows of working age men and women resulting in professional skill shortages, population decline and rapidly increasing old-age dependency ratios. Embedded in uneven development and the single market, such intra-EU imbalances will not go away quickly and may even be aggravated in the coming period, further weakening the growth potential of the periphery.

These structural imbalances require a fresh and serious analysis, but also more forceful and better focused investment strategies. It should be an explicit goal of the ESF to promote social investment states,⁷ and especially at the (eastern and southern) peripheries of the European Union, in order to counter divergence and facilitate upward convergence.

The Covid-19 pandemic and the recession it triggered offered the European Commission an opportunity to come forward with an initiative to boost solidarity in the EU, especially with workers whose jobs were put at risk by the pandemic and the management of the health crisis. A new instrument was born with the name SURE⁸, supporting the implementation of short-time work arrangements (or *Kurzarbeit*) with loans amounting to 100 billion euros at EU level. The demand for this support was demonstrated very quickly, raising speculation about the need to make SURE a permanent part of the EU toolkit as opposed to being a temporary solution only.

Towards unemployment reinsurance

Building a proper fiscal capacity for the eurozone is of vital importance. It is possible without a federal leap or a treaty change. The key requirement is for political leaders also in the surplus countries to be able to convince the public about the necessity of repairing the EMU and preparing it for the next downturn, including by adding shock-absorption tools. However, this is a function very different from the original and still standard mandate of Cohesion Policy, which is meant to address structural gaps and discrepancies rather than cyclical fluctuations.

7 See the classic text by Vandenbroucke, Hemerijck and Palier (2011).

8 The full name of the instrument is “temporary Support to mitigate Unemployment Risk in an Emergency”.

Following calls for a fiscal capacity, including from the European Parliament and the newly elected French President Emmanuel Macron, the Commission President in his State of the Union speech announced that a budget line dedicated to the eurozone would be embedded in the next MFF proposal. In the actual 2018 MFF proposal, the eurozone compartment includes two new items: a Reform Support Programme (RSP) with EUR 25 bn and a European Investment Stabilisation Function (EISF) with EUR 30 bn. However, neither of these proposals managed to make a breakthrough in the year-long debate that followed. Eventually, the Covid-19 crisis opened the door to the creation of a much larger instrument (“Next Generation EU”), with a stabilisation function, attached to the new MFF, but not as a part of it.

Whether embedded in the MFF or not, it is important to ensure that EMU fiscal capacity allows for demand side intervention, it can step in without major delays and it can reach a large number of citizens affected by adverse macroeconomic developments. Unemployment insurance, or reinsurance, satisfies these criteria. This is why progressive thinkers and leaders⁹ have been advocating this concept for some time, and Ursula von der Leyen, the new Commission President entering in 2019, launched preparatory steps in this direction.

A Community unemployment fund is not entirely a new idea. It was first outlined in the 1975 Marjolin Report and was supported in the 1977 MacDougall Report¹⁰ too. These early public finance analysis documents held it to be a no-brainer that monetary integration requires unemployment insurance as a form of *de facto* solidarity. Since the eurozone crisis of 2011-13, a great deal of analysis, including by the Commission itself and a host of think tanks and independent experts, has explored the case and run simulations, all pointing to overwhelming economic and social benefits.

9 Italian finance minister Pier Carlo Padoan (2014-8) campaigned for an unemployment insurance fund embedded in the MFF, and more recently German finance minister Olaf Scholz came out in favour of a similar idea but on the basis of loans rather than grants, which presents a rather more symbolic than substantial version of solidarity. For a concise economic argument on this issue, see Andor and Pasimeni (2016).

10 While distant in time from the actual introduction of the single currency, the MacDougall Report highlighted this important link Using the following argument: “Apart from the political attractions of bringing the individual citizen into direct contact with the Community, it would have significant redistributive effects and help to cushion temporary setbacks in particular member countries, thereby going a small part of the way towards creating a situation in which monetary union could be sustained.”

Various models have been put forward, including partial pooling of unemployment benefit schemes and reinsurance of national unemployment funds. Had either of these insurance mechanisms existed in the EMU from the start of the single currency, all the Member States would have been beneficiaries for shorter or longer periods. Countries experiencing a severe recession would have received fiscal transfers helping them towards a faster recovery and avoiding perceptions that for the EU arbitrary fiscal targets are more important than democracy and social cohesion.

Irrespective of which model will eventually be chosen, eurozone unemployment insurance can deliver stabilisation in three ways. First, it would contribute to economic stabilisation by shifting demand and purchasing power to countries and regions which otherwise would need to implement fiscal 'adjustment' and internal devaluation. Second, social stabilisation would be enacted too by directing the flow of funds towards more vulnerable groups and helping to tame the rise of poverty among the working age population (which has been a major trend in recent years in Europe). The third way is institutional stabilisation. The EMU is based on rules but the application of these rules has been the subject of both academic and political debates. While some experts simply recommend ignoring the rules and giving up on them entirely, it is more likely that a *modus vivendi* could be found through the creation of stabilisation tools that would allow reconciliation of uniform fiscal rules with the need to maintain national welfare safety nets and social investment capacities.

Studies have shown that even systems that do not redistribute many resources between countries can have an important stabilisation impact in the medium run. However, the risk of 'lasting transfers' through a common unemployment benefit scheme can be minimised by mechanisms which already exist in other unemployment insurance systems, namely experience rating and claw-backs (Andor and Pasimeni 2016). Given the limitations of the overall EU fiscal framework, it is very important for discussions exploring options for unemployment insurance or reinsurance to explore not only inter-regional but also in particular inter-temporal stabilisation solutions.

Concluding remarks

For the EU, the strong link between policies and funding is a source of credibility. However, in the current pre-federal model the EU is coordinating policies instead of governing, and it is bound to leverage private and public funds in addition to spending its own modest resources. There are limits to this model and its adequacy or resilience has to be assessed against increasing heterogeneity within Europe, occasional shocks like Covid-19, and a diminishing share of Europe in the world economy outside.

The EU may be at a historic turning point where citizens and Member States expect better outcomes from it, while there is hesitation in several finance ministries about providing more resources. To meet expectations, the EU would definitely need more resources (including own resources) and tools, and the available resources should be used in new ways.

Brexit and other recent developments should lead to a stronger and not weaker EU role in social and regional policies instead of leaving them completely to the Member States. Cities and NUTS 2 regions have to be empowered and allowed to have more direct linkages to the EU level as part of broader encouragement to pursue complex and robust strategies for development and sustainability.

However, political debates should go beyond changing the size of various envelopes. The experience of various crises call for a serious reflection on the economics of the EU budget, especially what concerns stabilisation capacity. Besides, some of the operational questions can be deemed as important as political or macroeconomic ones. Answering these, with openness to innovation, can help to bring various stakeholders on board for a more ambitious and more prosperous EU.

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Cohesion, Values and Natural Resources – Pld Policies or Perspectives for All Regions of Europe?

Reimer Boege¹

Abstract

The Commission's proposals for EU policies for the post-2020 period represent a good balance between traditional and new policies, a balance which should continue to strengthen and defend the EU and its citizens. In spite of this approach, at least four Member States maintain restrictive positions for an EU budget of 1% of GNI. These Member States are ready to increase financial resources for research and migration management but only with a reduction in support for structural funds, rural development and agriculture.

The European Parliament gave a clear message by for the first time since the existence of the multiannual financial framework adopting an ambitious and detailed resolution highlighting its priorities and asking for a budget of 1.3% of GNI.

This article focuses on how an equilibrium can be reached among the conflicting positions of some Member States and the European Parliament, given that the EP needs to approve any outcome from the European Council by qualified majority. It will argue that traditional policies must be connected with new challenges, such as security, defence, border control, migration management, environment and climate actions, the

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stabilisation of neighbouring countries and last but not least funds to deepen economic and monetary union. Maintaining strong support for cohesion, values, rural development and agriculture will offer a solid prospect for all regions attempting to close the gap between urbanised societies and rural areas.

Introduction

The citizens and Member states of the European Union are today confronted with many challenges in our globalised world. Conflicts and wars in our neighbourhood, migration and climate change need European answers. Despite its successes in the past 60 years, European integration might be at risk. The EU must stick to its values, deepen and strengthen cooperation and protect and defend its citizens.

For citizens in EU countries, the EU Charter of Fundamental Rights defends human dignity and the rule of law, including the balance of power and the independence of judges and courts. Implementation of it and constant respect for it are crucial for EU credibility.

The negotiations on the next multiannual budget 2021-2027 will show whether the Member States and the European Parliament are determined to combine political continuity with new priorities for political action: a budget that protects, empowers and defends.

The European Commission presented its proposals for the next Multiannual Financial Framework (MFF) in May 2018. The principle idea was to combine traditional policies with new instruments and to keep a balance between regional and national interests on the one hand (the distribution function) and investments (the allocation function) on the other. However, as in the past, a group of Member States (the frugal four: AT, DK, NL, SE) are determined to limit their budget ambitions to a level around 1% of GNI. This level might compromise the maintenance of a sufficient level of spending for structural funds, cohesion, rural development and agriculture.

The Commission's proposal is to spend €1279.4 billion (1.14% GNI) including the European Development Fund. Its strategy can be summarised as follows: first, close the gap caused by Brexit (€11-13 billion a year) with cuts and fresh money (50/50); second, make moderate cuts in cohesion, structural funds and agriculture, although some programmes

like investment and cohesion will suffer more than others; and third to connect traditional policies with new challenges – migration and border control, security and defence, stabilisation of Europe's neighbourhood and new funds to deepen economic and monetary union. Within the overall amount of €1279.4 billion, €442.4 billion is foreseen for cohesion and investing in people while €378.9 billion is to be spent on agriculture, maritime policy, rural development and environment climate action.

Cohesion for equal living conditions

The Lisbon Treaty (art. 6) mentions the objective of economic, social and territorial cohesion. The EU's model of a social market economy and the internal market as a success story is rightly accompanied by structural support as a major driver of job creation, sustainable growth and innovation in Europe's diverse regions. The objective is to reduce existing disparities within and between Member States and regions by means of the various cohesion policy instruments.

In future, less favoured areas will need further support to tackle new and persistent challenges such as globalisation, industrial change, innovation and digitalisation, migration and in the long run climate change. The European Regional Development and Cohesion Fund (€273 billion) will invest in research and innovation, support small businesses, digitalisation and energy networks, fund better health, education, social infrastructure and sustainable urban development and help with the transition towards a low carbon economy. The European Social Fund (€101 billion) will invest in people, ensure fairer opportunities for all and also finance the development of skills, youth employment and social inclusion.

Additional reform elements are a strengthened link with the European Semester to support growth-friendly measures and a more tailored approach to regional development. A new reform support programme (€25 billion) will provide incentives to all the Member States for structural reforms with national recommendations. The new Invest EU Fund (€15 billion) could trigger €650 billion of additional investment in strategic areas like research and innovation, digital networks and the low carbon economy across Europe.

The Asylum and Migration Fund (€ 10.4 billion) will focus on the short-term needs of migrants on arrival, helping the specific regions involved.

Without this basic funding and the new additional instruments, many regions could not reach the necessary level of growth. Unfortunately, implementation in some member states could be better and more in the interest of the citizens.

In the case of underspending, the amounts available should stay in the EU budget in favour of under-financed programmes. More flexibility between the different budget categories and the creation of a crisis reserve may help during the MFF negotiations. Cohesion policy is one of the most visible and effective programmes for solidarity in the EU. In a rapidly changing world and with the speed of globalisation, cohesion is also needed in the future.

Concerning values and principles, it is logical that Member States which are not respecting the principles and values in the Treaties and the Charter of Fundamental Rights should face cuts of financial transfers from the EU budget.

Therefore, as the Commission proposes, structural and cohesion policy should be maintained at a reasonable level and connected with the new instruments mentioned above. This can give more economic and social stability to citizens in all regions.

Respect and Acknowledgement for Agriculture

Since the Treaty of Rome, the political orientation of the Common Agricultural Policy (CAP) as laid down in its Article 39 has remained unchanged. The specific goals are to increase productivity, give farmers a reasonable standard of living, stabilise markets, ensure the supply of food and ensure reasonable prices for consumers.

The CAP has faced huge changes over time. The market interventions and export subventions of the past have been progressively replaced by a two-pillar system with direct payments and programmes for rural development. The direct payments are no longer related to productivity but are linked with many 'cross-compliance' conditions such as fertiliser and spray documentation, hygiene and consumer protection standards, basic animal welfare and ecological conditions.

The Commission suggests €365 billion for agriculture and rural development and €10 billion from the Horizon Europe programme for

research and innovation in the food sector in agriculture and development in rural areas. The Commission's aim is to link 'public goods' as a condition for a certain amount of direct payments. However, food security is also a public good. It should not be neglected that existing legislation and many cross-compliance rules already have an impact on production costs in relation to international competitors. More flexibility and simplification and concentrating on a more results-oriented CAP are needed. It is necessary to focus more on environment and climate. Agriculture can also play a role in limiting CO₂ in organic substances in soil.

It is important for the announced Farm to Fork strategy which is part of the Green Deal to be realistic and based on scientific knowledge and practical experience. The transition to this new strategy must focus on the whole food chain. Imports from third countries must comply with the EU's environmental standards.

There are two general sensitive issues. First, we are facing a growing conflict between the expectations of an urbanised society and working and living conditions in rural areas. Second, the dominant negotiating position of big supermarkets is becoming a particular problem for farmers and food producers.

The Farm to Fork strategy will contribute to achieving a circular economy from production to consumption. This includes better informed citizens, more sustainable processing and farm transport, more efficient food production systems, better storage and packing, healthy consumption and reduced food losses and waste.

Agriculture plays an important role in food production. In 2050, a world population of 10 billion people will need safe and affordable food. In 1950 one farmer produced food for 10 consumers and in 2017 for 155 consumers.

Today, society is not only expecting high standards and quality of food, but also higher standards of animal welfare, insect protection and a healthy approach to medical treatments. Water quality and many other public goods are not sufficiently reflected in food prices. Farm to Fork can become a basis for a new sustainable social contract with the farming sector in the context of which financial transfers are safeguarded.

Agriculture is facing big challenges and changes. Respect and recognition for the struggles of the farming community are needed to keep

young farmers in the sector. Only economically healthy farms can deliver sustainable public goods. A better CAP strategy including a new and serious contract for sustainability to encourage rural areas with a strong budget for the farming sector and rural development will bring back the credibility of the EU.

Concluding remarks

Cohesion and agriculture are important pillars for acceptance of the internal market and for social and economic cooperation with the aim of achieving similar living conditions. In a globalised world the importance of this has grown. Efficient instruments and flexible adjustments will transform old policies into new well-implemented traditional policies, the existence of which is justified in the future.

The compromise presented by the President of the European Council in February 2020 of €1,094.825 billion (1.074% GNI) is about €184 billion less than the original commission proposal. In principle “*the European Council shall not act in legislation,*” as the Lisbon Treaty says. Unfortunately, so-called net payments or the national envelopes for cohesion and agriculture are too often the key interests of many Member States. The EU must stick to internal solidarity and take on board new priorities which are crucial for stabilisation in the next decade.

We have to understand that proactive budget management to be better prepared for coming events is a must. A compromise on the MFF below the Commission’s proposal will not give the EU the budgetary means to win in the future. We need a budget that protects, empowers and defends.

Climate Action: A Policy With the Potential to Redefine the EU Budget¹

Alessandro D'Alfonso

Abstract

While there is general agreement that the EU budget needs reform, recent decades have shown the difficulty in aligning new strategies with the medium-term design of EU finances. The decision-making process for the adoption of the EU's multiannual financial framework (MFF), which requires unanimity in the Council following the consent of the European Parliament, is a clear challenge to reform, but the availability of a shared strategy with strong potential for a package deal is equally important. In this respect, climate action, which was a central topic in the 2019 European elections, and the recently launched European Green Deal represent a major opportunity for the post-2020 MFF. Various features make the EU budget particularly relevant in the fight against climate change, and its contribution to relevant policy objectives could be further increased with measures on both the expenditure and revenue sides building on the experience that the EU has acquired in climate mainstreaming during the 2014-2020 MFF. The coronavirus pandemic has raised concerns that decarbonisation strategies could be derailed but there is growing awareness of the need for a sustainable recovery. If the next MFF and the European recovery instrument are able to match a new strategy (the European Green Deal) with appropriate resources and strong delivery tools, they could provide the EU budget with a new narrative in line with long-term objectives and citizens' expectations. Parliament has fully supported the

1 The content of this document is the sole responsibility of the author and any opinions expressed herein should not be taken to represent an official position of the European Union or the European Parliament.

European Green Deal and called for an ambitious post-2020 MFF and a robust recovery instrument.

The EU budget: the need for reform

Preparation of the proposals for the post-2020 Multiannual Financial Framework (MFF) of the European Union (EU) has triggered a vivid debate on the EU budget and its role. Among policymakers, academics and stakeholders, there is general agreement that the EU budget has to change if it is to properly address traditional and new challenges. In 2016, a major example of this standpoint was the conclusions of the High-Level Group on Own Resources, which recommended in-depth reform of both revenue and expenditure.²

This observation is not new given that at the beginning of this century the Sapir Report on the European economic system qualified the EU budget as a historical relic.³ EU finances have positively evolved since then, including through a gradual development of a stronger performance framework.⁴ However, the widespread call for reform appears to suggest that more should be done. Difficulties that afflicted the 2014-2020 MFF since the very beginning of its programming period have reinforced this view.⁵

The importance of strategies and policy objectives

Historically, strategies and policy objectives have usually been important drivers of major modifications to the EU budget. At the end of the 1980s and in the 1990s, the so-called 'Delors package deals' genuinely reformed EU finances. At the time, the EU institutions and Member States agreed

- 2 High Level Group on Own Resources, [Future financing of the EU: Final report and recommendations](#), December 2016.
- 3 A. Sapir et al., *An Agenda for a Growing Europe: The Sapir Report*, Report of an independent High-Level Study Group established on the initiative of the President of the European Commission, 2003.
- 4 R. Downes, D. Moretti and S. Nicol, [Budgeting and performance in the European Union: A review by the OECD in the context of EU budget focused on results](#), Organisation for Economic Co-operation and Development (OECD), *OECD Journal on Budgeting* Volume 2017/1, OECD, 2017.
- 5 For an overview of the main challenges in the 2014-2020 MFF, see: A. D'Alfonso, [2014-2020 multiannual financial framework \(MFF\): Mid-term revision](#), EPRS, European Parliament, 6 July 2017.

to deepen the single market and economic integration.⁶ The EU's financial perspectives⁷ were developed to accompany these shared objectives, for example through a significant strengthening of cohesion funding, which increased by 75% in real terms from 1992 to 1999.⁸

On the contrary, more recent MFFs appear to have been less successful at matching a new strategy with the design and reform of EU finances. In particular, such a negative assessment is often addressed to the attempts to link the Lisbon strategy to the 2007-2013 MFF and the Europe 2020 strategy to the current framework.⁹

Of course, one significant challenge on the way to an innovative package deal for EU finances is the decision-making process. The Treaty of Lisbon formalised the practice of multiannual financial planning, establishing that the Council unanimously adopts the MFF following the consent of the European Parliament.¹⁰ Therefore, this provision gives a veto power to each Member State, which may prove a major hurdle for reform, and especially so in today's European Union, given the higher number of Member States that a package deal has to satisfy compared to the times of the Delors Commission.

However, an equally important challenge for reform is the availability of policy objectives with strong potential for a new package deal. In this respect, climate action and objectives have soon come to represent a major opportunity for the von der Leyen Commission. In December 2019, during its first days in office, the new Commission launched the European Green Deal as the key strategy for its mandate.¹¹ Unlike the Juncker Commission, which had to work with an MFF agreed in the previous institutional cycle, the von der Leyen Commission can try to steer an alignment of its main strategy with the medium-term design of EU finances.¹²

6 [The next Multiannual Financial Framework \(MFF\) and the Unity of EU budget](#), Directorate-General for Internal Policies of the Union, European Parliament, 2017.

7 At that time, the MFF was called 'financial perspectives'.

8 A. D'Alfonso, [External border control and asylum management as EU common goods: A budgetary perspective](#), EUI Working Paper RSCAS 2019/05, Robert Schuman Centre for Advanced Studies, European University Institute, 2019.

9 Directorate-General for Internal Policies of the Union, [op. cit.](#), 2017.

10 Article 312(2) of the Treaty on the Functioning of the European Union (TFEU).

11 European Commission, The European Green Deal, [COM\(2019\)640](#), 11 December 2019.

12 E. Rubio, [New beginnings: An EU budget in support of the next Commission's agenda](#), Institut Jacques Delors, 2 September 2019.

Why climate action can contribute to the design of the new MFF

Climate and environmental protection is a policy area that has strong potential to provide important elements of a reformed MFF. Among the various reasons for this, three are worth highlighting.

First, there is a democratic mandate for increased EU action in this domain. Climate was a central topic in the 2019 European elections, with EU citizens calling for a greener Europe.¹³ Various surveys show that respondents deem environmental protection one of the top priorities for the EU and consistently support more public financing for clean energy.¹⁴

Second, estimates concur that the transition to a climate-resilient economy requires huge investments in energy, land, urban areas, infrastructure and industrial systems,¹⁵ which the private sector alone is not providing at a sufficient pace.¹⁶ The United Nations Intergovernmental Panel on Climate Change (IPCC) and the Organisation for Economic Co-operation and Development (OECD) highlight the importance of the public sector in the fight against climate change, both as a source of direct investments and as a facilitator of increased financing by the private sector.¹⁷

Third, in climate policy, EU Member States share increasingly ambi-

13 E. Bassot, [Ten issues to watch in 2020](#), EPRS, European Parliament, January 2020; C. McDonald-Gibson, [Europe's Greens Hope EU Election Triumph Will Be Turning Point for Climate Policy](#), Time, 28 May 2019.

14 See, for example, C. E. de Vries and I. Hoffmann (ed.), [Great expectations: The New European Commission, its Ambition and European Public Opinion](#), Bertelsmann Stiftung, eupinions 2019/2, November 2019; and European Commission, [Special Eurobarometer 490: Climate change](#), April 2019.

15 According to conservative estimates by the European Commission, for example, meeting the current EU climate targets for 2030 will imply additional investments worth at least €260 billion each year. See European Commission, [United in delivering the Energy Union and Climate Action: Setting the foundations for a successful clean energy transition](#), COM(2019)285, 18 June 2019.

16 R. Clark, J. Reed and T. Sunderland, [Bridging funding gaps for climate and sustainable development: Pitfalls, progress and potential of private finance](#), Land Use Policy, Volume 71, February 2018, Pages 335-346; P. Ahairwe and S. Bilal, [Boosting EU climate finance: Mitigate more without neglecting adaptation in poorer countries](#), ECDPM, December 2019.

17 Intergovernmental Panel on Climate Change (IPCC), [Global warming of 1.5°C](#), IPCC Special Report, January 2019; and Organisation for Economic Co-operation and Development (OECD), [OECD Economic Outlook, Volume 2019 Issue 2](#), November 2019.

tious objectives¹⁸ that aim to deliver common goods of value to all stakeholders. When it comes to delivering such common goods, pooling and leveraging resources at the EU level can prove more efficient and effective than uncoordinated action by individual Member States through their national budgets.¹⁹

In a nutshell, there is a clear role to play in climate action not only for public finances in general but also for EU finances in particular. Various features make the EU budget relevant to the fight against climate change, including its focus on investment and its capacity to trigger additional funding from private and public sources. By financing projects and activities in many policy areas that have an impact and/or depend on climate (e.g. research and innovation, cohesion, agriculture, energy, transport, infrastructure and development cooperation), the EU budget can make a significant contribution to the achievement of climate-related objectives if the relevant budgetary instruments properly integrate these considerations. Finally yet importantly, the multiannual nature of the MFF, which is often criticised for its rigidity, is a positive feature for a policy with long-term objectives such as climate and environmental protection, since it can provide much-needed predictability of investments.²⁰

The European Green Deal as an opportunity for a sustainable recovery in the EU

The coronavirus pandemic has dramatically changed the backdrop against which the next MFF is being negotiated, shifting the focus of political attention to recovery plans. This unexpected challenge has raised concerns that decarbonisation strategies could be pushed onto the back burner, including in budgetary policies.

18 For example, the current targets for greenhouse gas (GHG) emissions are at least a 20% cut by 2020 and a 40% cut by 2030 compared to 1990 levels. In December 2019, the European Council (European Council, Conclusions, [EUCO 29/19](#)) endorsed the objective of achieving a climate neutral EU (with the exception of Poland, which could not yet commit to implement the objective). In this context, the intermediate target for 2030 is expected to be increased to at least a 50% cut.

19 J. Núñez Ferrer, [Spending at EU level saves at national level ... and more](#), External contribution to EPRS expert seminar on the MFF of 28 January 2020, EPRS, European Parliament, 2020; J. Pisani-Ferry, Europe can take a bigger role in providing public goods, *Financial Times*, 3 December 2019.

20 A. D'Alfonso, [Mainstreaming of climate action in the EU budget: The impact of a political objective](#), EPRS, European Parliament, October 2019.

However, climate-related risks have not disappeared. Many analysts, stakeholders and policymakers stress that sustainability must be central to investment decisions in recovery efforts, with a view to avoiding locking in unsustainable patterns for a longer timeframe. Unlike what happened to a large extent in the wake of the 2007-2008 financial crisis, economic priorities should go hand in hand with environmental objectives in the post-pandemic recovery.²¹

In this respect, the European Green Deal represents a readily available blueprint for orienting expenditure under stimulus packages towards sustainable projects and measures. The EU institutions have reconfirmed their commitment to the green transition. In May 2020, the European Commission put forward an amended proposal for the next MFF and a new European recovery instrument: Next Generation EU, which would reinforce the firepower of the MFF during the first half of the new financial period. The Commission stressed that both the MFF and Next Generation EU would be in line with the European Green Deal and contribute to implementing it.²²

Possible climate-related elements of EU finances in the new decade

The European Green Deal, the revised proposals for the 2021-2027 framework and Next Generation EU provide an overview of various climate-related elements that could characterise the new MFF, the EU recovery instrument and their spending programmes.²³

On the expenditure side of the EU budget, the European Commission has proposed both an investment plan for all and a specific mechanism

21 See, for example, Jacob Funk Kirkegaard, [Europe should seize oil price windfall to fund its pandemic response](#), Realtime economic issues watch, Peterson Institute for International Economics (PIIE), 2 April 2020; McKinsey & Company, [How a post-pandemic stimulus can both create jobs and help the climate](#), 27 May 2020; and Bailey A. et al., [The world must seize this opportunity to meet the climate challenge](#), in The Guardian, 5 June 2020.

22 European Commission, The EU budget powering the recovery plan for Europe, [COM\(2020\)442](#), 27 May 2020.

23 European Commission, A Modern Budget for a Union that Protects, Empowers and Defends: The Multiannual Financial Framework for 2021-2027, [COM\(2018\)321](#), 2 May 2018; European Commission, The European Green Deal, [COM\(2019\)640](#), 11 December 2019; European Commission, The EU budget powering the recovery plan for Europe, [COM\(2020\)442](#), 27 May 2020.

for the communities and regions most exposed to the impact of the transition to a climate-resilient economy.

In its initial design before the coronavirus outbreak, the European Green Deal Investment Plan aimed to trigger resources for climate and environmental action worth €1 trillion over the new decade, thus synchronising financial planning with the next milestone in EU climate targets (the year 2030).²⁴ Through a number of programmes and funds, the EU budget would provide around half the total amount, while the remainder would arrive from other public and private sources, with an important role assigned to the European Investment Bank (EIB) Group in the initiatives designed to leverage this additional funding.²⁵ Since the newly proposed European recovery instrument is to contribute to the green transition, the total EU resources devoted to the fight against climate change are expected to increase further.

As part of the investment plan, a just transition mechanism is designed to provide targeted support for regions highly dependent on activities such as fossil fuel mining and exploration with a view to helping them alleviate the costs of transition and address structural changes in their economies. Composed of three pillars (a newly proposed Just Transition Fund under the EU budget,²⁶ a dedicated mechanism under InvestEU and a public sector loan facility with the EIB), the mechanism will aim to mobilise additional public and private resources similarly to the broader investment plan.²⁷

On the revenue side of the EU budget, new possible own resources related to climate and the environment can help finance these efforts and the entire MFF, while at the same time contributing to the achievement of policy objectives. Such a development would be in line with the conclusions of the High-Level Group on Own Resources, which recommended exploring new revenue sources based not only on their possible proceeds, but also on their capacity to deliver on policy.²⁸ In fact, Pigovian or steering taxes are seen to have better chances of being acceptable in a package deal.²⁹

27 A. Widuto, [Just transition in EU regions](#), EPRS, European Parliament, January 2020.

28 High Level Group on Own Resources, [op. cit.](#), December 2016.

29 G. Benedetto, [A new package for finance and expenditure in the EU budget](#), External contribution to EPRS expert seminar on the MFF of 28 January 2020, EPRS, European Parliament, 2020.

The MFF proposals put forward by the Juncker Commission already included two new own resources in the fields of climate and the environment. Part of the revenue accruing from the existing EU emissions trading system (ETS) would be attributed to the EU budget, while each Member State would pay an own resource contribution proportional to the quantity of non-recycled plastic packaging waste that it generates.³⁰

In addition, in her political guidelines Commission President Ursula von der Leyen expressed her intention of introducing a Carbon Border Tax.³¹ The Commission has subsequently confirmed its plan to put forward a proposal for a new own resource based on such a carbon adjustment mechanism. This would help to repay the funds borrowed to finance Next Generation EU. The idea of such a mechanism at the EU borders presents administrative and trade-related challenges, but analysts deem it attractive for a number of reasons.³² On the one hand, it could prevent carbon leakage. On the other, it could contribute to policy objectives and push third countries to increase their climate efforts, keeping in mind that climate change is a global challenge and the EU is responsible for less than 10% of greenhouse gas (GHG) emissions worldwide.

The various examples show the major contribution that climate action can provide to the establishment of a new strategy for the EU and the design of its finances.

However, a strategy and its accompanying resources also require strong tools to implement and monitor progress towards objectives. Such tools can help increase trust in the EU budget's capacity to deliver, thus addressing one obstacle often perceived as preventing the EU from expanding its operations, i.e. a lack of trust between its Member States.³³

For this reason, how efficiently and effectively the EU integrates (or mainstreams) climate-related objectives across all its relevant funding instruments is equally important.

In this respect, the EU budget does not start from scratch. In the 2014-2020 period, the EU set itself the political objective of devoting

30 A. D'Alfonso, [Own resources of the European Union: Reforming the EU's financing system](#), EPRS, European Parliament, November 2018.

31 U. von der Leyen, [A Union that strives for more: My agenda for Europe](#), July 2019.

32 Financial Times editorial board, EU's carbon border tax plan is risky but needed, *Financial Times*, 29 January 2020.

33 J. Núñez Ferrer, *op. cit.*, 2020.

20% of its MFF resources to climate action. This mainstreaming methodology poses various challenges, in part due to the variety of policy areas at stake. Assessments of its impact have identified both achievements and shortcomings.³⁴

According to the European Court of Auditors, climate mainstreaming has been a driver of quantitative and qualitative increases in climate-related expenditure in some policy areas. In others, good practices have emerged, but progress has not been uniform.³⁵

For the 2021-2027 MFF, the European Commission has proposed raising the objective from 20% to 25% of total resources, while the European Parliament has called for an even more ambitious approach.³⁶ In addition, the Parliament has demanded a stronger methodology for climate mainstreaming, including reformed performance indicators.³⁷ Such improvements will be important for the success of the overall strategy, given the major contribution that the Commission expects climate mainstreaming to make to the European Green Deal Investment Plan.

34 A. D'Alfonso, [Mainstreaming of climate action in the EU budget: The impact of a political objective](#), EPRS, European Parliament, October 2019.

35 European Court of Auditors, [Special report No 31/2016: Spending at least one euro in every five from the EU budget on climate action: ambitious work underway, but at serious risk of falling short](#), 22 November 2016.

36 In July 2020, the European Council eventually reached a political agreement that sets an overall climate target of 30% applicable to the total amount of expenditure from the MFF and the recovery instrument.

37 European Parliament, Resolution on the 2021-2027 Multiannual Financial Framework and own resources: time to meet citizens' expectations ([P9_TA-PROV\(2019\)0032](#)), 10 October 2019.

Concluding remarks

Climate considerations have the potential to significantly shape the design of EU finances in the new decade. Since the green transition is increasingly perceived as central to the EU's identity,³⁸ the new MFF and Next Generation EU could in turn redefine the EU budget if they are able to match an ambitious strategy (the European Green Deal) with appropriate resources (both pooled and leveraged) and strong delivery tools (such as an enhanced methodology for climate mainstreaming).

The match would mutually benefit climate action and the EU budget. Climate action would receive much-needed financial support to help address structural changes in the Member States' economies and promote a green recovery. At the same time, while not exhausting the tasks and objectives of EU finances, reinforced climate action would provide the EU budget with a new and crosscutting narrative in line with EU citizens' expectations and a sense of shared direction, contributing to its reform from within.

The European Parliament has fully supported the European Green Deal, calling for it to be endowed with resources commensurate with its ambition. The Parliament is a strong advocate of a massive recovery plan with a robust MFF at its core.³⁹

Recent decades have shown that opportunities at the EU level to align strategies with the medium-term design of finances are rare, partly due to the fact that the institutional and budgetary cycles are usually not aligned. For this reason, the opportunity for the European Green Deal to provide a significant contribution to the shaping of EU finances in the new decade should not be missed.

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von der Leyen U., [A Union that strives for more: My agenda for Europe](#), July 2019;

Reactions to the Commission's Proposals on the Financing of Migration and Foreign Policy.

Ferdinando Nelli Feroci¹

Abstract

This chapter presents the main reactions to the Commission's original proposal for the 2021-2027 MFF in the areas of migration and foreign policy.

In the Commission's proposal, financial resources for migration and border management are significantly increased (€34.9 billion compared to €13 billion in the present cycle). In addition, two main instruments have been proposed to support Member States in this area: a new Integrated Border Management Fund and a reinforced Asylum and Migration Fund. Similarly, the financial resources proposed for external action (123 billion Euro) are increased by almost 26% compared to the present cycle, with the creation of a single fund (NDCI) for neighbourhood, development and international cooperation. Finally, in the area of security and defence the Commission has proposed the creation of a European Defence Fund to support cooperation among European defence industries.

The Chapter concludes with considerations of a more general nature on enhancing foreign policy and migration management in the EU.

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The main elements of the Commission's proposal

In May 2018, the EU Commission presented a courageous proposal for the long-term EU budget (the Multiannual Financial Framework (MFF) 2021-2027) which took into consideration the rather consistent reduction in the revenue side of the EU budget as a consequence of Brexit. This proposal was based on an assumption of an overall ceiling on expenditure of 1135 billion euros for the seven-year period of the MFF, equivalent to 1.11% of EU GDP in terms of commitments (corresponding to 1105 billion euros in terms of payments, equivalent of 1.08% of EU GDP).

The Commission's proposal was also characterised by a significant shift in terms of the resources available, from the traditional expenditure (agriculture and cohesion) to the broad area of public common goods, which includes among other things research, innovation, competitiveness and also the external projection of the EU, defence, security and the management of migratory flows.

The Commission also proposed integrating the revenue side of the EU budget with new authentic own resources (with the objective of reducing the impact of the 'net balance factor' in the negotiations on the MFF and the recurrent antagonism between net contributors and net beneficiaries) and eliminating all forms of rebates. Among other important innovations in the Commission's proposal, it is worth recalling the idea of a new dedicated financial instrument for Eurozone members (the so-called Convergence and Competitiveness Instrument) and the European Defence Fund, an instrument to support cooperation among EU defence industries in the development of joint projects and programmes. Finally, the Commission also proposed a new form of conditionality based on the rule of law (in addition to the existing forms of macro-economic conditionality). More flexibility, among and within headings, is proposed in order to allow the EU budget to better adapt to unforeseen developments and requirements.

At the time of the preparation of this article, the state of negotiations and the prospects for the conclusion of the negotiations on the MFF are still uncertain. In particular, the questions of the overall ceiling on expenditure and of the ceilings for individual headings in the EU budget are still open.

Furthermore, very little progress has so far been achieved on the pro-

posal for new own resources and on the related proposal to cancel all rebates. On other important elements in the package, like the new conditionality based on the rule of law, it is also still not clear if an agreement will be possible. In contrast, relevant progress has been achieved on the various regulations defining the functioning of the several instruments necessary to implement the MFF.

This article will focus in particular on reactions to the Commission's proposals on migration and border control (Heading no. 4) on security and defence (Heading no. 5), and on EU external action, neighbourhood, the rest of the world and pre-accession assistance (Heading no. 6).

Migration and border management

For this heading in the EU budget, the Commission has proposed a substantive increase in financial resources: a total of 34.9 billion euros compared to 13 billion euros in the present cycle. This increase witnesses the awareness of the Commission of the new political priority that Member States, and European citizens at large, are attributing to the objective of effective management of migratory flows to be realised at the EU level.

The Commission has also proposed two main instruments meant to support Member States in the control of the external borders and in the management of migratory flows. The first is a new Integrated Border Management Fund with 21.3 billion euros, with the task of strengthening Member States' capabilities in the control of their external borders and of supporting the operations a new European Border and Coastal Agency. The second is a reinforced Asylum and Migration Fund with an allocation of 10.4 billion euros, meant to assist Member States in the management of migratory flows, in their efforts to contrast illegal or irregular migration and to support irregular migrant repatriation and readmission to their home country programmes.

Main Reactions

Generally speaking, the reactions of national governments to the idea of spending more on controlling the external borders and on a common management of migratory flows and on these two proposed instruments have overall been positive. However, there are still uncertainties over the

actual total expenditure ceiling for this heading (which is probably going to be one of the likely victims of a reduction of the overall ceiling on expenditure in the final stage of the negotiations). Similarly, divergences have emerged among Member States on the very delicate question of the governance of the Asylum and Migration Fund, and in particular on the criteria to be agreed for the distribution of resources among the potential beneficiaries of this financial instrument.

External action

For this heading the Commission has proposed a total amount of 123 billion euros, which represents an increase of almost 26% compared to the financial resources available in the present cycle of the EU budget.

At the same time, the Commission has proposed a significant rationalisation of the instruments to be utilised to implement its policies in the area of EU external action. Three newly created funds should replace the numerous funds and facilities operating at present in this area:

1. a single fund for neighbourhood, development and international cooperation (the NDCI, which should absorb the activities previously performed by the European Development Fund (EDF) for the ACP countries, which has so far been a fund financed directly by Member States outside the scope of the EU budget);
2. a fund (IPA) meant to provide pre-accession assistance and support to candidate countries (which will remain separate and autonomous);
3. and a separate budget line to finance humanitarian and emergency aid.

The most relevant innovation in the Commission's proposal is the idea to create with the NDCI a new single financial instrument responsible for EU assistance in all parts of the world and in all sectors. This represents an appreciated effort to rationalise and modernise the existing instruments in the area of foreign policy. However, such a reform will require agreed and clear solutions to some aspects of the governance of the new fund.

Main Reactions

Among the problems that need to be solved to ensure a correct functioning of the NDCI, the following have emerged in the negotiations: 1) the criteria for the distribution of resources between the geographical pillar and the thematic pillars; 2) the criteria for the distribution of resources among country and region beneficiaries; 3) how to ensure specific spending targets for programmes aimed at tackling strategic EU priorities (like, for instance, the root causes of migration); 4) and finally how to guarantee an effective rapid response pillar to fund crisis management operations, or how to guarantee an effective 'flexibility cushion' for unforeseen priorities.

Security and defence

In the area of security and defence, the most significant innovation proposed by the Commission in the MFF is the creation of a European Defence Fund, a financial instrument dedicated to the objective of supporting cooperation among European industries for defence.

With a total allocation in the Commission's original proposal of some 13 billion euros, the Fund should operate through two 'windows' or facilities: 1) to finance collaboration among European industries in the area of research to address emerging and future security threats with an allocation of 4.3 billion euros; and 2) to finance cooperation among European industries in capability development with an allocation of 8.9 billion euros. As a necessary pre-condition, intervention by the EFF should be matched by national contributions.

The European Defence Fund represents a bold initiative by the Commission, which for the first time ever has proposed a financial contribution to support progress in the development of a European defence dimension through improved cooperation among European defence industries. In parallel, the Commission has also decided to review its internal organisation with the creation of a General Directorate for Defence, in charge among other things of the management of the European Defence Fund.

Main Reactions

The principle of an EDF as part of the next MFF is agreed, but the total amount of financial resources to allocate to the Fund remains open. The following issues are also still to be agreed: 1) the minimum number of participating Member States necessary to form a consortium eligible to accede to the Fund; 2) the possibility of companies with the participation of a non-EU partner to accede to the funding (of course if they are members of a consortium with EU companies); 3) the participation of companies in a third state to accede to the Fund (which is especially relevant for UK companies after Brexit).

Some considerations of a more general nature

Before concluding, I want to draw attention to some considerations of a more general nature regarding the policies touched on in this chapter.

Money is important if the EU wants to support common policies on migration and on the external projection of the EU. However, apart from the issue of financial resources the EU should seriously improve its performance in these two policy areas. The availability of financial resources is a necessary but certainly not sufficient condition.

If the EU wants to be credible in the international scene, if it wants to play the role of a protagonist in the world scene, if it wants to contribute to the consolidation of a multilateral international order under threat, it must be able to produce a quantum leap in its external projection and in its ability to manage a structural phenomenon like migratory flows.

Foreign policy

We know the weaknesses of EU foreign and security policy. Absent in the original Treaties, foreign policy has been included in the EU Treaties since Maastricht and has remained typically intergovernmental and governed by the rule of unanimity. Very few significant developments have taken place since Maastricht. The creation of the External Action Service and of the position of High Representative-Vice President (HR-VP) of the Commission has improved the visibility of the EU but not modified the intrinsic weaknesses in its Common Foreign and Security Policy.

These weaknesses are the result of a combination of factors: a reluctance of Member States to give up national sovereignty on foreign policy; different perceptions among Member States of threats and priorities; different attitudes with respect to defence; the modest progress achieved so far on the defence dimension of the EU; and the budgetary constraints which have limited the propensity of Member States to invest in crisis management operations.

In the future, there is a need to work on the governance of EU foreign policy. The unanimity rule should not be a taboo and more frequent use should be made of the flexibility/constructive abstention rule already foreseen in the Treaties. A more frequent use of flexible arrangements involving smaller groups of countries in specific initiatives should also be made possible. Finally, more progress should be achieved in the construction of an EU defence dimension as an essential component of the more general objective of achieving EU strategic autonomy.

Nevertheless, it should not be underestimated that the overall external projection of the EU cannot only be measured with reference to its performance in traditional foreign policy. In fact, it is the combination of other EU common policies (from trade to energy, from climate to cyber, from development to emerging technologies etc.) that generally results in the identification of the EU as a protagonist in the international scene.

Migration

Even though migratory flows are less a priority in national public debates than they used to be some years ago, their orderly management will continue to be one of the major challenges which the EU will be confronted with in the next years.

Migration is not a new phenomenon in Europe. In the recent past, the increased pressure of migrants at our borders has in turn increased fears and preoccupations in public opinion and fuelled support for nationalist anti-migrant political parties.

The EU's common response has been weak if measured in terms of internal solidarity. Very little has been achieved in terms of burden sharing, not only of economic migrants but also of asylum seekers. On the contrary, the EU response has been relatively more effective in its external dimension, i.e. in relation to countries of origin and transit.

If the EU really wants to develop a meaningful common policy with respect to migration, and if it wants to reduce the perception in national public opinion of migratory flows as a threat to internal security and to national identities, it should be able to develop a common approach based on a few principles:

- First, it should help Member States to effectively control the EU's external borders, (which is a precondition, by the way, for guaranteeing the free movement of people within the EU) and a correct integration of foreigners in our countries .
- Second, it should be capable of implementing an effective common asylum policy based, among other things, on a revision of the Dublin regulation and on improved assistance to Member States in their management of asylum seekers.
- Third, it should assist EU members States in their efforts to repatriate illegal migrants with EU-funded repatriation programmes and with a series of agreements with countries of origin.
- Fourth, the EU should help Member States in their legal migrant integration policies through financial assistance, defining common standards and comparing best practices.
- Fifth, and finally, if possible the EU should propose a system to manage legal migration, to be agreed at the EU level and based on the principle that new authorised arrivals should correspond to the requirements of the job market.

To conclude, particularly for migration and various aspects of foreign policy, the effectiveness of the use of financial allocations should be developed in parallel with the development of policies.

EU Migration Policy: Will More Money Solve Old Conflicts?

Florian Trauner¹

Summary

Since the migration crisis of late 2015 and early 2016, the EU has increased its funding of migration-related policies by re-organising the EU budget and nudging member states to contribute to newly created funds such as the African Trust Fund. The Commission now seeks to consolidate these efforts by proposing an increase of more than 200 percent in the next Multiannual Financial Framework (MFF) for 2021-2027. The main beneficiaries will be EU home affairs agencies, notably the European Border and Coast Guard agency, frontline member states in the south and EU foreign policy actors able to spend more money on objectives such as tackling the ‘root causes’ of migration in Africa and elsewhere. While better ‘managing’ migration is also a key priority across the EU’s institutions, the migration agenda in the MFF remains a controversial item. The debates concern in particular a proposed shifting of money from east to south and the question of whether conditionality between EU funds and compliance with migration law should be introduced.

Keywords Multiannual Financial Framework; migration; border control; conditionality;

The Commission’s proposal

According to the Commission’s proposal for the Multiannual Financial Framework 2021-2027, the overall Union budget for the management

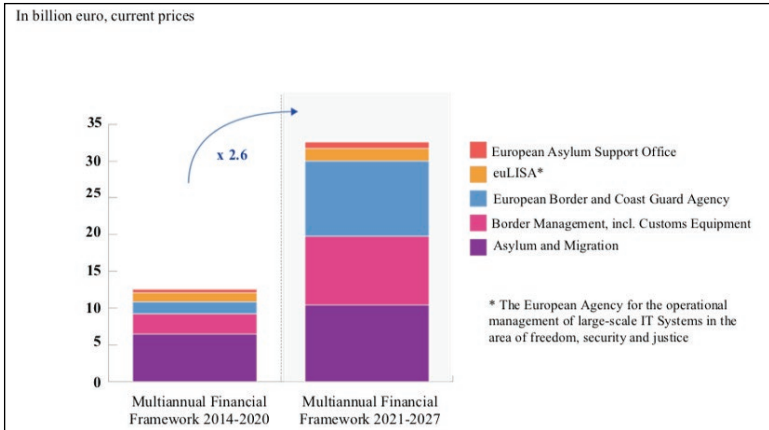
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of migration and external borders will be increased by over 2.6 times to nearly EUR 33 billion. By comparison, the EU earmarked EU 12.4 billion for the period 2014-2020 (European Commission 2018a: 15).

The reasons for this increase are straightforward: since the ‘migration crisis’ of 2015 and 2016, migration has become an item high on the EU agenda. Reforming the Common European Asylum Policy and reducing irregular migration in the Mediterranean region were defined as priorities by the Juncker II Commission (e.g. Juncker 2018: 7), which proposed the next MFF. This prioritisation was initially the same for the Commission under Ursula von der Leyen. When outlining her ‘political guidelines’ to the European Parliament, a need for “strong borders and a fresh start on migration” featured prominently (von der Leyen 2019: 15). The Covid-19 pandemic made the EU focus more on economic recovery and health-related measures. That said, among the ‘urgent major initiatives’ that were initially delayed because of the pandemic but were still to be tackled in 2020 was the new EU ‘Pact on Migration’ (European Commission 2020: 3). The Commission in this way signalled its continued attention to the migration topic.

An increase in budgetary spending on migration issues is a continuation of a more long-term development. ‘Budgetary measures,’ alongside operational and legal ones, were at the centre of the Commission’s immediate response to the 2015 migration crisis (European Commission 2015b). Referring to the perceived ‘emergency’ situation, the Commission re-labelled, re-organised and re-prioritised the EU budget and its funding instruments and nudged member states to contribute to newly created funds such as the African Trust Fund and the Refugee Facility for Turkey (den Hertog 2016; D’Alfonso 2019). For instance, an amendment to the 2016 EU budget transferred EUR 100 million in commitments and EUR 80.2 million in payments to Greece to help the country deal with the inflow of migrants. The Asylum, Migration and Integration Fund (AMIF) and the Internal Security Fund (ISF) were also increased by EUR 250 million in commitments and EUR 10 million in payments (Savage and Siter 2018: 133).

Figure 1: The Commission's MFF proposal on migration and border control



Source: European Commission (2018c: 15)

As can be seen from Figure 1, one budgetary increase is particularly visible, namely that of the European Border and Coast Guard Agency (Frontex). Frontex, together with the European Agency for the operational management of large-scale IT systems in the area of freedom, security and justice (eu-LISA), may receive more than EUR 12 billion in the next MFF, pending approval in the regular annual budgetary procedure (European Commission 2018b: 6). This will allow financing of the ambitious EU plan to increase the Frontex standing corps from currently 1,500 border guards to a total of 10,000 by 2027 (European Commission 2019).

The Commission has also underscored the need for more budgetary flexibility to tackle migratory challenges. This is most clearly expressed in the EU Migration and Asylum Fund. Only a comparatively small amount of EUR 5 million is pre-determined for each member state (the overall envelope of this fund is EUR 10.4 billion). The rest will be distributed depending on the needs and priorities of member states in three key areas: asylum (30 percent), legal migration and integration (30 percent) and countering irregular migration, including returns (40 percent) (European Commission 2018b: 4). The biggest share is therefore earmarked

for making return policy more 'efficient' (implying enhancing the rate of executed removals from the EU). The EU will support member states in activities such as capacity building for the management of returns, information and awareness campaigns and the reintegration of returnees. Another innovation in the Commission's proposal is a new 'integrated Border Management Fund,' which will support member states in areas such as border management, visas and customs control equipment. Its objective is to further harmonise customs controls at the EU external borders (European Commission 2018a: 14).

There are also other funding streams dealing with migration-related policies, such as the instruments under the EU external policy targeting the 'root causes' of migration and aiming to make third countries cooperate more with the EU on migration management. Concretely, the Commission has suggested increasing the funding for external action to EUR 123 billion and a strategy of mainstreaming migration in the geographical and thematic pillars. The horizontal spending target for 'root causes'-related policies is 10 percent (Knoll and Veron 2019: 4).

Key Controversies

Shifting Money from East to South. The Commission's proposal seeks to support member states that receive more asylum seekers or help other member states with migratory pressure (e.g. by relocating asylum seekers within Europe). In concrete terms, this implies that EU support will be increasingly geared towards southern frontline states (notably Greece and Italy) which usually first come in contact with asylum seekers after their arrival on EU territory. As the Commission (2018b: 2) highlights, "Article 80 of the Treaty on the Functioning of the European Union expressly states that the common policies of asylum and migration and external borders are based on the principles of solidarity and fair sharing of responsibilities between Member States. EU funding provides the concrete financial means to translate these twin principles into practice."

Discussion on solidarity in the migration field has become salient and controversial in the EU. To better support frontline member states during the migration crisis, the Commission proposed introducing an 'emergency relocation scheme' for up to 160,000 migrants from Greece and Italy (European Commission 2015a). This scheme was contested by eastern European states, led by the Hungarian government under Viktor

Orbán. Even when adopted by outvoting the eastern Europeans, Hungary and Poland refused to accept any relocation requests from within Europe (Trauner 2016). Regardless of this opposition, the Commission proposed permanently instituting a relocation quota in a revised Dublin IV Regulation. Again strongly opposed by eastern Europeans, the Dublin reform has stalemated and deepened cleavages between eastern, southern and western member states (Zaun 2018). The Commission's MFF proposal can be read as another chapter in this controversy, seeking to provide at least more financial support to southern member states in view of the EU's inability to legally reform the Dublin system.

Little surprisingly, this approach is not popular with some eastern European countries, particularly when viewed in combination with the significant cuts that the Commission proposed for EU Cohesion Policy and the Common Agricultural Policy. The Hungarian Prime Minister Viktor Orbán has criticised the Commission's plan to divert funds from these programmes and give them to 'countries that let in migrants.' In his view, these countries should pay for migration-related costs from their own budgets. "We don't think that even a single cent should be given to migrants," said the Hungarian Prime Minister (quoted in Politico 2018b).

Mainstreaming migration. Another debate concerns how much the migration agenda should be mainstreamed into the EU's external relations, and in particular into EU development policy. This is a long-standing debate, yet it has gained attention with the budget negotiations. Short-term security and migration policy interests are often considered to clash with or divert funds from the more long-term objective of sustainable development (Hackenesch et al. 2018). There tend to be different views on this issue depending on the political positioning. According to Knoll and Veron (2019: 12), members of the European People's Party consider the 'Neighbourhood, Development and International Cooperation Instrument' (NDICI) too "developmental" and would like to increase the importance of migration issues. By contrast, other parties in the European Parliament including the Liberals, Democrats and Social Democrats seek to align the fund closer to the United Nations Sustainable Development Goals. The NDICI is the main fund under the MFF 'neighbourhood and the world' heading, for which the Commission has earmarked a total of 9.6 percent of the next MFF (in total about EU 89.2 billion).

Conditionality. A question closely interrelated to 'what to do with EU

money?’ is ‘how to distribute it?’ Several EU politicians have been quite vocal in their demands for more conditionality to enforce the solidarity principle and ensure compliance with EU migration laws. For instance, French Foreign Minister Jean-Yves Le Drian has publicly stated that France would no longer pay for Hungary and Poland, which undermine the EU’s fundamental principles and do not show solidarity on issues such as the admission of asylum seekers from within the EU (quoted in EurActiv 2018).

The Commission has decided against such a direct link in its MFJ proposal. Given the controversial nature of this conditionality and the fact that each member state has a veto on the next Multiannual Financial Framework, such an approach was considered politically infeasible. The Commission has sought to de-couple the budgetary negotiations from the rule of law debate. In May 2018, it proposed a “simple” regulation aimed at protecting the Union’s budget in the case of “generalised deficiencies as regards the rule of law in the Member States” (European Commission 2018c). This is to be adopted according to the ordinary legislative procedure (with no veto rights for individual member states) and resembles the fines that the Commission may impose on breakers of economic governance rules (Politico 2018a). However, the proposal does not aim to link the EU budget to compliance with specific EU migration laws. In fact, the discussion on solidarity in the migration field seems to increasingly shift in the direction of Schengen-related conditionality. An open letter from French President Emmanuel Macron published on different European media outlets is a case in point in this regard. “We need to rethink the Schengen area: all those who want to be part of it should comply with obligations of responsibility (stringent border control) and solidarity (one asylum policy with the same acceptance and refusal rules” (Macron 2019). In other words, no more free movement benefits without helping frontline states to deal with asylum seekers.

Outlook

Migration policy has become politicised in the EU. While practically everyone agrees that more should be done, it is less clear how this should happen. A few migration-hostile governments would like to focus exclusively on stricter border controls. They refrain from accepting anything that may interfere with their national sovereignty (including harmonising

EU asylum laws) and/or can be seen as benefiting the rights of migrants. Others see a pooling of European resources and sovereignty as the only way forward to deal with complex global migration challenges and provide solidarity with the EU's frontline states that are most exposed to migratory pressure.

The next MFF for 2021-2027 has been negotiated within this wider debate. The Commission has pushed for a strong increase in the EU's migration and border-related budget. In particular, it has suggested the possibility of more flexible tailor-made spending. In effect, this shifts resources from eastern to southern member states and to EU home affairs agencies, first and foremost to Frontex, which are expected to take a more important role in EU migration management. The Commission has not opted to make a direct link between the budget and compliance with EU migration laws (some western member states have advocated for it). A new law, however, should allow the EU to freeze funds in the case of general deficiencies in the rule of law system of a member state.

In 2020, the debate and controversies on migration issues have been overshadowed by the Covid-19 pandemic, which has shifted priorities to economic recovery measures. Put differently, the pandemic has reduced the salience of migration issues in the EU, at least temporarily. This may facilitate a compromise on the migration dimension of the MFF regardless of the fact that the underlying struggles and ideological differences among member states continue to exist.

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EU Funding for External Action. The Evolution of Governance and Prospects for the Next Decade

Myriam Goinard¹

Abstract

Financial support for third countries is one of the EU's most important and effective tools in its external action. The viability of its ambition to be a more effective global actor, in line with the 2016 Global Strategy, will to a significant extent depend on whether it will be able to equip itself not only with the necessary resources in the next seven years but also with the appropriate rules to frame the spending of these funds. The EU must be able to spend its money in a more flexible and streamlined manner in order to respond quickly to crises and urgent needs around the world. However, advances in terms of coherence on the part of the executive and flexibility need to be balanced with accountability and effective democratic oversight.

A debate about the governance of external financing instruments has been at the heart of inter-institutional negotiations between the Parliament, the Council and the Commission, especially since the entry into force of the Lisbon Treaty. This chapter outlines the main dimensions of

1 Administrator in the Strategy and Innovation Unit of the Directorate-General for External Policies of the European Parliament. The views expressed do not necessarily represent the official position of the European Parliament. This chapter was drafted partly on the basis of research carried out during a fellowship at the Robert Schuman Centre for Advanced Studies (RSCAS) of the European University Institute (EUI) from February to June 2019. The author wishes to express her gratitude to the director, Ms Brigid Laffan, to the whole RSCAS team and to Tobias Voget and Ioana Logofatu for their comments on an earlier version of the chapter.

this debate. After analysing how the three institutions positioned themselves on the matter between 2009 and 2019 and the avenues explored to overcome their divergences, the paper presents and discusses the changes in governance proposed by the Commission of the two main external financing instruments foreseen under the new MFF, namely the Neighbourhood, Development and International Cooperation Instrument (NDICI) and the Instrument for Pre-Accession Assistance (IPA III).

Introduction

Financial support for and cooperation with third countries are among the European Union (EU)'s most important and effective tools in its external action and are an area in which it assumes a global leadership role. The viability of its ambition to be a more effective global actor, in line with the 2016 EU Global Strategy, depends to a significant extent on whether it will be able to equip itself not only with the necessary resources in the coming years but also with the appropriate rules to frame the spending of these funds. As with other headings, the Commission's proposal for Heading 6 'Neighbourhood and the World' in the 2021-2027 Multiannual Financial Framework (MFF) is characterised by a profound reshaping and a search for simplification compared to the architecture of the previous MFFs. Of the €118 billion proposed for this heading (in 2018 prices) in the updated MFF proposal of 27 May 2020 no less than €86 billion are meant to be covered by a single instrument, the Neighbourhood, Development and International Cooperation Instrument (NDICI), which merges the majority of the existing external financing instruments (EFIs). Not surprisingly, this radical merger has triggered – even before formal publication of the proposal – lively debates in the European Parliament, the EU Member States and civil society. One of the central questions is how to govern such a 'jumbo' instrument, thus echoing previous discussions on the governance of EFIs but also bringing in new challenges and issues.

After briefly presenting the key characteristics of Heading 6 as proposed by the Commission, this chapter outlines the main dimensions of the debate on governance, looking back at avenues explored particularly since the entry into force of the Lisbon Treaty to overcome the divergences between the institutions and presenting and discussing the changes in governance proposed by the Commission for the new generation of EFIs.

External Financing Instruments 2021-2027: the search for simplification

The NDICI, as proposed by the Commission, merges five of the six EFIs adopted for the period 2014-2020² and also the European Fund for Sustainable Development (EFSD) adopted in 2017 as one of the pillars of the new external investment plan. It also integrates the European Development Fund, which had remained outside the EC/EU budget (with funding provided by the EU Member States) since its creation in 1957. The NDICI is furthermore meant to provide the legal basis for the guarantees required for financial operations under the EFSD Plus and Macro-Financial Assistance. The Commission's proposal foresees allocations of funds to three pillars under the NDICI: i) geographical programmes (covering at least 75% of the overall envelope), ii) thematic programmes and iii) rapid response actions, plus an "emerging challenges and priorities cushion" of unallocated funds.

Heading 6 furthermore includes the third Instrument for Pre-accession Assistance (IPA III), which was also adopted under the ordinary legislative procedure, and two small instruments based on Council decisions: the Overseas Countries and Territories including Greenland instrument (a merger of two instruments) and the European Instrument for Nuclear Safety (the successor to the Instrument for Nuclear Safety Cooperation). While formally distinct from the NDICI, these three instruments are meant to be implemented to a large extent according to the rules enshrined in the NDICI, therefore making the NDICI proposal the central reference point for the entire debate on governance.

Lastly, Heading 6 comprises allocations for humanitarian aid (which operates under an open-ended Council regulation of 1996) and for the Common Foreign and Security Policy (CFSP) budget, which is spent through Council decisions on administrative and operational expenditures in the CFSP, except for those with military implications.

2 The Development Cooperation Instrument (DCI); the European Instrument for Democracy and Human Rights (EIDHR); the European Neighbourhood Instrument (ENI); the Instrument contributing to Stability and Peace (IcSP) as amended in 2017 with the insertion of an article on military actor capacity building in support of development and security for development; the Partnership Instrument for cooperation with third countries (PI); and the Common Implementing Regulation (CIR), which sets out implementation rules for all these instruments and for the Instrument for Pre-accession Assistance (IPA II).

Based on findings stemming particularly from the 2017 Coherence Report (European Commission 2017a), the mid-term review of the 2014-2020 EFIs (European Commission 2017b) and consultations with a broad range of stakeholders, the Commission justifies the major simplification of the heading's architecture with the needs to reduce administrative burdens, to overcome gaps and overlaps between instruments, to be more reactive to evolving needs and priorities, and to focus more on performance (European Commission 2018). However, the merging of so many different instruments in the NDICI, the proposed budget and the introduction of new features such as an unallocated "emerging challenges and priorities cushion" also raise even more questions than in the past regarding the definition of responsibilities and decision-making powers in the implementation phase of the instruments. As Member of the European Parliament (MEP) M. Schaake put it in the plenary debate on the Parliament's first reading position on the NDICI on 26 March 2019, "the only way we could actually assess whether the proposed new so-called architecture that merges various funding lines into one would be more fit for purpose is if we knew how the money would be governed. That is still a very weak spot in the Commission proposal."³

From multi-annual programming to the suspension of assistance: the co-legislators' roles in strategic decisions

The core questions in the governance debate relate to the definition of the roles of the co-legislators after the entry into force of the legislation: at which stage in the seven-year lifecycle of the MFF instruments should they have a say, on what topics and to what degree, and how should this be framed and codified in the basic acts? As for other areas, the Commission seeks flexible and broad 'enabling' regulations in the framework of which it can operate with a large margin of manoeuvre, and considers it an institutional prerogative to manage the implementation of financial assistance alone. The Council is keen to preserve control by national representatives over the implementation process, particularly through the comitology procedure, and wants to be involved in the strategic steering of instruments. The Parliament insists on a strong democratic accountability for the spending and on a legally binding role when strategic

3 <http://www.europarl.europa.eu/doceo/document/CRE-8-2019-03-26-ITM-019-EN.html>

decisions affecting the allocation of funds are taken on an equal footing with the Council – both as co-legislator and as one arm of the budgetary authority.

The divergences between these interests have crystallised most notably in discussions on the adoption of multi-annual programming documents.⁴ These documents define, for countries, regions or thematic programmes, the priorities and financial envelope of EU spending for several years (between 3 and 7) and therefore entail “upstream policy choices” (Jones et al. 2018). They form the basis for the implementation of the instruments, particularly for the adoption of annual action plans and specific measures. The introduction of delegated acts (art. 290 of the Treaty on the Functioning of the European Union – TFEU) brought about by the Lisbon Treaty had a far-reaching impact on this debate, mainly due to the significantly different rights attached to them for the European Parliament compared to implementing acts adopted under the comitology procedure. While the Parliament is involved in the preparatory process and can veto an act and/or revoke the delegation of powers in the case of delegated acts, in the case of implementing acts its prerogatives are limited to a right to information and scrutiny, and it can only object if it considers that the Commission has exceeded the implementing powers provided for in the basic act (for detailed analyses, see Brandsma 2016 and Marissen 2019).

Already in the mid-term review of the 2007-2013 EFIs, which started in 2009,⁵ the Parliament indicated in its first reading position of 21 October 2010 that “the Commission should be empowered to adopt delegated acts in accordance with Art. 290 of the TFEU in respect of Geographic Strategy Papers, Multiannual Indicative Programmes and Strategy Papers for thematic programmes, as they supplement this Regulation and are of general application.” This position reflected the guidance provided by the EP’s central governing bodies, namely that the Parliament’s negotiators on individual legislative files should always insist on

- 4 Under the 2014-2021 EFIs, the vast majority of financing measures are taken on the basis of multi-annual programmes. The most significant exception is ‘exceptional assistance measures’ which constitute the bulk (at least 70%) of the spending under the IcSP.
- 5 The proposals concerned were: the Financing instrument for development cooperation, 2009/0060A(COD); the Banana Accompanying Measures, 2010/0059(COD)), EIDHR (the financing instrument for the promotion of democracy and human rights worldwide, 2009/0060B(COD)), ICI (the financing instrument for cooperation with industrialised and other high-income countries and territories, 2009/0059(COD)), and the IfS (Instrument for Stability, 2009/0058(COD)).

the inclusion of delegated acts in all decisions fulfilling the criteria laid down in Art. 290 TFEU, and that for financing programmes this would apply to the objectives, choice of priorities, expected results and financial allocations in broad terms. This was meant to ensure the Parliament's substantial involvement in measures of general scope laying out important political choices not defined in the basic regulation, thus significantly increasing the accountability and parliamentary control in the system for implementing the MFF instruments.

Both the Commission and the Council strongly disagreed with the Parliament's position, considering that such programming documents did not fall within the scope of delegated acts but should remain, as in the past, adopted through the comitology procedure (implementing acts under the Lisbon Treaty). Both in 2009-11 and in 2012-13, this legal and political disagreement heavily affected the negotiation process. A last-minute compromise found for the 2014-2020 EFIs (maintaining the status quo on comitology but adding possible revisions of annexes by delegated acts and a political 'strategic dialogue' between the EP and the Commission ahead of the adoption of multi-annual programming documents) proved unsatisfactory from the EP's point of view as it did not translate into a legally binding say on strategic decisions.

Not surprisingly therefore, the three institutions started talks on the NDICI again with positions which on the question of the procedure for the adoption of multi-annual programming documents were similar to the starting point in the previous negotiations⁶ and hence very far apart from each other. The Commission presented the proposed inclusion (the so-called 'budgetisation') of the European Development Fund (EDF) in the NDICI, which was a longstanding request of the Parliament, as a significant step towards more accountability, as it means that funding to countries formerly covered under the EDF would be subject to the same budgetary rules and oversight as the other EFIs. However, in no way does this solve the bigger question which has been at the core of the interinstitutional discussions. The NDICI proposal even injected a new dimen-

6 With an evolution in the EP position, which again requested the use of delegated acts for the adoption of multiannual programming documents but at the same time proposed to abolish the use of implementing acts for other types of decisions and to replace them with Commission decisions executing the regulation. This position builds on the C-521/15 *Spain v Council* case and the related ECJ judgment of 20 December 2017, according to which implementing acts in the meaning of Art. 291(2) TFEU should be reverted to only where the acts are implemented by the Member States.

sion into this debate with the introduction of an unallocated ‘emerging challenges and priorities cushion’ covering a considerable amount – €10.2 billion (11.4% of the overall NDICI funds) – and designed to be mobilised in the case of unforeseen circumstances so as to reinforce envelopes under any of the three pillars. With one vast instrument for external assistance covering almost the entire world and such built-in flexibility elements, the stakes are higher: influence on the definition of multi-annual spending priorities becomes even more critical. Many crucial and politically difficult trade-offs will be required, *inter alia* choosing between or balancing long-term objectives (e.g. Sustainable Development Goals) and short-term priorities and interests (security, migration...). Regrettably, the legal dispute on the use of delegated acts for taking such decisions could not be solved during the inter-institutional negotiations which took place in 2017-2018 on ‘delineation criteria’ between implementing and delegated acts as the MFF programming documents were left outside the scope of the agreement reached between the Parliament, Council and Commission because their positions were too far apart.⁷ The question will therefore remain a thorny issue in the years to come.

In addition to discussions on the adoption modalities in the multi-annual programming, questions on decision-making powers in the implementation phase have emerged for all the decisions which entail a degree of political appreciation to adjust financial allocations in the course of the seven-year MFF lifecycle. For the 2014-2020 instruments, this was the case in particular of the incentive-based approach – or the so-called ‘more for more’ funding delivered under the European Neighbourhood Instrument – and the ‘performance rewards’ under the Instrument for Pre-Accession. Another strand of the debate focused on the modalities for the suspension of assistance in cases where a beneficiary country fails to respect the principles of democracy, rule of law, human rights or fundamental freedoms. During the negotiations on the 2014-2020 EFIs, the Parliament rejected a Commission proposal to root the suspension of assistance in a Council decision under Art. 215(1) TFEU – the legal basis for the adoption of restrictive measures, a procedure under which the Parliament only has a right to information. In the Parliament’s view,

7 ‘Non-Binding Criteria for the application of Articles 290 and 291 of the Treaty on the Functioning of the European Union.’ This agreement is a follow-up to the Inter-institutional Agreement on Better Law-Making, paragraph 28. The text of the agreement is available at <https://eur-lex.europa.eu/legal-content/EN/TEXT/PDF/?uri=OJ:C:2019:223:FULL&from=EN>.

this would have meant a unilateral modification by only one co-legislator of the financing scheme agreed in the ordinary legislative procedure, and would furthermore have meant that a CFSP decision would be made a pre-condition to suspend assistance governed by a non-CFSP instrument. Since these alternative paths were rejected in the course of the negotiations, the proposed provisions were deleted altogether and in a declaration attached to the regulations the Parliament insisted that it should be entitled to fully exercise its prerogatives in the event of a suspension. The NDICI Commission proposal remains silent on this issue and on the Council's mandate, while the Parliament's mandate adds a dedicated article which requires the use of delegated acts to add a partner country to a new annex listing partner countries for which Union assistance is suspended or partly suspended.

Steering on the executive's side: towards a clearer definition of roles

While questions remain linked to the roles of the co-legislators in the implementation phase of instruments, and in particular when decisions of a strategic nature are taken, which have largely dominated the governance debate since 2009, the issue of the steering of instruments on the Commission's side has progressively emerged, including the question of the specific role of the European External Action Service. For the 2014-2020 instruments, the co-existence of instruments with different objectives possibly covering the same countries and handled by different Directorate-Generals and services in the Commission raised questions of coherence and consistency between the instruments and highlighted a need to enhance coordination mechanisms, both at the headquarters level and in the EU delegations throughout the world. In the 2017 mid-term review report, the Commission noted "significant variations (...) at the level of EU delegations" in terms of coherence and a need to "ensure better interactions at the operational level, in particular between geographic and thematic instruments and programmes that can intervene in the same areas."

In this respect, the NDICI proposal constitutes a probable improvement as a single instrument should help overcome the sometimes fragmented approach noted in the past, but it also increases the need to have strong coordination on the side of the executive, including at the

country level. While this particular question is not explicitly tackled in the NDICI proposal, the Parliament's mandate contains a proposal to establish a "horizontal steering group composed of all relevant Commission and EEAS services and chaired by the VP/HR or a representative of that office" which "shall be responsible for the steering, coordination and management of this instrument throughout the management cycle in order to ensure consistency, efficiency, transparency and accountability of all Union external financing." The proposed article stems from the role of VP/HR in the "overall political coordination of the Union's external action." In his written answers to the Parliament ahead of his hearing, Josep Borrell stressed that he agreed with the EP "on the need for horizontal steer and coordination of the EU external financing" and noted that the new "Commissioner's Group for A Stronger Europe in the World" he would chair "can be one of the instruments to ensure such coordination" in order to "ensure that our external financing instruments are used strategically and contribute to enhancing Europe's leadership and influence in the world."⁸ This debate can therefore not be isolated from the broader discussion on the steering of EU external action and the call for coherence, but it also needs to be reflected in concrete institutional mechanisms to ensure an adequate level of steering, in particular coherence between EU political priorities and the spending of funds. EEAS plans to prepare "strategic framework documents" for each country (Jones et al. 2018, p. 10) are promising if they help clarify the EU's objectives at the country level and integrate the different channels through which the EU can achieve these objectives, thus forming the basis for coordination of all relevant Commission and EEAS services.

Conclusion

During the years to come, the EU must be able to spend funds under the external action heading in a more flexible and streamlined manner than has been the case in the past in order to respond quickly to crises and urgent needs around the world. However, advances in terms of flexibility and coherence on the executive's side have to be balanced with accountability and effective democratic oversight, especially regarding the adjustment of priorities and financial allocations in the course of the seven

8 Answers to the European Parliament. Questionnaire to the Commissioner-Designate Josep Borrell <https://www.europarl.europa.eu/resources/library/media/20190927RES62426/20190927RES62426.pdf>

years of implementation of the EFIs. The volatile international environment, the evolution of partnerships between the EU and third countries, the development of new policy frameworks at the EU and global levels, and the geopolitical consequences of the COVID-19 crisis make it highly necessary and urgent to overcome institutional divergences and to settle the remaining open questions on governance.

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Part 3

MFF 2021-2027:

The Transnational
Challenges –
the Euro, the Green
Deal, Covid-19

Euro Area Macroeconomic Stabilisation and the EU budget: A Primer

Johannes Lindner & Sander Tordo¹

Abstract

Against the backdrop of the EU economic recovery measures taken in response to the Covid-19 pandemic, this paper takes stock of the role that the EU budget, as the only existing fiscal policy tool at the European level, can play in euro area macroeconomic stabilisation. Government budgets typically stabilise aggregate demand through discretionary fiscal policy and automatic stabilisers. The EU budget traditionally could not fully imitate these functions given its focus, which prioritises allocation and distribution, its small size, strict balanced budget rules and its EU rather than euro area delimitation. Unlike the financial crisis or the euro crisis, the Covid-19 led to a watershed moment in which joint fiscal action at the European level was endorsed by a critical mass of political stakeholders. As a result, the EU budget showed surprising flexibility and was equipped with a novel one-off ability to borrow on a large scale to hand out recovery grants and loans through the Next Generation EU programme. While this programme facilitates recovery, further strengthening resilience and dealing with high debt levels are likely to be key issues also in post-Corona times, posing a challenge to the well-functioning of Economic and Monetary Union. Therefore, the question remains of which enduring

1 The views represented here are our own and do not necessarily represent the views of the European Central Bank. We are grateful for research assistance by Maximilian Dyckerhoff and comments by Alessandro Giovannini and Simone Macchi. An earlier version benefited greatly from comments by Fabio Panetta.

European mechanisms will be available for stabilisation purposes complementing national fiscal policies and the European economic governance framework.

Taking the EU budget as the point of departure, this paper provides a comprehensive mapping of the five emerging mechanisms through which the EU budget can have a counter-cyclical impact. First, the budget provides stable streams of public investment spending as long as Member States do not cancel projects to avoid co-financing requirements. Second, the national co-financing requirements that typically accompany EU projects can be lowered or revoked. Third, although its current revenue mechanically moves with rather than against the cycle, the budget can be equipped with cyclically sensitive own resources. Fourth, the budget allows for some inter-temporal shifting of resources in the form of unused payments and margins. And fifth, the EU budget has a borrowing capacity with the highest possible credit rating to support to Member States or finance EU-level spending.

1. Introduction

The relationship between the EU budget and euro area macroeconomic stabilisation is subject to a returning contradiction. Each successive crisis faced by the Union in recent decades – the financial crisis, the euro crisis and the onset of the Covid-19 crisis – has underlined that the EU budget has not been well-equipped to swiftly respond to unexpected events and sudden shocks to the economy. It is small, relatively rigid and, until the Covid-19 crisis, could not borrow on a large scale. In principle, a fiscal capacity for stabilisation purposes can be designed fully within the EU budget, using a combination of the EU budget and other resources, or fully outside the budget. The poor track record of the EU budget in responding to shocks has led many experts, commentators and policymakers to call for a separate euro area budget outside the Multiannual Financial Framework (MFF). However, in discussions on both a euro area budget and the Covid-19 recovery, Europe's political leaders have tended to seek a solution within the MFF. A wide variety of political pressure points have underpinned this equilibrium, including the inertia of the EU budget as the only European-level fiscal instrument, the Commission's institutional interest in avoiding intergovernmental solutions, a desire to not drive a wedge between euro-area and non-eu-

ro-area countries and possibly also tactical considerations on the part of Member States sceptical about euro-area stabilisation.

The unlikely political salience of the EU budget as the solution for macroeconomic management arguably culminated in the response to the Covid-19 pandemic. After some smaller initial reactions using existing space within the budget, the first set of measures at the EU level saw an approach that combined three different instruments, of which only one was based on the EU budget: (i) a Pan-European Guarantee Fund from the European Investment Bank using national guarantees to mobilise up to €200 billion; (ii) Pandemic Crisis Support for health-related costs of up to €240 billion based on the Enhanced Conditions Credit Line for euro-area Member States in the European Stability Mechanism; and (iii) a €100 billion loan-based scheme for Member States called SURE to support unemployment-related costs financed by issuing debt backed by national guarantees. To finance the recovery, in April 2020 the European Council tasked the Commission with presenting a recovery fund alongside a new proposal for the regular Multiannual Financial Framework starting in 2021. The subsequent political agreement by the European Council in July 2020 on a 750 bn. Covid-19 recovery fund called Next Generation EU (NGEU) confirmed the EU budget as the key instrument. Although temporary in design, NGEU crossed a proverbial *Rubicon* in that for the first time and albeit on a temporary basis it allows the Union to engage in common borrowing to provide grants and of relatively large sums backed by the EU budget own resources. It is expected to increase Union debt issuance by a factor of 15, constituting the largest ever euro-denominated issuance at supranational level (Giovannini et al, ECB, 2020). However, while NGEU focuses on facilitating the Covid-19 recovery and ensuring a lasting increase in resilience, high debt levels and fragmentation are likely to be key issues in post-Corona times, posing a challenge in particular to monetary union. Therefore, the question remains of which lasting mechanism will be available for stabilisation purposes beyond the Covid-19 crisis.

With its lasting economic consequences and the specific EU-budget-linked response, the Covid-19 pandemic demonstrates more than before the merit of building bridges between the debate on euro-area stabilisation and the institutional one on the EU budget. This paper responds to this challenge by providing a comprehensive overview of the mechanisms through which the EU budget could potentially play a role

in managing the business cycle. What is more, after Brexit, EU and euro area cyclical developments are likely to be highly correlated. This lessens the need for a dedicated euro area stabilisation facility if a functioning EU stabilisation facility exists. The paper consists of two parts. The first section provides a primer on stabilisation in the EU budget from a conceptual and historical perspective. The second section comprehensively maps five EU budget mechanisms that can be linked to stabilisation against the backdrop of existing proposals for a euro-area capacity, the Covid-19-related measures and their interplays with the EU budget. This is followed by a conclusion pointing to potential avenues forward.

2. Stabilisation in the EU budget: a conceptual and historical primer

In the fiscal federalism literature, government budgets are usually defined as having three core functions: redistribution, allocation and stabilisation (Musgrave, 1969; Oates, 1972; Hanke & Heine, 2016). Redistribution refers to the redistribution of goods, services and/or income among citizens to mitigate differences in income, whereas allocation concerns the most efficient allocation of resources between alternative uses, for example by providing public goods. The stabilisation dimension of budgets deals with using fiscal levers to ensure stable growth, output and employment levels in the economy.

Stabilisation is usually achieved in two main ways, namely through discretionary fiscal policy and automatic stabilisers. Discretionary fiscal policy is defined as non-mandatory changes in government spending or taxes to stimulate or contain economic growth. Debt-financed discretionary spending or shifts in budgets across components with different multipliers have stabilisation properties. These policies usually require approval by the legislature (e.g. additional military spending or topping up unemployment insurance during prolonged recessions). Automatic stabilisers are defined as constant government policies which automatically adjust taxes or spending in relation to the business cycle to stabilise income, consumption and aggregate demand (e.g. unemployment insurance). In allocating the three core functions to different levels of governments, the fiscal federalism literature makes the case that the central level should exercise the lion's share of the stabilisation function, as the spill-overs/externalities of stabilisation measures

would probably lead to under-provision of them at a sub-central level (Klößers & Tordoir, 2020).

Compared to other government budgets, the EU budget is in many respects a unique construct and is often seen as a reflection of the *sui generis* nature of the European Union (Laffan/Lindner, 2014; Enderlein et al., 2015). It is significantly bigger than the budgets of other international organisations yet it is drastically smaller than the budgets of nation states. While growing over time in conjunction with integration decisions, the EU's focus on economic integration and regulatory tools has entailed that the EU budget's size has been kept limited and fiscal policy has remained largely in the national domain. Moreover, the EU budget is historically focused on allocation and distribution, mainly as a result of package deals around major integration decisions. In order to establish the distributive compromises around the EU budget annually, its key parameters are frozen in a relatively rigid system of annual sectoral ceilings and a unanimity rule for significant changes. These constraints apply even more so to the revenue side: changes to the own resources have to be adopted with unanimity and ratified in compliance with national procedures and recourse to the debt markets is limited to exceptional circumstances for the Union in line with its balanced budget rule. Even in the presence of NGEU, the EU budget's overall impact on macroeconomic developments is limited in comparison to national budgets in the EU and euro areas, which absorb over half of unemployment shocks (Draghi, 2018).

Over the decades, attempts – based on economic reasoning – have been made to introduce a stabilisation focus at the European level (see, for example, the McDougall report of 1977). In particular, linked to the proposal to create a monetary union there were calls early on for the euro area to be equipped with fiscal means to counter economic shocks. For example, in the Padoa-Schioppa report of 1987, the possibility of an autonomous fiscal and borrowing capacity for the European Community to address asymmetric – i.e. country-specific – shocks was already tabled as an option. This observation, later reiterated following the euro crisis, related to the fact that federations with a centralised monetary policy usually have a central instrument to support sub-federal entities, countries or states to cater for specific shocks (IMF, 2018).

However, the agreement on the Maastricht architecture for the euro in the early nineties did not include a consensual move towards a larger central budget for stabilisation purposes. The consensus at the time foresaw a clear separation of tasks. National fiscal policies were meant to smooth idiosyncratic shocks through the operation of automatic stabilisers and monetary policy to stabilise euro-area wide shocks. Keynesian economic theory and its fiscal prescriptions had been replaced by monetarist economic thinking, which made the credibility of an independent central bank the cornerstone of a well-functioning monetary union. It saw market integration as the key instrument to ensure an adequate economic environment and provided a rationale for introducing fiscal rules that would seek to ensure that national budgets build up buffers in good times to counteract economic shocks in downturns.

The financial crisis in 2007/8 that subsequently led to the sovereign debt crisis in Europe led to a reappraisal of the fiscal institutional architecture of EMU. In addition to proposals on different aspects of fiscal policies, such as the interplay with banking supervision, the link to economic imbalances and the incentives to build-up buffers, calls for a central fiscal capacity also gained traction. A Commission blueprint on a genuine EMU and the Four Presidents' report, both from 2012 at the height of the euro area crisis, mentioned this possibility.

Before the Covid-19 crisis, most proposals for a euro area fiscal capacity had, either explicitly or implicitly, placed it fully outside the EU budget. The stabilisation rationale is closely linked to monetary union and so spans the euro area but not the whole of the EU. This distinction has been seen as a reason to articulate proposals outside the EU budget context. A number of prominent proposals, including by the 7+7 French and German economists (Bénassy Quéré et al., 2018) and the IMF (Arnold et al., 2018), therefore abstracted away from the EU budget set-up in favour of questions of design, the euro area fiscal capacity's impact on growth and inflation, potential triggers and how to avoid setting the wrong incentives for national policymakers. Such proposals foresaw a significant capacity and considerable inter-temporal smoothing of fiscal resources up to a few percentage points of GDP. Given the small size and balance constraints of the EU budget, this implies a set-up outside the EU budget or a larger overhaul of the current framework.

Mirroring the policy debate, academics had limited incentives to understand how a euro-area stabilisation instrument could be achieved

within the EU budget, the focus and purpose of which seemed distinctively different (a notable exception is Nuñez Ferrer & Alcidi, 2018). The long-term growth impacts and redistributive functions of the EU budget have been extensively studied (de la Fuente and Domenech, 2001; Citi, 2017). There are, however, only a handful of studies that touch on the stabilisation impact of the EU budget and they have remained largely empirical (Adrubali and Kim, 2008; Freyrer and Sacerdote, 2013; Pasimeni and Riso, 2019). These studies generally find that the EU budget is not particularly responsive to changing economic conditions and only smooths a very small percentage of GDP shocks, below 5% of the total, owing to its small size. Alcidi, Gros, Nunez Ferrer and Rinaldi (2017) outline the instruments with which the EU budget supports Member States facing a deep crisis in the context of macroeconomic adjustment programmes. Similarly, a working paper by Rinaldi and Nunez Ferrer (2017) looks at how the EU budget might be reformed to support stabilisation. The focus of these papers is, however, not on stabilisation. The former focuses on crisis management, i.e. when countries lose access to financial markets, rather than on managing regular fluctuations in the business cycle, and the latter has a more narrow focus on the role of EU budget employment programmes in downturns. In other words, no comprehensive investigations or holistic proposals have been made to map all of the existing EU budget mechanisms that could be employed for stabilisation.

Paradoxically, despite the limited interest on the part of most euro-area economists and academics in EU-budget-based solutions, the political road to a stabilisation capacity generally leads back to the EU budget. The Commission has a strong interest in keeping any potential fiscal instruments for the euro area within the EU budgetary framework and proposed a hybrid solution with its 2018 European Investment Stabilisation Function proposal. In the context of this proposal, the Commission suggested redirecting some of the EU budget's lending capacity to provide financial assistance in the form of loans and interest subsidies to protect Member State public investment in the presence of large asymmetric downturns. It left open the possibility of top-ups from the ESM. This put it thus between the EU budget and an intergovernmental set-up and based on loans rather than sizeable grants.

Even the Council has generally ended up going back to the EU budget for solutions, for example with the now defunct budgetary instrument for convergence and competitiveness (BICC), which built

on a subset of EU budget mechanisms to support counter-cyclicality. Reflecting continued disagreement over the need for a stabilisation function, the BICC, which was agreed on by the European Council in 2019,² focused on improving economic structures, not macroeconomic stabilisation. Nevertheless, the BICC was supposed to be equipped with some counter-cyclical features through a modulation of co-financing rates in the case of severe economic conditions and would possibly require additional flexible resources via an intergovernmental agreement.

Arguably raising the stakes more than ever before, the Covid-19 pandemic definitively brought the interplay between the EU budget and stabilisation to the fore.³ As the enormous magnitude of the consequences of the pandemic unfolded, the EU budget responses also changed in a remarkably short timeframe, not only in size but also in nature. First, the existing flexibility instruments and adjustment mechanisms in the EU budget were used. Second, next to the ESM- and EIB-based tools, the SURE instrument introduced the option of providing back-to-back loans to Member States on the basis of EU issuance against national guarantees. Third, Next Generation EU provided a one-off sizeable top-up of €750 billion over and above the regular MFF. Pivoting away from the difficult decision on Eurobonds that would have possibly implied mutualizing old debts, NGEU built on the insight that the Union could leverage the EU budget for common borrowing to finance a common investment programme (Odendahl, Guttenberg, Grund, 2020). It combines EU issuance with the provision of grants (€390 bn.) and loans (€360 bn.) to increase EU spending programmes and provide direct support to Member States on top of the regular EU 2021-2027 budget. The €390 billion in grants was a step down from the Commission's proposal for €435 billion (which added €65 billion in guarantees). Nevertheless, in particular, the €390 billion represents over 2.5% of 2019 EU-27 GDP and can thus be seen as a unique and sizeable discretionary fiscal stimulus in the spirit of Musgrave on the part of the Union. The overall NGEU envelope, including the loans component, is over 5% of GDP (Giovannini et al, ECB, 2020). It

2 The BICC was the landing zone for a euro area fiscal instrument after calls by French President Macron and other stakeholders to reform the eurozone architecture. The BICC was supposed to be legislated into the 2021-2027 MFF but was overtaken by the COVID19 crisis, although it inspired some of the features of the Recovery and Resilience Facility.

3 Numbers for the new MFF and the Next Generation EU are taken here from the July Conclusions of the European Council as, at the time of finalising this chapter, an agreement between the EP and the Council had not been reached.

is noteworthy that the BICC provided the blueprint for the Recovery and Resilience instrument, the largest programme under the EU COVID-19 pandemic recovery fund NGEU.

Following the decisions on the next MFF and Next Generation EU, a comprehensive and broader institutional overview of the EU budget's role in managing fluctuations in the business cycle seems warranted.

3. Mechanisms for the EU budget to work counter-cyclically: a primer

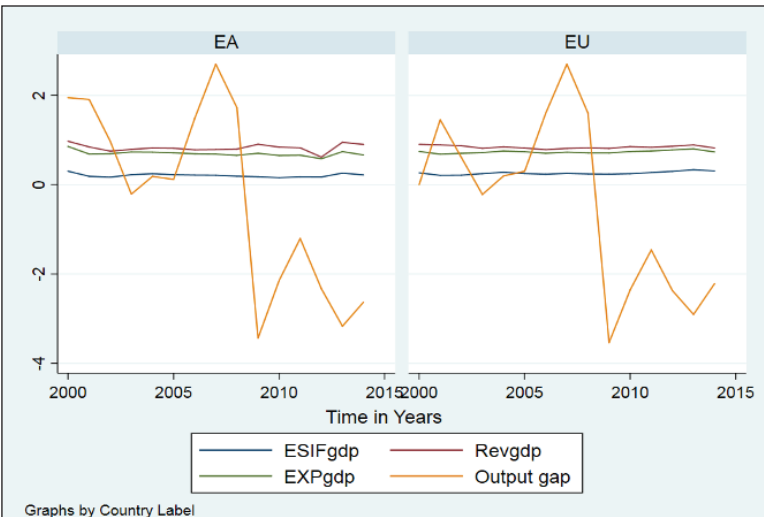
We map five different and interrelated mechanisms with which the EU budget could work counter-cyclically. Our interest is in the institutional design of the budget, where the following dimensions can be of relevance for stabilisation: (i) stable investment spending; (ii) modulated national co-financing rates; (iii) cyclically-sensitive revenue; (iv) inter-temporal budgetary resources; and (v) the EU budget borrowing capacity which can support Member States or finance EU-level spending. Some of these mechanisms are in-built/standard features (i, some iii and iv) whereas others pertain to ideas for enhancing stabilisation within the framework (ii and v). Some of these mechanisms have been identified in other papers and some have been used in various programmes, including as fiscal crisis response in view of the Covid-19 pandemic, but they have never been mapped comprehensively.

Stabilisation mechanisms can work in two ways: across countries or across time/the cycle (Draghi, 2019). The first three mechanisms we lay out below – revenue, spending and co-financing rates – relate more to stabilisation across countries. The other two mechanisms – flexibility mechanisms and loans – relate to the possibility of stabilising countries or the euro area as a whole across the business cycle. We focus here on the mechanisms that could provide stabilisation but abstract away from the separate debate on possible different triggers such as rising unemployment, negative annual GDP growth or an accumulated loss of output during a protracted period of very low annual GDP growth relative to its potential (Arnold et al., 2018; see also Article 2 of [Council Regulation \(EC\) No 1467/97](#)).

3.1 EU budget spending

The first counter-cyclical mechanism relates to the stability of spending outlays, in particular through investment projects supported by the EU budget. During cyclical downturns, governments – both at the national and especially at the regional level – often cut investment to accommodate fiscal consolidation pressures. The resulting fall in public and private investment levels can potentially have detrimental short- (aggregate demand) and long-term (productivity) effects on economic growth. These effects have also been observed in the euro area, where the public investment to GDP ratio stood at 2.7% of GDP in 2018, compared to 3.7% in 2009 (Ameco). The EU budget may offer a mechanism to lessen the potential impacts of these dynamics during cyclical downturns.

Figure 1: EU budget revenue, expenditure and structural and investment funds (ESIF) vis-à-vis output gap (all as % of GDP)



Source: own computations based on European Commission EU budget data 2000-2015 and Ameco. All variables are graphed in percentage of GDP, as indicated on the vertical axis, and plotted for the timespan 2000-2015. ESIF = EU structural and investment funds, EXP = overall EU budget spending, Rev = EU own resources.

Although it does not increase during downturns, EU budget spending is already fairly resilient to the business cycle. Figure 1 plots the output gap (yellow line), which measures the capacity utilisation of the economy, budget revenue (red line), budget expenditure (green line) and the European structural and investment funds (ESIF) (blue line) for the euro area and the EU. The output gap shows significant fluctuations for the years 2008, 2009 and 2013. However, budget expenditure and European structural and investment funds barely react to changes in the output gap. This has two positive effects. If spending outlays remain constant even in a downturn or decrease less than overall GDP it avoids pro-cyclical cuts. Moreover, if spending outlays manage to protect a portion of public investment it can have positive composition effects on overall public finances. Here, the EU budget can punch above its overall weight. From 2000 to 2015 the EU budget dedicated around 29% of its funding to structural and investment funds, whereas public investment makes up only 5-10% of national budgets in the euro area (own calculations based on Commission MFF data and Ameco). In other words, despite the EU budget's small size, it can have a fair degree of impact on keeping public finances geared towards investment even in downturns.

3.2 Modulated co-financing rates

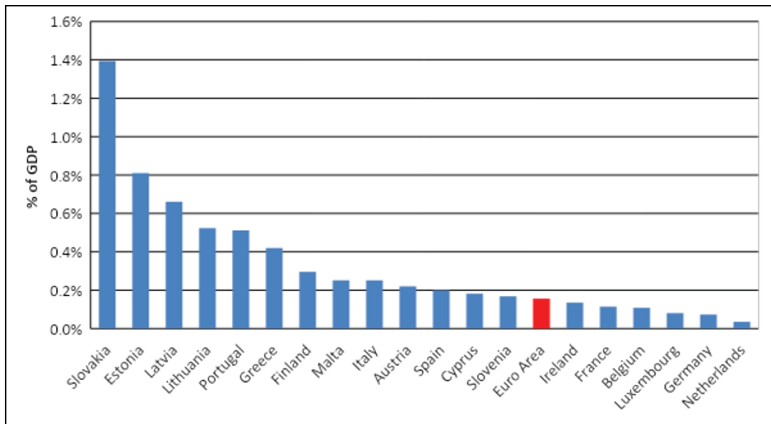
The co-financing requirements of EU funds for Member States may hamper a stable funding flow in recessions. National and regional governments have to pay for up to 25% of ESIF projects themselves (Commission regulation 1303/2013). In recessions, the national and regional governments that pay for this may come under fiscal strain and renege on their payments, leading to cancellations of the projects at large. This phenomenon is well-documented in the literature (see Bachtrögler, 2016; Camagni & Capello, 2015). As a strong illustration, the committed funds for regional investment projects that actually materialised went down from 98.2 % in 2000-2006 to 62.09 % in the eurocrisis period of 2007-2013 (Camagni & Capello, 2015).

This brings us to the second mechanism with which the EU budget can make a small contribution to stabilising the business cycle: reducing co-financing requirements for Member States in a downturn. There are two options to operationalise this: to cancel the requirement for national co-financing and to have the European level subsidise the part of

investment projects that is normally paid for by the national level, as was done for Greece in 2015. The second option has potentially a stronger effect, as merely relinquishing the co-financing requirement would not put extra money on the ground. If European co-financing subsidies can be disbursed into the real economy quickly, they may actually increase public investment envelopes in downturns whilst freeing up national and regional fiscal resources. The Budgetary Instrument for Convergence and Competitiveness was supposed to leverage on this notion. Its ambition in terms of cutting co-financing rates was low, however. It would have only applied to BICC projects, not the structural funds of the overall EU budget, while only cutting rates in half. If this were done for all the euro-area Member States, the stabilisation impact would be around 0.003% of weighted euro area GDP (Eurogroup BICC term sheet, AMECO and own computations). One step that would further aid macroeconomic management would be to increase co-financing rates in upswings.

If co-financing rates were made cycle-dependent for all EU structural funds, the potential stabilisation impact of reducing co-financing rates in downturns would increase but vary widely between euro-area countries. EU budget cohesion and investment funds are disbursed according to convergence logic and favouring regions with lower GNI per capita, resulting in a high dispersion of commensurate co-financing payments. As is indicated in Figure 2, for a number of smaller euro-area Member States with relatively low GNI per capita, co-financing payments for EU projects are close to or above 0.5% of their annual GDP. In these cases, if the European level paid for co-financing in a given year it would constitute a macro-economically significant amount. Conversely, for Member States with a higher GNI per capita like the Netherlands and Germany, co-financing rates make up only a fraction of their overall GDP, making this avenue less promising as a stabiliser.

Figure 2: EU budget co-financing as a % of GDP for euro-area Member States, 2014-2020



Exempting co-financing rates, cost per year	
Exempting all EA countries	~35 billion
Exempting EA countries with co-financing >0.4%	~3 billion
Exempting EA countries with co-financing >0.2%	

Source: Own calculations based on European Commission, AMECO.

3.3 Cyclically-sensitive revenue

The third mechanism concerns the revenue side of the budget, also known as own resources. There are three types of own resources contributing to the MFF revenue system: duties and levies, value added tax (VAT) and GNI-based national contributions. The GNI-based national contributions are the largest source of revenue and account for roughly 70% of the total financing sources in the MFF. By definition, the most important parameter – GNI – moves mechanically with the economic cycle. As national GNIs decrease, contributions from Member States to the EU budget similarly decrease. While this does not increase the likelihood of pro-cyclical tendencies on the EU budget revenue side, they also do not ‘lean against the wind.’ Similarly, VAT, another major revenue source, is not very cycle sensitive, and may even be moderately pro-cyclical.

EU National budgets have other forms of revenue that are seen in the literature as more effective in helping to stabilise the cycle, such as corporate or income taxation. These help for two reasons: they are more volatile than GDP, i.e. they move more quickly than the economy as a whole, thus alleviating burdens on households and firms in downturns (Auerbach and Feenberg, 2000; Buettner & Fuest, 2010); and these forms of taxation, in particular on corporations, are asymmetric – they do not need to be paid by companies that are making losses. There has been long-standing discussion about introducing an EU Common Consolidated Corporate Tax Base (CCCTB) or a Financial Transaction Tax (FTT). Both taxes, again under discussion for the Covid-19-related recovery package, could be used to provide resources for the EU budget and make it more sensitive to the economic cycle.

Beyond the political difficulties in introducing new forms of resources, equipping the EU budget with cyclically-sensitive revenue sources would potentially create mismatches between the revenue and the spending sides of the budget. The borrowing done under Next Generation EU is legal only because it is done on a temporary basis and in response to the unique and deep Covid-19 crisis. In principle, the regular EU budget has planned envelopes for a seven-year period with no possibility of running a deficit, requiring revenue sources that are similarly static. One possibility to address this issue, as proposed by Funke et al. (2019), is to have a cyclically-sensitive revenue source subject to a pre-determined aggregate. Funke et al. propose funding the budget with contributions from Member States linked to synthetic or real corporate tax revenue. While the overall envelope would remain constant, the relative contributions by Member States would be allowed to vary according to their respective corporate tax income, thus synchronising the business cycle among EU Member States. The downside of this innovative proposal is that the revenue side would only help to alleviate asymmetric shocks, i.e. divergences between Member States, and not symmetric shocks that hit the euro area as a whole, as the overall envelope remains fixed *ex ante*.

Therefore, for the revenue, expenditure and co-financing mechanisms to work when the euro area as a whole is in recession, some inter-temporal shifting of resources would be needed. One way to get around this problem is by allowing the EU budget to run a deficit and tap the capital markets (which is limited to very exceptional circumstances)

or build up reserves that can be activated when receipts from corporate or financial taxes decline. Next Generation EU which will entail debt creation, that is heavily frontloaded and then repaid over a period of decades (until 2058), implies - that except of the initial support for the recovery - no subsequent smoothing of shocks during the business cycle events that will undoubtedly take place within this time window. The new 2021-2027 MFF – at least as laid down by the European Council in July 2020 - also foresees that a new own resource based on non-recycled plastic waste will be introduced and apply as of 1 January 2021. The Commission is further asked (by the European Council) to put forward in the first semester of 2021 proposals on a carbon border adjustment mechanism and on a digital levy, with a view to introducing them at the latest by 1 January 2023. In addition, a reform of the *EU emissions trading system* is foreseen and further work towards a proposal for a Financial Transaction Tax. The proceeds of the new own resources introduced after 2021 will be used for early repayment of Next Generation EU borrowing.

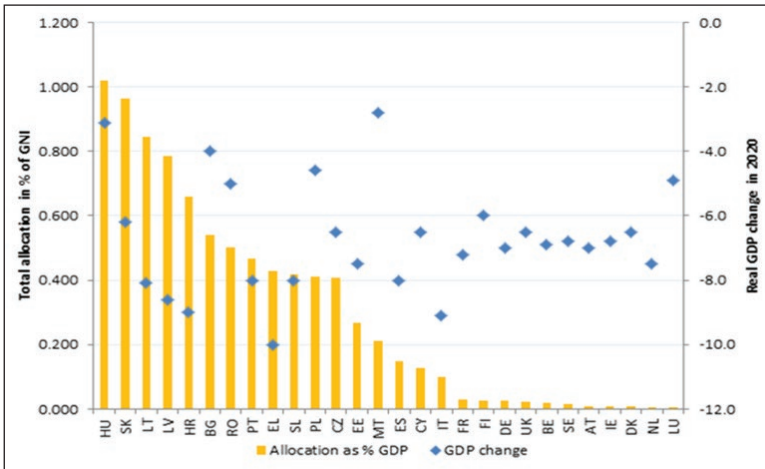
3.4 Inter-temporal EU budget resources

A fourth mechanism in the EU budget to support macroeconomic stabilisation relates to the share of its fiscal resources that can already be used inter-temporally. As a rule, EU funds are subject to strong annualised balanced budget requirements, implying that fiscal resources cannot be shifted inter-temporally, i.e. between years. There are exceptions to this rule, including frontloaded and flexible payments leveraging the EU budget margins, back-to-back loans to Member States and, most akin to other government budgets, grants using EU borrowing.

In a 7-year MFF cycle, the Commission can make advance payments of future cohesion funds to Member States. The advance payments serve as *de facto* frontloading of general budget support. The Member States then have to pay for cohesion projects in later years out of their own pockets. In 2009, €23.3 billion was paid out to Member States in this way. In the initial phase of the Covid-19 crisis, the Commission used this logic in the Corona Response Investment Initiative to frontload around €37 billion in cohesion funds. As can be discerned from Figure 3, such frontloading is not perfectly suited to stabilisation purposes as the funds can only be disbursed based on the existing cohesion distribution key, which prioritises GNI per capita convergence needs rather than the

Covid-19 shock. On a more general note, this mechanism is only useful if downturns are short lived and happen at the beginning of an MFF budget period. In addition to advance payments, there is the difference between the payment appropriations, which are the actual amounts to be paid, and the commitment appropriations, which are the amounts committed but not paid. In other words, these are unused payments.

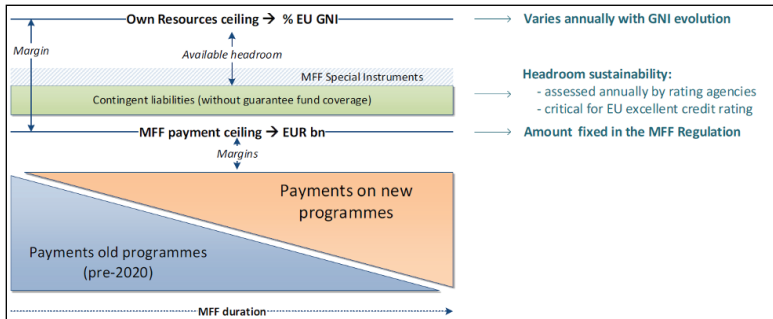
Figure 3: Allocations to Member States of the Corona Response Investment Initiative



Source: European Commission (2020) and own computations

The other, more sizeable, avenue for intertemporal resource shifting within the budget is provided by the so-called margin or headroom. Headroom refers to the difference between the own resource ceiling and the payment commitments on the expenditure side. As is outlined in Figure 4, this headroom is meant to provide Union guarantees, provide for Union borrowing and cater for unforeseen circumstances. In addition to the overall margin, there is some limited space beyond the ceilings, which are linked to dedicated flexibility mechanisms.

Figure 4: The mechanics of the EU budget margin



Source: European Commission (2020)

The margins and flexibility instruments are a way that EU budget funds could serve as an incipient reserve to pay for macroeconomic stabilisation. For example, they could be used to step in for national co-financing rates in the case of a deep crisis. As is indicated in Figure 2, covering the co-financing requirements of all the euro-area Member States in a deep crisis would cost approximately €35 billion a year. However, as is outlined in Table 1, the regular 2014-2020 EU budget would not have had sufficient flexibility to pay that full amount. However, covering the co-financing payments for a sub-selection of euro-area Member States would have been feasible. For example, exempting all countries spending more than 0.4% (€4 billion) or even all those spending more than 0.2% of GNI (€11 billion) would have been possible in 2016, 2017 and 2018. A relatively modest reform of the EU budget could therefore already harness its ability to support Member States facing cyclical downturns.

Table 1: Flexibility in the MFF 2014-2020

Flexibility in the current MFF (EUR million)								
	Special Instruments (commitments)				Instruments maximising the use of margins			
Year	Flexibility Instrument	Emergency Aid Reserve	European Globalisation Adjustment Fund	European Union Solidarity Fund	Contingency Margin	Global Margin for Commitments (2016-2020)	Global Margin for Payments	Total commitments-total payments
2014	89.3	98.1	81.0	126.7	2,818.2	0	104.2	6,288
2015	149.5	83.6	43.4	66.5	0	0	1,287.9	4,233
2016	1,530	210.4	28.0	33.1	240.1	1,410.9	13,991.3	5,010
2017	805.0	276.1	18.1	1,191	1,906.20	1,632.0	16,413.7	10,323
2018	837.2	345.0	28.0	138.2	0	1,446.8	11,385.5	8,088
2019	1,164.30	n.a.	n.a.	298.2	0	1,418.7	n.a.	8,185
2020	778.1 (p)	0 (p)	0 (p)	0 (p)	0 (p)	n.a.	n.a.	9,461

Source: Annual European Commission budgetary and financial management reports, European Commission Technical Adjustments to the financial framework. Notes: (p)=provisional data; n.a.=non-available. Global margins for commitments and payment are expressed in 2019/current prices and GNI in 2018 prices.

The new MFF (2021-2027) provides for an increase in flexibility with a streamlining and simplification of the thematic flexibility instruments and a new Single Margin Instrument. The maximum total amount of the special instruments for 2021-2027 outside the ceilings is foreseen to be €20.1 bn to address new priorities and unforeseen events in the light of the rapidly changing situation following Covid-19, of which €5 bn is to be available for a new special Brexit Adjustment Reserve to be established to counter adverse consequences in the Member States and sectors that are worst affected. A new Single Margin Instrument will replace the existing global margins for commitments and for payments and the contingency margins.

3.5 EU budget borrowing capacity

A fifth, related, mechanism in the EU budget relates to the EU's ability to borrow. The EU budget has the capacity to borrow using its triple-A rating to garner cheap financing and lend onwards to Member States. Before the Covid-19 pandemic, this mainly consisted of the European Financial Stabilisation Mechanism (ESFM) and the Balance of Payments Facility for non-euro area Member States (BOP). Moreover, using the aforementioned 'margin/headroom,' the EU budget has the capacity to provide guarantees, most importantly to the European Investment Bank (EIB) to empower its lending operations. In the first response to the economic consequences of the Covid-19 pandemic, the Commission already provided an extra 1 billion budget guarantee to the EIB for credit guarantee schemes to banks and Member States and provided guarantees to the EIB for pan-European credit guarantees to financial intermediaries, including national promotional banks. Such guarantees can indirectly support Member State stabilisation efforts. Building on the European Fund for Strategic Investments (EFSI) structures allows the Union to put triple-A guarantees into the system to protect the single market. Such high-quality guarantees can either be used as capital relief for banks or complement Member States guarantees which have different ratings given the different sovereign ratings of countries.

The Next Generation EU programme introduced, for the first time, the use of the EU budget's borrowing ability to raise funds in the market and pay out grants, not only loans. Such an evolution was long considered undesirable, infeasible or legally difficult, but the Covid-19 crisis overcame these trepidations. Albeit on a one-off basis, the European Council gave the Commission permission to issue €360 billion in bonds to provide direct disbursements and grants to help the European economy recover from the Covid-19 crisis. The NGEU bonds will be repaid from the EU budget's own resources over a period of around 30 years, starting at the end of the 2021-2027 MFF. Such EU borrowing for grants can provide stabilisation support by borrowing resources from the future for stabilisation today and by moving resources from stronger to weaker countries and sectors. This is done at favourable interest rates due to the Union's triple-A rating while spreading the repayment cost far into the horizon, thus reducing the annual burden through potentially positive dynamics of growth that outstrip the interest burden. This structure

goes beyond the long-standing practice of providing self-financing structures in the form of EU-budget-backed bonds for back-to-back lending to Member States.

From a stabilisation perspective, back-to-back loans to Member States have a more limited impact than grants from the EU level. Loans have no value added for Member States that can themselves borrow at similar conditions to the EU budget. However, for Member States whose debt has less than the triple-A rating of the EU budget, a loan from the EU budget can come with more favourable conditions than issuing own debt. In this way, the EU budget can pay out loans at lower interest rates than market conditions, thus subsidising Member States indirectly and providing a little stabilisation support. This is illustrated in table 2, which outlines that the SURE programme will likely culminate in less than €1 billion in annual transfers to Member States. Moreover, the loans tend to have less of a stabilisation impact than direct grants as they have to be repaid at some point in the future and can thus feed into debt sustainability concerns. This was at the heart of the debate on the Covid-19 recovery: it motivated Chancellor Merkel and President Macron to make their call for a grant-based €500 billion recovery fund, the Commission to present its NGEU proposal and, after intense negotiations, made the European Council in July to agree on providing sizeable grants rather than only loans.

Table 2: implicit transfers due to EU Support to mitigate Unemployment Risks in an Emergency (SURE)

	Amount requested from SURE (€ bn.)	10Y Yield per Member States end-August 2020	Approximate interest rate differential with EU	Transfer, interest subsidy (€ bn.)	Transfer (million)
Belgium	7.8	-0.170	-0.17%	-0.013	-13.260
Bulgaria	0.511	0.326	0.33%	0.002	1.666
Czechia	2	0.982	1.18%	0.024	23.640
Greece	2.7	1.086	1.29%	0.035	34.722
Spain	21.3	0.39	0.59%	0.126	125.883
Croatia	1	0.95	1.15%	0.012	11.500
Italy	27.4	1.025	1.23%	0.336	335.650
Cyprus	0.479	0.854	1.05%	0.005	5.049
Latvia	0.192	0.550	0.75%	0.001	1.440
Lithuania	0.602	0.180	0.38%	0.002	2.288
Malta	0.244	0.421	0.62%	0.002	1.515
Poland	11.2	1.345	1.55%	0.173	173.040
Romania	4	3.875	4.08%	0.163	163.000
Slovakia	0.631	-0.250	-0.05%	0.000	-0.316
Slovenia	1.1	-0.091	0.11%	0.001	1.199
Portugal	5.7	0.339	0.54%	0.031	30.723
Total	86.9			0.867	867

Source: European Commission, Reuters, Bloomberg, own computations. State of play per mid-September 2020.

The degree to which margins and loans are pre-committed for other purposes will reduce their ability to pay for stabilisation across the euro-area economic cycle. As is illustrated in Tables 1 and 3, under the 2014-2020 MFF the margins were already largely used to provide guarantees for a number of the EU-area lending schemes, notably the EFSM, the BOP and part of the European Investment Bank-administered European Fund for Strategic Investments (EFSI). This reduced the availability of margins for other purposes. Precisely because of the limited headroom available for further Covid-19-related loans in 2020, the Commission mobilised €100 bn under the SURE programme instead of using guarantees (€25 bn) provided by the Member States.

Table 3: Overview of lending and guarantee operations by the EU budget pre-Covid19

Overview of lending and guarantee operations by the EU budget (outstanding, mln)								
	EESC	Euratom	BOP*	MFA	EFSM*	EIB**	Total (ex-EIB)	Total
2011	225	447	11400	590	28000	22531	40662	63193
2012	183	423	11400	545	43800	25020	56351	81371
2013	179	386	14000	565	43800	25574	58930	84504
2014	192	348	8400	1829	46800	26929	57569	84498
2015	204	300	5700	3007	46800	27388	56011	83399
2016	175	251	4200	2947	46800	28133	54373	82506
2017	0	249	3050	3901	47456	27169	54656	81825
2018	0	253	1734	4387	47400	28536.2	53774	82310

Source: 2011-2018 reports from the Commission to the European Parliament and the Council on guarantees covered by the general budget. Notes: *Risks of default are born by the Member States for EIB, MFA and Euroatom. **Both programmes managed by the COM and the EIB itself.

For the foreseeable future, the margin is likely to be fully used to pay back the borrowing that will take place under the Covid-19-related Next Generation EU. The margin will be increased to up to 2% of GNI in response to the Covid-19 crisis to provide the cornerstone for repayment of the NGEU linked borrowing. The credit support for NGEU is thus organised through a sufficiency guarantee of the EU budget through an earmarked contribution of the Own Resource ceiling, constituting the 0.6% of GNI the ceiling is raised above and beyond regular MFF spending and other programmes. The 0.6% of GNI is a multitude larger than the expected annual NGEU coupon and redemption payments the Union will owe on the bonds, thus ensuring a high credit rating. However, looking beyond Covid-19, if the EU budget is to effectively become more reactive to the economic cycle on a more structural basis, a sizeable portion of the margins and flexibility instruments could be kept in reserve for downturns.

The borrowing capacity is the only one of the five mechanisms that can create a significant stabilisation function in case of the EU as a whole is faced with a shock. The margins and flexibility instruments can

also be used, but will be hampered by the availability of funds in a 7-year period and the tight constraints imposed at the end of the period. The first three mechanisms may help cushioning asymmetric shocks but are unlikely to be able to do any heavy lifting at the EU level.

One critical question on the stabilisation capacity of the EU budget will be whether NGEU and the ability to do Union borrowing to pursue Union tasks heralds a permanent change in the structure. One possibility is that, while NGEU is - by legal construction - indeed temporary and linked to the current crisis, the door has been opened to a similar response in another severe crisis. Another is the possibility that the strong fiscal response rekindles the debate on establishing a permanent stabilisation facility, as argued by the European Fiscal Board in its assessment of the fiscal situation following the creation of NGEU (EFB 2020).

3. Conclusion

For long, the academic debates on euro-area stabilisation and on the EU budget have largely been separated. This reflects the institutional and financial stasis of the EU budget and the hope that institutional innovations for the euro area could be combined with the emergence of a political consensus on a central stabilisation function within the EMU. So far, the consensus has not emerged and in reality the political attraction of the EU budget has been stronger than was recognised by many. In particular, the Covid-19 pandemic has led to a crisis response based on the EU budget that has been massive in scale and innovative in its legal construction. The EU response has highlighted the potential that the EU budget has to counteract shocks and spur a cyclical recovery. The temporary nature of the response and at the same time the potentially long-lasting effect of the Covid-19 response in terms of debt levels and economic fragmentation within the Union raises the question of how the EU budget can contribute to stabilisation in a more permanent form, in particular among the Member States sharing the euro as their currency.

This paper has reviewed five existing mechanisms which could be expanded on a more structural basis to make the EU budget respond to economic shocks more effectively. First, the EU budget provides stable streams of public investment spending as long as Member States do not cancel projects to avoid co-financing requirements. Second, the national co-financing requirements that typically accompany EU projects

can be lowered. Third, although its current revenues mechanically move with, rather than against, the cycle, the EU budget could be equipped with cyclically sensitive own resources. Fourth, the EU budget allows for inter-temporal shifting of resources in the form of advance payments, unused payments and margins which can be used in bad times. Fifth, the EU budget boasts a borrowing capacity with the highest credit rating to support guarantees, loans and grants.

One solution that has not been discussed in the paper is to delegate further fiscal and policy tasks to the European level. While the Next Generation EU's Recovery and Resilience Fund (RRF) has a strong focus on providing support to national governments in their national investment and reform programmes, the overall emphasis on climate and digitalisation – not only in the NGEU and the new MFF but also in the policy agenda for the new legislature more generally – raises the question of whether the EU level could take on a stronger role in this transformation process with combined regulatory and fiscal measures. The Commission had proposed an increase in EU spending programmes (linked to the provision of European public goods) but it found little support in the Council. Nevertheless, if certain institutional features, such as the possibility of issuance for grants, and an increase in the size of the EU budget were to become permanent as a result of allocating more policy tasks to the EU level, the role of the EU budget in stabilisation would naturally increase. In such a more medium- to long-term perspective, the distinction between an EU and a euro-area focus would probably also lose much of its relevance. A political consensus would not be forged on a more abstract concept of euro-area stabilisation but on the question of which level would be best equipped to take over tasks that generate significant synergies if done at the European level. As is the case with existing federations, like the United States, stabilisation could then emerge as a useful collateral of increased spending at the central level. Such a change in the nature of the EU as a polity would install a stabilisation function through genuine policies rather than discrete payments to national governments, which in existing federations tend to attract more criticism (e.g. the German *Finanzausgleich*) than a central fiscal policy to pay for central tasks. The mechanisms that we delineate here could be instrumental in operationalising this virtuous side effect.

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Building a Euro-area Budget Inside the EU Budget: Squaring the Circle?

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Abstract

This paper explores how a budget for the euro area might be established within the European Union budget as part of the 2021-2027 Multiannual Financial Framework. I first discuss what budgetary tool the euro area needs and what essential characteristics it should have. I then compare these with the characteristics of the 'Budgetary Instrument for Competitiveness and Convergence' agreed on by the Eurogroup in 2019. I conclude that in its current form this new instrument, which has been labelled a '*mini revolution*', will most probably be inadequate to deal with the most important challenges facing the euro area.

1. Introduction

In 2012, three major institutional developments marked a turning point in the unfolding of the euro-area crisis: the establishment of the European Stability Mechanism (ESM), the European Central Bank's announcement of its Outright Monetary Transactions (OMT) programme and the decision to create a European banking union. The combination of these institutional innovations finally brought to an end the crisis in the sovereign debt markets, which almost derailed the monetary union project.

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However, with the end of the most acute phase of the crisis, the deepening of Economic and Monetary Union (EMU) also came to halt, leaving the currency area incomplete. Several key pieces of the euro architecture to prevent crises and absorb shocks remain missing: the banking union is still incomplete, risk-sharing (both public and private) is still minimal and macroeconomic stabilisation policies remain too limited, especially with the ECB stuck at the lower bound (Claeys, 2017). Although the debate among academics and practitioners on what needs to be done has continued, nothing major has been enacted. In particular, the possibility of creating a euro-area specific budget was intensely debated but the discussion went unheeded.

At least, this was the case until 2018, when the European Commission tried to revive the euro-area budget debate by linking it to the discussion on the future of the EU budget and the negotiations on the Multiannual Financial Framework for 2021-2027 (European Commission, 2018). The Commission also made some detailed proposals on how to do this in practice, but these plans were quickly rejected by the EU countries. Nevertheless, since then the member states have taken up the issue and have tasked the Eurogroup with reaching an agreement in order to provide the euro area with a budgetary tool.

This paper investigates the reasons why it is essential to establish a budget for the euro area and how to do it in practice. I first discuss what kind of budgetary tool the euro area needs and what essential characteristics such a tool should have (Section 2). I then examine the benefits and drawbacks of establishing this euro-area specific instrument within the EU budget (Section 3). Next, I explore the main characteristics of the 'Budgetary Instrument for Competitiveness and Convergence' agreed on by the Eurogroup in 2019 and compare them to the needs of the euro area. I conclude that in its current form this new instrument, qualified by some policymakers as a '*mini revolution*', will most probably be inadequate to meet the most important challenges facing the euro area (Section 4).

2. Why does the euro area need a specific budget?

There are several important reasons why euro-area countries need a specific budget.

First, it is more difficult for countries inside a monetary union to deal with asymmetric shocks than for countries with their own central banks. In a monetary union, there is no exchange rate with the main trading partners that can depreciate quickly to regain competitiveness after a shock. There is no autonomous monetary policy if the business cycle diverges from the rest of the monetary union. And in the euro area in particular, unlike federations such as the United States, there are no alternative mechanisms available for shock absorption given that labour mobility, federal transfers and capital market integration are all very low.

This means that fiscal policy must play a more active role in the euro area to compensate for the other missing channels. However, national fiscal policy is constrained in the euro area. First, fiscal policies adopted by euro-area countries have to respect a series of complex fiscal rules that proved to be flawed during the last recession and which contributed to over-tight fiscal policy between 2011 and 2014. Second and more importantly, if a country experiences a large shock that leads to a significant increase in its debt-to-GDP ratio, doubt will be cast on the sustainability of its debt given that fiscal policy is under more scrutiny in the monetary union because of the prohibition on monetary financing by the ECB enshrined in Article 123 of the TFEU. The creation of the ESM and OMT in 2012 was clearly helpful but their setup is still imperfect (Claeys, 2019). As a result of these two elements, adequate stabilisation through national fiscal policy might be unavailable to some countries.

Moreover, an adequate aggregate fiscal stance and ensuring the right policy mix with the ECB's monetary policy have proven very difficult to attain in recent years. Coordination through the fiscal framework or the European semester has proved illusory. In particular, when some countries are constrained from implementing what would be the optimal fiscal policy, there is no way to force other countries that have fiscal space to use it if it does not seem to be directly in their own interests. As a result, the aggregate fiscal stance in the euro area has been too tight on many occasions during the last decade. Moreover, if you combine fiscal and monetary policy to determine what should be the optimal mix of macro-

economic stabilisation policies, the fact that monetary policy is currently stuck (and is expected by financial markets to be stuck for a long time) at the lower bound makes the situation even worse in terms of policy mix. In particular, a side-effect when monetary policy is constrained by the lower bound is that inaction on fiscal policy obstructs the efforts of the central bank to fulfil its mandate and to bring inflation back towards its target.

A fiscal stabilisation tool at the euro-area level would provide a welcome solution to these problems.

3. What should a euro-area budget ideally look like?

In order to play this role and to be both economically effective and politically acceptable, such a tool should have seven main characteristics.

First, it should be of a sufficient magnitude to be able to deliver the right level of stabilisation in combination with the ECB's monetary policy and with national fiscal policies. If it is not large enough at its inception, the instrument should at least be scalable if it is needed in the future.

Second, it should provide cross-country risk sharing in the case of large shocks that countries cannot deal with on their own without risking their debt sustainability being questioned by the markets. Loans (such as those that can be provided by the ESM) can be helpful but are not sufficient to deal with this issue as they only shift the debt problem to another level.

Third, to increase its stabilising effectiveness through intertemporal smoothing, such a tool should have a borrowing capacity. Given the uncertainty about the size of future shocks, being able to borrow is more efficient than having an *ex-ante* limited rainy day fund, which might either be too small when needed or might never be used. This also means centralising some resources to pay for the debt. One step in this direction would be to fund the euro-area budget with a volatile tax and allow for borrowing over the cycle to ensure stable spending.

Fourth, in order to have the maximum impact (i.e. to have the highest fiscal multiplier), a stabilisation tool should be targeted – as argued by Summers (2008) when the crisis started in the US – both geographically and in terms of the type of expenditure which is chosen.

Fifth, the deployment of such a tool should be timely. For this, its release should either be automatic or, if this is not the case, it should be activated as quickly as possible. This is also to maximise its impact because multipliers are higher in the trough of a recession.

To these crucial economic characteristics, two more features should be added to make a stabilisation tool politically acceptable for all European countries.

Sixth, the creation of a stabilisation tool should not give an incentive to countries to reduce fiscal discipline or neglect structural issues.

Seventh, a euro-area fiscal capacity should not lead to permanent or even persistent transfers between countries. Ideally, it should be designed behind a veil of ignorance. Economically, this means that the tool should be budget-neutral in the long run for each country.

4. Should this euro-area budget be within the EU budget?

There might be several advantages to establishing an EU budget line to create a stabilisation tool for EMU (Claeys and Wolff, 2018). An EU budget line would, in principle at least, avoid the need to create a new *ad-hoc* inter-governmental institution, and it would avoid driving an additional political and financial wedge between euro- and non-euro-area countries.

Another important justification for keeping the euro-area budget in the EU budget is a political economy one. One reason why setting up new budgetary resources for the euro area faces fierce resistance in some countries is the perception that existing EU resources are poorly used. Politically, an important precondition for mobilising additional resources for the euro area is therefore a better use of existing EU resources. This should put reform of the EU budget at the centre of the euro-area budgetary discussion.

However, there would also be major drawbacks to building a euro-area tool within the MFF. The EU budget is based on a highly complex set of treaty rules, allowing for limited flexibility and essentially no bor-

rowing capacity.² Moreover, the establishment of real own resources for the EU budget would need unanimity among the members. In addition, the use of a tax more substantial than regulatory taxes (e.g. environmental taxes) to finance the EU budget (such as a corporate tax) would also require a Treaty change. That is why there is currently no borrowing capacity and no own resources in the EU budget, apart from customs duties representing less than 10% of the revenue. This means that, unless there are major changes to the EU budget (which would probably involve Treaty changes), a euro-area stabilisation tool as a part of the EU budget would not function with taxation and borrowing.³

Overall, while it is important to acknowledge the constraints on the EU budget and existing EU structures, it is also important not to confuse cause and effect. The constraints on the EU budget are a result of a desire by some countries to prevent taxation and borrowing at the EU level. Therefore, the real question is not the legal constraints but the political willingness of EU countries to upgrade the EU's fiscal capacities. The EU budget could be substantially modified to provide more meaningful European public goods and also to allow for some stabilisation. To transform it into an insurance policy for large asymmetric shocks will essentially require much political will. Once the determination is there, meaningful instruments can be built either within or outside the EU budget.

5. What have euro-area countries agreed so far?

At the beginning of May 2018, the European Commission made a full proposal for the future of the EU budget after 2020. Part of this (European Commission, 2018) was two concrete tools to try to improve the functioning of the monetary union: the European Investment Stabilisation Facility (EISF) and the Reform Delivery Tool (RDT).⁴

Despite the modest scope of the EISF (Claeys, 2018), the Commission's proposal was quickly dismissed by member states, while most of the funds that were intended to be devoted to the RDT were re-routed to other initiatives.

Instead of the Commission's proposal, after months of difficult negotiations, the Eurogroup and the European Council agreed to set-up a so-called 'Budgetary Instrument for Competitiveness and Convergence' (BICC) for the euro area. What are the main characteristics of this future instrument dedicated to the euro area and how does it fulfil its needs?

At first glance, the stated objectives of this new instrument are both structural and cyclical, as it is intended to "*strengthen potential growth of euro-area economies and the resilience of the single currency against economic shocks*" (Council of the EU, 2019b). In order to do this, the idea is to use dedicated funds from the EU budget to co-finance structural reforms and public investment in euro-area countries.

However, despite highlighting "*the lack of a fiscal pillar*" and the importance of "*increas[ing] the effectiveness of monetary policy,*" it appears that the main objective of the BICC will not be to provide *ex-post* stabilisation but only to enhance the competitiveness of, and the convergence between, euro-area countries to avoid crises *ex ante*. This is not a bad idea *per se*, as countries participating in the monetary union should converge (or at least avoid building up large differences in competitiveness as happened in the years before the last crisis) and should share some essential characteristics (for instance in the way their labour markets function) for the currency area to work smoothly.

However, there are two main problems with the BICC proposal. First, it is naïve to believe that convergence and improved competitiveness are substitutes for macro stabilisation policies. Even if euro-area economies converge fully and are highly competitive, there will always be economic

crises to deal with – whether they originate from exogenous or endogenous shocks – and the euro-area countries will have difficulties in dealing with them for the reasons I have discussed. Structural and cyclical policies are complements not substitutes. Second, the BICC very much duplicates existing programmes financed by the EU budget as its objectives are similar to those of the EU Structural Funds. The main differences are its narrower focus (i.e. to finance structural reforms) and geographical scope (the euro area) and its governance (as the Eurogroup will provide “*strategic guidance*” on the use of funds). The only stabilisation element in the current ‘term sheet’ (Council of the EU, 2019a) is the possibility of reducing the rate of co-financing provided by member states from 25% to 12.5% in “*severe economic circumstances*.” However, this ‘stabilisation’ measure is not specific to the BICC. In 2011, the Commission significantly reduced (to 5%) the minimum financial contribution to projects financed by EU structural funds of the countries most affected by the crisis.⁵

How does the BICC compare with the other previously described desirable characteristics?

First, the BICC will be characterised by its small size. While the current BICC proposal (Council of the EU, 2019b) evokes an “*indicative*” amount of €17 billion over the whole seven-year multi-annual financial framework – i.e. the equivalent 0.14% of the euro-area yearly GDP but for seven years and for 19 countries – the most recent proposal for the 2021-2027 MFF from the Finnish Presidency reduced the funds devoted to the BICC to €13 billion (Council of the EU, 2019c). This means that the BICC will be irrelevant from a macroeconomic perspective. In addition, at the time of writing, the tool will not be scalable. Member states have not yet managed to conclude an intergovernmental agreement to increase its size outside the EU budget if it is needed, for instance if there is a crisis and countries want to use the BICC to avoid a harmful reduction in public investment similar to that observed during the last euro-area recession.

Second, there will not be much cross-country risk-sharing in the BICC, as the usual *juste-retour* logic in the EU budget will apply in full. The agreement stipulates that at least 70% of the funds go back to the contributors. This ensures that there are no significant transfers between countries, but it also means that the tool will not be flexible and that the

5 For details, see https://ec.europa.eu/commission/presscorner/detail/en/IP_11_942.

money will not go to the countries that need it most. This also implies that the instrument will not be targeted geographically and therefore that its macro impact will not be maximised.

Third, there is no borrowing capacity envisaged in the BICC. The idea is not even discussed in the current documents and, as was highlighted in Section 4, it is practically impossible to build up a borrowing capacity in the current version of the EU budget.

Fourth, in terms of timeliness, it seems that the funds from the BICC will not be released quickly given the particular governance of the tool and its inclusion in the European Semester. The process will probably be quite lengthy as the Eurogroup will first provide its strategic priorities before countries can submit proposals (which should consist of packages of reforms and investments) for the next year's budget and the Commission approves them.

On the other hand, the BICC fully responds to the political constraints put forth by some countries – probably at the expense of other desirable characteristics. With the BICC there will be no significant transfers between countries and, given the insignificance of the tool, countries will have no incentive to reduce fiscal discipline or to neglect structural issues.

6. Conclusions

The agreement on the BICC has been sold to citizens as a '*mini-revolution*'⁶ or, at least, as a first step towards a genuine euro-area budget, the scope and size of which can be increased later if needed. However, for this to be possible the BICC needs to be both flexible and scalable, which is not the case for the moment (Guttenberg, 2019).

As the proposal stands (at the beginning of 2020), the BICC is unlikely to fundamentally change the nature of fiscal stabilisation policy in the euro area. In addition, even from a convergence perspective, the BICC mainly duplicates something – EU structural funds – that already exists but with more complex governance and no noticeable improvement other than its focus on the euro area. It is therefore largely a reshuffling of funds inside the EU budget with no real value added. As a result,

6 See, for instance, the declarations of France's Finance Minister Bruno Le Maire after the agreement in June 2019: <https://www.lefigaro.fr/flash-eco/union-europeenne-compromis-sur-un-futur-budget-de-la-zone-euro-20190614>.

the BICC does not represent an enhancement of the still incomplete euro architecture.

There are two ways forward at this stage:

If it is still possible to amend the agreement, then it should be done. At the moment, discussions appear to be closed but this should not necessarily be the case because the BICC should be discussed again as part of the overall MFF negotiations between countries, and because it also needs to be approved by the European Parliament. In this case, the proposal should be changed in two main ways: 1) it should be made flexible by escaping the *juste-retour* logic; and 2) it should be made scalable with an intergovernmental agreement in order to be macroeconomically relevant and effective when it is needed. Both changes are equally necessary because they are complementary. Imagine that the size increases later thanks to an intergovernmental agreement but that the *juste-retour* rule continues to prevail. In that case, for every additional euro a country would put in it would always get back at least 70 cents, which would prevent risk-sharing and the efficient use of the tool.

If changes are not possible at this stage, it might be better to abandon the current BICC project altogether. In the worst case, the BICC could be damaging by giving a false sense of security to euro-area countries, leaving them with the false impression that they can rely on a euro-area budget. In addition, the BICC's mere existence might make it more difficult to re-open the discussion about a genuine euro-area budgetary tool. If countries that have been pushing for a euro-area budget suggest, for political (and purely domestic) reasons, that the BICC is the adequate tool to meet euro-area challenges, then they will have some difficulties in justifying that another tool might be necessary later when the BICC proves inadequate. It might therefore be preferable to abandon the BICC now and wait for the right time when it will be politically feasible to build a euro-area stabilisation tool (e.g. in the form of a European unemployment insurance scheme, as discussed in Claeys, 2017), either outside the EU budget or inside it as part of a comprehensive future reform of the EU budget.

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A Relevant MFF in the Long Term: Innovative Yet Feasible Reforms

Marta Pilati and Fabian Zuleeg¹

Abstract

The Covid-19 crisis has created some political will for a quick agreement on the next Multiannual Financial Framework (MFF) and recovery package. Nonetheless, the MFF structure will remain rooted in the past. National disagreement on EU values and visions for the future of the EU coupled with unanimity impede significant reform, resulting in only a minor departure from the *status quo*, protecting vested interests and underfunding new priorities. The EU risks falling behind the global curve of change.

This paper explores realistic politically feasible ways to circumvent the MFF rigidities and make the EU budget more relevant for the future. Some of the positive steps forward made in Next Generation EU should be taken as inspirations for permanent instruments. First, an increased use of financial instruments and a boosted InvestEU to attract and leverage private funding to deliver EU priorities such as the Green Deal and new technologies. Second, a package of new own resources that can simultaneously convince the Member States and deliver on broader EU policy objectives. Third, some fiscal space for Member States to invest in key priorities. Lastly, there is scope for expanding the use of match funding to a number of policy areas, e.g. migration, to further align national spending with EU goals.

Keywords: MFF, Next Generation EU, EU budget negotiations, match funding, new own resources, political deadlock, EU reform, financial instruments, fiscal flexibility.

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The Covid-19 crisis has made an agreement on the 2021-2027 Multiannual Financial Framework (MFF) more likely. By tying the MFF to the Next Generation EU recovery package,² the European Commission put pressure on the Member States to reach an agreement quickly. They were successful in July 2020. While Next Generation EU makes some steps in the direction of modernising the EU budget, the MFF structure remains largely unchanged. Once the temporary changes expire in 2024, there is a risk that the MFF will continue to be unfit to address EU priorities and challenges.

The current crisis could have been an occasion to overhaul the MFF structure towards more flexibility and a shifting of funding to new priorities. Instead, it was left largely untouched. With radical changes unlikely in the near future, there is a need for realistic reforms to the existing arrangements that can improve the EU's ability to address emerging challenges while remaining politically feasible.

1. A largely unchanged MFF structure

The package proposed by the European Commission in May 2020 and approved by EU leaders in July 2020 consists of two parts: on the one hand, Next Generation EU, a €750 billion loans and grants instrument that will last until 2024; on the other hand, the 2021-2027 MFF amounting to slightly more than €1 trillion. Although the MFF has not yet been approved by the European Parliament, large changes are unlikely. Next Generation EU envisages a Recovery and Resilience Facility separate from the EU budget to support more vulnerable Member States and additional funding for existing EU budget programmes. This additional funding goes in the right direction to modernise the EU budget and increase support for programmes relevant to future priorities. For example, Next Generation EU increases the budgets of Horizon Europe, the Just Transition Fund and for health. In addition, InvestEU is strengthened with a new window, the Strategic Investment Facility, which will invest in strategic sectors including new technologies, artificial intelligence, cybersecurity and energy storage.

According to the proposals, this additional funding will cease in 2024

2 European Commission (2020), "Europe's moment: Repair and Prepare for the Next Generation," COM(2020) 456 final, 27 May 2020; European Commission (2020), "The EU budget powering the recovery plan for Europe," COM(2020) 442 final, 27 May 2020.

when Next Generation EU ends. The programmes will be subject to a considerable budget cut that will be detrimental for future implementation. The few steps made towards budget modernisation are intended to be temporary, while there is a small chance that by then there will be some political will to maintain the funding of the programmes. However, there is a significant risk that this will not be the case and that after 2024 the MFF structure will return to grossly underfunding priority areas such as the sustainable transition and new technologies.

2. Contrasting views and unanimity: a recipe for reform failure

While the health and economic crisis puts pressure on national governments to swiftly find an agreement on the recovery package, fundamental disagreements among Member States remain and were clear during the July 2020 negotiations. The intention to keep the MFF structure in line with the past while ensuring that all reforms are temporary signals overall reluctance to change the MFF in the longer term.

The MFF must be agreed unanimously by the Member States represented in the European Council and approved by the European Parliament. Finding an agreement among 27 Member States is always a difficult exercise as they all try to shape the common budget in the way that best serves their interests and priorities.³ On the surface, Member States disagree on the overall size of the common budget and funding allocations for different programmes.

These ‘monetary’ frictions arise from the so-called ‘juste retour’ logic in which each Member State seeks to benefit ‘fairly’ from EU funding in line with what it contributes. Without considering the added value and the non-monetary benefits arising from EU operations, Member States tend to focus on improving their net budgetary balance.⁴ Although they are acknowledged to not be representative of the benefits for Member

3 This governance limitation is not new. See Hagemann, Sara and Zuleeg, Fabian (2008), “Troubles ahead: Can the EU agree a better way of negotiating its budget?”

4 Pilati, Marta and Zuleeg, Fabian (2020), “The benefits of EU membership are not measured by net operating balances,” European Parliament. Net budgetary balances are the difference between the national contribution and the expenditure ‘allocated’ to the country. However, the allocation exercise is sometimes arbitrary and often based on ex-ante estimates. Additionally, the net balance indicator is not representative of the true benefits of the EU budget and EU membership in general.

States and promote a zero-sum view of the EU in which if one country gains another has to lose, net balances and their optimisation remain the basis on which the MFF is discussed.

These tensions are also due to disagreement at a deeper level. The debate on programme funding allocations arises from the values that stand behind them. For example, there is conflict between on the one hand supporting competitiveness, excellence and innovation and on the other promoting regional economic convergence and support for less developed areas. There is also tension over whether the EU budget should be used as a corrective tool of national ‘misbehaviour.’ This would happen in the case of a rule of law conditionality, which would effectively limit access to EU funding for countries with rule of law deficiencies. Furthermore, there is disagreement around the flexibility of budget allocations. Currently, the structure of the budget is extremely rigid, with most funding allocated to countries at the beginning of the period and very little room for shifting amounts among headings. While this makes the structure unfit to adapt to changes, some countries oppose more flexibility as it would entail more uncertain calculation of national shares and more control by the European Commission and Parliament over the allocation of funding.

While MFF agreements have always been hard to achieve, an underlying dispute about values and goals is gaining importance. Even if Member States agree to a radical change towards a temporary transfer union, the deep rooted ‘juste retour’ approach and different views on EU values will be difficult to overcome. There is a significant risk that future MFFs will maintain the rigid structure that is unfit to address emerging priorities and challenges.

3. A dysfunctional EU unable to keep up with change

Because compromise is so difficult to achieve, political negotiations avoid discussing most controversial and far-reaching modifications to the current budget structure.⁵ Opportunities to deeply reform the EU budget are therefore repeatedly missed, including this time around, resulting in a structure that underfunds policy priorities that have emerged more recently, e.g. research and innovation, border management and sustainability.

5 See also Pilati, Marta (2019), “The MFF non-decision: More at stake than delays,” European Policy Centre, Brussels.

The inability to adequately allocate funding to pressing issues will inevitably lead to the EU falling behind the global curve of change. This can result in citizens being frustrated with an EU unable to deliver its promises. Similarly, international actors may deem the EU unreliable and incapable of acting as a global leader on key issues.

Importantly, there are economic consequences. An outdated budget structure entails risks for future prosperity. The EU budget provides economic actors with an indication of the future direction of investment needs and regulation. This is particularly the case of emerging sectors, e.g. in relation to new technologies and the need to make the economy and industry environmentally sustainable. These sectors will require regulation and large private and public investment. If the EU budget underfunds these priorities and does not provide adequate guidance, the EU's economic fitness for the future will suffer. While some efforts to target new priority sectors were made in the May 2020 Commission proposals, they were far from enough and further reduced by the European Council's compromise deal. Additionally, there is a risk that the temporary additional funding of Next Generation EU will be discontinued. This is exemplified by the Strategic Investment Facility of InvestEU, which is expected to invest in strategic sectors for the future. According to the proposals, it will cease to exist after 2024.

With deep-rooted frictions among Member States likely to persist, negotiations on future MFFs are doomed to remain rigid and unsatisfactory, once again resulting in an EU budget unfit to deal with emerging priorities.

4. How to deliver an EU budget more fit for purpose

The effort to keep the 2021-2027 MFF structure largely unchanged indicates that political path dependency remains even in times of crisis. The probability of an overhaul of the MFF after 2027 remains low. There is therefore a need for realistic reforms that could improve the EU's ability to direct funding to pressing priorities without fundamentally altering the current structure of the MFF.

Financial instruments

In times of crisis, there may be low demand from investors, thus reducing the effectiveness of leverage funding through EU budget financial instruments. Nonetheless, the limited ‘firepower’ of the EU budget remains an issue and once the investment environment goes back to normal increasing the use of financial instruments in some policy areas can boost the reach of EU action. By providing funding with advantageous and facilitated conditions and reducing risk through guarantees, financial instruments can leverage public and private investment in projects and policy areas that align with EU priorities. At the same time, they stimulate the business environment by creating new opportunities for public and private investors.

With the European Fund for Strategic Investments and its successor InvestEU, the EU is making steps in the right direction by increasing the role of financial instruments, which has been one of the biggest changes in the recent MFFs. There is scope for further expanding their use, especially in policy areas that are highly relevant but risky such as in the context of the European Green Deal and for the development and diffusion of new technologies and processes for the transition towards a more sustainable economy.

Match funding

Match funding could be an innovative mechanism to put in place in a number of additional policy areas, taking inspiration from the national co-financing already required in regional policy.⁶ A fund in the MFF would set aside an amount dedicated to match funding, which would be pre-allocated to Member States according to needs in different policy areas, e.g. innovation, energy transition, migration, etc. For example, countries facing higher migration pressure would be allocated a higher share of funding. The funding, however, would only be disbursed to ‘match’ equivalent national expenditure. All countries would have a share allocated to them that can be used according to national preferences. For example, the funding for digitalisation could be directed to creating digital infrastructure in rural areas or to developing new cutting-edge technology.

6 The concept of match funding was first developed in Zuleeg, Fabian (2018), “[Squaring the MFF circle: How match funding can deliver the EU’s new priorities](#),” European Policy Centre: Brussels.

This mechanism offers multiple benefits: first, it provides an incentive for national governments to invest in priority areas identified at the EU level. Second, Member States would be able to double the resources available for their investment needs thanks to EU funding. Third, it improves the EU's capacity to leverage investment without increasing the size of the EU budget. Fourth, it allows Member States that have no interest or needs related to a certain policy to 'opt out' by not making a claim to the fund. This in turn improves Member States' net balances as the funding is allocated even though it might not be claimed.

A package of new own resources

To repay the EU debt issued to finance Next Generation EU, the European Commission had proposed introducing additional sources of EU revenue, a position shared by the European Parliament. These new own resources should not be relegated to repaying the additional funding but should become a permanent feature of the EU budget. This can be an effective way to improve the capacity of the EU budget without increasing the GNI-based Member State contributions.

Once again, however, the interests of Member States differ and are overall reluctant to introduce new own resources. Many of the proposals on the table are unlikely to be unanimously approved. This is particularly the case of a common consolidated corporate tax base. To be accepted, a package of new own resources should be carefully designed in order to find new sources of revenue that are not state-based while avoiding disproportionately penalising some countries. For example, 'environmental' new own resources, such as a levy on non-recycled plastic or on carbon emissions, are opposed by countries that face high sustainability pressure and a relative lack of resources. To compensate for possible disproportionality, the package could include other measures that support the energy transition in the Member States most affected, eventual correction mechanisms and a focus on economic actors rather than countries. At the same time, net contributors will be likely to oppose any new own resource that is disproportionately raised by them. It should therefore be ensured that the new resources are raised 'fairly' across the EU. Additionally, the design of new mechanisms should ensure uniformity across the single market and economic sectors in order to avoid fragmentation.

Fiscal flexibility for investment priorities

If some policy priorities are considered to be of crucial importance to the EU's future (e.g. innovation, skills, sustainability), then Member States should be allowed some fiscal space to invest in them. The application of the general escape clause in the Stability and Growth Pact is currently allowing Member States to provide fiscal stimulus beyond the EU fiscal constraints. In the longer term, the EU could consider permanently excluding some expenditure from the calculation of government deficits. This can be the case of, for example, investment in digital skills and retraining the workforce, measures supporting the phasing out of fossil fuels for energy production and investment to improve the energy efficiency of industry and households. The types of investment that would benefit from the exclusion should be clearly defined at the EU level and Member States should provide accurate reporting of expenditure on relevant projects.

Conclusion

While the Covid-19 crisis has opened the door to unprecedented instruments and has created the political will for a relatively quick agreement, the structure of the next MFF is doomed to remain unchanged. Conflicts among national interests and visions for the EU project, coupled with governance characterised by unanimity, make it impossible to implement far-reaching reforms of the EU budget. These constraints are likely to remain even after the recovery package related to Covid-19 ceases to exist. The outcome, once again, is a common budget that is stuck in the past and disproportionately underfunding recent priorities that need an adequate response. Consequently, the EU's ability to keep up with the current challenges of technological change and the climate emergency is severely constrained, with negative effects on its economic strength and international credibility.

With a comprehensive reform of the MFF out of the picture, the remaining option is to expand and adapt the existing structure. Some novelties proposed and/or introduced with Next Generation EU should be made permanent, such as a package of new own resources, a strengthened use of financial instruments and the introduction of fiscal instruments for national investment deemed to be of crucial strategic impor-

tance. Additionally, a system of match funding could help leverage public investment in priority areas. The solutions proposed in this paper will not address fundamental issues but instead constitute small steps in the right direction.

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Maximising Innovation Funding in the EU's Next Long-term Budget

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Since 1984, the EU has funded research and innovation (R&I) through seven-year R&I multiannual framework programmes. There are, however, many other EU programmes and funds that support innovation. The European Regional Development Fund (ERDF), for instance, supports the planning and implementation of regional R&I specialisation strategies. Sectoral programmes such as NER300 (energy), LIFE (environment) and the Connecting Europe Facility (infrastructure) provide funding for the development and deployment of innovative technologies and solutions in particular sectors.

The importance of these other sources of EU innovation funding is non-negligible. A study conducted on behalf of the European Parliament estimates that altogether these other programmes have provided more support for innovation than Horizon 2020 (H2020), the EU R&I framework programme for 2014-20. The study also shows that they are largely complementary to H2020 in their goals and intervention approaches. Whereas H2020 promotes the development of market-shaping breakthrough innovations, these other programmes and funds usually support incremental innovations. They also provide important support for the dissemination of commercially-tested innovative technologies and solutions in specific policy fields.

This chapter provides an overview of the various EU programmes and funds that provide direct and indirect support for innovation and assesses how these different programmes interrelate both at the project and programming levels. On the basis of this analysis, I develop some recommendations on how to maximise the use of EU innovation funding

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in the EU's next long-term budget. In particular, the chapter highlights a need to introduce more synergy-enhancing rules in the legal basis of the various sectoral programmes in order to incentivise synergies at the project level. It also points out a need to ensure a more strategic alignment of these other programmes with the Commission's five 'research missions' established for 2021-27. This is particularly important for the new programmes and instruments established in response to the Covid-19 crisis which have a strong innovative dimension, such as the Recovery and Resilience Facility, the EU4Health programme and the new 'Strategic European Investment window' of the InvestEU fund.

1. The multidisciplinary and cross-sectoral nature of innovation

Innovation can be defined as the adoption of new or improved products, processes or services that are put into use (commercially or non-commercially) and that create a valuable outcome for society (be it in the form of increases in firm competitiveness, improvements in the quality or scope of public services or capacity to address new challenges).² Thirty years ago, innovation was mostly seen as inventions arising from the research laboratory. Today we know that innovation is a somewhat complex and unpredictable process which can be generated almost everywhere, driven by exchanges of knowledge, skills and funds between different public and private actors. This complexity and unpredictability has been reinforced with the digitalisation of our economies and societies. Indeed, innovations are now faster, more bottom-up and less research-driven than in the past.³

Policies in support of innovation have also changed over time. It is now widely agreed that innovation must be encouraged via means other than traditional R&I. More attention is being given to promoting bottom-up experimentation and learning so as to nurture the innovation

2 A more precise definition of innovation is that provided by the OECD/ Eurostat Oslo Manual: "a new or improved product or process (or combination thereof) that differs significantly from the unit's previous products or processes and that has been made available to potential users (product) or brought into use by the unit (process)" (OECD/Eurostat, 2018, Oslo Manual: Guidelines for Collecting, Reporting and Using Data on Innovation).

3 European Commission, *Science, research and innovation performance of the EU, 2018: key findings*.

process through dynamic feedback loops. There is also more emphasis on non-technological forms of innovation and on actively promoting the dissemination of innovative solutions to a wider base of users. Finally, inspired by the work of Marianna Mazzucato,⁴ there has been a change in the way the role of the state is conceived in the field of innovation. Instead of limiting themselves to correcting market failures, states are now expected to take an active strategic role, steering public and private efforts to generate and disseminate innovations that are deemed crucial to attain key public objectives or 'missions' – e.g. moving towards a carbon-neutral economy or finding a Covid-19 vaccine. As such missions are broad and complex, a mission-oriented innovation policy requires a coordination of actions in different sectors and disciplines.

2. How the EU budget supports innovation

The EU level supports innovation in many different ways: by creating a more innovative-friendly regulatory framework, through soft measures such as guidance or indicators and by providing direct funding. If we look at the funding aspect, the most important EU budget programme providing support for innovation is the seven-year R&I framework programme (called 'Horizon 2020' in the 2014-2020 period). There are, however, many other programmes and funds in the EU budget providing support for innovation activities. The importance of these other programmes is non-negligible. A 2019 study conducted on behalf of the European Parliament⁵ estimates the total EU budget support for innovation during the period 2014-2020 at €152 bn. More than half of this support comes from programmes other than H2020.

Table 1. EU budget support for innovation in 2014–2020: summary of estimations

In billions of euros	H2020	ERDF	Other EU programmes	Total
Direct support for R&I projects, including close-to-market activities	46.1	0	17.7	63.8
Support for the dissemination of innovations	0	10.3	5.1	15.3
Support for innovative firms	3.3	19.6	0.6	23.5
Support for innovative partnerships, clusters and networks	2.6	8	0	10.6
Support for research infrastructure and skills	9.4	8.2	4.3	21.9
Unclassifiable	0.4	7.4	9.1	16.9
Total	61.8	53.5	36.7	152

Source: Rubio, E. et. al. (2019)

The largest support for innovation outside H2020 comes from the European Regional Development Fund (ERDF). According to the aforementioned 2019 study, the ERDF's support for innovation amounted to €53.5 bn in the period 2014–2020. This represents 27% of the total ERDF budget. An important part of this consists of support for innovative firms and R&I infrastructure under Thematic Objective 1 ('strengthening research, technological development and innovation'). However, the ERDF also plays an important role in promoting the dissemination of commercially-tested innovative solutions and technologies, such as the deployment of e-technologies and e-solutions in various sectors. Innovation support under ERDF has a strategic focus. Member States cannot invest ERDF funds under TO1 without having a national and/or regional smart spe-

cialisation strategy (RIS3) defining their strategic approach to innovation on the basis of the state or region's competitive advantages. However, there is no compulsion for RIS3 to be aligned with H2020 actions, not even with its thematic 'Societal Challenges' (which encapsulate DG Research's 'R&I missions').

Other EU programmes allocate €36.7 bn to various innovation actions. Some of them finance applied research in specific sectors (nuclear research in the case of ITER, space research in the case of Copernicus and Galileo). Others support the demonstration and commercialisation phase of innovative projects (e.g. NER300 for renewable energy sources, LIFE for climate and environment) or the set-up of bottom-up innovative partnerships (e.g. the Agricultural European Innovation Partnership operational groups financed by the European Agriculture Fund for Rural Development). Many of these programmes also provide support for the deployment of innovative solutions and technologies in certain areas, such as basic digital service solutions (Connecting Europe Facility – digital), smart grids, innovative storage projects, intelligent transport systems (Connecting Europe Facility – energy and transport) and e-health applications (EU Health programme). In most of the cases, innovation is a secondary or intermediate objective of the programme. As a result, investments in innovation actions lack a clear strategic focus. Illustrative of this is the fact that many programmes do not include mechanisms to evaluate the result of funded innovative actions or foresee mechanisms to coordinate them with H2020 actions.

Finally, a more recent source of EU innovation funding is the European Fund for Strategic Investments or EFSI (popularly known as the 'Juncker Fund'). This consists of an EU budget guarantee entrusted to the European Investment Bank (EIB) which allows the bank to provide concessional loans, guarantees or equity support to private investment projects or operations considered of strategic importance to the Union. According to EIB evaluations, the EFSI has already aimed to mobilise more than €520 bn of additional private investment in projects across the Union. Around a third of this additional investment has gone to projects labelled R&I. EFSI's support for innovation, however, may be larger. Many projects classified as 'energy' or 'transport' support the deployment of innovative technologies or solutions on a large scale or in new sectors or regions.

3. Synergies between different sources of EU innovation funding

As was seen in the previous section, other EU budget programmes providing support for innovation are roughly complementary to H2020 in their goals and intervention approaches. Rather than focusing on the promotion of worldwide breakthrough innovations, they support local-based incremental types of innovations. They also provide important support for the dissemination of innovations in specific policy fields. However, at the project level, synergies between H2020 and these various programmes could be better exploited.

For instance, H2020 support typically ends with the pre-commercial phase. Even if H2020 projects are excellent, there is a risk that some of them struggle to obtain enough private funding for the commercialisation phase. It therefore makes sense to ensure the take-up and deployment of H2020 projects through other EU budget programmes which focus precisely on later stages in the innovation process. At present, this role is only explicitly played by the digital pillar of the Connecting Europe Facility and the LIFE programme.⁶

Synergies between the two main EU sources of innovation funding, H2020 and ERDF, could also be improved. Over the last few years, various regulatory changes have been introduced for this purpose. It is now easier to combine ERDF and H2020 funding of the same project. New mechanisms have been created to facilitate ERDF's support for high-quality projects receiving good scores from H2020 but not being financed as a result of an insufficient H2020 call budget ('Seal of Excellence'). An initiative has been launched to promote the exchange of information and best practices between R&I stakeholders in different member states on how to better exploit complementarities between ERDF and H2020

6 CEF digital allocates funding for the deployment of basic digital service solutions (such as e-signature, e-identification and e-invoicing). DG connect and DG RTD coordinate their actions and in various cases CEF has been used to deploy digital solutions developed under pilot programmes with H2020 money. The LIFE programme provides funding to develop, test and demonstrate new policy or management approaches, best practices and solutions to tackle environmental and climate challenges. Projects receive higher points in the selection process if they are planning to take up the results of environmental and climate-related R&I projects financed by Horizon 2020 or previous EU R&I framework programmes. According to the H2020 interim report only 14% of the LIFE projects approved between 2014-2016 were linked to formerly H2020-funded activities.

actions ('Stairway to Excellence'). However, these mechanisms and rules have had limited effects, partly because of persisting regulatory differences that complicate the combination of H2020 and ERDF funds or do not provide sufficient incentives for ERDF managers to use the 'Seal of Excellence' label.

Another area in which there is potential for synergies is support for start-ups and SMEs working on areas of disruptive and breakthrough market-creating innovation. Since 2017, there has been a specific EU instrument for this called the 'European Innovation Council' (EIC). Established as a pilot project within H2020, the EIC provides tailored financial support and technical assistance to top-class innovative start-ups and SMEs. In particular, it provides grants and technical assistance for the early technology and pre-commercial stages (proof of concept, demonstration and pilot phase) and financial support – in the form of grants and equity – for the commercialisation phase. This second type of support, however, is limited to 1-2 years. Some firms may still struggle to be fully financed by private investors after this time. It would make sense to articulate EIC with the EFSI (or its successor, the InvestEU Fund) to help these companies attract additional private investment.

Finally, at the programming level, although these programmes are somewhat complementary to H2020, they are not designed as part of the efforts to tackle Horizon 2020's societal challenges. As a result, their contribution to meeting these challenges is sometimes weak or incidental. In some cases, they have run in clear contradiction to the vision set in the H2020 societal challenges. For instance, the relatively high amount of Connecting Europe Facility (CEF) funding in support of mature gas infrastructure is incoherent with both the vision set in the 2016 Communication on 'Accelerating Clean Energy Innovation' (ACEI) and the H2020's 'secure, clean and efficient energy' societal challenge.

4. Maximising innovation funding in the next MFF

At the time of writing this chapter, we still do not know what will be the final size of Horizon Europe, the next EU R&I framework programme covering the 2021-2027 period. In its amended MFF proposal of May 2020, the Commission proposed increasing the R&I programme by 27%, with most of the increase financed by the new post-Covid recovery instrument ('NextGenerationEU'). However, the agreement reached at the European summit of 20-23 July significantly reduced the ambition of Horizon Europe. Its budget is now fixed at €80.9 bn, which represents a mere 9% increase compared to Horizon2020. This number can still be challenged by the European Parliament but it is now clear that the EU's next R&I programme will be far less strengthened than initially expected. Against this backdrop, and taking into account the massive innovation needs stemming from the Covid-19 crisis, it will be very important to fully exploit synergies with other EU programmes.

The draft legislation governing the programmes in the 2021-2027 Multiannual Financial Framework (pending approval at the time of writing) put stronger emphasis on synergies. The proposed regulation for Horizon Europe, for instance, includes a specific annex outlining the possible synergies between Horizon Europe and around fifteen other EU programmes.⁷ This is a first for an EU research programme. There are also changes in the ERDF regulation to further incentivise the use of the 'Seal of Excellence' label⁸ and the pooling of ERDF and Horizon Europe resources has been made easier with the possibility offered to all Member States to transfer up to 5% of the financial allocations of any ESIF to any other fund or instrument (including Horizon Europe). However, the emphasis on synergies is less marked in other sectoral programmes. For instance, the need to promote synergies is mentioned in the preamble to the Connecting Europe Facility's draft regulation but nothing is said in the body of the regulation.

7 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CONSIL:ST_14298_2019_REV_1&from=EN

8 The draft regulation stipulates that projects awarded the 'Seal of Excellence' label will be funded by the ERDF keeping the (higher) co-financing rate of Horizon Europe. Besides, if the Seal of Excellence project is consistent with the region's smart specialisation strategy, it will not be subject to a second selection process.

The lack of specific synergy-enhancing rules is particularly worrying regarding the new Covid-19-related instruments and programmes (Table 2). Take the case of the Recovery and Resilience Facility, the instrument intended to support national post-Covid recovery plans. Article 22 of the Facility's draft regulation stipulates that the Commission and the Member States "shall, in a measure commensurate to their respective responsibilities, foster synergies and ensure effective coordination between the instruments established by this Regulation and other Union programmes and instruments." However, the Member States are not asked to detail how they plan to ensure such synergies in their draft national plans (art. 16). Another example is the new fifth window created under the InvestEU fund to support the Union's strategic value chains. This new window will finance *inter alia* "key enabling, transformative, green and digital technologies and game-changing innovations where the investment is strategically important for the Union's industrial future" (Art 7.1.e.4). The preamble mentions that particular synergies will be ensured between this fifth window and Horizon Europe "for follow-up investments in the scaling up of strategic EU start-ups and SMEs emerging from the European Innovation Council (EIC)." However, there are no specific rules or mechanisms to ensure this link.

Table 2. New Covid-19-related programmes providing support for innovation in the period 2021-2027

Name	Proposed size (European Council agreement of 21 July 2020)	Support for innovation	Potential synergies
Recovery and Resilience Facility (RRF)	€672.5 bn (of which 312.5 bn in the form of grants)	National Recovery and Resilience Plans can finance <i>inter alia</i> R&I actions (art. 3 draft RRF regulation)	Article 22 stipulates that the Commission and the Member States “shall, in a measure commensurate to their respective responsibilities, foster synergies and ensure effective coordination between the instruments established by this Regulation and other Union programmes and instruments.” However, Member States are not asked to detail how they plan to ensure such synergies in their draft national plans (art. 16).
New ‘Strategic European Investment window’ within the InvestEU Fund	€5.6 bn	Reinforcement of the InvestEU fund and creation of a fifth window aimed at supporting strategic value chains. This new window will finance <i>inter alia</i> “key enabling, transformative, green and digital technologies and game-changing innovations where the investment is strategically important for the Union’s industrial future” (art. 7.1.e.4).	The preamble mentions that particular synergies will be ensured between the ‘Strategic European Investment’ window and Horizon Europe “for follow-up investments in the scaling up of strategic EU start-ups and SMEs emerging from the European Innovation Council (EIC).” However, there are no specific rules in the regulation to ensure the link between EIC and the InvestEU fund.
EU4Health programme	€1.7 bn	One of the three general objectives of the programme is “to improve the availability in the Union of medicines, medical devices and other crisis relevant products, contribute to their affordability and support innovation” (art. 3.2.). Among the eligible actions listed in the annex of the regulation is support for clinical trials to speed up the development of and access to innovative medicines and vaccines and support the uptake of innovative tools and technologies in healthcare systems.	The preamble to the regulation acknowledges potential synergies with other EU programmes, particularly Horizon Europe (funding health research and clinical innovation) and ERDF (which also support the uptake, scale-up and deployment of innovative solutions in healthcare systems). The regulation includes a rule facilitating cumulative funding with other EU programmes to finance the same action (art 12).

Source: own elaboration

It is also important to reinforce the strategic alignment at the programming level. The different EU programmes providing support for innovation should be better coordinated in terms of their scope and clearly inspired by the five 'research missions' set by the Commission for 2021-2027. Mission objectives should give direction at the moment multi-annual programmes and calls are drafted so that in each stage of the innovation cycle projects aiming to contribute to a mission have clear possibilities to apply for EU financial support. The same is needed for EU financing instruments. Apart from the InvestEU fund, which has a broad scope and is demand-driven, there is a case for developing thematic instruments to support breakthrough innovations in key specific policy areas. At present there are two instruments of this type, supporting high-risk R&I projects in the areas of energy (InnovFin Energy Demonstration) and infectious diseases (InnovFin Infectious Diseases). According to the first evaluations, these two instruments have worked well. We can imagine the development of similar financial instruments to support innovation in other mission-related sectors.

Last but not least, a particular obstacle to maximising synergies is a lack of information. At present, many EU programmes with an innovative dimension do not have mechanisms to track the amounts allocated to support innovation. As a result, we do not have clear information to assess and improve the EU budget's role in supporting innovation. To resolve this, the Commission should explore the possibility of introducing an 'innovation tracking' methodology in the next MFF. This does not need to be as complex as the 'climate tracking methodology', which applies different weightings to funding activities on the basis of their expected impact on climate, but would provide some basic harmonised data on allocations supporting innovation. This would also require an introduction of reporting requirements in programming documents and interim evaluations so as to track the funding allocated to innovation.

5. Final remarks

The ongoing negotiation of the 2021-2027 EU long-term budget and recovery instrument will probably end up with a budget for the EU's next R&I programme far less strengthened than initially expected. However, massive investments in research and innovation will be needed to tackle the Covid health crisis and ensure an inclusive and sustainable recovery. Against this backdrop, it is essential to maximise the impact of Horizon Europe investments by better exploiting synergies with other EU programmes providing direct or indirect support for innovation. It is also essential that the five 'research missions' set by the Commission for 2021-2027 give direction at the moment the scope and priority actions of all the EU innovation programmes are defined so that in each stage of the innovation cycle projects aiming to contribute to a mission have clear possibilities to apply for EU financial support.

Strengths and Weaknesses of the EU Budget Flexibility ‘toolbox’¹

Magdalena Sapala

Abstract

The introduction of multiannual financial frameworks (MFFs) in 1988 improved the predictability of budgets and facilitated the development of multiannual spending programmes. However, they soon had to be balanced out with special flexibility measures allowing the EU to react to unexpected circumstances, be they natural disasters or economic crises or when there is a need to swiftly finance new political priorities. The flexibility ‘toolbox,’ which contains special mechanisms and instruments, has expanded with each following MFF. The development was triggered by increasingly frequent situations in which unexpected financial needs collided with the limitations of the agreed MFF ceilings. In particular, the experience of the implementation of the 2014-2020 MFF, including after the outbreak of the Covid-19 pandemic, has shown that without relevant flexibility mechanisms and without the possibility to revise the budget, achieving policy goals and reacting adequately to a number of unexpected events and crises would be impossible. It has also shown the limitations of the flexibility instruments currently available and the role of other elements in the EU budgetary architecture, such as the duration of MFFs, the levels of MFF ceilings and margins and the decision-making required to approve changes to the MFF. The flexibility of EU budgets has already featured as an important issue in the ongoing preparation of the 2021-2027 MFF and it may play a role in reaching a final agreement.

1 This paper derives from an in-depth analysis published in January 2020 by the European Parliamentary Research Service (EPRS) as background material to assist Members and staff of the European Parliament in their parliamentary work. ([https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_IDA\(2020\)646138](https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_IDA(2020)646138)). The content of the document is the sole responsibility of its author and any opinions expressed therein should not be taken to represent an official position of the European Parliament.

1. Striking a balance between stability and flexibility in the long-term EU budget

The flexibility of a multiannual financial plan is understood as a capacity to accommodate spending to finance actions when unexpected challenges and crises occur and when there is a need to change spending priorities. It is aimed at enabling objectives to be achieved efficiently and effectively. Most of the OECD countries use medium-term financial frameworks to plan their public finances and they apply various flexibility measures.²

This is also the case of the long-term budget of the European Union. The 1988 introduction of multiannual financial frameworks (MFF) improved financial predictability and facilitated the development of multiannual spending programmes, but soon had to be balanced with measures that would provide some flexibility and ability to react to unexpected situations. In the years that followed, striking a balance between predictability and flexibility in the long-term EU budget turned out to be both an indispensable and challenging task.

Although, due to the specific character of the EU budget, its flexibility tools differ from those applied at the national level,³ the definition of and reasons for a flexible approach to long-term financial planning are similar. In the context of the EU multiannual financial frameworks, budget flexibility should facilitate fulfilling the Union's obligations,⁴ effective resource allocation and swift responses to unforeseen circumstances and emergency situations.⁵ Experience shows that it also allows updating of the allocation of resources in line with new or changing priorities.⁶

2 OECD, *Budgeting and public expenditure in OECD countries 2019*, OECD Publishing, 2019.

3 For more, see: E. Rubio, *Benefits outweigh costs of flexibility in EU multiannual financial framework*, EPRS, European Parliament, 2020.

4 Recital 4 of Council Regulation No. 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020.

5 European Commission, *Proposal for a Council Regulation laying down the multiannual financial framework for 2021-2027*, Explanatory memorandum, COM(2018) 322 final.

6 P. Becker, *The EU budget and the MFF between flexibility and unity*, in *Features and challenges of the EU budget. A multidisciplinary analysis*, (ed.) L. Zamparini, U. Villani-Lubelli, Edward Elgar, 2019.

Flexibility instruments

Over the last 30 years, the flexibility toolbox available in the EU budget has developed into a complex system. It includes concrete instruments mobilised by the budgetary authority under specific circumstances. The instruments available under the 2014-2020 MFF differ in terms of their legal basis, aims, scope for intervention, the amounts available, the decision-making process and their interrelation with other instruments.⁷ Often they are presented in three groups: instruments maximising the use of margins, special flexibility instruments (outside the MFF) and legislative flexibility instruments (Figure 1).

The role of the instruments maximising the use of margins, such as the global margin for commitments, the global margin for payments and the contingency margin, is to enable transfers of commitments and payments between headings or unused appropriations between years. They facilitate the full use of the funds available and provide a possibility of financing unforeseen needs. They are budgetary neutral, meaning that they do not increase the overall need for commitments and payments over the entire financial period.

The special flexibility instruments, such as the Emergency Aid Reserve (EAR), the European Solidarity Fund (ESF), the European Globalisation Adjustment Fund (EGAF) and the Flexibility Instrument, are reserves outside the MFF. These instruments, known as 'instruments outside the MFF' are intended to allow additional commitments and corresponding payment appropriations to be entered into the budget 'over and above' the MFF ceilings, i.e. without a revision of the ceilings (which would require unanimity in Council).⁸ Three of them are thematic and support specific ad hoc needs that are not programmable and there-

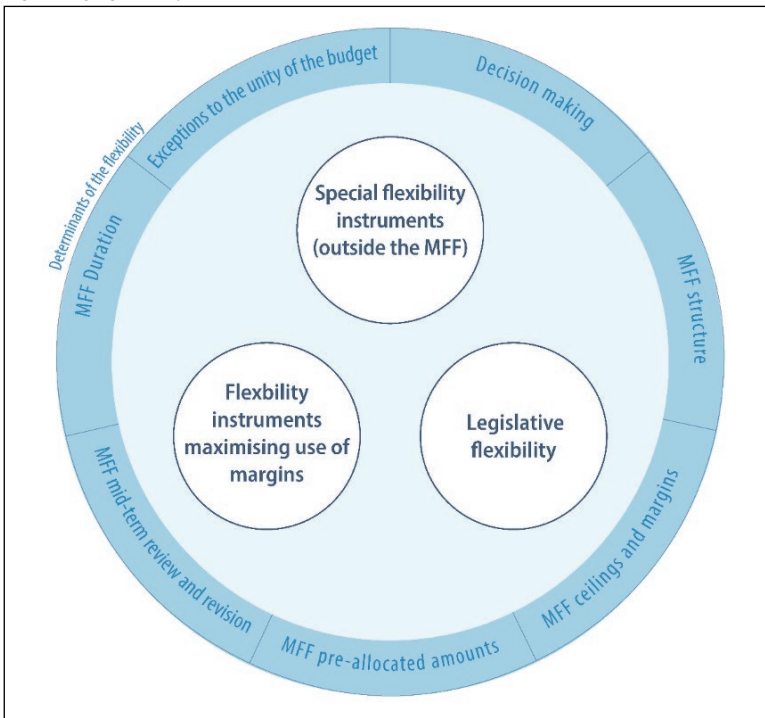
7 For a detailed overview, see M. Sapala, *How flexible is the EU budget?*, EPRS, European Parliament, 2020.

8 Since the beginning of the 2014-2020 MFF, the Parliament and the Council have diverged on their interpretations of the MFF Regulation concerning whether payments related to the use of the special instruments are entered within or outside the MFF ceilings. Article 3.2 of the MFF Regulation refers to commitment appropriations but does not mention how payment appropriations should be treated. Clarifying the treatment of payments is of crucial importance for the proper calculation of the payment ceiling – and to avoid another payment crisis. In the proposal for the 2021-2027 MFF, the Commission, siding with the Parliament, clarified that both commitments and payments resulting from the use of the special flexibility instruments should be counted over and above the MFF ceilings.

for their financing cannot be integrated in the MFF programmes and funds. One, the Flexibility Instrument, has a broader scope of action and addresses new or emerging situations that cannot be financed under the expenditure ceilings.

Finally, there are some mechanisms, usually referred to as 'legislative flexibility,' which include limited possibilities to modify the financial envelopes of multi-annual spending programmes (by up to a margin of 10% of the amount agreed for the entire duration of the programme concerned, except cohesion policy and large-scale programmes), options to re-programme EU funds or combine different sources of funding and financial instruments (loans, guarantees, equity and other risk-bearing instruments) envisaged in the basic acts on spending programmes and funds (for example under the Common Provisions Regulation for cohesion funds).

Figure 1. Flexibility instruments and determinants of them in the 2014-2020 MFF.



Source: EPRS.

Flexibility determinants

The above-mentioned instruments and mechanisms should be seen in the broader context of the functioning of the EU budget. Their functioning and usefulness is determined by important structural features of the EU budgetary system such as: the duration and structure of the MFF, the share of MFF resources pre-allocated to Member States, the size of unallocated margins, the level of ceilings, the decision-making necessary to mobilise the flexibility instruments, and to revise the MFF regulation. Last but not least, budgetary flexibility is linked to the principle of unity of the EU budget.

Duration of the MFF

Although according to the Treaty on the Functioning of the EU the MFF should cover a minimum of five years, in practice, with the exception of the first one (1988-1992), they have all covered seven years. This is longer than the practice in most OECD countries (including the EU Member States), where medium-term expenditure frameworks cover three to a maximum of five years.⁹ A longer duration usually implies an enhanced need for flexibility measures and for possibilities to adjust the framework in the course of its implementation via, for example, a mid-term review and revision.

The implementing programmes, including detailed spending goals and modalities, are usually also fixed for the period covered by the MFF, and therefore are more rigid and difficult to redefine if circumstances change. Moreover, the current MFF cycle is not synchronised with the political mandates of the European Parliament and the Commission. As a consequence, while during some legislative terms the institutions take this important budgetary decision, the implementation phase falls in the successive term. A study of the advantages and disadvantages of different options shows that, from the point of view of MFF responsiveness and EU spending effectiveness, the most desirable duration would be a period of five or ten years, with a substantial mid-term review, known as the '5+5' option. The feasibility of this solution would require ensuring sufficient flexibility by including relevant reserves, margins and special

⁹ Medium-term expenditure frameworks, in *Government at a glance 2013*, OECD 2013.

instruments.¹⁰ The European Parliament supports this idea and already called for a change during the negotiations on the 2014-2020 MFF. However, the European Commission again proposed that the next MFF should cover a seven-year period (2021-2027).

Structure of the MFF

The structure of the MFF, understood as a number of headings and the distribution of spending programmes between these headings, has an impact on flexibility. It has implications for the possibilities to re-allocate funds during the course of budget implementation and, as a result, for the efficiency of the budget. The flexibility is greater within headings than between headings. In practice, any changes to the agreed ceilings under headings require revision of the MFF regulation (and therefore unanimity in the Council), whereas transfers within headings can take place through the budgetary procedure (with the approval of the two arms of the budgetary authority). Therefore, reducing the number of headings can be a way to increase the scope for re-allocating resources between priorities while avoiding the need to renegotiate the MFF.

For the 2021-2027 MFF, the European Commission has proposed increasing the number of headings from 5 to 7, reducing the number of programmes from 58 to 37 and changing the distribution of programmes between headings. These changes make the MFF structure clearer and closer to the EU's priorities. By bringing fragmented funding resources together, the new structure may have some impact on flexibility. One potentially significant change in this regard concerns the budget for cohesion policy and consists in a proposal to merge funds under the European Social Fund+ and to ring-fence the allocation for economic, social and territorial cohesion under a sub-ceiling instead of a subheading.¹¹

Level of ceilings and margins

The ceilings set on the MFF and the EU own resources and the different

10 The Multiannual Financial Framework (MFF) and its duration, Directorate-General for Internal Policies, Policy Department for Budgetary Affairs, European Parliament, October 2017.

11 M. Sapała, Cohesion fund, values and economic and monetary union in the 2021-2027 MFF, EPRS, European Parliament, May 2019.

types of margins allowed to cover the risk of unexpected events are among the most important determinants of budgetary flexibility. One of the consequences of agreeing low ceilings is a need for more flexibility instruments, especially those counted over and above the MFF. Low ceilings combined with insufficient margins can substantially reduce the budget's ability to react to unforeseen circumstances and new needs. They create little room for manoeuvre in annual budgets to adjust and react to unplanned events, and can undermine the Union's ability to address future challenges. Moreover, they reduce the amounts possible to mobilise under these flexibility instruments, which are based on the unused margins, such as the global margin for commitments under the 2014-2020 MFF.

In the proposed 2021-2027 MFF, the margins left under the headings are, in general, higher than in the current MFF. The margins for spending in the areas which came under the greatest pressure in the 2014-2020 MFF, such as migration and border management, security and defence, are relatively high (6.6% of the heading allocation).

Pre-allocated spending

The share of EU spending pre-determined by 'amounts of reference' in co-decided legislation is currently about 80%. In other words, the bulk of EU expenditure, mostly concerning the budget for cohesion and agriculture policies, is pre-allocated to Member States and fixed for seven years in so-called financial envelopes.¹² This rigidity is only partially relaxed by the use of financial instruments and some legislative flexibility, which allows a maximum 10% deviation from programmes' overall financial envelopes decided in the legislative act. In practice, this means that the cost of necessary adjustments to the MFF usually falls in the remaining categories of expenditure, such as spending on research, youth, competitiveness or external actions. This was the case, for example, with setting up the EFSI. The financing of the EU budget contribution was ensured by the (temporary) use of margins and by redeployments from the Con-

¹² The envelopes include cohesion policy funds for European regions, allocations for the European Agricultural Fund for Rural Development, direct payments to farmers within the common agricultural policy, the European Maritime and Fisheries Fund, and the nuclear decommissioning assistance programme.

necting Europe Facility and Horizon 2020.¹³

As far as the proposal for the next MFF is concerned, the proportion of changes is in line with a trend that can be observed since 2006.¹⁴ Cuts in the areas of agricultural and cohesion policy, on the one hand, and increases in research and innovation and migration and border management, on the other, result in a drop in the share of pre-allocated amounts in the total MFF, i.e. fixed for seven years, to about 64%. In addition, the new provisions allowing for multi-annual spending programme financial envelopes to be modified within the same heading would increase from the current 10% to 15% of the amount agreed for the entire duration of the programme (with the exception of pre-allocated programmes and large-scale projects).¹⁵

Mid-term review and revision

The mid-term review and revision of an MFF can improve flexibility by providing an opportunity to redefine EU spending priorities and introduce changes necessary for a smooth and more realistic implementation of the MFF in the second part of the term. The practice has been gaining importance since the introduction of multiannual financial planning in the EU and was made compulsory in the 2014-2020 MFF regulation.¹⁶

However, whether the relevant procedure for revision of the MFF is triggered depends on the European Commission and a final decision requires a unanimous vote in the Council and the consent of the European Parliament. The process proved indispensable but challenging under the 2014-2020 MFF (see section 2). Based on this experience, and in line with recommendations of the OECD, the mid-term review should be maintained and its role should be enhanced in the next MFF. Spending reviews, already common practice in the budgets of the Member States,

13 A. D'Alfonso, *European Fund for Strategic Investments (EFI): set-up and EU budget contribution*, EPRS, European Parliament, 2015.

14 J. Haas, E. Rubio, P. Schneemelcher, *The MFF proposal: what's new, what's old, what's next?*, Jacques Delors Institute, 2018.

15 *Proposal for an Interinstitutional Agreement between the European Parliament, The Council and the Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management*, COM(2018) 323 final, Brussels, 2 May 2018.

16 M. Sapala, *Mid-term review of the Multiannual Financial Framework 2014-2020 - A round-up of key issues at stake*, *Perspectives on Federalism*, Vol 8, issue 2, 2016.

should be linked to it and made standard procedure. Moreover, it would allow better use to be made of performance and evaluation data and bring the EU budget closer to the model of performance-based budgeting.¹⁷

Decision-making

It goes without saying that rapid decision-making is necessary in emergencies, when the financial resources needed have to be made available without delay. Most of the flexibility instruments available under the 2014-2020 MFF regulation are mobilised jointly by the European Parliament and the Council as part of the annual budgetary procedure. However, any revision of the MFF, including of the ceilings, requires amendment of the 2014-2020 MFF regulation and therefore requires unanimity among the Member States and the consent of the European Parliament. Unanimity has proven difficult to achieve in the Council. One way to improve the process would be to use article 48(7) of the Treaty on the Functioning of the EU. This allows the European Council, via the 'passerelle clause,' to alter the threshold for Council decision-making on the MFF from unanimity to qualified majority voting. Changing the majority required may facilitate decision-making within the Council and allow greater room for negotiations with the Parliament.

Exceptions to the principle of unity on the EU budget

Despite the principle enshrined in Article 310 TFEU requiring that all revenues and expenditures of the EU have to be included in one EU budget, the current system of financing EU actions is ever more fragmented. Described as a 'budgetary galaxy,' the instruments created outside the EU budget at the intergovernmental level include budgetary items of different origin, type and purpose, including the European Development Fund, the Financial Stability Facility, the European Stability Mechanism and regional trust funds (e.g. the Madad Trust Fund and the Emergency Trust Fund for Africa), among others. An important reason for establishing such instruments outside the EU budget was a

17 Budgeting and performance in the European Union: A review by the OECD in the context of EU budget focused on results, OECD Journal on Budgeting Volume 2017/1.

lack of resources and sufficient flexibility available within the MFF.¹⁸ It has been a way to avoid the rigidity of the system in crises to date, but it is nevertheless a controversial solution that raises important questions regarding the fragmentation and differentiation of the EU budget system, and also regarding ensuring that robust accountability and rights of democratic scrutiny are in place.¹⁹

2. Flexibility instruments used under the 2014-2020 MFF

The flexibility toolbox available in the 2014-2020 MFF includes elements that were inherited from the previous multiannual frameworks, but also important new possibilities and mechanisms. They were introduced in the MFF regulation as a result of the negotiations, during which the European Parliament insisted on increased flexibility when confronted with the Council's position to set the MFF ceilings lower than in the previous period. The new instruments enable shifts of commitments and payments across MFF headings and years. Additionally, a major innovation is that, based on a compulsory mid-term review, the European Commission can propose a revision of the MFF regulation.

Already in the first years of the 2014-2020 programming period these instruments proved to be crucial for the realisation of the EU goals, but insufficient. The EU had to address a number of unexpected needs and new emerging priorities. Most of them were related to instability in the EU's neighbourhood, the migration crisis, security threats and the consequences of the financial and economic crisis. The resources available under the MFF's flexibility provisions played an important role in ensuring that the EU could react to these challenges despite the low MFF expenditure ceilings.

In each year of the 2014-2020 MFF, the budgetary authority has had to resort to the flexibility provisions in order to provide adequate financing for increasing needs (Figure 2). They were applied to finance actions under Heading 1a 'Competitiveness for growth and jobs,' Heading 1b 'Economic, social and territorial cohesion,' Heading 3 'Security and citizenship' and

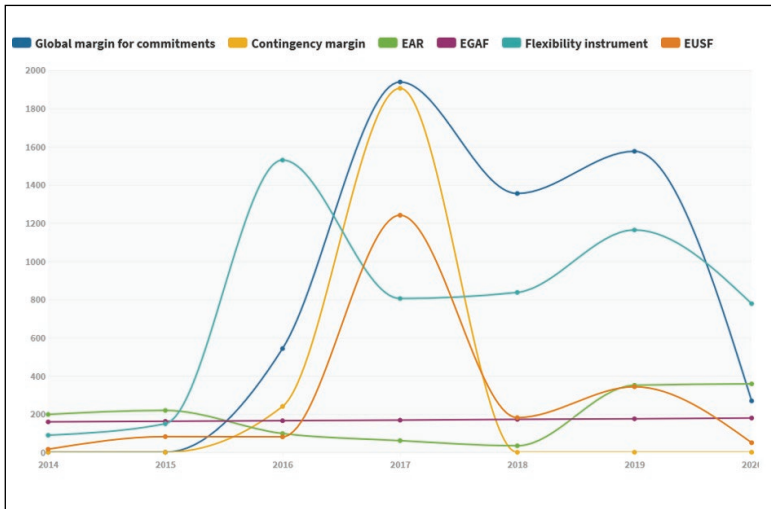
18 A. D'Alfonso, B. Immenkamp, EU Trust Funds for external action. First uses of a new tool, EPRS, [European Parliament](#), November 2015.

19 For more, see The next Multiannual Financial Framework (MFF) and the unity of EU budget, Directorate-General for Internal Policies, Policy Department for Budgetary Affairs, European Parliament, November 2017.

Heading 4 'Global Europe.' The programmes reinforced thanks to the different flexibility instruments include the European Fund for Strategic Investments (EFSI), Horizon 2020, Erasmus+, the Youth Employment Initiative (YEI), the Asylum, Migration and Integration Fund (AMIF), the Internal Security Fund (ISF), COSME (the programme for small and medium-sized enterprises) and the Connecting Europe Facility (CEF).²⁰

Most frequently, additional resources were aimed at providing adequate financing to address migration and security challenges under Heading 3. The scale of the gap between the planned and actual needs in this area can be illustrated by the fact that in 2017 almost 40% of the total envelope for the heading was financed with the flexibility instruments, a quarter in 2018 and 2019, and a fifth in 2020. To date, in total the budgetary authority has agreed to use €4.7 billion under the Flexibility Instrument and €1.4 billion under the Contingency Margin for this purpose.

Figure 2. The flexibility instruments mobilised in 2014-2020 (€ million).



The table does not include the flexibility instruments mobilised in 2020, i.e. after the outbreak of Covid-19.

Source: EPRS, based on the EU annual budgets 2014-2020.

The scale of the budgetary consequences of the new initiatives the EU had to undertake raised questions about the functioning of the MFF through to 2020 and led to a revision of the relevant MFF provisions in 2017.²¹ To ensure that the EU could react to unforeseen circumstances and challenges in the remaining years of the MFF, the flexibility instruments were reinforced and modified. The changes included: removing the cap on the global margin for payments for the years 2018-2020 to address possible pressure on payments in the final years of the MFF; increasing the resources of the Flexibility Instrument and the Emergency Aid Reserve to €1 billion (from €471 million) and €500 million (from €280 million) respectively (2011 prices) to address unexpected crises in the EU neighbourhood and their humanitarian and security implications; and removing the limitations (time and scope) in the global margin for commitments to increase EU support for objectives related to growth and employment, in particular young people, and other policy challenges.²²

The role of flexibility in the MFF increased even more during the crisis caused by Covid-19. In the moment of the outbreak of the pandemic in early spring 2020, the resources under relevant MFF headings (mostly Heading 3) were exhausted and there were no available margins or scope for redeployments. At this point, also almost all the amounts available under the MFF flexibility instruments had been used.²³ In April 2020, in order to provide urgently needed financial support for the health-care sectors in the Member States, the European Commission proposed mobilising all the still available amounts under the contingency margin, the flexibility instrument and the global margin for commitments. It was only able to use the latter after amending Article 14 of the MFF regulation and removing the limitations on the application of the instrument. All in all, in the first half of 2020 the EU budget provided, mostly through the use of flexibility instruments, an additional €4.4 billion to cope with the consequences of the coronavirus pandemic.²⁴

21 Council Regulation (EU, Euratom) 2017/1123 of 20 June 2017.

22 A. D'Alfonso, 2014-2020 Multiannual Financial Framework: Mid-term revision, EPRS, European Parliament, 2017.

23 For details, see Technical adjustment in respect of special instruments for 2020, European Commission, [COM\(2020\) 173](#), 2 April 2020.

24 Amending budgets 1 to 5 in the 2020 budget, including amending budget 4 on the mobilisation of the EU solidarity fund. For more, see M. Pari, The EU's 2020 budget: Response to the coronavirus pandemic, EPRS, [April 2020](#).

3. Conclusions

In a rapidly changing political and economic environment, successful multiannual financial planning has to include mechanisms allowing for the management of pressing financial needs resulting from unexpected circumstances, events and crises, or from new priorities occurring during the execution of the multiannual budget. This is also the case of the EU's multiannual financial frameworks.

The experience of implementing the 2014-2020 MFF demonstrates that without either the relevant flexibility mechanisms or the possibility of revising the MFF in the mid-term, achieving policy goals and reacting adequately to unexpected events and crises would be impossible. Each year, flexibility was helpful when there was a need to respond swiftly to unforeseen crises, and when there was a need to change spending priorities due to political or economic processes. This was particularly evident during the refugee and the Covid-19 crises. Furthermore, by creating possibilities to shift resources between years and programmes, the MFF flexibility allowed more efficient and effective resource allocation.

However, the usefulness and efficiency of the instruments set out in the MFF regulation, and therefore the level of budgetary flexibility or rigidity, depends on a number of additional aspects of the EU budgetary architecture. Among them, many significantly reduce and limit the EU's reactivity to unexpected challenges, for example the relatively long duration of the MFF, low annual commitment and payment ceilings, small margins left under the headings and the weaknesses of the mid-term review process. Last but not least, the unanimity requirement in the Council for revision of the MFF regulation hinders the decision-making process in cases when changes should be introduced swiftly. All these elements show the limitations of the flexibility currently available in the EU budget. These limitations, which encouraged the creation of extra budgetary instruments, such as the trust funds, have led to a more fragmented system for financing EU policies and actions, and raised questions about accountability and democratic scrutiny.

There are reasons, therefore, for a more agile structure of the next MFF giving the EU sufficient funding at short notice in a wide range of un-programmable situations. The issue was highlighted in the European Commission's initial and amended proposals for the 2021-2027

MFF²⁵ and in the European Parliament's negotiating position. Both institutions broadly agree when it comes to enhancing the MFF's flexibility. The Council, however, proposed changes to the flexibility provisions and amounts, which could result in a less agile MFF. Given the differences in the views of the main actors in the negotiations, this seemingly technical and marginal issue may again become one of the elements decided in the final stages of the process.

25 Based on experience with the limited but very useful flexibility instruments during the current MFF, in the revised proposal for the 2021-2027 MFF, the European Commission reinforced and extended the scope of this kind of emergency tool, which can be used to deal with unforeseen challenges. On top of the amount proposed back in May 2018 (€16.8 billion), the instruments would provide up to €21 billion of additional emergency financing over the 2021-2027 period. However, the Commission significantly reduced the margins left under all the headings except for the one dedicated to natural resources and environment, thus limiting the flexibility provided by the possibility to resort to these reserves in the event of unforeseen circumstances. See European Commission, The EU budget powering the recovery plan for Europe, [COM \(2020\) 422 final](#), 27 May 2020.

Innovation Investments for the Future

Leena Sarvaranta¹

Abstract

The corona virus has shaken Europe. The introduction and implementation of the EU Recovery Package, with new instruments and one-off measures, aims to get Europe back on its feet. The EU long-term budget, the 2021-2027 Multiannual Financial Framework, will contain a new set of policy areas ('headings') and EU policies will be implemented through a wide range of programmes and funds. Making sense of the complex landscape – and deciding on appropriate budgets under the new 'headings' – calls for a fresh mindset, a forward-looking approach and jointly agreed directionality. Monitoring progress will be equally important. Ahead of the final decisions on the EU's 2021-2027 MFF – and the EU Recovery Package – this paper is an attempt to analyse the opportunities, and some pitfalls, in terms of innovation investment. The huge investment needs and the complexities we are facing are not making policy implementation easy. It is important for the EU to have a coherent approach, which is set out in the European Green Deal. Therefore, we can expect there to be innovation mainstreaming in several policies. Conventional approaches that sometimes tend to place 'research & innovation' outside hard-core investment are no longer sufficient.

Taking a strategic direction - the European Green Deal will turn an urgent challenge into a unique opportunity

The European Commission published its proposal for the 2021-2027 Multiannual Financial Framework (MFF) in May 2018: "*A modern budget for a Union that protects, empowers and defends*" [1]. To respond to

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the economic and social fallout from the Covid-19 pandemic, the Commission proposed a revamped long-term EU budget in May 2020. The proposal includes an emergency recovery instrument, Next Generation EU, to help repair the immediate damage caused by the coronavirus pandemic and to kick-start the recovery [2, 3, 4, 5].

At the time of writing this article, no decision on the budget has not yet been made, but things have been moving at the political level. With its Communication on the Green Deal in December 2019, the new Commission set out a clear directionality which will affect all EU policies in the sense that deeply transformative policies will start to be implemented in the coming years [6,7]. The European Green Deal is an integral part of the von der Leyen Commission's strategy to adopt the United Nation's 2030 Agenda and meet the sustainable development goals. EU actions and policies will have to contribute to the Green Deal objectives. The Green Deal will make a consistent use of all policy levers: regulation and standardisation, investment and innovation, national reforms, dialogue with social partners and international cooperation.

The challenges are complex and interlinked. We need systemic transitions. More than ever, we need knowledge-based decision-making, but how can we secure it? Conventional short-term approaches will not be sufficient. Policy failure, governance failure and institutional resistance are real risks. Directionality, synergies and interoperability between policy design and various instruments will be crucial. How can the focus be kept on goals and transformation instead of obstinately trying to stick to existing tools and technical practices that may no longer serve the purpose?

The European Green Deal Investment Plan

The overall aim is to create the right regulatory incentives for green investments. An important impetus comes from the fact that the EU is examining how to integrate sustainability considerations in its financial policy framework in order to mobilise finance for sustainable growth. All three ESG components – environmental, social and governance – are integral parts of sustainable economic development and finance [8]. The Capital Markets Union with the Sustainable Financing Package [9] aims to create a level playing field in the EU by eliminating greenwashing (unsubstantiated or misleading claims about the sustainability character-

istics and benefits of an investment product). It aims to bring regulatory neutrality and rules for different financial market operators to apply in the same manner. The Taxonomy Regulation will be a key piece of legislation that will contribute to the European Green Deal by boosting private sector investment in green and sustainable projects [10].

The EU budget will be used to leverage private funds for green projects across Europe. In January 2020 the Commission presented the European Green Deal Investment Plan, which is expected to mobilise at least €1 trillion of sustainable investment over the next decade [11]. Part of the Green Deal investment plan, InvestEU, will leverage investments for (i) higher-risk projects in 2021-2030 financed by the European Investment Bank EIB and (ii) contribute to the Just Transition Mechanism, which is targeted at mobilising sustainable investments and a fair and just green transition in the regions [12].

State-aid modernisation [13] allows the Member States to quickly implement state aid that fosters green investment, economic growth and job creation, leaving the Commission to focus its state-aid control on the cases most liable to distort competition. More than 97% of all state-aid measures are already implemented by Member States without a need for prior approval by the Commission.

The Innovation and Modernisation funds, which are financed by the auctioning of carbon allowances under the EU Emissions Trading System, will provide some €25 billion for the EU transition to climate neutrality, depending on the carbon price, with a special focus on lower-income Member States in the case of the Modernisation Fund [14].

The EU budget powering the recovery plan for Europe

In 2018, the Commission proposed a long-term budget equal to 1.114% of EU 27 GNI (Gross National Income) – hence smaller compared to the MFF 2014-2020 – and clearly stated that if the EU budget was further reduced it would seriously make it difficult for the Union to deliver on its priorities [15]. The negotiations on the new EU budget were slow, and in February 2020 the corona virus changed everything.

The landscape is completely new. We are in a fundamentally different world compared to before and the EU needs to get back on its feet. Delivering the recovery plan will require collective resolution and massive

public and private investment. The total investment that could be generated by the EU Recovery Package measures amounts to € 3.1 trillion [3].

Next Generation EU, proposed by the Commission in May 2020 and agreed by the EU leaders in July 2020 is to be used to tackle the most crucial investment needs: to support Member States to recover and to kick-start the economy and private investment (Figure 1). The Commission proposes creating new tools. The extent to which innovation will be effectual and cross-cutting in temporary reinforcement investments is not yet clear.

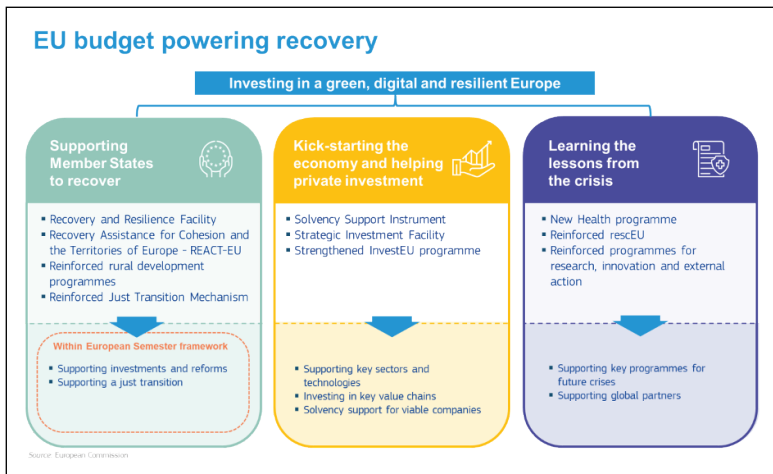
Figure 1. The proposal for the EU Recovery Package [3]. Size of 2021-2027 long-term budget was decreased to EUR 1074,3 billion as per the July 2020 European Council compromise. Amounts are expressed in constant 2018 prices.²

A budget for European recovery and resilience	
SURE / ESM Pandemic Crisis Support / EIB Guarantee Fund for Workers and Businesses	EUR 540 billion
Next Generation EU	Temporary reinforcement EUR 750 billion
Multiannual Financial Framework	EUR 1100 billion

2 The implementation of the EU Recovery Package is currently under negotiation. Therefore, any budget numbers presented in this paper are not necessarily accurate and are only suggestive.

The plan for European recovery and resilience is built on three main pillars (Figure 2).

Figure 2. Next Generation EU (EUR 750 billion) is a historic one-off proposal for an emergency European Recovery Instrument and is built on three pillars [3]. Recovery and Resilience Facility (EUR 672,5 billion) is the central part of Next Generation EU.



Innovation is mainstream in several policies and budget headings³

The key priority areas clearly representing investment for the future in the 2021-2027 MFF are Climate and Environmental Policy and Innovation & Competitiveness.

A 25% target for climate mainstreaming across all EU programmes in the next EU budget is important for Climate and Environmental Policy [6]. In addition, national budgets will play a key role in the transition. New own resources based on plastic packaging, an EU Emissions Trading System (ETS) and a carbon border adjustment mechanism will be directly linked to climate and environmental objectives [3].

The Commission also proposes to modernise Cohesion Policy, the

³ The next long-term budget for 2021-2027 is currently under negotiation. Some investment estimates are extrapolated to ten years, without prejudice to the final agreement. Therefore, any budget numbers presented in this paper are not necessarily accurate and are only suggestive.

EU's main investment policy and one of its most concrete expressions of solidarity [16]. As part of the European Green Deal investment plan in January 2020, to make sure that no region is left behind the Commission proposed establishing a new Just Transition Fund (JTF), originally equipped with fresh funds of €7.5 billion from the EU budget and on top of its 2018 proposal for the long-term budget [12]. In May 2020 in the new proposal the Commission proposed substantial additional funding for the JTF.⁴ The Commission will work with the Member States and regions to help them put in place territorial transition plans. There will be a thematic concentration of 'greener, low-carbon Europe' and CO₂ emissions, a higher climate target for agriculture and infrastructure spending and new and reinforced actions on renewables and clean energy. The EU budget framework provides predictability for planning and investing in relevant activities, including tangible and intangible investments.

To maintain competitiveness and to achieve the necessary transition in the EU economy, we need to pay attention to the directionality of RDI. It is high time to make the EU's 3% target of GDP investment in RDI a reality. An increase in funding for research, innovation and digital is necessary to enable Europe to keep up with its global competitors [17]. Europe's technological excellence and sovereignty will be the decisive strategic factors in tackling the crisis and ensuring its economic recovery, rebuilding its industrial competitiveness and safeguarding its long-term prosperity. The focus on the green and digital transitions is essential to strengthen Europe's strategic value chains and ecosystems, and to boost the resilience of our societies in the long run.

With EU private RDI investment reducing, strong commitments of public RDI investments at the EU, national and regional levels become critical and there needs to be a decent chance of pooling resources. Horizon Europe is the envelope for research and innovation at the EU level and its budget should be secured. Regional Smart Specialisation Strategies with thematic concentration requirements are place-based approaches in Cohesion Policy building on the assets and resources avail-

4 In the context of recovery from the coronavirus pandemic, an amended proposal on the Just Transition Fund (JTF) was published on 28 May 2020, increasingly the previously proposed JTF budget from €7.5 to €40 billion (in 2018 prices, with €10 billion under the core EU budget and €30 billion from Next Generation EU). The European Council cut the core budget part to €7.5 billion and Next Generation EU part to €10 billion in July 2020, while the European Parliament proposed an increase of the core budget resources to over €25 billion in September 2020.

able for the regions and Member States and embracing a broad view of innovation [18]. Among other things, they define an ex-ante conditionality for the ERDF investments in research and innovation, thus adding to directionality. The Digital Europe Programme targets the uptake of key digital technologies by European industry and public sector organisations [1]. This is crucial, in particular for artificial intelligence (AI), high performance computing (HPC) and cybersecurity.

Investment in research and innovation is essential for prosperity and sustainable progress. To this end, Horizon 2020, the framework programme for research and innovation in 2014-2020, aimed to maximise Union added value and impact, focusing on objectives and activities that cannot be efficiently realised by the Member States acting alone. With a budget of €77 billion, over the period 2014-20 Horizon 2020 has invested in research, science and innovation, which come under the budget heading 'Competitiveness for growth and jobs' and so is a core pillar of the Europe 2020 strategy (2014-2020). The Horizon 2020 budget represents about 7% of the EU's 2014-2020 Multiannual Financial Framework but the economic impact of the EU research and innovation budget is bigger than that, as "*one euro invested leads to multiple results*" [19].

In the three decades of their existence, the European Framework Programmes for Research and Innovation have shown a dynamic development from a technology focus to a challenge focus, and an evolution of budgets, instruments and modalities. They have managed to attract new participants and stakeholder groups too. An important feature is that FP participation and funding rules are harmonised at the EU level, unlike the Structural Funds, which are managed by the Member States.

Mobilising public and private investments

The need for investments, both tangible and intangible, is enormous. The EU's intention is to mobilise public investment and help unlock private funds through EU financial instruments. A range of funding schemes at the EU level can be mobilised. If this can be done in a coordinated way, there can be more leverage and impact. We could also expect this to 'de-risk' private investment in Europe.

There are a whole variety of financial instruments available. Directionality, synergies and interoperability between policy design and dif-

ferent instruments will be crucial. So far, we are not yet in a situation where the connections between various financial instruments are clearly identified. Moreover, the impacts of these instruments depend not only on their features, which vary across countries, but also on other policies in place. It is important to build linkages between Next Generation EU, Horizon Europe and the other programmes in the 2021-2027 MFF and the industrial and digital strategies in the Green Deal. It is worth noting that Member States have the possibility of transferring up to 5% of their cohesion funds to other EU programmes and Member States can earmark RDI investments in their recovery plans to achieve the targets set in the Green Deal and the digital transition.

Different policy instruments may reinforce and complement each other when implemented simultaneously but can also result in contradictions. Different policy instruments can also create excessive complexity, and implementing too many instruments easily results in confusion for target groups [20]. This can lead to increased operational difficulties and administrative costs.

A systemic approach and an engagement of the private and public sectors in large initiatives is key for Europe. Green Deal investments go beyond business as usual. Therefore, the EU needs broad-based innovation investments, both tangible and intangible. However, the sense of urgency and focus on broad-based systemic innovation seems to significantly vary among stakeholders.

How can we make the transition towards a digital and safe sustainable climate-neutral circular economy, and towards strategic access to raw materials and affordable energy? This transition presents a multitude of opportunities for Europe and requires urgent action and the implementation of an ambitious industrial strategy, including a vision of ecosystems with strategic value chains (SVCs) aiming at facilitating large-scale transnational innovation investments but also considering other actions needed [17]. These SVCs are interlinked and integrated industrial activities with great potential to contribute to Europe's green and digital transition and to improve its industrial competitiveness. IPCEI, a special mechanism under state-aid rules, is a way forward to structure and stimulate large-scale and innovation-driven industrial projects in Europe where the Member States can be part of co-financing large transnational projects of strategic importance [21].

Monitoring

There is consensus on a need for further analysis on a performance framework for innovation investments. There are now a fragmented set of monitoring reports. Some are good and some are less seriously compiled. A high number of key performance indicators (KPIs) have several disadvantages and problems with consolidation. It is nearly impossible to assess how well an individual policy instrument works. This situation is a systemic weakness.

KPIs and ‘impact’ too often get mixed. Return on innovation investment involves a complex relationship of inputs, activities, outputs, outcomes and impacts. Impacts are outcomes to be expected in the long term, such as institutional and societal changes, or the green transformation. Market impact, which is about economic outputs, is part of the story. It is related to societal or systemic impact, which is about many issues such as sectoral or innovation policies, or healthcare systems and education systems etc. There is a long way to go to measure KPIs in individual projects and consolidate them through a mission-driven portfolio up to the dynamic system level.

It is important for policy measures and investments to be designed and implemented in a way that allows appropriate target-setting and follow-up of achievement. The existence of a percentage objective will trigger increased monitoring, evaluation and reporting of climate-related expenditure at various levels (note that both mitigation and adaptation measures require considerable investment). It is becoming necessary to establish climate-related results indicators and harmonise the methodologies across funding instruments. For the purpose of climate mainstreaming, D’Alfonso [22] proposes setting up a development activity to achieve improvements in the methodology,⁵ including a reform of performance indicators, prevention of financial support for harmful measures and monitoring of the medium- to long-term impact of mainstreaming.

5 The European Commission has developed a methodology to track climate expenditure across the EU budget, adapting the ‘Rio Markers’ for climate that the OECD promotes to monitor and report relevant flows in development finance. The EU climate markers take the features of each EU policy area into account and divide its activities into three categories depending on whether they make a significant, moderate or insignificant contribution to climate objectives. For those classed as significant, 100% of their commitment appropriations are counted as climate finance, for those classified as moderate, 40% and for those classed as insignificant, 0%.

D'Alfonso also reflects on major project categories based on funding. Follow-up measures on EU programme subcategories are already underway, and it should be possible to follow-up national public/private subcategories as well. Implementation of the Sustainable Financing Package [8, 9] should gradually help the follow-up of private investment subcategories.

Concluding remarks

The transformation process is about balancing between conventional and innovative

Policy failure, governance failure and institutional resistance are real risks. Directionality, synergies and interoperability between policy design and various instruments will be crucial. We must pay attention to focusing on goals and transformation instead of obstinately trying to stick to existing tools and technical practices that may no longer serve the purpose. Constant dialogue is needed.

Building critical mass is about facing the devil in the details

'Synergies and pooling financial resources' has almost become a mantra. Positive steps have been taken to increase the funding available to meet the ambition of capital-intensive industrial projects [11]. The EU budget alone cannot be enough to meet the massive investment needs. Member States and private actors together will need to provide the scale. However, we still need to work on effective solutions to cumulate funding from different sources (EU, Member States, regions, private). Appropriate fitness checks for state-aid rules [8] play a crucial role in this respect.

Investment in innovation ecosystems gives Europe a competitive edge

The European innovation ecosystem is moving towards evolutionary and complex sub-systems and open innovation, and towards place-based innovation hubs where open-access technology infrastructure for demonstration, scaling up and collaboration within cross-sector public-private partnerships give the competitive edge. A recent analysis by the Euro-

pean Commission [23] suggests that there is a critical momentum for the EU together with the Member States to be more ambitious, with relevant national and regional stakeholders exploring a shared vision and jointly developing a European strategy for technology infrastructure to support industry scale-up and the diffusion of (green) technologies across Europe. Technology infrastructure requires high investment in the set-up, in keeping up with the state of the art and skills. Dedicated policies and budgets are currently lacking in many regions, and this should no longer remain a missing link when implementing the Green Deal.

Science, research and innovation are investments for future resilience

To make the green transition a reality, the magnitude of the investment challenge requires mobilising both the public and the private sectors, and it is important to understand that the EU needs broad-based innovation investments. Therefore, heavy investments in research and innovation are necessary to back up the 'right' industrial investment decisions and to deliver Next Generation EU. The Horizon Europe programme has a special instrumental value. The exceptional bearing of the EU's Framework Programme should not be reduced. Horizon Europe is the envelope for research and innovation at the EU level and its positive spill-over effects need to be better leveraged [24, 25]. It is also important to build linkages between Next Generation EU, Horizon Europe and other programmes in the 2021-2027 MFF and the industrial and digital strategies in the Green Deal. It is worth noting that Member States have the possibility of transferring up to 5% of their cohesion funds to other EU programmes and Member States can earmark RDI investments in their recovery plans to achieve the targets set in the Green Deal and the digital transition.

Appropriate follow-up of policy measures through appropriate monitoring

Currently, there are a fragmented set of monitoring reports. Some are good and some are less seriously compiled. A high number of KPIs have several disadvantages and problems with consolidation. A reform of performance indicators is needed to make better monitoring of the medium- to long-term impact of policy measures and investments. Directionality, synergies and interoperability between policy design and various instru-

ments will be crucial. So far, we are not yet in a situation where connections between different financial instruments can be seen clearly.

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An Innovative Financing Mechanism to Boost Sustainable Development¹

Carla Montesi²

Abstract

This paper focuses on the EU's contribution to reach the Sustainable Development Goals together with the Paris Agreement. Evaluation of these needs, especially in the post-Covid-19 period, encourages the EU to go beyond official development assistance and stimulate private capital to invest in sustainable development guaranteed with EU funds. The new Multiannual Financial Framework, complemented by Next Generation EU, offers a unique opportunity to boost sustainable investment in growth and job creation in developing countries. The paper highlights how pilot instruments in the current MFF will be improved and scaled up in the next financial framework.

Keywords: MFF, sustainable development, developing countries, private investment

Introduction

EU External Action: reshaping the framework for financing development

The international community's work to provide answers to today's global,

1 The views presented in this article are solely those of the Author and should not be attributed to the European Commission or any other institution, agency or body of the European Union.

2 Director, European Commission

complex, multidimensional and rapidly evolving challenges was crystallised in the 2030 Agenda for Sustainable Development and the Paris Agreement. The world set Sustainable Development Goals (SDGs), a blueprint to guide it towards a better future.³ Today we are within a decade of the timeline originally set to achieve the 17 SDGs and the aims of the Paris Agreement. A major challenge to reach these goals still remains: how to finance our efforts.

In its 2014 World Investment Report, the United Nations Conference on Trade and Development estimated that developing countries alone needed an additional USD 2.5 trillion annually to reach the SDGs.⁴ However, official OECD statistics show that in 2019 official development assistance (ODA) by member countries of the Development Assistance Committee (DAC) totalled only USD 152.8 billion.⁵ If we compare the amount of DAC ODA for 2019, USD 152.8 billion, to the additional funding needed to reach the SDGs, USD 2.5 trillion, we see that DAC ODA only scratches the surface of the colossal bill for the SDGs. What this back-of-the-envelope calculation indicates, and many more in-depth analyses confirm, is that ODA and other traditional forms of development assistance are not enough to provide the amount of financing needed to reach the SDGs.

When we compare the estimated cost of the SDGs to DAC ODA, we see a massive financing gap. However, if we compare the cost of the SDGs to other parameters, we understand that the cost, although high, is not astronomical. In its Quarterly Report for the 1st Quarter of 2020, BlackRock, the world's largest asset manager, reported managing USD 6.47 trillion of assets.⁶ Vanguard, the second largest asset manager, reports having "About \$6.2 trillion in global assets under management, as of Jan-

3 'Transforming our world: the 2030 Agenda for Sustainable Development' UN General Assembly Resolution 21 October 2015 https://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E

4 'World Investment Report 2014' UNCTAD https://unctad.org/en/PublicationsLibrary/wir2014_en.pdf

5 'ODA Detailed Summary' OECD, 16 April 2020: <http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2019-detailed-summary.pdf>

6 BlackRock Q1 2020 report, Quarterly Report Pursuant to Section 13 Or 15(D) of The Securities Exchange Act of 1934, United States Securities And Exchange Commission <http://d18rn0p25nwr6d.cloudfront.net/CIK-0001364742/5918de32-77bb-4569-8d7c-0b5e9fdedf4c.pdf>

uary 31, 2020.⁷ Although these are complicated metrics which should not be used flippantly, what they suggest is that we should ask ourselves how we can tap into different sources of financing to achieve climate goals and the SDGs while bringing important economic gains.⁸

The UN Roadmap for Financing the 2030 Agenda for Sustainable Development clearly states that “Financing for sustainable development is available, given the size, scale and level of sophistication of the global financial system.”⁹ The task is therefore to find a way to effectively channel this financing. The European Commission’s innovative financing mechanisms are an attempt to find additional sources of financing by looking at how we can use public resources to leverage funds from the private sector to get closer to our global objectives.

The EU and its Member States are already the biggest development aid donors in the world and the largest providers of public climate finance.¹⁰ EU funding accounts for over half of the total ODA provided to developing countries by the international community.¹¹ However, the point is that as a global leader in international cooperation we need to go beyond ODA.

For this purpose, the European Union is working to strengthen its intervention by building on a stronger and more responsive, efficient and flexible financial architecture capable of attracting external investments to fill the funding gap, both from within the EU and outside. EU development policy can help bridge the gap more fully and efficiently by boosting investments and mobilising private sector resources to foster sustainable growth and decent job creation.

Of course, it is important to mention that investment is just one of the

7 ‘Facts About Vanguard’ Vanguard <https://about.vanguard.com/who-we-are/fast-facts/>

8 New Climate Economy report 2018: shifting to a low-carbon economy could create a \$26 trillion growth opportunity and 65 million new jobs by 2030.

9 ‘Roadmap for Financing the 2030 Agenda for Sustainable Development – 2019 2021 - Executive Summary,’ United Nations Secretary-General https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/EXEC.SUM_SG-Roadmap-Financing-SDGs-July-2019.pdf

10 The EU and its member states remain the largest provider of public climate finance, providing up to €21.7 billion in 2018, Council Conclusions 8 November 2019 <https://data.consilium.europa.eu/doc/document/ST-13871-2019-INIT/en/pdf>

11 ‘The European Union remains world’s leading donor of Official Development Assistance with €75.2 billion in 2019’ European Commission Press Release, 16 April 2020 https://ec.europa.eu/commission/presscorner/detail/en/IP_20_674

tools in the EU's development policy. We should recall that these alternative financial instruments complement and go hand in hand with traditional development assistance, an area where the EU and its Member States are world leaders. In this sense, traditional collaboration with NGOs, Civil Society Organisations and other development players is still very much alive, but the 2030 deadline is approaching and the magnitude of the challenges exceeds the resources available.

The External Investment Plan: leveraging private finance for impact

To step up its action and leverage additional funds from the private sector, the EU has set up a flagship initiative in the form of the European External Investment Plan (EIP). Launched in 2017¹² and modelling the European Investment Plan, it is at the core of the Africa-Europe Alliance.¹³ The EIP has three complementing interconnected pillars and aims to mobilise sustainable public and private financing to boost economic and social development and decent job creation. It supports partner countries in the EU neighbourhood and sub-Saharan Africa through a system of three interconnected pillars:

- i. Pillar 1: the European Fund for Sustainable Development, which mobilises financing through blending and guarantees;
- ii. Pillar 2: technical assistance to authorities and companies to help them prepare and develop sustainable and financially viable projects;
- iii. Pillar 3: improving the investment climate by facilitating a structured public-private dialogue as a key element to develop a favourable investment environment.

This three-pillar approach is how the EIP acknowledges and addresses the fact that the problem for private sector engagement in these countries is not just a question of the financing mechanism but the realities the private sector faces when working in them. Fragile countries, least

12 EU External Investment Plan Official Website: https://ec.europa.eu/commission/eu-external-investment-plan/what-eus-external-investment-plan_en#abouttheplan

13 'Communication from the Commission to The European Parliament, the European Council and the Council - Communication on a new Africa – Europe Alliance for Sustainable Investment and Jobs: Taking our partnership for investment and jobs to the next level' Brussels, 12 September 2018 <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1537433689163&uri=CELEX:52018DC0643>

developed countries and DEVCO's partner countries are disproportionately over-represented in the lower ranking numbers of the World Bank Group's 'Doing Business' report.¹⁴ For this reason, dialogue with the local private sector, amelioration of the local investment climate and collaboration between the European and local private sectors are essential elements of the EIP.

From a financial perspective, the most innovative instrument is the use of guarantees in Pillar 1, the European Fund for Sustainable Development. The guarantees cover a variety of sectors and their objective is to leverage private-sector funds to maximise impacts on the SDGs and climate objectives. They are designed to find strategic investments which, with targeted funds, can leverage much larger investments.

An example of one of these guarantees is the African Energy Guarantee Facility, a €46 million guarantee agreement with the KfW Group. This guarantee identified a key limitation in the African energy sector, namely the constrained balance sheets of reinsurers in the region. With reinsurers not able to provide additional cover, insurance companies are in turn incapable of providing protection to investors ready to finance sustainable energy projects. By partially covering the offtake risks in renewable energy projects, the guarantee aims to provide more space for investors and investments in sustainable sources of energy. KfW is partnering up with Munich Re and the Africa Trade Insurance Agency, German and African insurance companies. These partnerships combined with the EFSD's EUR 46 million guarantee could unlock approximately EUR 700 million in additional investments.¹⁵

Another example of how guarantees use partnerships to leverage investments is the Africa Health Diagnostic Platform (AHDP). In this programme, the EIB uses the Commission's guarantee and collaborates with the Bill and Melinda Gates Foundation to reduce and remove financing constraints on health-related diagnostic services in sub-Sa-

14 'Doing Business 2020 - Comparing Business Regulation in 190 Economies,' World Bank Group <http://documents.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf>

15 'Africa-Europe Alliance: Four new financial guarantees worth €216 million signed under the EU External Investment Plan,' European Commission Press Release, 22 January 2020 https://ec.europa.eu/commission/news/africa-europe-alliance-four-new-financial-guarantees-worth-eu216-million-signed-under-eu-external-investment-plan-2020-jan-22-0_en

haran Africa.¹⁶ Testing laboratories exist in Africa but they often only provide a limited range of services of varying quality. Only reliable testing allows doctors to detect diseases early and countries to respond faster and better to outbreaks such as Covid-19. With this guarantee, poorer people in sub-Saharan Africa will have better access to higher quality testing, and more and better testing means better chances of proper treatment. This strategic intervention specifically in the diagnostics phase will lead to better and cheaper healthcare for people on low incomes. These guarantees are only two examples of the innovative products that guarantees can support and how they have the capacity to increase the overall amount of financing contributing to the SDGs.

Like all modalities and instruments, there are challenges and risks associated with the EFSD in general and the use of guarantees in particular. As one of the Commission's many development tools, it is vital that activities are well-integrated with other forms of support. However there are challenges in ensuring coherence and a strong drive for policy reform objectives.¹⁷ When using public money to work with and facilitate private-sector activities, a key challenge remains aligning public and private sector interests, with a risk of over-paying for impact and public sources unknowingly contributing to excessive private returns.¹⁸ In addition, using instruments to develop the private sector runs the risk of creating market distortions and the accompanying negative societal impacts.¹⁹ Aware of these risks and challenges, the Commission is improving the design of its interests to ensure readiness and flexibility in addressing these challenges.

16 'Bill Gates and EIB President Hoyer agree to accelerate support for human development and climate action' EIB Press Release, 9 October 2019 <https://www.eib.org/en/press/all/2019-259-bill-gates-and-eib-president-hoyer-agree-to-accelerate-support-for-human-development-and-climate-action>

17 'Implementation Report of the EFSD and the EFSD Guarantee Fund,' European Commission and BKP Development Research & Consulting GmbH, 14 January 2020 https://ec.europa.eu/commission/sites/beta-political/files/efsd-implem_report-external_support_study-final.pdf

18 Hovy, P. 'Aligning Public and Private Interests in a Public-Private Partnership: Safeguarding the public interest while allowing private returns,' International Institute for Sustainable Development and IMG Rebel, August 2015 <https://www.iisd.org/sites/default/files/publications/aligning-public-private-interests-in-ppp-discussion-paper.pdf>

19 Tewes-Grادل, et al. 'Minimising the Risk of Negative Market Distortions in Private Sector Engagement: A practical framework,' The Donor Committee for Enterprise Development, November 2018 https://www.enterprise-development.org/wp-content/uploads/DCED_Minimising-the-Risk-of-Market-Distortions-in-PSE_Practical-Framework.pdf

The original design of the EFSD aimed to build a flexible instrument capable of responding to the different realities in the multitude of our partner countries. This built-in flexibility is particularly useful when looking at how this instrument, and future ones, can respond to crises. This recently became salient when the EU was debating how to address the impacts of the Covid-19 pandemic.

As the Covid-19 pandemic and its socio-economic effects began to materialise, the European Union looked for ways in which it could provide support to its partner countries that were likely to be drastically hit by the pandemic. A United Nations University working paper suggests that due to Covid global poverty could increase for the first time in 30 years, erasing approximately a decade of the world's progress in reducing poverty.²⁰ The EU will use various instruments in its efforts to offset the economic impact of the pandemic through a coordinated 'Team Europe' approach²¹ but with the Green Deal and the Digital Agenda as the focus of our action to guide the recovery phase.²²

The EFSD quickly became part of the new 'Team Europe' proposal and the instrument was able to quickly re-calibrate its activities to provide support.²³ The EFSD will provide support to micro, small and medium-sized enterprises, lending to beneficiaries most likely to suffer from a lack of access to finance such as women and young people. It will provide financing programmes that support diagnostic medical services and provide small businesses with working capital and liquidity support, technical assistance, trade finance and local currency financing to enable them to withstand the impact of the pandemic.²⁴

20 Summer, A. et al. 'Estimates of the impact of Covid-19 on global poverty,' WIDER Working Paper 2020/43 <https://www.wider.unu.edu/publication/estimates-impact-covid-19-global-poverty>

21 Joint Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Communication on the Global EU response to Covid-19, Brussels, 8 April 2020 <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020JC0011&from=EN>

22 Europe's moment: Repair and Prepare for the Next <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1590732521013&uri=COM:2020:456:FIN>

23 Ibid.

24 'EU global response to coronavirus: supporting our partner countries - Factsheet,' European Commission, 8 April 2020 https://ec.europa.eu/commission/presscorner/detail/en/fs_20_607

Instruments for the future: the NDICI/EFSD+ in the new MFF

The Multiannual Financial Framework (MFF) for the period 2021-2027 represents an opportunity to rethink the current system to strengthen the impact of external investment instruments and build on European expertise and the progress made in key development areas. The European Commission is looking to increase collaboration and partnerships by ensuring that these financial tools are employed strategically and respond to identified political priorities, including climate change and environmental protection, with an increase in the target dedicated to climate action to at least 25%. To do this, the Commission proposed establishing the Neighbourhood, Development and International Cooperation Instrument (NDICI), a single instrument with increased resources and a global scope to ensure enhanced coordination and greater flexibility, including a European Fund for Sustainable Development Plus (EFSD+) and an External Action Guarantee, both of which are fundamental to implement the external dimension of the Green Deal.

In the original EU Commission Proposal, the External Action Guarantee will have a capacity of EUR 60 billion to provide guarantees, EUR 16 billion of which is under the EFSD+. The EFSD+ builds on the successful experience of the current EFSD²⁵ in raising and leveraging additional financial resources. The Commission has proposed going beyond the current area of activities of the EIP – the EU neighbourhood and sub-Saharan Africa – and going global with the use of innovative financial instruments.

For the implementation of the EFSD+, the Commission proposes continuing the successful ‘open financial architecture’ model, which means that it can draw on the expertise of development financial institutions such as the European Investment Bank and the European Bank for Reconstruction and Development and Member State development finance and multilateral development banks. So far, this has proven to be an effective strategy to maximise the leverage of EU funds and make full use of partners’ combined resources.

Guarantees are complex instruments which require the support and

25 ‘Report from the Commission to the European Parliament and the Council on the implementation of the European Fund for Sustainable Development’, European Commission, Brussels, 2 June 2020 <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1591201472899&uri=CELEX%3A52020DC0224>

cooperation of a variety of players. For this reason, when using guarantees a partnership approach to programming is especially important. In addition to the various roles of internal EU institutions such as the External Action Service and the Commission's policy officers, discussions with our partner countries define how we wish to work together to achieve our common goals. In addition, regarding instruments for the development of the private sector, the EU needs to use its delegations to engage in discussions with local private sector actors to understand the needs in our partner countries. Of course, our partner financial institutions which will then implement the guarantee programmes need to be part of the discussion as the instruments they are able to provide differ from region to region. Finally, discussions also need to include stakeholders such as civil society organisations, NGOs and other partners willing to work with us, as in the example of the Bill and Melinda Gates Foundation and the Africa Health Diagnostics Platform. To be as effective as possible, discussions and planning need to bring all these players together to see how everyone can participate in and contribute to these programmes.

The NDICI proposal builds on the current set-up to develop and orchestrate the right set of instruments. Evolving needs and changing priorities resulted in a variety of different tools and management structures which made it challenging for the EU to easily coordinate activities. By combining several tools in a single instrument, the NDICI, allows the EU to overcome potential gaps and avoid overlapping structures and inconsistencies that existed due to the multitude of instruments. More flexibility will enable the EU to react swiftly to evolving needs and deliver results following its working principles of development impact, policy coherence and effective coordination.²⁶

Although the NDICI is still under negotiation, the programming process is already taking place to ensure that when the instrument is accepted our programmes are ready to begin. To be able to better respond to development challenges when the design of the future framework is officially approved, we are already assessing the risks and opportunities in our partner countries, identifying EU and partner priorities in line with the new Commission's priorities and initiating conversations with

26 Wise Persons Group, Council of the European Union General Secretariat (2019) 'Europe in the World, The future of the European financial architecture for development, An independent report by the High-Level Group of Wise Persons on the European financial architecture for development' https://www.consilium.europa.eu/media/40967/efad-report_final.pdf

various stakeholders. With this increasingly coordinated response, we are strengthening the EU's global leadership by collaborating with a variety of partners to ultimately achieve the objectives of the world's global development agenda.

Conclusions

Ensuring continuity while innovating our systems – finance and sustainability

The attempt to drive a global transition to a sustainable, climate-neutral and resilient economy is a significant challenge for both the European Union and its partner countries. It requires a deep transformation of our societies and economies ensuring that no one is left behind. Integrated and inclusive institutional structures capable of maximising the mobilisation of investments quickly and efficiently to deliver results will be an essential ingredient along the road towards the SDGs and the Paris Agreement. The EU is mainstreaming sustainability in all its policies, with the new Commission's policy priorities, above all the Green Deal, already included in the recovery plan. Mobilising private investments to achieve objectives such as the Green Deal is crucial and a priority for the Commission as it looks to "direct private capital towards climate and environmental action."²⁷

Europe's development framework needs to combine instruments to deal with fragile and low-income countries while also mobilising domestic resources and facilitating private sustainable investments. The NDICI proposal submitted for the new multi-annual budget is designed to meet these needs and drive EU-coordinated action for the achievement of global objectives.

While this article is being written, the next Multiannual Financial Framework (MFF) for the 2021-2027 period is still being negotiated as in the aftermath of the Covid-19 crisis the Commission launched a new proposal for the budget and a new recovery instrument, 'Next Generation

27 'Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions – The European Green Deal,' Brussels, 11 December 2019 https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0002.02/DOC_1&format=PDF, p.2

EU' (NGEU).²⁸ This new budget proposal and recovery instrument for the next MFF allocates an additional EUR 16.5 billion for external action, and the additional funding will focus on the use of guarantees. Although the exact figures and the shape they will take are yet to be finalised, the adoption of the NGEU recovery instrument and the new NDICI, with its improved programming of resources, partnership approach and sound EFSD+ governance, will improve EU development action.²⁹

This next period presents a unique opportunity to focus on how to link finance to sustainability. The EU is leading global efforts towards a transparent financial system that supports sustainable growth in line with the Paris Agreement and other environmental objectives. To address the urgency and new ambitions set out in the Green Deal a **Renewed Strategy on Sustainable Finance** is currently under preparation. Among the fundamental tools, there is a proposal for a regulation on an EU-wide classification system, or 'taxonomy': a common classification system to encourage private investment in sustainable growth and contribute to a climate-neutral economy. It will provide businesses and investors with a common language to identify environmentally sustainable activities. The delegated act for the taxonomy for climate change mitigation and climate change adaptation will be established by the end of 2020 and four other environmental objectives will be incorporated by the end of 2021.³⁰ This classification will be a critical tool to provide guidelines for all stakeholders in the financial world – companies, investors, project promoters and issuers – on the rules on how to plan and report the transition to an economy that is consistent with our climate and environmental objectives. In our external actions, using tools such as the taxonomy will be fundamental in our promotion of financing that puts sustainability among its key priorities.

Concerns about sustainability are no longer exclusive to the public sector. Global investors are increasingly conscious of sustainability, so much so that leading names in the world of finance such as BlackRock,³¹

28 'Europe's moment: Repair and prepare for the next generation' European Commission Press Release, Brussels, 27 May 2020 https://ec.europa.eu/commission/presscorner/detail/en/ip_20_940

29 Wise Persons Group (2019).

30 <https://data.consilium.europa.eu/doc/document/ST-5639-2020-INIT/en/pdf>

31 Fink, L. 'A Fundamental Reshaping of Finance – 2020 Letters to CEO' 2020 <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

JP Morgan³² and Goldman Sachs³³ are increasingly vocal about it. The demand for climate-related disclosure has increased significantly, with, for example, over 370 investors with more than \$35 trillion in assets committed to strengthening their climate-related disclosures.³⁴ In addition, as a study by McKinsey shows, there is growing evidence that there are positive links between the financial performance of a company and its scores for environmental, social and governance (ESG) performance.³⁵ What all this indicates is that in development as in other areas the EU's capacity to find answers to today's challenges will not just be impacted by the final shape and size of this multiannual financial framework. It will also be impacted by our ability to work with the global financial system to channel funds in the direction of our policy objectives and to respond to the Covid-19 crisis with a greener, more sustainable and more inclusive recovery.

32 <https://institute.jpmorganchase.com/impact/sustainability>

33 <https://www.goldmansachs.com/what-we-do/sustainable-finance/>

34 Task Force on Climate-related disclosures March 2020 https://www.fsb-tcfd.org/wp-content/uploads/2020/03/TCFD_Booklet_FNL_Digital_March-2020.pdf

35 Gunnar Friede et al., "ESF and financial performance: Aggregated evidence from more than 2000 empirical studies," *Journal of Sustainable Finance Investment*, October 2015, Volume 5, Number 4, pp.210-33; Deutsche Asset and Wealth Management Investment; McKinsey analysis.

A Package Deal to Exit From Net Balances in the EU Budget

Giacomo Benedetto¹

Abstract

Reforming the EU budget so that it is more responsive to changing collective needs such as responding to pandemics or energy security while still securing minimum levels of solidarity to those sectors most in need depends on changing the means of financing the budget in the first place. This chapter evaluates the ingredients of a package to achieve such a reform. It does so by analysing what we know already about package deals in the EU in which the major actors are able to gain more than they lose. Next, it deconstructs the case for countries to use national net balances in calculating budgetary costs and benefits given that flows of funds at the EU level do not correspond to their distribution by country. High contribution burdens can be addressed by compensating for gross rather than net contributions, while new forms of revenue would avoid increasing the tax burden to finance the post-Covid-19 recovery plan and could deliver policy objectives in relation to combating challenges like climate change and transnational tax avoidance.

Introduction²

Every time a new multiannual financial framework (MFF) is negotiated, there is a call for the European Union (EU) to invest in new policies that provide added value. What does this mean? First, that EU investment is cost effective and that it is cheaper to run a single EU expenditure policy even in a policy such as agriculture than as 27 different national expenditure policies. Second, that there are cross-border benefits efficiently linking areas of opportunity between the Member States. Erasmus+, Horizon 2020 and the Connecting Europe framework are examples of this. Third, it is the ability to afford expensive investment in the collective good that any one Member State alone would not be able to afford. Examples include Galileo, the nuclear fusion ITER programme and the expenses associated with Covid-19.

These three types of added value are the basis for a reform of the budget. Added value always faces challenges from the Member States, which are concerned either to maximise their economic benefit or to minimise the cost to their treasuries. Faced with expenditure reductions, some Member States move to salvage their benefits from agriculture or cohesion expenditure. The predictable results from negotiating the MFFs in 2006 and 2013 were somewhat smaller budgets. They contained smaller increases in added value expenditure than was originally proposed and smaller reductions than anticipated in agriculture and cohesion expenditure against a backdrop of net balance or *juste retour* calculations by Member States. The question is how to break this logjam.

In 2013, the European Parliament accepted a package deal of expenditure reductions in exchange for significantly more flexibility in the budget, a full-scale review of the MFF in 2016-17 and the establishment of a High Level Group on Own Resources to investigate new sources of finance for the budget (Benedetto 2019).

This chapter focuses on the European Commission's 2020 proposal for the new MFF and the recovery plan, the challenge of net balances, funds and instruments outside the EU budget and possible reform packages.

2 This chapter is developed from a paper on package deals by the same author prepared for the European Parliament Research Service (Benedetto 2020). I am grateful to Marta Pilati for supplying the data for Table 2.

The Commission's proposals

In May 2018, the Commission made its first proposal for the post-2020 MFF, the first to take Brexit and the loss of the British contribution into account. It proposed a figure of 1.11% of gross national income (GNI), implying another cut close to the reductions that had occurred in 2013 and 2006.³ Part of the 'cost' of the British withdrawal was met by the Commission proposing some limited areas of new financing of the budget. No consensus was reached on the proposal in 2018 or 2019 and the non-decision was overtaken by the Covid-19 pandemic in 2020.

In May 2020, the Commission made a new proposal supplemented with a recovery plan worth €750bn over four years and named Next Generation EU (NGEU). Given the potential impact of NGEU, the size of the MFF proposed by the Commission was reduced from 1.11 to 1.08% GNI. In terms of planned expenditure, more was proposed for added value areas and less for cohesion and agriculture, as had also occurred in the 2006 and 2013 negotiations. Strategic investment (Table 1) included Connecting Europe and the Digital Europe Programme, whereas People and Values included the European Social Fund (investing in employability and previously part of cohesion) and Erasmus+. There were also some new budget priorities in response to the refugee and migration crises and for Covid-19 under Recovery and Resilience.

Table 1: The MFF proposal for 2021-2027 and NGEU 2021-2024 by policy cluster

Policy Cluster	MFF €mn, 2021-2027	% share	% change from last MFF	NGEU €mn, 2021-2024	MFF + NGEU €mn
1. Research & Innovation	87659	8.0	+26	13500	101159
2. Strategic Investment	30800	2.8	-3	56300	87100
3. Single Market	5832	0.5	+14	0	5832
4. Space	13437	1.2	+17	0	13437
5. Cohesion	237745	21.6	-13	50000	287745
6. Recovery and Resilience	18247	1.7	New	560000	578247
7. People and Values	116367	10.6	+1	0	116367
8. Agriculture and Maritime	340182	30.9	-13	15000	355182
9. Environment and Climate	15338	1.4	+339	30000	45338
10. Migration	12084	1.1	+68	0	12084
11. Border Management	17675	1.6	+222	0	17675
12. Security	4580	0.4	+33	0	4580
13. Defence	9500	0.9	New	0	9500
14. Crisis Response	4334	0.4	+255	9700	14034
15. External Action	89172	8.1	+5	15500	104672
16. Pre-accession assistance	12865	1.2	-1	0	12865
Administration	74602	6.8	+5	0	74602
Commitments	1100000		2	750000	18750000
GNI%	1.08				

Prices of 2018

Sources: European Commission (2020: 20); Parry and Sapala (2018: 21-24)

If it is agreed, NGEU is to be financed through debt raised on the financial markets repayable from 2028 until 2058. The repayment and interest will be financed through own resources, which will require an increase of 0.6% GNI. €500bn of NGEU will be spent through grants and €250bn will be provided in loans. More than €500bn is destined for Recovery and Resilience (cluster 6) until 2024, with smaller amounts allocated to strategic investment, cohesion and public goods, including crisis management.

The net balance challenge

The pervasiveness of net balance considerations prevents the budget from responding with agility to new challenges in domains such as migration, the climate crisis, energy security, regional stability in Europe's neighbourhood and Covid-19. Appealing to the collective interest is ineffective against the pressure that Council members face to deliver benefits to domestic audiences. It remains to be seen whether the NGEU recovery plan is part of a package deal that all can accept.

Heinemann *et al.* (2010) and Osterloh *et al.* (2009) propose solving the net balance approach through a mechanism that makes it explicit and accountable. Their generalised correction mechanism reforms and reinforces net balances. Each country's budgetary balance would be pre-established according to income per capita. Regardless of this, expenditure would take effect, after which rebates or extra contributions would follow. Certain EU priorities could be excluded from the calculations such as targeted cohesion payments and investment in types of added value.

This would be a transparent and accountable reform contingent on further institutionalising the net balance approach and assuming that the effect of all types of expenditure is equal apart from that excluded from the calculations. A presumed advantage is that it would free Member States from opposing new expenditure since they would no longer fear for their net balances, which would be guaranteed. One problem with this type of correction is that it assumes that all types of expenditure are of equal value regardless of their differing investment potentials or the non-financial benefits that may accrue, for example in medical research.

Instead, another solution is to confront the issue and show its flaws. The use of net balances disregards the cross-border and long-term

impact of EU policies, e.g. the benefits of economic integration, the value of which is hard to estimate (Benedetto 2012; Cipriani 2014; Haug *et al.* 2011). Securing the prospects of fellow Member States is not only a matter of solidarity but instead of securing stability and avoiding negative spill-overs. Taking into consideration the unforeseen refugee emergency of 2015-2016, energy security, tensions in Europe's neighbourhood and Covid-19, it is fair to ask whether Member States can ensure national security only through their own activities.

Expecting a net budgetary return from membership of international organisations is not the norm. It is usual to decide policies and then to finance them. Instead, for the EU the reverse is true. A rigid ceiling applies, with a legally binding commitment to disburse pre-allocated funds for agriculture and cohesion. The effect of investment in scientific research can be very different if advances in knowledge have knock-on effects besides the purely economic ones. To treat all EU expenditure as if its effects or value were equal is therefore flawed.

Meanwhile the budget's relevance has diminished. It is rigid and prone to veto (Benedetto 2013) due to net balance considerations. Sapir (2003) described it as a historic relic, with embedded obligations to finance agriculture (a consideration of the 1960s customs union) and cohesion (a consideration of the 1980s single market programme and enlargement to southern Europe). It has not adapted to meet public expectations and is constrained at 1.1% of GNI for political reasons – richer Member States do not accept growth in the budget. The EU has therefore innovated and created funds outside the budget. For example, the European Fund for Strategic Investments (EFSI), worth up to €500bn until 2020, and its successor InvestEU are backed by a guarantee from the EU budget, but generate private and public sector lending to invest in the economy.

While the budget has changed with the reduction in expenditure on agriculture and cohesion (still two-thirds of the budget between them), investment in 'competitiveness' grew from 9.2% of the commitments in the previous MFF (2007-2013) to 13.1% in the 2014-2020 MFF. This is due to grow in the post-2020 MFF but it will be divided between clusters 1, 2, 3, 4, 6, 7 and 9 (Table 1). Unlike agriculture and cohesion, investment in competitiveness is centrally managed and not pre-allocated. Unlike agriculture, it also requires co-funding at the local level. In other words, its share of the budget has gradually increased, it is not directly linked

to economic redistribution and it operates under different rules to the traditional policies.

Funds and instruments outside the budget

Table 2 shows that for the years 2014-2019, the latest estimate of the size of the EU budget is €926.8bn. During this period, Member State contributions to EU or Europe-wide funds associated with the budget or outside it amounted to €334.2bn. These comprised Member State payments for EFSI projects, EU trust funds in third countries, EU structural and investment funds and the Globalisation Adjustment Fund. They also included payments from the Member States to the European Development Fund, the European Stability Mechanism (ESM), the capital base of the European Investment Bank and the European Investment Fund. Concerning the ESM, the amount reported is not loans but capital paid in by the treasuries of the euro area countries. Together with the EU budget, it amounts to €1261bn.

A further €480.8bn is the value of what is leveraged through EU programmes. Putting this together with the EU budget and the Member State contributions takes us to a *de facto* budget of 1.88% GNI. Table 2 shows that the total size of operations would reach a maximum of 2.66% GNI in times of crisis until 2019 if the full capacity of the ESM were used.

Table 2: Breakdown of different EU operations as a percentage of EU GNI, 2014-2019

EUR Million		% EU GNI
EU GNI	91,420,500.00	-
EU Budget	926,783.30	1.01%
EU operations (EU Budget + MS contributions)	1,261,016.70	1.38%
EU operations (EU Budget + MS contributions + leveraged funding)	1,722,656.20	1.88%
EU operations in times of crisis (EU Budget + MS contributions + leveraged funding + ESM full capacity)	2,427,454.90	2.66%

Part of the leverage of EFSI and the full capacity of the ESM are based on loans, although they are guaranteed by public money. Whereas disputes on net balances in the EU budget focus on the 1% of GNI, which is the EU's *de jure* budget, the financing of which is easy to trace, they overlook the full value of financial flows at the European level. NGEU financed through the financial markets will further complicate the tracing of payers and beneficiaries as it would disperse grants, loans, repayments through own resources and interest earned by lenders.

A package deal for agreeing a new budget

For Lindner (2006, 171-2), package deals on the EU budget are easier when a previous package has started to break down. This was how an important reform of the budget was achieved in 1988 to replace that of 1970. By 1988, the Member States that had negotiated the 1970 agreement had seen their negotiating power reduced through three enlargements, the European Commission had linked reform to different subfields in the budget like the internal market and growth in cohesion, the status quo was becoming more costly and there was an inability to accommodate pressure for reform only through small changes. When the European Parliament (EP) faces a unanimous Council whose internal divisions almost undermine unanimity, it has an opportunity.

In 2013 when the 2014-2020 MFF was negotiated, the EP's push for budgetary flexibility, a legally-constrained review of the budget and a legally-enforceable investigation of new forms of revenue reflected the EP's preferences and won support from the Commission and some national governments. The result was the creation of new institutions [rules] for governing the new flexibility, review and revenue systems in the budget (Benedetto 2019).

Once the Council reaches internal agreement on the MFF, the EP can try to extract its price for approval. It can do this when the Council or its member governments are anxious to pass budgets or legislation quickly (Kardasheva 2013, 870). It is not just net receivers that want the money; the payers also want certainty and to have an agreement before anything is picked apart.

A reform of the budget that is an ambitious package will have to address both own resources (revenue) and expenditure. The 2020 pro-

posal updates the possibilities, which would cover no more than 20% of the budget's needs, and somewhat less if repayment of NGEU is to be financed through own resources. These comprise levies on non-recycled plastic and the Emissions Trading System, a Carbon Border Adjustment Mechanism, a digital tax and a single market levy for large corporations (European Commission 2020, 16). They stand the best chance of acceptance if they can fill an added value criterion, contributing to an EU policy as Pigovian or steering taxes (Pigou 2013[1920]). Pigovian taxes could discourage carbon use or transnational tax avoidance in a way consistent with EU policy.

The next tables illustrate different types of package deals on the financing side, based on the package deal methodology presented by Núñez Ferrer *et al.* (2016). Accepting them may make it easier to achieve a more flexible, agile budget. The tables assume that there are five Member States (A to E) of equal economic size, each contributing 20% to a pre-existing GNI-based own resource. Table 3 illustrates a non-controversial package deal involving a new own resource. State E contributes the largest amount of revenue from the new resource, and State A contributes the least. This could have a Pigovian effect on the newly taxed sector in all five states, and the residual to fund the budget is made equally in proportion to GNI.

Table 3: Non-controversial package deal

	State A	State B	State C	State D	State E
Original GNI contribution	20	20	20	20	20
New Own Resource	4	5	5	5	6
Residual GNI Resource	15	15	15	15	15
Total contribution	19	20	20	20	21

In the case of Table 4, State E finds the new tax unacceptable and negotiates an opt-out. The new tax can still be a real own resource in States A to D with Pigovian effects. State E pays the full contribution only via GNI. State A benefits from lower overall costs as its sectors are less affected by the new tax.

Table 4: Package deal with opt-out

	State A	State B	State C	State D	State E
Original GNI contribution	20	20	20	20	20
New Own Resource	4	5	5	5	-
Residual GNI Resource	15.2	15.2	15.2	15.2	20.2
Total contribution	19.2	20.2	20.2	20.2	20.2

In the case of Table 5, the only way to reach agreement on a new budget with new expenditure and new forms of revenue is to create a parallel budget outside the core budget. State E finds either the new revenue or expenditure to be unacceptable and does not take part. The new tax is raised in States A to D at different rates and may have Pigovian effects. It is then spent separately from the core budget but only in the participating states. Blankart and Koester (2012) designed a similar system and suggested that such a parallel budget should be characterised by a renewable sunset clause to reassure participants that their commitment would not be locked in. The danger with this package is that it threatens the unity of the budget. This would mean Member States may later question the legitimacy of other parts of the budget, which would risk being moved into funds and instruments outside the budget.

Table 5: Parallel budget

	State A	State B	State C	State D	State E
Original GNI contribution	20	20	20	20	20
Core budget	20	20	20	20	20
Parallel resource	4	5	5	6	-
Parallel budget	5	5	5	5	-

The package deal in Table 6 is one in which a new own resource excessively penalises State E, which takes part. In this case, a rebate of minus 5 on the gross contribution would be appropriate, regardless of levels of EU expenditure in State E. If the new tax is Pigovian, the rebate would need to be conditional on not cross-subsidising the affected policy area. The rebate would also need to be large enough to incentivise the participation of State E in the new resource, so it could be more than 5. Rather than name it a rebate, it could be a version of the recently proposed Just Transition Fund and take the form of supplementary EU expenditure.

Table 6: Package deal with new rebate

	State A	State B	State C	State D	State E
Original GNI contribution	20	20	20	20	20
New Own Resource	3	4	6	7	25
Residual GNI Resource	15	15	15	15	-5
Total contribution	18	19	21	22	20

Concluding Remarks

The current EU budget structure does not respond to new policy needs and is a prisoner of vetoes. The rigidity of the budget is in part related to the fact that Member States approach MFF negotiations with a net balance logic that fails to address four recent trends:

- Growth in the use of non-pre-allocated funds, the beneficiaries of which it is impossible to know in advance;
- Growth in funds and instruments outside the budget;
- Increasing fragmentation and complexity, which make accurate computation of net balances impossible;
- Unexpected demands for expenditure, typified by the migration crisis and Covid-19

Escape from net balances will reduce the need to create ad-hoc funds to overcome the lack of flexibility in the budget and will facilitate a package

deal that is less costly in financial and political terms than the status quo for all the actors around the table, addressing both expenditure and revenue. If it includes Next Generation EU, such a package will require non-state-based revenues that do not penalise those least able to pay. A strategy that results in providing goods like energy security, digital networks and pandemic alleviation through NGEU could be more acceptable to those economic sectors that will contribute more through new own resources, while offering continued benefits to the less prosperous.

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Innovative Options for a Sustainability-oriented Reform of the EU Own Resources System

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Abstract

The current system of own resources to finance the EU budget does not contribute to the overarching goal of sustainable growth and development in the EU. Therefore, the current own resources, which primarily consist of contributions by Member States, should be partially replaced by sustainability-oriented own resources. Such a reform would create space for Member States to reduce their tax burdens (particularly high taxes on labour) in a supranational sustainability-enhancing tax shift.

Candidate resources are taxes or levies that cannot be effectively enforced at the Member State level due to tax competition and avoidance and/or cross-border externalities, and that contribute to central European strategies and policies. A basket solution would be preferable, consisting of 'green' and other innovative own resources, so that potential negative effects on individual countries could be cancelled out to some degree.

We analyse several options for sustainability-oriented own resources and provide estimates of their potential revenues. These options include various green own resources (a carbon-based flight ticket tax, a border carbon adjustment for the EU emission trading system and a surcharge on national fuel taxes) particularly addressing environmental problems, and other candidates which could contribute to further dimensions of sustainability (a financial transactions tax, a net wealth tax and a CCCTB-

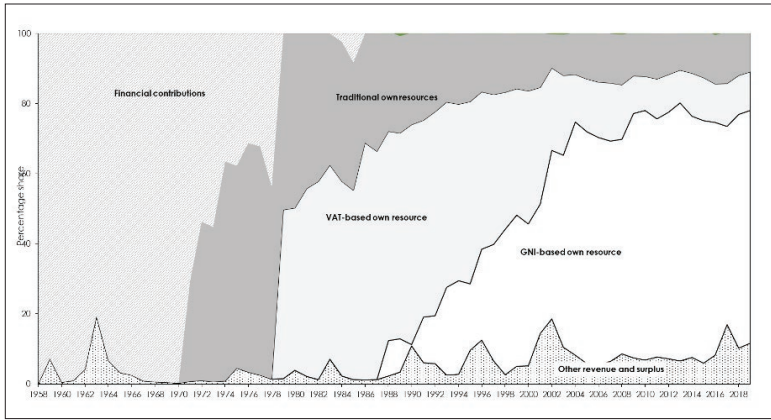
based own resource). We also discuss the candidates for innovative own resources suggested by the European Commission in its proposals for the next 2021-2027 MFF, namely a plastic-based contribution, a share in revenue from auctioning emission trading certificates and a CCCTB-based own resource. Based on a summary evaluation considering a number of sustainability criteria relevant to the assessment of own resources, we find that all the options considered are in principle well-suited candidates, while none can be identified as the ‘perfect’ candidate. We also analyse the legal basis of the various candidates for sustainability-oriented own resources and find that almost all the candidates could be introduced within the existing legal framework so that no Treaty changes would be required.

1. Introduction and background¹

The current negotiations on the European Union’s next Multiannual Financial Framework (MFF) for the period 2021 to 2027 focus not only on EU expenditure but also on the own resources system financing it. The EU budget primarily depends on contributions from Member States (VAT- and GNI-based own resources), whereas ‘true’ own resources have been continually losing importance over time. In 2019, VAT-based own resources accounted for 11 per cent of overall EU revenue and GNI-based own resources for 66.4 per cent, while traditional own resources contributed a rather small share of 13 per cent (figure 1).

1 The research leading to these results has received funding from the European Union’s Horizon 2020 research and innovation programme 2014-2020, grant agreement No. FairTax 649439. This paper is a slightly shortened and updated version of Schratzenstaller and Krenek (2019). The authors are indebted to Andrea Sutrich for careful research assistance.

Figure 1: Composition of EU revenues in a long-term perspective



Source: European Commission (Directorate-General Budget), 2020.

One central objection brought forward in particular by the European Commission and by the High Level Group on Own Resources (HLGOR) established to explore reform needs and options for the own resources system (HLGOR 2016) is the lack of a contribution by the own resources system to the various EU strategies and policies designed and implemented to cope with the manifold long-term challenges confronting the EU.

Against this background, the European Commission in its proposals for the 2021 to 2027 EU budget (European Commission 2018A, 2018B), the European Parliament and the HLGOR have called for the introduction of innovative own resources to partially substitute national contributions to the EU budget. Innovative own resources play a role in the compromise proposals issued by European Council President Charles Michel in February 2020 and July 2020. The proposal put forward by the European Commission for a European Covid-19 recovery instrument – Next Generation EU – also suggests using innovative own resources to finance the debt servicing of the debt-financed recovery measures (D’Alfonso et al. 2020). In the conclusions of the European Council meeting in July the European Commission was asked to elaborate proposals for own resources to be used to advance repayment of debt incurred to finance Next Generation EU. Altogether, the long-standing debate about reforming the EU own resources system has been revived by new impulses recently: First, the existence of new potential pan-European revenue sources that can be

exploited based on European cooperation only; and second, the need to repay the considerable amount of debt incurred by the EU to finance the European Covid-19 recovery instrument (Fuest and Pisani-Ferry 2020).

2. Evaluation of selected options for sustainability-oriented innovative own resources

Table 1 shows that the revenue potential of selected candidates for innovative own resources that we analysed in our research conducted within the H2020 EU project FairTax varies widely, ranging from €4 billion to €156 billion a year.

Table 1: Options for innovative own resources and potential revenue

Potential innovative own resource	Study	Reference year	Member States involved	Details	Potential revenue, billion €	Potential revenue, % of EU budget 2021
Carbon-based flight ticket tax	Krenek/Schratzenstaller (2017A)	2014	EU28	carbon price €25 to €35 per tonne of CO ₂ emissions	4 to 5	2 to 3
Border carbon adjustment for the EU Emission Trading System	Krenek/Sommer/Schratzenstaller (2020)	2021	EU28	carbon price €54 per tonne of carbon emissions embodied in imports	9 to 65	5 to 39
Surcharge on national fuel tax	Nerudová/Dobranschi/Solilová/Schratzenstaller (2018)	2014	EU28	€0.03 to €0.20 per litre of fuel	13 to 86	8 to 51
Net wealth tax	Krenek/Schratzenstaller (2018)	2014	EU20 (member states for which HFCS data are available)	1% on household net wealth above €1 million; 1.5% on household net wealth above €5 million	156	93

Financial transactions tax	Nerudová/Schratzenstaller/Solilová (2017)	2016	EU10 ('Coalition of the Willing')	0.1% on equity; 0.01% on derivatives	4 to 33	2 to 20
CCCTB-based own resource	Nerudová/Solilová (2019)	2014	EU28	1% of CCCTB	8	5

Source: Bachtröglger-Unger et al. (2020).

To illustrate their potential contribution to financing the EU budget, we relate potential revenues to the volume of the EU budget for 2021 according to the European Commission's 2018 proposal. A financial transactions tax based on conservative assumptions, a carbon-based flight ticket tax and a share of 1% of a CCCTB would not be able to provide a substantial contribution to EU revenue. However, a financial transactions tax estimated under less conservative assumptions, a net wealth tax, a border carbon adjustment for the EU ETS and a surcharge on national fuel tax rates could substitute significant shares of the current own resources.

Table 2 gives an overview of the results of a summary evaluation of our selected options for innovative own resources for the EU budget.

Table 2: Summary evaluation of candidates for sustainability-oriented innovative own resources

Potential innovative own resource	Carbon-based flight ticket tax	Border carbon adjustment	Surcharge on national fuel tax	Net wealth tax	Financial transactions tax	CCCTB
Growth friendliness	?	+	?	?	-	+
Sufficiency	?	?	?	+	+	?
Personal distribution of income and wealth	+	-	0	+	+	0
Environmental sustainability	+	+	+	0	0	0
Non-attributability	+	+	+	-	+	-
Short-term revenue stability	+	+	+	+	-	-
Fair national distribution	+	-	-	-	-	+
Non-enforceability	+	+	+	+	+	+
Fiscal integration	+	+	(+)	+	+	+
Non-interference	(+)	+	+	(+)	(+)	+
Visibility	+	-	+	+	-	-

Source: Krenek/Schatzenstaller (2019). Notes: + = positive contribution; - = negative contribution; 0 = neutral; ? = unclear/not known.

Overall, based on various sustainability-oriented evaluation criteria,² a carbon-based flight ticket tax and a net wealth tax are best suited among the potential options analysed here. A border carbon adjustment, a surcharge on national fuel taxes and a financial transactions tax also appear well suited, whereas a share of a CCCTB scores less well. The non-attributa-

² See Schatzenstaller and Krenek (2019) for details regarding these evaluation criteria.

bility criterion for tax revenue, which we consider particularly important to assess whether revenue from a specific candidate should be used to finance the EU budget³, is met by all the options with the exception of a net wealth tax and a share of a CCCTB. All the candidates would further European integration and most of them could not be effectively implemented at the national level.

3. Implementation aspects

3.1 Legal implementation aspects

First of all, any decision on new own resources has to comply with the own resource system in Article 311 (1) TFEU. Article 311 (3) TFEU sets down the procedure for implementing and changing the current form of own resources. A decision about changes in the existing own resource system not only requires the unanimous support of the Council after consulting the European Parliament but also the approval of national parliaments according to their constitutional requirements.

Moreover, tax-based own resources, based on the introduction or expansion of taxes across the EU, have to comply with the EU's tax competences, which are addressed in Articles 113, 115, 192 and 194 TFEU. New own resources may either be based on the provisions relevant to the harmonisation or approximation of national taxation necessary for the functioning of the internal market (Articles 113, 115 TFEU), or they may consist of fiscal measures introduced for environmental and energy purposes (Articles 192 (2) and 194 (3) TFEU). In a second step, a decision to use the revenue from harmonised or approximated taxes or from fiscal measures relevant to environmental or energy policy has to be based on an own resource decision according to Article 311 TFEU, as mentioned above.

All decisions to harmonise or to approximate national taxes or to introduce new taxes across the EU are subject to a special legislative procedure (Spangenberg, Mumford and Daly 2018; Weishaar 2018). This special legislative procedure requires the unanimous agreement of the European Council, while the European Parliament and the European Economic and Social Committee only have consultation rights.

3 See also Fuest and Pisani-Ferry (2020).

The legal basis of the EU own resources system

As mentioned above, the EU finances its budget exclusively with so-called 'own resources' on the basis of Articles 310 and 311 TFEU. This has two important implications (Waldhoff 2016; Spangenberg, Mumford and Daly 2018). First, the EU in principle is not allowed to incur debt. Second, it does not have genuine taxation rights in the sense of legislative and revenue competences (Kube 2017). However, own resource decisions based on Article 311 TFEU allow the introduction of new or different own resources, and therefore also tax-based own resources. Any decision to introduce tax-based own resources as new own resources would have to comply with the own resource rules in Article 311 (3) TFEU, as the provisions that allow for the harmonisation of existing taxes or the introduction of new taxes across the EU do not automatically include taxes for which the revenue competence lies with the EU.

3.1.2 The legal basis of innovative (tax-based) own resources

As mentioned above, the legal provisions governing innovative (tax-based) own resources include Articles 113 and 115 TFEU (referring to the harmonisation of direct taxes and the approximation of indirect taxes) and Articles 191 and 192 TFEU (referring to the introduction of environmentally-motivated fiscal revenue).

Article 113 TFEU confers a direct mandate on the EU to harmonise indirect taxes insofar as such harmonisation is necessary to guarantee the functioning of the internal market. This implies that the EU can adopt legislation which Member States are obliged to implement (Spangenberg, Mumford and Daly 2018). The harmonisation mandate only covers taxes already existing in EU Member States, which precludes the use of Article 113 TFEU as justification for the harmonised introduction of not yet existing new taxes in EU Member States (Buser 2013).

Unlike indirect taxes, the EU does not have an explicit mandate to harmonise direct taxes. The precondition for the EU to take the initiative with regard to harmonising direct taxes is imminent distortions of the internal market. In such cases, Article 115 TFEU permits the adoption of directives for the approximation of laws, regulations and administrative provisions of the Member States which directly affect the establishment

or functioning of the international market, which includes directives about direct taxes. These directives are to be implemented by the Member States and result in the harmonisation of national tax provisions across the Union (Kube, Reimer and Spengel 2016).

Articles 191, 192 and 194 TFEU constitute the legal basis for the EU to become active with regard to environmental and energy policy. Article 191 provides the EU with a mandate regarding initiatives aimed at “preserving, protecting and improving the quality of the environment.” According to Article 192 (2) TFEU, such initiatives can also include fiscal measures under the premise that their primary purpose is not the generation of revenue but the achievement of environmental goals (Spangenberg, Mumford and Daly 2018). Article 194 (3) provides a similar specific competence that permits the adoption of fiscal measures with a view to the objectives concerning energy policies in Article 194 (1) TFEU. In contrast to Article 113 TFEU, Articles 192 (2) and 194 (3) TFEU would permit the introduction of new taxes for environmental purposes, thus granting the EU legislative competence with regard to environmental taxes (Buser 2013). According to Waldhoff (2016), allocating the revenue from such environmentally-motivated fiscal measures to the EU budget should be possible if they do not constitute a primary revenue source.

3.2 Institutional implementation aspects

In principle, there are various design options for innovative (tax-based) own resources to finance the EU budget.⁴

Under a revenue-sharing system, both the EU and the Member States would participate in the revenue from a tax that would be fully harmonised across the Member States. As the tax would be introduced by the Member States, which would receive the revenue and transfer it (partially) to the EU, this implementation model can also be called a transfer system. Such a transfer system offers itself for innovative tax-based own resources depending on taxes which do not yet exist in any EU Member State and would therefore be additional to the already existing national taxes. It can also be applied to already existing taxes levied in only a few Member States. In this case, however, the agreement of these Member States to give up their claims to the revenue from the tax and, if necessary, to adjust the tax rate and/or the tax base to the harmonised design of the

4 See HLGOR (2016); Raddatz and Schick (2003).

tax agreed EU-wide would be required.

The surcharge system would only require the harmonisation of the tax base. The EU would then levy a surcharge in addition to the existing national tax rates, which would not be harmonised, and would receive the revenue from this surcharge. This is the appropriate model for taxes which already exist in all the EU Member States and are levied on an identical tax base.

The separation system would allow the EU to introduce a specific tax and to collect its revenue. In this case the EU would have legislative and revenue competencies.

Of these three models, both the transfer and the surcharge system would be compatible with the current EU Treaties. A separation system, which would require legislative and revenue competencies of the EU, is not possible within the existing EU legal framework (Waldhoff 2016).

3.3 Legal basis and institutional implementation of candidates for sustainability-oriented innovative (tax-based) own resources

In principle, all our candidates for innovative (tax-based) own resources should be permitted according to Article 311. Besides an own resource decision, their introduction would be based on the relevant harmonisation or approximation rules anchored in the TFEU, an overview of which is presented in Table 3.

Table 3: Legal basis of candidates for sustainability-oriented innovative own resources

Potential innovative own resource	Carbon-based flight ticket tax	Border carbon adjustment for the EU Emission Trading System	Surcharge on national fuel tax	Financial transactions tax	CCCTB-based own resource	Net wealth tax
Art. 113 TFEU	X	-	X	X	-	-
Art. 115 TFEU	-	-	-	-	X	-
Art. 192 (2) / 194 (3) TFEU	X	X	X	-	-	-
Implementation model	transfer system	transfer system	surcharge system	transfer system	surcharge system	transfer system

Source: Krenek/Schratzenstaller (2019).

The most obvious legal basis for an EU-wide *carbon-based flight ticket tax* is Articles 191 and 192 (2) TFEU. A mandate to introduce a harmonised flight ticket tax could also be based on Article 113 TFEU.

The legal basis for the Emission Trading System (ETS) itself is Article 192 TFEU. This provision should also permit the introduction of a *border carbon adjustment for the EU ETS*.

Article 113 TFEU is the legal basis for the EU Energy Tax Directive adopted in 2003, which also includes fuel taxes (Weishaar 2018). A *surcharge on national fuel taxes* should be permitted by Article 113 TFEU as well. Article 192 (2) TFEU may constitute an additional legal basis for a uniform surcharge on national fuel tax rates for environmental purposes.

The *financial transactions tax* was initiated by the European Commission (2011) based on Article 113 TFEU.

A *CCCTB-based own resource*, drawing on a harmonised corporate income tax base in the EU, would be based on Article 115 TFEU (Kube 2017).

An *EU-wide net wealth tax* is the only candidate analysed here that obviously does not have any legal basis in the EU Treaties.

4. Conclusions

Replacing current own resources partially with sustainability-oriented innovative (tax-based) own resources would contribute to sustainable growth and development in the EU. Green own resources would strengthen the contribution of the EU budget to the European Green Deal, the flagship project of the new European Commission agreed on in January 2020. Other innovative own resources – e.g. a CCCTB-based own resource or a financial transactions tax – would contribute to other important EU strategies. Therefore, the design of the EU system of own resources should be reformed more fundamentally than is currently discussed to exploit the considerable potential of innovative own resources.

In its proposals released in May 2018, the European Commission suggested the introduction of a plastic-based contribution of €0.80 per kilo of non-recycled plastic packaging waste and a 20% share of revenue from auctioning emission trading certificates. The introduction of a plastic-based contribution as of 2021 is also an element in the compromise proposals made by European Council President Michel in February 2020 and in July 2020, while his proposal that only revenue in excess of the average revenue from auctioning emission certificates between 2016 and 2018 is transferred into the EU budget waters down the original European Commission proposal. The introduction of a plastic-based own resource in 2021 to finance the MFF is part of the European Council conclusions of July. In principle both are suitable revenue sources. The plastic-based contribution is an obvious candidate due to the cross-border nature of plastic waste and fossil fuel use. It could curb plastic production and consumption, thus supporting a circular economy and decreasing carbon emissions, and its introduction would be possible without Treaty changes. Revenue from emission certificates is also an obvious candidate for own resources, as it stems from an EU-wide carbon pricing mechanism and also due to the cross-border nature of carbon emissions. This ETS-based own resource could be implemented without Treaty changes on the basis of Articles 192 and 194 TFEU. However, conflicts between Member States and the EU may arise about the revenue, which currently goes into MS budgets. This is obviously the reason for the modification of the original European Commission proposal in Michel's compromise proposal.

The EU Commission Next Generation EU proposal puts forward various options for innovative own resources: revenue from the auctioning off of ETS emission certificates, a common market levy for large multinationals, revenue from a border carbon adjustment mechanism, and a digital tax. Altogether, these could yield annual revenue between €26.3 billion and €35.3 billion, according to the European Commission. Michel's February 2020 proposal also suggests further evaluating innovative own resources during the 2021 to 2027 MFF period, mentioning a digital levy, levies on aviation and financial transactions, and revenue from a border carbon adjustment mechanism. In his July 2020 proposal, Michel invited the European Commission to put forward proposals for a border carbon adjustment mechanism and a digital levy next year. The Commission should also continue work on own resources based on the ETS and financial transactions (D'Alfonso et al. 2020). According to the European Council conclusions of July, the European Commission is to submit proposals on a border carbon adjustment mechanism and a digital levy in the first semester of 2021, aiming at their introduction by 2023 at the latest. Moreover, the European Commission is asked to put forward a proposal for a revised ETS scheme which may be extended to aviation and maritime. In addition, the Union should also consider other own resources, including a financial transactions tax, during the next MFF period. The revenue from these innovative own resources should be used to enable early repayment of Next Generation EU debt. While these potential new own resources are very promising candidates, as our research shows, their implementation should not be delayed further. Moreover, they should not only be used to finance debt servicing with Next Generation EU, but also be introduced permanently to substitute a substantial part of current own resources to finance the EU budget.

Of course, a central prerequisite for the implementation of innovative (tax-based) own resources is a parallel far-reaching shift in the EU's spending priorities (HLGOR 2016, Schratzenstaller 2017). Otherwise, the introduction of innovative (tax-based) own resources may instead reinforce Euroscepticism in the EU, as they are much more visible for EU citizens than the current revenue sources.

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The MFF 2021-2027: A Game Changer?

Alfredo De Feo

Abstract

On 21 July 2020 the European Council reached a political agreement on the Multiannual Financial Framework for the period 2021-2027 which includes an extra €750 bn (Next Generation EU) to be borrowed by the Commission and to be repaid starting from 2027.

This chapter discusses how these measures will change the approach of the MFF and whether they constitute a change in the construction of European integration. The chapter concludes with a recognition of the importance of the measures proposed but also focuses on some of their shortcomings.

Keywords: MFF, Next Generation EU, EU budget negotiations, Own Resources, EU reform, financial instruments, Flexibility, Conditionality.

Background

The unimagined and unforeseen spread of Covid-19 suddenly showed the fragility of nations, the vulnerability of their health systems worldwide and the limits of the lifestyle which we have proudly built up during recent decades. Many have defined this crisis as biblical and comparable to a war. In addition, it has produced the collapse of a large part of the economies of many countries, including those of the EU Member States.

The Commission's decision to put forward a new MFF proposal to relaunch the European economies with the ambitious top-up of the Next

Generation EU programme has improved the EU's capacity to react to serious events which might threaten its resilience.

The fact that the European Council decided unanimously less than two months after the proposal is another sign of the exceptionality and seriousness of the situation, and also of the capacity of the Member States to react with unprecedented measures to new challenges. It is irrelevant to discuss whether the Member States agreed out of pure solidarity or in the conviction that the European economies are too interlinked and that collapses of some of them could have a heavy impact on all the EU Member States. This political agreement marks an important step in the European integration process.

The crisis in Europe

Europe did not need a virus to be in crisis. Crises of variable magnitudes are recurrent in Europe but they have always been solved with small or big compromises. In some cases the compromises reached have produced a slowdown in the integration process (e.g. the Luxembourg compromise in 1965); in others an acceleration (e.g. the crisis in the mid-1980s with the launch of the single market).

The crisis in Europe also has a geopolitical dimension, which contributes to destabilisation of the European project:

- a. The American policy inaugurated by President Trump has somehow legitimated the political forces actively engaged in breaking up the EU.
- b. The Chinese strategy to expand its influence all over the world, starting with developing countries and using its commercial power and its technological capacity to penetrate western countries.
- c. Last, but not least, Russia's external policy, which is aggressive with neighbouring countries and makes Russia increasingly present in the Middle East.

In addition, the United Kingdom's decision to leave the EU has been another element of destabilisation. Apart from its motivations, this decision has de facto paralysed the European institutions for a good part of the last five years.

The unstable situation and the EU's difficulty in offering its citizens convincing responses to the different crises have favoured a growing disappointment among the part of public opinion that has been attracted to nationalistic responses to transnational challenges.

Just as Delors's proposals in the 80s gave a new impetus against European stagnation producing an acceleration of European integration, Von der Leyen's proposals of May 2020 and the European Council's decisions of 21 July have the potential to shape a new dimension of European integration.

The supranational challenges

The last decade saw the development of a number of transnational challenges, to which responses by individual Member States are certainly less efficient than a global EU response. Climate change, the environment, energy, the management of migration, European defence and the geopolitical situation are all areas where a common or coordinated European policy would be more efficient than individual positions.

Covid-19, which spread all over the world with no respect for administrative borders, added a new challenge for which no one was ready to assume collective responsibility or leadership. The virus started in the world as a Chinese problem and in Europe as an Italian problem but little by little all countries had to face the same problem with hospitals not equipped to receive the many in need of intense treatment and, even worse, cemeteries not ready to bury in a dignified manner people who had died from the virus.

Health systems are an exclusive national competence but in all countries people and politicians, including nationalists, have turned to Europe to have some indication and support. Covid-19 became an additional transnational challenge.

If health systems are a national responsibility, after several weeks of worldwide lockdown it appeared that the economic consequences of the lockdown would affect most economic activities in all the European countries with devastating social consequences and a potential destruction of the single market: a symmetric shock but with asymmetric consequences. A strong appeal was made to Europe to act.

European finances

Before describing what Europe did we should remember that the EU has no fiscal capacity of its own, and 85% of its financial firepower comes from transfers that the Member States make to the EU budget in proportion to their GNI. Only 15% derives from taxes (import duties and levies, and a percentage of VAT). The EU Treaty does not allow the EU to borrow to finance its budget.¹

In spite of the ceiling being set at 1.23% of GNI, in the last twenty years the EU budget has always been around 1%, which has limited its impact on the real economy.

In the last decade, a growing part of the budget has been used to guarantee the EIB, which has leveraged financial funds on capital markets and then offered them as loans to private and public companies to pursue EU priorities. This has allowed an increase in the financial capacity of the EU budget but at the same time caused a reduction in its capacity for direct public spending. The European Fund for Strategic Investment (EFSI, better known as the Juncker plan) has been the most important of these financial tools. The Fund aims to unlock investments of about €500 bn, an amount much higher than the EU budget capacity, with a guarantee of €33.5 bn² and the EIB in the driving seat.

The Multiannual Financial Framework (MFF)

Since 1988 financial planning has represented the topical moment for the Member States to define the direction for the years to come. In 2009, the planning was embedded in the Lisbon Treaty and assumed a more important role.

In February 2018 the Juncker Commission presented its proposals but failed to have them approved before the end of its mandate. Therefore, the new Von der Leyen Commission had a great opportunity to reshape the 2018 proposals and adapt them to new priorities: the European Green Deal, an enhancement of digitalisation, promotion of the European way of life, a stronger Europe in the world and a reinforcing of

1 Principle of equilibrium, art. 311 TFEU and art. 17 Financial Regulation.

2 €26bn of the guarantee to the EFSI is given by the EU budget and €7.5 bn by the EIB's own capital.

European democracy. This opportunity was missed. The Council's presidency actively worked to find a compromise. A first attempt in December 2019 by the Finnish Presidency was rejected and a second attempt in February 2020 by Charles Michel, President of the European Council, did not receive the support of all the Member States.

The Commission's reaction to Covid-19

A few weeks later, the spread of Covid-19 in Europe completely changed the scene. The business as usual approach followed by the VdL Commission until the end of February was no longer sustainable. The single market was in danger and the interlinkage among the EU economies threatened supply chains across the Member States, making all of them more vulnerable.

The leadership assumed by Macron and Merkel, proposing a €500 bn plan in grants to support the economies most affected by the pandemic and less resilient to economic crisis, obliged the European leaders to give serious consideration to this proposal and paved the way for the Commission's proposals of May 2020.

The Economic impact

In May 2020, the economic forecast predicted a drop of 7½% in the EU economy in 2020 and then growth in 2021 of about 6%. The shock to the EU economy has been across the board, but neither the drop in output (from -4¼% in Poland to -9¾% in Greece) nor the forecast strength of the rebound in 2021 is the same for the different Member States. The economic recovery of individual Member States will depend not only on the evolution of the pandemic but also on the resilience and structure of their economies and their capacities to respond with stabilising policies. At the same time, the interdependence of the EU economies and the dynamics of the recovery in each Member State will also affect the strength of the recovery in other Member States. The ECB forecast is even more negative for the eurozone, with a fall in GDP expected to be around -12%.³

3 Economic Bulletin ECB May 2020 <https://www.ecb.europa.eu/pub/pdf/mobu/mb201405en.pdf>

The Commission decided to act at two levels: an immediate response and a medium-term one.

The first EU measures to respond to the crisis

Several measures have been taken by the EU institutions to offer a rapid response to the Covid-19 crisis:

- Making the implementation of EU rules more flexible with a suspension of the rigid rules in the Stability pact, allowing national budgets to support their economy without respecting the limit on public debts;
- Suspending the rules concerning state aid to facilitate public support for companies;
- Increasing ECB support for monetary policy to increase the liquidity of the Member States through the Pandemic Emergency Purchase Programme (PEPP);
- Increasing the flexibility of the EU budget allowing the Member States to revise priorities and abandon national co-financing;
- Already in the 2020 budget reinforcing the EU's civil protection mechanism (€128 m), and introducing a Coronavirus Response Investment Initiative;

Supplementary measures, for a total amount of €540 bn, have been taken, notably:

- Creating an instrument to mitigate unemployment risks in an emergency (SURE). This new instrument offers Member States the possibility of financing up to €100 bn in loans to cover the costs directly related to the creation or extension of national short-time work schemes;
- Creating specific ESM pandemic crisis support (240 bn) available to all euro area Member States with standardised terms agreed in advance by the ESM governing bodies;
- Launching by the EIB of a pan-European guarantee fund (EGF) to tackle the economic consequences of the Covid-19 pandemic. The Fund will allow the EIB Group to scale up its support mostly for small and medium-sized European companies, providing up to €200 bn of additional financing.

The 2021 MFF and European Recovery plan

On 27 May the Commission presented a revision of the proposal for the 2021 MFF complemented with a new innovative proposal for Next Generation EU. In a nutshell, the proposal foresees a MFF of €1,100 bn⁴ (1.11% GNI). This proposal is topped up with €750 bn to be borrowed by the Commission on capital markets. The total amount of €1,850 bn will represent 1.4% of EU GNI.

The structure

The architecture proposed by the Commission is relatively simple:

- It complements the traditional MFF with Next Generation EU to the amount of €750 bn, which the Commission should collect on the capital markets and redistribute to the Member States.
- It revises the own resources decision, authorising the Commission to borrow €750 bn (0.6% GNI) on the financial markets. This authorisation is strictly linked to the response to Covid-19.
- It maintains all the new proposals under the cover of the MFF and existing policies. This approach guarantees a known structure and monitoring of the accounts by the Court of Auditors and by the EP (discharge procedure).
- It redistributes from 2021 to 2024 the supplementary amount as grants (€500 bn) and loans (€250 bn) through EU policies, some of which are new and need a legal base.
- It proposes introducing some fiscal measures by 2028 to raise the money to repay the loan without raising the contributions from the Member States.

The repayment of the borrowed money will be from 2028 to 2058. In a nutshell, €750 bn of Next Generation EU will be divided into grants (€440 bn of which through the Recovery and Resilience Facility), guarantees (€60 bn) and loans (€250 bn).

4 The Commission's proposal is €34 bn less than the initial proposal of May 2018 but €6 bn more than the proposal by the President of the European Council in February 2020.

The political agreement of the European Council

The Commission proposals were submitted against the usual crossfire of the Member States, all trying to defend their national positions. The Franco-German proposal for a recovery plan of 500 bn in grants greatly influenced the discussions.

Agreement came less than two months after the proposals were launched by the Commission, but not without pain. Charles Michel, President of the European Council, had to spend many hours in bilateral (confessional) talks to build the compromise which in the early hours of 21 July reached the unanimity of the European Council. All the Prime Ministers could claim a success and overall everyone was equally dissatisfied: the perfect compromise.

While endorsing the total amount of €750 bn for Next Generation EU to be borrowed by the Commission, The European Council introduced some modifications,⁵ the most relevant being:

- Modification of the share of loans to €360 bn (Commission €250 bn) and of grants to €390 bn (Commission €500 bn);
- Modification of the repartition of the €750 bn of NGEU to reinforce the share for the Recovery and Resilience Facility (RRF), which is shared out among the Member States;
- Attributing to the Council the responsibility to assess by a qualified majority the Commission's proposal for recovery and resilience plans.
- Agreeing to open the possibility, even for single Member States, to refer to the European Council in the case they consider that there are serious deviations from reaching the milestones and targets of their national programmes.

Concerning the allocation of the NGEU funds, the European Council decided a different repartition, as follows:

- **Recovery and Resilience Facility (RRF)** €672.5 bn
(Commission: €610 bn),
of which €360 bn in loans (Commission: €250)
of which €312.5 bn in grants (Commission: €310 bn)
- **ReactEU:** €47.5 bn (Commission: €50 bn)
- **Horizon Europe:** €5 bn (Commission: €13.5 bn)
- **InvestEU:** €5.6 bn (Commission: €15 bn)
- **Rural Development:** € 7.5 bn (Commission: €15bn)
- **Just Transition Fund (JTF):** €10 bn
- **RescEU:** €1.9 bn (Commission:€2 bn)
- **Total:** €750 bn

NGEU is only a component of the new 2021-2027 MFF. The European Council set the traditional 2021-2027 MFF at €1074 bn, introducing further cuts to the previous proposals as part of the global compromise. These are the reductions compared to the Commission's initial proposal:

Commission proposals May 2018:	1,134
European Parliament⁶	1,324(+ 190 bn)
Michel compromise February 2020	1,094 (- 40 bn)
Commission revised proposals May 2020	1,100 (- 34 bn)
EUCO agreement 21 July 2020:	1,074 (-60 bn)

Some considerations

The European Council decisions of 21 July endorsed the architecture proposed by the Commission with important modifications. Below are some of the critical points which appear in the decisions.

6 EP resolution of 14 November 2018 on the 2021-2027 MFF – the Parliament's position https://www.europarl.europa.eu/doceo/document/TA-8-2018-0449_EN.html

The 28th negotiator

European Council decisions are not a legal act but only the first, though decisive, step before starting the final phase of the adoption procedure, without which the decisions remain void and inapplicable.

The European Council's conclusions are in fact addressed to the Council, which now has to open negotiations with the European Parliament. The EP has to give its consent to the Regulation on the MFF and NGEU and its approval in co-decision of all other legal texts regarding most EU policies.

Apart from the introductory speech by its President at the opening of the EUCO, the European Parliament had no part in the negotiations but its role nevertheless remains crucial as it has to give its consent to the Council proposals.

The EP's role is particularly difficult as it cannot amend the text but only accept or reject it globally. Nevertheless, as recommended in the Treaty, EU Institutions shall take any measure necessary to facilitate the adoption of the MFF. This good practice has been followed in the renewal of each of the previous MFFs. In the past, the EP has always achieved marginal modifications to some of the decisions by the EUCO concerning figures or, more frequently, principles.

Has the role of the '28th negotiator' been taken into consideration in the final agreement? Or are the 27 Prime Ministers determined to convince their respective parliamentary majorities (European and national) to rubber stamp their decisions? These questions have no answer at this stage, but it will not be surprising if some of the reductions of the EUCO are completely or partially cancelled after the interinstitutional negotiations.

On 22 July the EP plenary voiced these and other criticisms in a resolution adopted by a large majority⁷ the day after the European Council's decisions. It is crucial for the credibility of the EP to achieve some positive results during the interinstitutional negotiations.

7 EP resolution winding up the debate on the statements by the European Council and the Commission https://www.europarl.europa.eu/doceo/document/B-9-2020-0229_EN.html

Timeline for final adoption

The timeline for final adoption is highly uncertain, even if the urgency to implement the measures is generally widely supported.

In fact, democratic oversight of EUCO decisions is not limited to the consent of the EP. Due to the importance of these decisions, once the legal acts are formalised at the European level the approval of the national parliaments (in some cases both chambers) is necessary to render the decisions operational. The calendar for adoption in the national parliaments might interfere with important national debates or, in some cases, even national elections. The definitive calendar is at this stage highly unpredictable. It is clear that the Commission, pending the approval of the national parliaments, can make some preparations but it certainly cannot take decisions with a legal dimension.

Community vs Intergovernmental method

Analysing the Commission's proposals and the EUCO agreement, we see the same common thread which appears in the most important phases of EU life.

With the proposals of May 2020, the Commission has constructed a convincing model where the reference was the Commission with the necessary checks and balances of the EU Institutions: the Council, the EP and the Court of Auditors. According to this model, all the new funds will be channelled through old or new EU policies and in a framework set by the specific legislation to be adopted by the two branches of the legislative authority. This structure is known as the Community method.

The compromise reached by the Council partially unravels this model and introduces several elements of control/decision on the part of the Member States. Assessment of the recovery and resilience plans presented by the Member States is to be *approved by the Council, by qualified majority, through an implementing act which the Council shall endeavour to adopt within 4 weeks of the proposal*. Several Member States required unanimity on this point. The qualified majority became the sub-optimal point of compromise.

The EUCO's conclusions also imposed that the Commission should

seek the opinion of the Economic and Financial Committee⁸ on the satisfactory meeting of the relevant milestones and targets set for each national plan. The Committee “*shall strive to reach a consensus,*” ideally meaning unanimity. The political agreement reached in the EUCO conclusions also foresees that a single Member State can ask to refer the matter to the European Council if it believes that there are “*serious deviations from the satisfactory fulfilment of the relevant milestones and targets.*” The language is vague and recalls the term ‘vital interests’ in the Luxembourg compromise of 1965, which blocked the development of European integration for many years. This emergency brake given to individual Member States can jeopardise the Commission’s implementing powers and the Community method.

The balance between the Community and intergovernmental methods could be precarious in the implementation phase and could lead to a blockage of the implementing mechanism. If we want to see a positive side, the emergency brake should constitute a further stimulus for Member States to respect the targets they have set with the agreement of the Commission.

Budgetary principles

Unlike its Member States, the EU is not allowed to borrow to cover its spending. The Commission has to introduce two exceptions to the budgetary principles, which need modifications of the own resources decision and the Financial Regulation. Both these acts require ratification by the national parliaments, often two chambers according to their constitutional rules.

Like many other budgetary principles, the ‘golden rule’ of **Equilibrium** between revenue and expenditure will now have its exception. The principle of equilibrium means that budget revenue must equal budget expenditure. Due to the present extraordinary circumstances, the Com-

8 Consolidated version of the Treaty on the Functioning of the European Union Article 134 (ex Article 114 TEC).

mission proposes borrowing on the capital market⁹ to enhance the European answer to the economic crisis generated by Covid-19 and in this way complement national measures.

The second exception will be to the principle of **Universality**, according to which budget revenue may not be assigned to specific items of expenditure (non-assignment rule) and revenue and expenditure may not be set off against each other. Consequently, revenue is pooled and used without distinction to finance all expenditure. The Financial Regulation already allows an exception for 'assigned revenue.' This exception allows the allocation of borrowed appropriations to specific policies. The size of the assigned revenues will constitute a 'premiere' in the history of 'assigned revenues.'

Conditionality

Each specific regulation will detail the conditions under which the funds can be allocated (either under the traditional MFF or under the Next Generation funds). As a general approach, the Commission made it clear that green and digital Europe remain its main objectives. All support should be consistent with the Union's climate and environmental objectives. Investing in digital infrastructure and skills will help boost competitiveness and technological sovereignty. Next Generation EU will channel one-off funds to Member States to support investment and reform priorities, and will reinforce financial programmes aimed at recovery during the period 2021-2023.

In particular, the Recovery and Resilience Facility will be firmly embedded in the European Semester. Member States will have to present their recovery and resilience plans as part of their National Reform Programmes and in line with the EU general political priorities. Each national plan has to respect the timeline and the benchmarks and on

9 The European Commission is empowered by the EU Treaty to borrow from the international capital markets on behalf of the European Union. The EU currently has three loan programmes to provide financial assistance to countries experiencing financial difficulties, all three of which are funded through bonds issued on the capital markets. The funds are raised by issuing bonds on international markets on behalf of the EU. The Commission then lends this money to the country in need at exactly the same interest rate. This allows the countries receiving assistance to benefit from the low rates available to the EU as a top-rated borrower. The Commission borrows within these programmes: balance of payments assistance; European Financial Stability Mechanism; macro-financial assistance for non-EU partner countries.

these conditions the disbursements will be released in instalments, following verification of the timeline and targets set in the national plans.

Concerning the rule of law, fundamental rights and democracy, the European Council *underlines the importance of respect for the rule of law*” but without making it a condition to access the funds. The weakening of the conditionality on the rule of law was one of the prices the EUCO had to pay to gain unanimity on the Conclusions. The EP stresses its will to protect the EU budget *where there is a systemic threat to the values enshrined in Article 2 of the TEU, and where the financial interests of the Union are at stake; stresses that, to be effective, this mechanism should be activated by a reverse qualified majority; underlines that this mechanism must not affect the obligation of government entities or of Member States to make payments to final beneficiaries or recipients; underlines that the Rule of Law Regulation will be adopted by co-decision.*¹⁰

Flexibility

The European Parliament has always fought to have the maximum flexibility in each Multiannual Financial Framework. For instance, the flexibility agreed in 2014 was of paramount importance in 2016 to respond to the massive migration into Europe.

The Commission proposes enhancing even further some of the tools which might provide greater flexibility in implementation, reflecting the need for new provisions to be activated in emergencies. Flexibility is also proposed for the future cohesion policy to give stronger support to crisis-related investments, allowing, should it be necessary, transfers between funds and categories of regions, and introducing new provisions to be activated in the case of a new emergency.

EUCO seems to maintain the flexibility proposed by the Commission in various policies but, at the same time, it excludes this flexibility leading to a mid-term revision of the MFF (point 6).

Own resources and repayment of grants

As in the previous MFF, reform of the own resources mechanisms remains marginal in this decision, even though the authorisation given to the Commission to reimburse at least the grant component of the €750

¹⁰ EP Resolution 22 July 2020, see above, par. 9.

bn borrowed on the financial market should encourage the Member States to find some European fiscal measures to repay these amounts.

The only concrete decision appearing in the EUCO conclusions is a new own resource composed of a share of revenue from a national contribution calculated on the weight of non-recycled plastic packaging waste with a call rate of €0.80 per kilogram, with a mechanism to avoid excessively regressive impacts on national contributions. This new method of calculation will modify the proportion of national contributions, but it cannot be considered a new own resource.

As in the past, EUCO invites the Commission to present proposals. The Commission is not short of ideas and has suggested that the new own resources should complement the traditional own resources. The global approach is that the new resources should be coherent with the main policy objectives of the EU, i.e.

To contribute green own resources to the Green Deal such as the Emissions Trading System, (estimated at €10 bn yearly) with a possible extension to the maritime and aviation sectors, and a carbon border adjustment mechanism.

A carbon border adjustment mechanism to prevent carbon leakage from non-EU countries could bring additional revenue ranging from about €5 bn to €14 bn, depending on the scope and design.

Benefits from the single market: an own resource based on operations of companies, which, depending on its design, could yield around €10 bn annually.

This could also include a digital tax to be built on OECD work on corporate taxation. Such a tax applied to companies with a turnover above €750 million could generate up to €1.3 bn a year for the EU budget.

The influence of Brexit

If the United Kingdom had still been part of the EU, its voice would have had important weight in the negotiations. But not having a crystal ball, this question is totally irrelevant in the current circumstances. Nevertheless, the UK would probably have led the 'frugals' and would probably have attracted other delegations to join them. Therefore, the Commission would have been influenced by the UK position and adjusted its proposals accordingly.

However, the UK, as one of the countries most affected by Covid-19 could also have seen an opportunity in this proposal and tried to get the most from the repartition of the cake, especially if the London financial market could see a business opportunity in the borrowing operation.

The UK attitude may have been similar to the one it had on the Delors proposals on the single market: constructive silence. The strong Kohl-Mitterand alliance at that time, similar to the Merkel-Macron entente, would probably have also influenced the UK position, especially if its rebate was not in danger.

Final Considerations

The proposals launched by the Von der Leyen Commission on 27 May have raised the game in Europe and represent a sizeable response to the extreme gravity of the crisis. Many economists join the *too little, too late* party while others consider the proposals too extreme, at the limit of budgetary orthodoxy. The agreement by the European Council on a sub-optimal compromise nevertheless makes the EU stronger. An absence of decision would probably have caused irreparable damage to the image of Europe, accelerating the collapse of the single market and fuelling the arguments of nationalists.

Is Next Generation EU a step forward in EU integration?

My immediate answer is yes, but.....

It is YES because it has double coherence: 1) it increases financial firepower with the only possible method, borrowing on the capital markets. It would have been impossible to demand a supplementary financial effort by the Member States; 2) it maintains the financial envelope in the EU budget, after the proliferation in recent years of off-budget financial tools, most of which are managed through the intergovernmental method, the so-called *galaxy* around the EU budget.¹¹

It is BUT as these decisions have a limited time span and are meant to end in 2023. In the first three years of its mandate the Juncker Commission stimulated a debate to reform the EU and its policies. In its conclusions, the High Level Group on Own Resources recommended that,

11 See High Level Group on Own Resources: *Future Financing of the EU*, December 2016, Annex IV - The galaxy around the EU budget – an illustration of the complexity of the financing of EU activities.

as regards the main expenditure items in the EU budget, they should be redirected towards the policies which produce the most European added value, or reformed in order to produce such added value.

Several ideas were presented around the debate on the Future of Europe by political leaders and scholars. The Commission proposals of February 2018 were less ambitious and showed little appetite for an ambitious change of the MFF structure and priorities.

The urgency of the situation has resulted in a proposal coherent with a vision but only linked to the emergency, without a strong ambition for reform. This approach was probably the only one which could guarantee relatively speedy adoption.

The 27 May proposals and the 21 July decisions broke a taboo and are important at several levels: first, because the global amount, even if already criticised as insufficient, has a size that can have an impact on the real economy, complementing national measures. Second, in spite of the specific and limited scope in time of this new approach, the financial markets will ascertain that the EU has a supplementary stabilisation tool to respond to crises. Third and last, the size of the sums to be repaid should encourage the Member States to launch a fiscal policy with the double objective of supporting the political objectives and contributing to the repayment of the borrowed funds without aggravating national finances.

To conclude, these decisions with all their limits show the vitality of the EU and its capacity to offer solutions to transnational challenges, but not the in-depth reform necessary to renew and adapt the European Union. The procedure should now be finalised. Modifications to the political agreement of the European Council cannot be excluded, and the European Union will be stronger and better equipped to face crises. Once the MFF and NGEU are fully operational the game will not be over. The Member States, especially the most exposed and less resilient ones, must show a capacity to invest in and implement long-term projects. The opportunity offered by NGEU is a one-off one. Missing it could be fatal for the Member States concerned.

Post scriptum: the game starts

On November 10th, a few hours before this book goes under print, the EU German Presidency and the EP Negotiating team have announced a political agreement on the MFF 2021 and NGEU¹². This agreement should be adopted by the unanimity of the Council and by the qualified majority of the Parliament. The EU financing for the next decade is now closer.

The European Parliament was not afraid of challenging one of the most important decisions of the European Council of the last thirty years. At the end of the negotiation, the EP can legitimately claim some successful progress. The consent procedure foreseen by the Treaty is not a take or leave one but it offers space for negotiation, which, at the end, can deliver a positive result.

In a resolution of July 2020¹³ the EP gave a mandate to its President and negotiating team on three key points, among others:

- **Respect of the Rules of Law,**
- **Own resources**
- Adequate financing to the **EU flagship** programs.

The European Parliament has a long tradition in using the budgetary negotiations to achieve progress in European integration¹⁴. The 2019 Parliament could not miss out on this opportunity and could not remain silent on one of the most important decisions, which might have an influence on the future of the EU. The negotiation was complex, with several

12 Information concerning the agreement of November 10th 2020 from the EP press releases <https://www.europarl.europa.eu/news/en/press-room/20201106IPR91014/compromise-on-long-term-eu-budget-ep-obtains-EU16-billion-more-for-key-programmes> and Council press release <https://www.consilium.europa.eu/en/press/press-releases/2020/11/10/next-multiannual-financial-framework-and-recovery-package-council-presidency-reaches-political-agreement-with-the-european-parliament/>

13 Resolution of 3 July 2020 on the conclusions of the extraordinary European Council meeting of 17-21 July 2020 https://www.europarl.europa.eu/doceo/document/TA-9-2020-0206_EN.html

14 S. Becker, M. Bauer, A. De Feo, *The New Politics of the European Union Budget*, Nomos, 2017, ISBN 978-3-8487-3500-6 (Print), 978-3-8452-7803-2 (ePDF) @ <https://www.nomos-elibrary.de/10.5771/9783845278032-15/the-new-politics-of-the-european-union-budget-background-key-findings-and-outlook>

technical aspects, and the three key points mentioned above were the most difficult on which to come to an agreement.

The political agreement establishes supplementary guarantees for the EP for an improvement of the decisions taken by the European Council on July 21st, 2020. As all political compromises, many will find this outcome useless or unsatisfactory while others will present it as a historical success. None of these positions reflects reality. The compromise is the genuine effort to find a political balance between opposite approaches. With this agreement the EP has confirmed, once again, its crucial role in the EU architecture.

The outcome of the political agreement on the key points of negotiations is the following:

- **Rules of Law:** the EP Negotiating team succeeded in enlarging the scope of the regulation to systemic aspects linked to the fundamental values of the EU, which all member states must respect, such as freedom, democracy, equality, and respect for human rights including the rights of minorities. Further to that, the procedure can now be triggered also when there is a serious risk of the rules being broken, thus preventing possible situations where EU funds could finance actions that conflict with EU values. Finally, MEPs were able to shorten the length of the procedure that the EU institutions will have for the adoption of measures against a member State, to a maximum of 7-9 months (down from 12-13 months as initially requested by the Council).
- **Own resources:** it was agreed that the cost of repaying the debt from the recovery fund should neither come at the expense of well-established investment programmes, nor result in much higher GNI-based contributions from member States. Moreover, the Commission committed itself to put forward more concrete proposals in the following years.
- **The increase of funds** for the so-called EU Flagships was, probably, the most concrete outcome obtained by the EP. Those flagship programs will be increased by a supplementary 15 billion Euros over the seven-year period. These supplementary Funds will be drawn mainly from the amounts corresponding to competition fines, which will not be returned to the Member States but kept in the budget to reinforce programs like Horizon, Erasmus and EU4Health. This

‘creative’ financing allows the German Presidency to respect the global ceiling set at the European Council in July.

Concerning the Next Generation EU, based on article 122 (TFEU), which excludes the European Parliament by the procedure to implement the recovery instrument. The Presidency has nevertheless agreed to involve the EP in “constructive dialogue” following an assessment by the Commission, in order to agree on the budgetary implications of any proposed new legal act, based on art. 122. All the above points will be part of a new Interinstitutional agreement, which will have a legal status.

To conclude the agreement of November 10th marks another step towards the final adoption of the MFF and NGEU. Even though we can expect that the Council and the European Parliament endorsement of the agreement will arrive fairly soon, there is not a precise timeline for the ratification of the 27 National Parliaments of the own resource decision, a pre-requisite for the Commission to start borrowing money for the new recovery fund. The procedure in the 27 National Parliaments might delay the entry into force of the Next Generation EU. The follow up of this budgetary saga will be the object of further studies by scholars in the coming years.

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Abbreviations

ACP	Africa, Caribbean and Pacific
AECM	Agri-environment climate Measure
AHDP	Africa Health Diagnostic Platform
AMIF	Asylum, Migration and Integration Fund
BEPS	Base Erosion and Profit Shifting
BICC	Budgetary Instrument for Convergence and Competitiveness
BoP	Balance of Payments
BRICS	Brazil, Russia, India, China and South Africa
CAP	Common Agriculture Policy
CCCTB	Common Consolidated Corporate Tax Base
DAC	Development Assistance Committee
DEVCO	Developing countries
EAGF	European Agricultural Guarantee Fund
EAR	Emergency Aid Reserve
EARFD	European Agricultural Fund for Rural Development
ECA	European Court of Auditors
ECB	European Central Bank
ECSC	European Coal and Steel Community
EDF	European Development Fund
EEC	European Economic Community

EFSD	European Fund for Sustainable Development
EFSI	European Fund strategic investments
EFSM	European Financial Stabilisation Mechanism
EGAF	European Globalisation Adjustment Fund (EGAF)
EIB	European Investment Bank
EIC	European Innovation Council
EIP	European External Investment Plan
EISF	European Investment Stabilisation Function
EMU	European Monetary Union
EP	European Parliament
EPPO	European Public Prosecutor's Office
EPSR	European Pillar Social Rights
ERI	European Recovery Instrument
ESA	European Space Agency
ESF	European Social Fund
ESG	Environmental, Social, Governance
ESM	European Stability Mechanism
ETS	Emissions Trading System
EU	European Union
EUCO	European Council
Euratom	European Atomic Energy Community
EVA	European Value Added
EZ	Eurozone
Frontex	European Border and Coast Guard Agency
FTT	Financial Transaction Tax
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product

GNI	Gross National Income
GNP	Gross National Product
HLG	High Level group
IPA	Instrument for pre-accession
IPCC	Intergovernmental Panel on Climate Change (UN)
ISF	Internal Security Fund
ITER	Energy projects worldwide
JTF	Just Transition Fund
KfW	German Development Bank (Entwicklungsbank)
LIFE	Instrument for the environment and climate action
MTF	Multiannual Financial Framework
MS	Member States
NDICI	Neighbourhood, Development and International Cooperation Instrument
NGEU	Next Generation EU
NGOs	Non-governmental Organisations
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OLAF	European Anti-Fraud Office
OMT	Outright Monetary Transactions
OR	Own Resources
RD&I	Research, Development and Innovation
RDT	Reform Delivery Tool
RRF	Recovery and Resilience Facility
RSP	Reform Support program
SDG	Sustainable Development Goals
SGP	Stability and Growth Pact

SURE	Support to mitigate Unemployment Risks in an Emergency
TFEU	Treaty on the Functioning of the European Union
TFP	Total Factor Productivity
UK	United Kingdom
UN	United Nations
VAT	Value Added Tax
VdL	Ursula Von der Leyen

Biographies¹

László Andor | Foundation for European Progressive Studies (FEPS)

László Andor is a Hungarian economist and former EU Commissioner for Employment, Social Affairs and Inclusion (2010-2014). Since stepping down from the Commission, he has been head of the department of economic policy at Corvinus University (Budapest), Senior Fellow at Hertie School of Governance (Berlin) and a visiting professor at ULB (Brussels) and Sciences Po (Paris). He has also become a member of various think tanks (EPC, RAND Europe, Friends of Europe) in an advisory capacity. Between 1991 and 2005, Andor taught political science and economic policy in Budapest and was editor of the progressive social science journal *Eszmélet*. He was also a regular columnist for the weekly business magazine *Figyelő* and the daily *Népszava*. He has authored, edited or co-edited a dozen books in Hungary, including on economic and political history, comparative economics and globalisation. Andor has also taught at Rutgers (State University of New Jersey, USA) as Visiting Fulbright Professor (1997-8) and worked as an adviser for the World Bank on SAPRI (Structural Adjustment Participatory Review Initiative). He also worked as an adviser to the Budget Committee of the Hungarian Parliament (1998-9) and the Prime Minister's Office (2002-5). From 2005 to 2010, he was a member of the Board of Directors of the EBRD (London), representing the Czech Republic, Croatia, Hungary and Slovakia. Andor holds a degree in Economic Sciences from Karl Marx (now Corvinus) University, an MA in Development Economics from the University of Manchester and a PhD from the Hungarian Academy of Sciences (1995). He was awarded Doctor Honoris Causa at Sofia University of National and World Economy and the Legion of Honour by the French President in 2014.

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He is a co-author of the Study on the Potential and Limitations of Reforming the Financing of the EU Budget prepared for the EU's High Level Group on Own Resources, and he has authored briefings and provided evidence on the EU's budget for the Budgets and Budgetary Control Committees of the European Parliament. He has published on matters concerning the EU budget in scientific journals such as the *Journal of Common Market Studies*, the *Journal of European Public Policy* and the *Journal of European Integration*. He has also co-edited with Simona Milio a collection of essays on the reform of the EU budget published by Palgrave-Macmillan in 2012.

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Reimer Böge is a German politician who served as Member of the European Parliament (MEP) from 1989 until 2019. He is a member of the Christian Democratic Union of Germany, part of the European People's Party.

Böge served as vice-chair of the Delegation for relations with Australia and New Zealand, member of the Committee on Budgets and the Special committee on the policy challenges and budgetary resources for a sustainable European Union after 2013 and substitute of the Committee on Foreign Affairs and the Delegation for relations with Japan. In addition, he was standing rapporteur on policy challenges and budgetary means of the enlarged Union 2007-2013.

Böge served as vice-chairman of the Budget Committee and the Parliament's lead negotiator on the EU's financial framework for 2007-13. Under his stewardship, the Parliament got an extra €4 billion and the chance to vote on the budget review. He later chaired the Budget Committee from 2007 to 2009, when he was succeeded by Alain Lamassoure. In 2010, he drafted the Parliament's legislative bill on the extra financing

needs of €1.4 billion for the International Thermonuclear Experimental Reactor (ITER). Also in 2010, he joined the Friends of the EEAS, a unofficial and independent pressure group formed because of concerns that the High Representative of the Union for Foreign Affairs and Security Policy, Catherine Ashton, was not paying sufficient attention to the Parliament and was sharing too little information on the formation of the European External Action Service. In 2009, Böge was a CDU delegate to the Federal Convention for the purpose of electing the President of Germany.

In June 2013, Böge resigned as the EPP group's budget negotiator in protest at an initial compromise deal between the European Parliament, the European Commission under the leadership of José Manuel Barroso and the European Council on a €960 billion budget for 2014-20. Alongside Pervenche Berès, he currently serves as rapporteur on the European Parliament's report on a budgetary capacity for the eurozone. In September 2017, Reimer announced that he would not stand in the 2019 European elections but instead resign from active politics by the end of the parliamentary term.

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Grégory Claeys has been a research fellow at Bruegel since 2014 and an associate professor at the Conservatoire National des Arts et Métiers in Paris where he has taught macroeconomics since 2015. His research interests include international macroeconomics and finance, central banking and European economic governance. Prior to joining Bruegel, he conducted research in several capacities, including as a visiting researcher in the Financial Research Department of the Central Bank of Chile in Santiago and as an economist in the Research Department of the French bank Crédit Agricole in Paris. He holds a PhD in Economics from the European University Institute (Florence), an MSc in economics from Paris X University and an MSc in management from HEC Paris.

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He has been a Fellow at the Robert Schuman Centre for Advanced Studies (RSCAS) since 1/10/2014. He has also been Distinguished Fellow at the Jean Monnet Centre of New York University (2017) and visiting professor at LUISS University and at Complutenses University, Madrid (2018). Alfredo worked for the European Parliament from 1981 until the end of 2015. He was Director for Budgetary affairs until 2008 and Director of the EP Library and Archives until 2015. He is author of publications in the budgetary and institutional domain.

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Myriam Goinard works as a policy advisor in the Directorate General for External Policies of the European Parliament (Secretariat of the Committee on Foreign Affairs 2011-2014, and since 2015 in the Eastern Partnership and Russia Unit). She previously worked in the General Secretariat of the Council of the European Union (2007-2011), as a lecturer at the University of Nantes (2003-2007) and as a policy assistant at the Institut für Europäische Politik in Berlin (2001-2002). She holds a master's degree from the College of Europe (Natolin Campus) and a PhD in Contemporary History from the University of Nantes and the Ludwig-Maximilians-Universität of Munich. She was a visiting fellow at the Robert Schuman Centre for Advanced Studies at the EUI from February to June 2019.

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Fabia Jones is acting head of the Budgetary Policies Unit in the European Parliamentary Research Service. She began working on EU finances at the UK Permanent Representation to the EU and continued at the European Parliament with posts in research and the secretariats of the Committees on Budgetary Control and Budgets, where she was Head of Secretariat. She has a PhD in Economics from the European University Institute.

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Ivailo Kalfin was Member of the European Parliament (2009-2014) and co-rapporteur on the current Multiannual Financial Framework. He was also a member of the High Level Group on Own Resources (2014-2017) and Special Adviser to the Commissioner for Budget, G.Oettinger (2017-2019). He served twice as Deputy Prime Minister of Bulgaria, being Minister of Labour and Social Policy (2014-2016) and Minister of Foreign Affairs (2005-2009). Prior to that, he was elected Member of Parliament in Bulgaria in 1997. Currently Ivailo is a Chief Economic Adviser at Razvitie Corporation in Bulgaria, a Senior Lecturer at Varna University of Management (since 2001) and Director of the Economy and International Relations Institute.

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Alexander Kreneck was involved as a junior researcher at WIFO (Austrian Institute of Economic Research) in the EU Horizon 2020 FairTax project from 2015 to 2019. His work on sustainability-oriented tax-based own resources to finance the EU budget was published in peer-reviewed journals and won several awards. Currently he studies at the Vienna School of International Studies (Diplomatische Akademie Wien) and is working on a research project about inheritance taxation in the context of population ageing for the JRC of the EU Commission.

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Brigid Laffan is Director and Professor at the Robert Schuman Centre for Advanced Studies, Director of the Global Governance Programme and of the European Governance and Politics Programme at the European University Institute (EUI), Florence. In August 2013, Professor Laffan joined us after leaving the School of Politics and International Relations (SPIRe) at University College Dublin (UCD), where she was Professor of European Politics. She was Vice-President of UCD and Principal of the College of Human Sciences from 2004 to 2011.

Previously, she was the founding director of the Dublin European Institute UCD from 1999 and in March 2004 she was elected a member of the Royal Irish Academy. She is a member of the Board of the Mary Robinson Foundation for Climate Justice, the Fulbright Commission (until September 2013) and was the 2013 Visiting Scientist for the EXACT Marie Curie Network.

In November 2018 she was ranked among the women who shape Europe by POLITICO and was also awarded the University of Limerick Alumni Association's highest honour.

In September 2014 Professor Laffan was awarded the UACES Lifetime Achievement Award. In 2012 she was awarded the THESEUS Award for outstanding research on European Integration. In 2010 she was awarded the Ordre national du Mérite by the President of the French Republic.

Alain Lamassoure | Former MEP

Alain Lamassoure graduated from the ENA (National School of Administration). He has been Magistrate at the French Court of Auditors, Mayor of Anglet, Member of the French National Assembly (1986-1993) and of the European Parliament (1999-2000). Alain Lamassoure also served as Chairman of the Budgets Control Committee and then of the Budgets Committee in the EP. He has been Minister for European Affairs, then Budget Minister (1993-1997).

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Previously, he served in New York at the United Nations, in Algiers, Paris and Beijing. He also served as Diplomatic Counsellor of the Vice President of the Italian Council of Ministers (1998).

In June 2014 he was appointed to the post of European Commissioner in the Commission chaired by Manuel Barroso to replace Antonio Tajani, a position he held until the end of the mandate of the Commission on 1 November 2014.

Formerly a Fellow at the Center for International Affairs, Harvard University (1985-86), and Visiting Professor at the Istituto Universitario Orientale of Naples (1989), he is currently a professor at the School of Government of LUISS, Rome.

He is author of many articles and essays on international relations, European affairs and political affairs.

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Pier Carlo Padoan has been a Member of the Italian Parliament since March 2018, after serving as Minister of Economics and Finance from February 2014 to May 2018.

Between 2007 and 2014, he was Deputy Secretary General of the OECD and became Chief Economist in 2009. Prior to that, Pier Carlo Padoan was Economic adviser to Italian Prime Ministers Massimo D'Alema and Giuliano Amato (1998-2001). He was also Executive Director of the International Monetary Fund (2001-2005) and Director of Fondazione Italianeuropei, a policy think tank focusing on economic and social issues.

Pier Carlo Padoan holds a degree in Economics from the University of Rome and was Professor of Economics at University La Sapienza of Rome (now retired). He has held various academic positions in Italian and foreign universities, including at the University of Rome, College of Europe (Bruges and Warsaw), Université Libre de Bruxelles, University of Urbino, Universidad de la Plata, University of Chulalongkorn and University of Tokyo. He has published widely in international academic journals and is the author and editor of several books.

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Eulalia Rubio is senior Research Fellow at the Jacques Delors Institute in Paris. She is author of numerous publications on the EU budget, EU budgetary politics and EU spending programmes, including various reports on behalf of the European Parliament on the role of the EU budget in support of public sector reforms, ways to enhance flexibility in the EU budget, the impact of Brexit on the EU budget and CAP and, more recently, the role of the EU budget in support for innovation. Over recent years she has also worked extensively on the role of the EIB and other promotional institutions in the implementation of EU financial instruments and guarantees. Eulalia holds a PhD in political sciences from the European University Institute (Florence) and a Master in Public and Social Policy from the University Pompeu Fabra (UPF). Prior to joining the JDI she was Associate Professor in comparative politics at the University Pompeu Fabra (Barcelona) and research and teaching assistant at the Department of Political and Social Sciences of the University Pompeu

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Magdalena Sapala is a policy analyst at the European Parliamentary Research Service, a think tank of the European Parliament in Brussels, where her research focuses on the budget of the European Union. She holds a PhD in economics and was a fellow of the Jean Monnet Programme. She has held post-doctoral research positions at the Institute for European Studies (Free University of Brussels) and at the European Studies Department of the Poznan University of Economics. Magdalena is an author and academic editor of numerous publications on different aspects of EU cohesion policy and the EU budget. You can follow her on twitter @SapalaMagdalena

Leena Sarvaranta | Technical Research Centre of Finland (VTT)

Leena Sarvaranta has been Head of EU Affairs at VTT since 2007. VTT is a fully state-owned non-profit research organisation with a specific public service mandate from the Finnish Ministry of Economic Affairs and Employment.

Leena's work is guided by achieving sustainability and competitiveness of the Finnish and European economy and society. In 2014-2018, she was member of the Strategic Research Council, a Finnish funding mechanism for long-term research to support decision-making across society. In 2016-2019, she acted in the Government Foresight Group, and as of 2016 she is member of MATINE, the Scientific Advisory Group for Defence in Finland. In 2014, she was nominated to the Coordination Committee for development of the Smart Specialisation Strategy in Helsinki-Uusimaa Region.

VTT is active in EU RDI programmes. As a member of EARTO, VTT takes part in constructive dialogue with European institutions, examining issues in a broad innovation policy context across traditional sectoral and administrative boundaries. Leena has gained experience from various EU-level initiatives, most recently the Strategic Forum for

Important Projects of Common European Interest (2018-2019), and earlier High Level Groups on Key Enabling Technologies (2010-2011, 2013-2015) and Expert Evaluation Panels of Contractual PPPs in the FP7 and H2020 programmes.

Margit Schratzenstaller | Austrian Institute of Economic Research (WIFO)

Margit Schratzenstaller has been working as an Economist at WIFO (Austrian Institute of Economic Research) since 2003 and she was Deputy Director of WIFO from 2006 to 2008 and 2015 to 2019. She is expert in the Austrian Fiscal Council, lecturer at the University of Vienna, member of the board of trustees of the European Forum Alpbach and the KDZ – Centre for Administrative Research. Her areas of expertise include (European) tax and budget policy, the EU budget, tax competition and harmonisation, fiscal federalism, family policy and gender budgeting. She was a partner in the Horizon 2020 EU FairTax project (2014-2019).

Sander Tordo | European Central Bank

Sander Tordo has been an economist in the European Central Bank's (ECB) Directorate-General International and European Relations since 2016. His key areas of focus are the governance of Economic and Monetary Union, the development of European fiscal instruments and the ECB's relations with EU institutions, in particular the European Council and the eurogroup. He is a former member of the EU's Economic Policy Committee (2017-2020). Before joining the ECB, he worked at the World Bank Group in Washington D.C. (2014-2016). He holds a bachelor's degree in liberal arts and sciences from Amsterdam University College and a master's degree in political science from Columbia University.

Florian Trauner | University of Brussels (VUB)

Florian Trauner holds a Jean Monnet Chair at the Institute for European Studies of the Vrije Universiteit Brussel (VUB). He is also a Visiting Professor at the College of Europe, where he teaches a course on EU immigration, asylum and border control policies. His research interests concern the field of European integration, notably migration and asylum

policies, the role of EU institutions, linkages between European internal security and foreign affairs/external relations and EU-Western Balkan relations. Among his recent publications is the *The Routledge Handbook of Justice and Home Affairs Research* (with Ariadna Ripoll Servent). In 39 chapters, the volume comprehensively covers scholarly discussions on the theories, policies and actors in this field. In terms of projects, he is currently participating in the Horizon-2020 MINDb4ACT project on tackling radicalisation and violent extremism and has just completed the AMIREG project exploring the interest of West African policy-makers in (EU) migration policy.

Viorica Vita | European University Institute

Viorica Vita serves as a European integration officer at the European Commission. She holds a PhD from the European University Institute (2018) with the thesis title ‘The rise of conditionality in the EU.’ Viorica was a Fulbright-Schuman scholar at Harvard Law School and New York University Law School (2016-2017). She has published extensively and advised EU institutions on the subject of EU spending conditionality, human rights and the rule of law.

Anne Vitrey | College of Europe

Anne Vitrey graduated from the University of Pennsylvania (US) (Master in Civilisation and Philology), from the Panthéon Sorbonne University in Paris (PHD in Human Sciences and Civilisation) and from the Paris Institute of Political Studies (Public Service section).

She worked for the United Nations and for the French Senate before becoming an Official of the European Institutions (European Parliament) where she has spent most of her career in communication and parliamentary committees. She was seconded to the Temporary Committee on the Reform of the European Commission after the dismissal of the Santer Commission. As Director for Budgetary Affairs (2005-2017), she was responsible for activities related to the Budget and Budgetary Control on behalf of her Institution. She contributed to all the institutional negotiations on the EU Budget and Multi Annual Financial Framework. She participated in the High Level Group on the Reform of Own Resources (Monti Group) and contributed to the drafting of the report (2015-2017).

She is a Visiting Professor at the College of Europe in Bruges (Public Finances) and at the Collegio Europeo di Parma. She is a coordinator for European studies at the ENA (Ecole Nationale d'Administration). She regularly contributes to seminars, round tables and publications on European institutional and budgetary matters.

Fabian Zuleeg | European Policy Centre

Since October 2013, Fabian Zuleeg has been Chief Executive of the European Policy Centre, with overall responsibility, including providing strategic direction, managing its staff and resources and representing the EPC. He remains Chief Economist at the same time (a post he has held since January 2010). Fabian holds a PhD on the political economy of EU accession from Edinburgh University. Before going to the EPC he worked as an economic analyst in academia and the public and private sectors.

His analysis focuses on EU economic policies, including economic governance at the EU/eurozone level, the Single Market, Digitalisation, Industrial Policy, Better Regulation and the EU budget, and EU international economic relations. He has a long-standing interest in the political economy of European integration, with a particular focus on the UK-EU relationship, analysing the impact of Brexit on the UK and the rest of the EU, as well as the process of separation.

Fabian is currently Honorary Fellow at the Europa Institute of the University of Edinburgh and Honorary Professor at Heriot Watt University, and sits on the Advisory Board of the Scottish Centre on European Relations (SCER). He was appointed to the Standing Council on Europe established by Scotland's First Minister after the Brexit vote in June 2016.

Fabian works closely with decision makers in the European institutions, the EPC members and partners and the wider Brussels stakeholder community. Fabian regularly comments on current political and economic issues in the EU in the media. He also chairs and contributes to a wide range of debates, conferences and seminars and has researched and published widely on European integration and European economic and social policies.

PROGRAMME



Workshop

The MFF and EU Policies 2021-2027: The EU Towards 2030

 @RobSchuCentre

17 - 18 October 2019

Sala del Capitolo - Badia Fiesolana, Via dei Roccettini 9 - San Domenico di Fiesole (Fiesole, Florence)

Scientific organisers:

Alfredo De Feo | European University Institute (EUI)

Brigid Laffan | European University Institute (EUI)

Introduction

In this crucial period of the future of the European project, the definition of the financial and political priorities after 2020 will be one of the major challenges of the EU Institutions and the Governments of the Member States.

The outgoing Commission has left its legacy of proposals to renew the Multiannual financial framework (MFF) for the period after 2021 and all the EU legislation with a financial impact. Some consider the legislative package presented by the Commission a step towards a more ambitious reform, while others deem that the proposals are only a cosmetic change in the continuity of the past.

The Workshop, organised by the Robert Schuman Centre for Advanced Studies, will take place after the new Commission and the new Parliament have taken office.

The aim of the workshop is to assess which policy options could contribute to shape the EU policies for the next decade.

The outcome will constitute a source of inspiration not only for the stakeholders during the negotiations but also after the approval of the package for those who are interested in renewing the EU policies as part of the relaunching of the European project.

Programme

17 October

- 11.30 - 12.00 Registration
- 12.00 - 13.45 Light lunch
- 13.45 - 14.00 Welcome
Renaud Dehousse | European University Institute
- 14.00 - 15.30 **Panel 1 - MFF post 2020: Ambition or Continuity**
- Chair and Keynote Speaker
Pier Carlo Padoan | Member of the Italian Chamber of Deputies
- Panelists
László Andor | Foundation For European Progressive Studies (FEPS)
Brigid Laffan | European University Institute
Mariusz Pomiński | European Court of Auditors
Silvano Presa | European Commission
- 15.30 - 15.45 Coffee break
- 15.45 - 17.15 **Panel 2 - MFF: Migration, Security Defence and Neighbourhood Po**
- Chair and Keynote Speaker
Elmar Brok | Former MEP
- Panelists
Ferdinando Nelli Feroci | Istituto Affari Internazionali (IAI)
Florian Trauner | Vrije Universiteit Brussel
Tobias Voget | European Parliament
- 17.15 - 18.45 **Panel 3 - MFF and Cohesion, Values and Natural Resources**
- Chair and Keynote Speaker
Reimer Böge | Former MEP
- Panelists
Fabia Jones | European Parliament
Alan Matthews | Trinity College Dublin
Jorge Núñez Ferrer | Centre for European Policy Studies (CEPS)
Vita Viorica | European University Institute
- 18.45 - 19.30 Networking Cocktail



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