BRIEFING
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A new package for finance and expenditure in the EU budget

Introduction

Every time a new multiannual financial framework (MFF) is negotiated, there is a call for the EU to invest in new policies that provide added-value. What would this mean? Firstly, 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 or 28 different national expenditure polices. Secondly, that there are cross-border benefits, efficiently linking areas of opportunity between the Member States. Erasmus+, Horizon 2020, or the Connecting Europe Framework are examples of this. Thirdly, 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 and the nuclear fusion ITER programme.

These three types of added-value are the basis for the case of reform of the budget. They always face challenges from the Member States concerned either to maximise their economic benefit, or to minimise the cost for their Treasuries. Others simply call for a lower budget, even if most of them recognise the collective benefits of added-value. Moreover, some Member States in the face of expenditure reductions, move to salvage their benefits in agricultural or cohesion expenditure. The predictable results in negotiating the MFFs in 2006 and 2013 were somewhat smaller budgets. These contained less of an increase in added-value expenditure than originally proposed, and smaller reductions than anticipated for agricultural 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 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). The flexibility and the mid-term review may have allowed for a larger real terms budget to have taken effect despite the reduction in commitments and payments in the official figures.

In turn, the paper will focus on the European Commission's proposal of 2018 for the new MFF, the challenge of net balances, funds and instruments outside the EU budget, and possible packages for reform.

The Commission's proposal of May 2018

In May 2018, the Commission made its proposals for the post-2020 MFF, the first to take account of Brexit and the loss of the British contribution. To retain expenditure at current levels, given the departure of the United Kingdom, commitments in the budget would need to be set at 1.16% of gross national income (GNI) (Parry and Sapala 2018).

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Instead, the Commission proposed a figure at 1.11% implying a repetition of a cut close to the reductions that had occurred in 2013 and in 2006.[1] Part of the "cost" of the British withdrawal was indeed met by the Commission in proposing some limited areas of new financing of the budget but not by an amount sufficient to retain the balance at 1.16% of GNI.

In terms of planned expenditure, more was proposed for areas of added-value, what used to be Heading 1a, and less for cohesion and for agriculture, as had also occurred for the negotiations of 2006 and 2013. Strategic investment includes Connecting Europe and the Digital Europe Programme, whereas People and Values include the European Social Fund (investing in employability and previously part of cohesion) and Erasmus+. There were also some new priorities in response to the refugee and migration crises. See Table A.

Table A: The MFF proposal for 2021-2027 by policy cluster

Policy Cluster	€mn	% share	% change from last MFF	
1. Research & Innovation	91028	8.2	+30	
2. Strategic Investment	44375	4.0	+39	
3. Single Market	5672	0.5	+11	
4. Space	14404	1.3	+25	
5. Cohesion	242209	21.8	-11	
6. EMU	22281	2.0	New	
7. People and Values	123466	11.1	+7	
8. Agriculture and Maritime	330724	29.7	-15	
9. Environment and Climate	5085	0.5	+46	
10. Migration	9972	0.9	+39	
11. Border Management	18824	1.7	+243	
12. Security	4255	0.4	+23	
13. Defence	17220	1.5	New	
14. Crisis Response	1242	0.1	+122	
15. External Action	93150	8.4	+9	
16. Pre-accession assistance	12865	1.2	-1	
Administration	75602	6.8	+7	
Commitments	1134583		+5	
GNI%				1.11
Payments	1104805			
GNI%				1.08

Source: Parry and Sapala (2018: 21-24)

The challenge of net balances

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. Appealing to the collective interest is ineffective against the pressure faced by Council members to deliver benefits to domestic audiences, so a new approach is needed.

Heinemann *et al.* (2010) and Osterloh *et al.* (2009) propose to solve the net balance approach through a mechanism that makes the approach explicit and accountable: a generalised correction mechanism that reforms and reinforces net balances. According to income per capita, each country's budgetary balance would be pre-established. 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 or investment in some types of added-value.

It 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 those 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. There are several problems with this type of correction. As mentioned above, 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. Choosing to exclude some types of expenditure from the calculation of the generalised correction mechanism could also be unfair as added-value expenditure still benefits those who are employed because of the allocation of such contracts.

Instead, a solution to the dead hand of net balances 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, i.e. the benefits of economic integration, whose value is hard to estimate (Benedetto, 2012; Cipriani, 2014, Haug *et al.* 2011). Improving the economic prospects of fellow Member States is not only a matter of solidarity but rather of securing stability and avoiding negative spill-overs. Taking into consideration the unforeseen refugee emergency of 2015-2016, energy security, and tensions in Europe's neighbourhood, one may ask whether Member States can effectively ensure national security only through their own activities.

It should also be noted that expecting a net budgetary return from membership of international organizations 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 in 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. 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 an 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% 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, and its successor InvestEU worth up to €650bn, are backed by a guarantee from the EU budget, but generate private and public sector lending to invest in the economy, including in areas of innovation.

Where the budget has changed with the reduction in expenditure for agriculture and cohesion (still two-thirds of the budget between them), investment in "competitiveness" has grown from 9.2% of 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 to be divided between clusters 1, 2, 3, 4, 7 and 9 (Table A). Unlike agriculture and cohesion, investment in competitiveness is centrally managed, and non-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 from the traditional policies.

Funds and instruments outside the budget

Table B shows that for the years 2014-2019, the latest estimates for the size of the EU budget are €926.8bn. During the same 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 towards EFSI projects, EU Trust Funds in third countries, EU structural and investment funds and the Globalization 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 the capital paid-in by the Treasuries of the euro area countries.

Table B: Paid additional contributions from Member States to EU operations (€mn), 2014-2019[2]

Budget Related Instruments		
EFSI	19.064,20	
Trust Funds and Investment Facilities	2.717,47	
ESIF	184.428,30	
EGF	104,60	
Non-Budget Related Instruments		
EDF	25.349,76	
ESM	80.483,00	
EIB Capital	21.699,13	
EIF	387,00	
Paid MS contributions in addition to the EU Budget		**334.233,39**
EU Budget (2014-2019)		**926.783,33**
EU operations (EU Budget + MS contributions)		**1.261.016,72**
EU operations (EU Budget + MS contributions) as % of EU GNI		**1,38%**

Table B reported contributions made directly by Member States through public spending to programmes, for example through co-funding. Table C reports the funds leveraged from partners by EU programmes. They amounted to €480.8bn. Putting these together with the EU budget and the Member State contributions already reported in Table B, takes us to a de-facto budget not of 1% of GNI but of 1.88%.

Table C: Funds leveraged by EU programmes (€mn), 2014-2019

Leveraged funding		
EFSI	**424.000,00**	
Trust Funds and Investment/Blending Facilities	**23.505,20**	
Horizon 2020	**10.000,80**	
COSME	**22.800,00**	
EaSI	**152,30**	
Creative Europe	**350,00**	
Total funds leveraged by EU programmes		**480.808,29**
Other MS contributions (as of Table B)		**334.233,39**
EU Budget (2014-2019)		**926.783,30**

EU operations (EU Budget + MS contributions + leveraged funding)	1.722.656,20
EU Operation as % of EU GNI	**1,88%**

Table D: Breakdown of different EU operations as 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%

Table D reports the size of total operations as reaching a maximum of 2.66% GNI in times of crisis if the full capacity of the ESM were used.

The significance of the data in Tables B, C, and D is to show that the total size of financial flows at EU level (or euro area level) can amount to more than double the size of the EU budget itself. Admittedly, part of the leverage from EFSI and the full capacity of the ESM would be based on loans, though these are guaranteed by public money. Whereas disputes on net balances in the EU budget focus on the 1% of GNI that is the EU's de-jure budget, they overlook the full value of financial flows at European level.

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 to the budget was achieved in 1988 to replace that of 1970. By 1988, the original "Six" that had negotiated the 1970 agreement had seen their negotiating power reduced through three enlargements, the European Commission 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 through only small changes. When the EP faces a unanimous Council whose internal divisions almost undermine unanimity, it has an opportunity.

During 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 into 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 to the budget that is an ambitious package will have to address both Own Resources (the revenue) and expenditure. The Commission's proposal of 2018 focused on three possible new Own Resources: levies on non-recycled plastic packaging, the Emissions Trading System, and on a Corporations Income Tax. The latter seems not to have been accepted in the Council. Other

proposals remain part of the debate including other carbon taxes, a single market levy, and a financial transactions tax. These would in part fill the gap in the budget's financing opened by Brexit. 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 risky financial transactions in a way consistent with EU policy. That the EU might be the best authority to raise such revenue (and to use it) is a secondary consideration.

The next tables illustrate different types of package deal 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) and that each of them is of equal economic size, contributing 20% each to a pre-existing GNI-based Own Resource. Table E illustrates a non-controversial package deal involving a new Own Resource. State E contributes the largest amount of revenue from the new resource, but each country is guaranteed that its contribution will not exceed a value of 20. This could have a Pigovian effect on the newly taxed sector in State E, but State E would pay no more in total than beforehand.

Table E: 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	6	10	8	4	12
Residual GNI Resource	14	10	12	16	8
Total contribution	20	20	20	20	20

In the case of Table F, 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 via GNI only.

Table F: 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	6	10	8	4	-
Residual GNI Resource	14	10	12	16	20
Total contribution	20	20	20	20	20

In the case of Table G, 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 only in the participating states. Blankart and Koester (2012) designed a similar system and suggested that such a parallel budget should be designed with a renewable sunset clause, reassuring participants that their commitment would not be locked-in, unless they wished to renew the programmes in due course. 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 G: 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	6	10	8	4	-
Parallel budget	7	7	7	7	-

Inspired by Blankart and Koester (2012)

The package deal in Table H is one where 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 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 H: 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	6	10	8	4	25
Residual GNI Resource	14	10	12	16	-5
Total contribution	20	20	20	20	20

CONCLUDING REMARKS

The current EU budget structure is unfit to respond to policy priorities and developments. 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 three recent, major trends:

1. Growth in the use of non-pre-allocated funds, whose beneficiaries it is impossible to know in advance.
2. Growth in the use of financial instruments that mobilise additional investment volumes outside the budget.
3. Increasing fragmentation and complexity that make the accurate computation of net balances impossible.

MFF negotiations should shift focus towards the gross expenditures of the EU budget (Benedetto 2017: 626).

Escape from net balances will remove the need to create ad hoc funds to overcome the lack of flexibility within the budget as the structure of the budget would become clearer and more responsive.

A package deal to escape net balances needs to find non-state based taxes or levies that do not penalise those least able to pay. Richer, and more budget-sceptical Member States should specify their priorities for investment at the EU level along with a strategy for persuading the less prosperous to accept them. At the same time, a strategy that results in providing goods like energy security and digital networks could be more acceptable to those economic sectors that will contribute more through new Own Resources, while offering continued benefits to the less prosperous.

The EU's budget lacks the agility to respond rapidly to new challenges because of net balances. The creation of a more responsive budget will require an ambitious package deal that addresses the expenditure and revenue sides of the budget, while satisfying all of the governments around the table.

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ENDNOTES

[1] In 1999, commitments for the 2000-2006 MFF were set at 1.08% GNI, in 2006 they were set at 1.05% for the 2007-2013 MFF, and in 2013 they were set at 1.00% GNI for the 2014-2020 MFF.

[2] I am grateful to Marta Pilati for supplying the data for Tables B, C and D.

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