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The EU budget after 2020

Abstract

The EU will need to begin soon to negotiate a new Multi-annual Financial Framework (MFF), to run from 2021, for the EU budget. The backdrop to the forthcoming negotiations is, self-evidently, very different because of Brexit, but also the many other pressures for reform, both of the budget itself and the Union more generally. This briefing paper explores the direct consequences of Brexit for EU resources as well as the wider ramifications of the departure of an influential Member State. Drawing on various recent contributions to the debate on the future of Europe, such as the European Commission White Paper and Jean-Claude Juncker's 2017 State of the Union address to the European Parliament, it reviews likely demands for reform of the budget and how they might be accommodated in the next MFF. Three scenarios for the development of the EU's finances are then set out, covering the status quo, moderate reform and the (admittedly implausible) prospect of a radical reconfiguration of public finances in the EU. Conclusions and predictions about likely outcomes complete the paper.

1 Introduction

Negotiating the EU budget is invariably an acrimonious and lengthy process. Although there are frequent battles over the annual budget, the agreement that matters most is the Multi-annual Financial Framework (MFF) setting overall ceilings for broad headings of expenditure. Detailed annual budgets respecting the annual ceilings for policy areas such as competitiveness, direct payments for agriculture and regional development (Cohesion Policy) are then a second level of negotiation. Since the major reform of the budget in 1988, there has been one five-year agreement, followed by four lasting seven years, the last due to end in 2020.

A new MFF will be needed from 2021 and will become one of the principal issues for decision at EU level in the next eighteen months. The backdrop to the forthcoming negotiations is, self-evidently, very different because Brexit – the first ever secession of a Member State – will mean the loss of the second largest net contributor (in cash terms, not as a share of GDP) to the EU budget, after Germany. Indeed, there is an irony that, because of the UK's departure, an aspect of the EU which the UK consistently sought to reform may now have to change more radically than at any time since 1988. Nor is Brexit the only impetus for reform in a Union struggling with new demands, ranging from how to cope with the influx of migrants, through new security concerns, to how to consolidate reforms of the governance of the single currency.

In political economy terms, the budget is an oddity. It has been castigated as a historical relic (Buti and Nava, 2003) and is regularly criticised by all sides, yet has proved remarkably resistant to change. The economic functions it fulfils are limited and disputed. Some regard it as essentially (re)-distributive (for example Tabellini, 2003), albeit at the level of the Member States or regions, rather than the household, yet it is perceived by the European institutions to be allocative in its objectives, notably by trying to balance economic development across the

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Union and serving as the investment instrument of the Union (European Commission, 2014). Some three quarters or more of the spending has gone on just two policy areas: direct payments to producers (farmers and the fishing industry) under the Common Agricultural Policy (CAP) and the Common Fisheries Policy; and Cohesion Policy, including rural development. The share of direct payments has fallen while that of Cohesion Policy has risen, but the stability of the sum of the two is striking, as can be seen from figure 1, below.

This briefing paper starts by considering how the MFF will need to change, especially in the aftermath of Brexit, but also in response to current debates on the future of European integration, extended most recently in the 2017 State of the Union address by Jean-Claude Juncker. It discusses some of the issues expected to prove contentious in the negotiations and sets out three scenarios, the last of which is acknowledged to be implausible, but is included because it explores a different conception of EU public finances. Conclusions and predictions complete the paper.

2 The departure of the UK

All sides agree that Brexit will affect the revenue side of the EU budget and, as a result, will prompt fresh thinking about its role in economic governance. The more intriguing question about the UK leaving, though, is to what extent and in what ways it will be a catalyst for the sorts of reforms often canvassed by critics of current arrangements. Three decades on from the last major shake-up, a fundamental reappraisal would be timely.

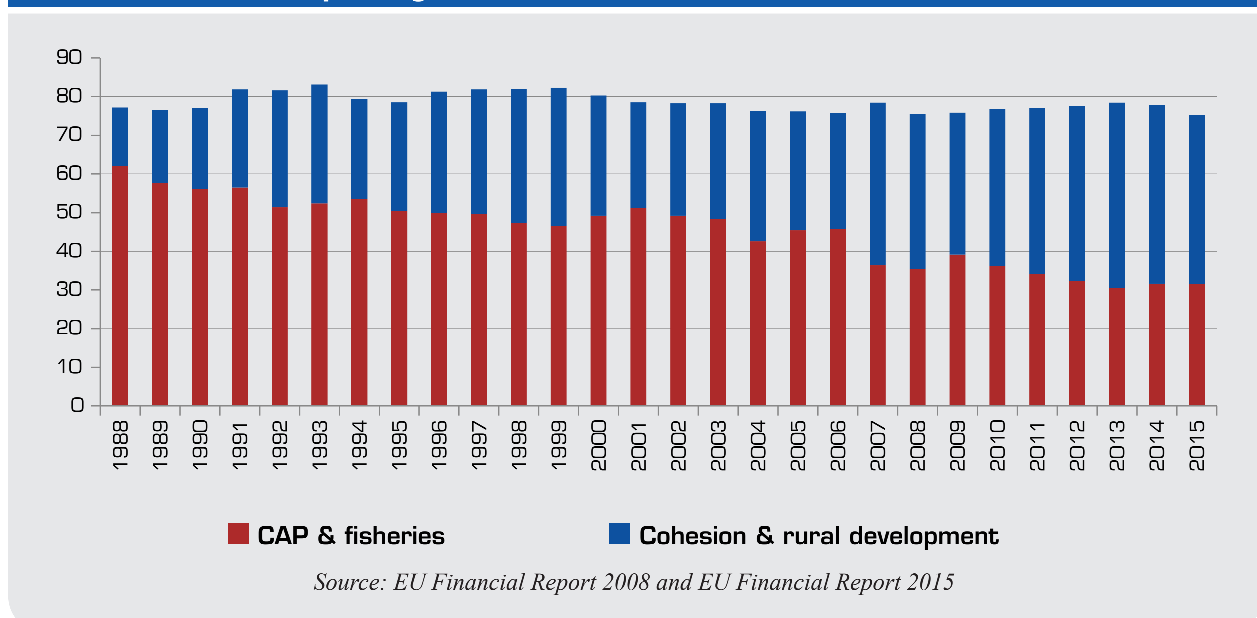
The likely funding gap

In round numbers, the loss of the UK will mean a hole of around €17 billion (the annual average for the period 2013-15) in the EU's receipts – roughly 12%. To put this in perspective, it is equivalent to the gross payments into the EU budget of the twelve Member States which acceded to the EU in 2004 and 2007. This revenue shortfall will only partly be offset by identifiable spending in the UK of about €7 billion (also the annual average for 2013-15); in other words a net loss of the order of €10 billion – amounting to the entire budget for the EU's Horizon 2020 research programme in 2015.

For Nunez-Ferrer and Rinaldi (2016) the departure of the UK would have only a rather muted impact. They note the prospect of increased tariff revenue accruing to the EU budget if the UK is outside the customs union, offsetting the loss of the UK payments, and the end of the UK rebate, as well as any continuing payments. However, this reasoning confuses cash flow with net costs. By the very nature of the own resources system, an increase in tariff revenue would reduce the amount of post-Brexit national contributions, leaving no shortfall in EU revenue. Yet, even though the payments might be less visible, they would still be a burden on EU27 taxpayers, requiring them to pay more towards the EU through tariffs instead of general taxation, and reducing their disposable incomes.

In the short-term – specifically, the seven quarters of the current MFF remaining if, as expected, the UK exits at

Figure 1 Proportion of EU budget spent on two main policy areas, 1988-2015 (% of total spending)



Source: EU Financial Report 2008 and EU Financial Report 2015

the end of March 2019 – reductions in EU spending will be almost impossible because of existing commitments. This would mean tax-payers in the EU27 would have to pay more, unless the EU side succeeds in extracting a substantial ‘divorce’ settlement from the UK. At a time of fragile public finances in many Member States and hostility to ‘Brussels’, higher payments could have damaging political consequences.

The negotiations over the divorce bill are already proving to be difficult and, irrespective of how they conclude, tough stances are inevitable going into the early discussion on the next MFF. Thus, in a speech in Brussels, Magdalena Andersson, the Swedish Finance Minister, made her views clear:[1]

> To ask us to show even more solidarity as a net contributor than we do today would be, to say the least, difficult to explain to the Swedish public.

She was also dismissive of one means of resolving the hole left by Brexit: “other net contributors with an EU-skeptical opinion would need to pay even more to the EU-budget – well that is simply unthinkable”.

Other changes consequent on Brexit

The departure of the UK will have other, less direct effects. First, it will alter the balances among Member States on a number of key dimensions. As a simple exercise shows, just spreading the burden of replacing the UK contribution in proportion to current contributions of the remaining 27 Member States results in a change in their average net contribution to the budget of 0.12% of GNI. Based on 2015 payments to ‘Brussels’, Greece and Austria would have the smallest worsening of their net operating balances, at just over 0.09% of GNI, but for Belgium and Cyprus they would worsen by as much as 0.15%. While there is an aspiration (notably in the report of the HLGOR, 2016; reiterated in the Commission, 2017a, Reflection Paper and consistently advocated by the European Parliament) to shift the terms of debate away from net balances, experience suggests the Member State focus on juste retour will remain sharp. Even such small changes would, consequently, be provocative.

A second kind of shift will be in preferences for what the EU spends. The UK has, for instance, been a persistent proponent of spending more on global Europe and on boosting competitiveness (respectively headings 1a and 4 in the current MFF, as well as for restricting the geographical coverage of Cohesion Policy to poorer Member States. Similarly, the absence of the UK will push certain Member States to espouse positions the UK has typically advocated forcefully, for example on resisting new own resources, maintaining ‘corrections’ (the various rebates) and boosting the use of loans rather than direct grants. For significant net contributors, such as the Netherlands or Sweden, life could become more awkward if they are obliged to become the ‘bad guys’ calling for unpopular options.

More generally, the UK’s has often been the voice articulating what others hesitated to say, but some specific provisions in the budget for the UK may, paradoxically, have inhibited reform. There are many implicit, almost Faustian, pacts, typically belying formal positions. In the past, the UK rebate has offset the French net benefit from the CAP. Cohesion Policy allocations are enough to secure support from lower-income countries for bigger amounts going to research which favour the richer, among which the UK has been the most successful. On the revenue side, the UK has been among those most supportive of retaining national contributions as opposed to creating new resources and has also been insistent on corrections. Yet most national governments and their parliaments also see this as a means of curbing the ambitions of the EU institutions.

The effects of Brexit on the EU budget will, unsurprisingly, hinge on what sort of deal the UK negotiates for its future relationship. The UK position at the time of writing is far from clear. On the one hand, the official position remains as set out in Theresa May’s Lancaster House speech on 17th January 2017 and the White Paper published shortly thereafter. As stated in the speech:[2]

> There may be some specific European programmes in which we might want to participate. If so, and this will be for us to decide, it is reasonable that we should make an appropriate contribution. But the principle is clear: the days of Britain making vast contributions to the European Union every year will end.

If that means, as would seem conceivable, even probable, remaining in programmes covering the likes of research or certain elements of security cooperation, the EU may be able to extract a small net contribution from the UK, but political realism suggests it would nevertheless entail the loss of nearly all the current net contribution. Remaining part of the EU research programme has already been canvassed in one of the papers put forward by the

[1] http://www.government.se/speeches/2016/09/speech-by-minister-for-finance-magdalena-andersson-at-the-eu-budget-focused-on-results-conference-in-brussels/

[2] https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech

British side, but the document[3] is not explicit about how much the UK might pay towards continuing research collaboration, nor does it comment on the fact that the UK has secured a disproportionate share of past research spending. However, it paints a very positive argument for cross-border initiatives and of how UK participation benefits others.

While the latter claim can be regarded as well-founded, an obvious retort from the EU side will be to insist that the UK cannot be a net beneficiary from research programmes to the extent it has been previously. The document discusses the broad scope of a future agreement and calls for it to be closer than with other non-EU countries already collaborating with the EU, but is vague on how much the UK might contribute, stating: 'these terms include the size of any financial contribution, which the UK would need to weigh against other spending priorities'. In short the UK wants to be involved, but not at any price, and is unlikely to accept a per capita payment as high as Norway, a prominent non EU participant in Horizon 2020.

On the other hand, May's failed general election gambit has weakened her drastically and she remains Prime Minister largely because there is not yet a consensus inside her party on who should replace her. As a result, senior ministers have sought to reframe the UK positions on Brexit, including the possibility of a future relationship akin to that of Norway. If this were to become the approach, a much more substantial UK contribution to the EU budget could be envisaged. However, it should be stressed that such an outcome would be incompatible with one of the key (albeit misleading – see Begg, 2016) promises to the British electorate during the 2016 referendum campaign: regaining £350 million a week to spend on the National Health Service. Along with the demand for a Brexit 'divorce bill settlement' the public finances seem set to become a toxic component of the Brexit negotiations at a time when EU Member States will be embroiled in equally fractious disputes over the next MFF.

3 The MFF starting in 2021 and the 'Future of Europe' debate

The first step towards a new MFF to run from 2021 onwards was taken earlier than usual in the cycle with the publication in June 2017 by the European Commission of a Reflection Paper (European Commission 2017a). This was part of the promised follow-up to the white paper on The Future of Europe (European Commission, 2017b) issued earlier in the year and setting-out a number of scenarios for the European integration process. The Reflection Paper promises the customary Commission proposals for the next MFF in the summer of 2018, after which there will be several quarters of difficult negotiations culminating in a deal at the European Council, likely to be in mid- to late-2019.

A further significant contribution to the debate is the report of the High-Level Group on Own Resources (HLGOR, 2016), chaired by Mario Monti, and comprising three members each nominated by the Council of Ministers, the European Commission and the European Parliament. The group's report makes many recommendations, but also highlights the intractability of a system likely only to evolve when there is sufficient political will to make it happen. Put another way, the technical challenges – extensively examined in previous work without ever resulting in decisive reforms – are generally secondary to the political ones.

Although changing the overall shape, size and funding of the EU budget is likely to prove difficult, certain features must be expected to attract fresh attention. They include the extent to which conditionality is applied and the degree of integration of 'financial instruments' – jargon for loans as opposed to direct payments – in financing EU policies, as well as rates of co-financing.

New demands

As stated in the Reflection Paper 'the challenges to the Union are multiplying at the same time as the pressure on European and national budgets increases'. It provides a well-written and cogent analysis of key drivers for change, other than Brexit. In no particular order, they include:

- New security challenges
- Dealing with refugees
- Responding to the social and economic legacies of the years of crisis
- The need to go further in the governance of the Eurozone
- Reacting to the upsurge of populist movements and the social inequalities fuelling them

The Reflection Paper emphasises the underlying political objectives of peace, values and well-being – who could object? – as the core of what the EU and, by extension, the EU budget does. It then cites a range of areas where the EU can make a difference, including securing the southern and eastern borders, promoting democracy and stability (both internally and in neighbouring states), developing trans-national infrastructure and funding re-

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642542/Science_and_innovation_paper.pdf

search. Cohesion Policy is also mentioned for its role in promoting macroeconomic stability and enhancing growth potential, but agriculture is noticeably omitted. A brief paragraph mentions avoiding duplication and ensuring coherence. Traditionally, the EU has had no budgetary role in inter-personal distribution, but social divisions inside the Union are leading to new demands for at least some response.

Many of the positions put forward to justify what is, or should be, spent by the EU emphasise added value from spending by the supranational level. Although the Reflection Paper's presentation of added-value is well articulated, it overlooks the crucial political economy dimension: the propensity of beneficiaries to find added value in programmes from which they benefit and to be blind to what attracts others. Subsidies, not least for agriculture, can be deemed valuable if they guarantee supply of something deemed essential, but through other eyes may be seen as side-payments necessary only to unblock co-operation in other policy domains. Cohesion Policy, vying with agricultural support to be the largest component of EU spending at present, has the explicit Treaty objective of reducing regional disparities, but has increasingly been seen as the investment instrument intended to deliver some of the EU's overarching objectives.

This is more than a cynical observation because it goes to the heart of how eventual compromises are achieved. In agriculture, food security, sustainability of land use or product standards are frequently put forward not just as reasons for subsidy but also for adopting a particular model of agricultural production – implicitly one with added value. EU regional and social policy interventions may indeed foster economic development and activate resources, but they can also be wasteful of scarce public resources and, through the fiscal burden on more successful regions or groups, detract from their potential. This sort of tension has prompted a number of commentators to revisit the rationale for Cohesion Policy (Bachtler et al., 2017; Iammarino et al., 2017; see also, OECD, 2015).

The revenue side

Brexit will almost certainly trigger another attempt to alter the revenue side of the budget. The flaws in the current system have long been recognised, but proposals to correct them comprehensively have consistently been rejected. The UK rebate agreed at the Fontainebleau as long ago as 1984 has had a persistently toxic effect. Already at the outset, it was accompanied by a correction for Germany, then the only other net contributor to the budget, in the form of a 'rebate on the rebate' reducing its ex-ante contribution to the UK rebate. Shifts over the decades in the pattern of expenditure away from price support to large farmers and towards less prosperous regions have seen several other Member States become substantial net contributors, including Austria and Sweden after acceding to the Union in 1995. They too argued successfully for corrections and they will not easily be persuaded to forgo their corrections after Brexit.

The latest initiative comes from the group chaired by Mario Monti. It seeks to solve two distinct problems (HLGOR, 2016):

- The first is the revenue streams used to finance the budget, the bulk of which in recent years has been in the form of direct contributions from Member States (principally the 'GNI resource', levied as a proportion of each Member State's gross national income[4]).
- Second, the proliferation of 'correction' mechanisms through which the payments into the budget of some of the net contributor Member States are mitigated has become complex and opaque, fuelling calls for change.

The exit of the UK, consistently one of the more hard-line opponents of assigning new tax-raising powers to the EU level (though far from the only one), may make it marginally easier to implement the HLGOR recommendation to bring in new own resources, but there should be no illusion about it being easy. The arguments for doing so have been well-rehearsed over the years. 'Own taxes' are consistent with the tenets of fiscal federalism because they would mean revenue-raising at the same level of government as expenditure and thus align incentives appropriately (Begg, 2009). National contributions can, though, encourage an undue focus on a narrow accounting conception of juste retour instead of the wider assessment of the benefits of EU membership. Accountability and legitimacy are undermined because the European Parliament has powers over expenditure but not over revenue, and so on.

There is no shortage of ways in which the financing of the EU budget could be adapted, but nor is there an imaginative solution – capable of transforming the political economy of the EU budget – waiting to be discovered. Indeed, the existing arrangements have considerable mer-

[4] GNI is a close cousin of the more familiar notion of Gross Domestic Product (GDP), differing from the latter because it takes account of remittances from the country where output is produced to other countries, either as profits or wages. Ireland, for example, favours GNI because foreign investors who produce there send substantial flows of profits to other countries, with the result that Irish GDP is significantly higher than its GNI.

its. Although the system lacks transparency and is largely invisible to voters, tax-payers or even their elected representatives, it offers a tamper-proof way of funding EU spending without the EU level having to fret about tax rates, the reliability of different revenue streams or any aggregate shortfall in receipts. Most finance ministers can only dream of having such a congenial system.

An interesting proposal from the HLGOR, consistent with one of the scenarios in the White Paper on the Future of Europe (Commission, 2017b), is to allow some differentiation among Member States in raising revenue for the EU. Those, for example, which want to adopt a financial transactions tax (FTT) could hypothecate the revenue from such a tax directly to the EU budget, thereby enabling their GNI contribution to be cut. Bluntly, this is a somewhat disingenuous notion. The tax systems of all Member States differ markedly and in most cases the revenue is aggregated within the finance ministry without explicit hypothecation to specific spending. Some impose high levies on alcoholic drinks, while others have next to none; wealth taxes can be prominent or negligible; and income taxes can be flat-rate or progressive. These are all national choices reflecting many decades of domestic political bargaining.

There are several persuasive arguments for a collective choice to adopt an FTT, but the primary rationale would be economic: taxing a sector many consider to be undertaxed or ensuring a level playing-field for the single market. The more interesting question is whether the principle of differentiation in how payments to the EU are made will prove to be acceptable. It would undoubtedly be a politically significant move.

Complementary financing

At present, Cohesion Policy is routinely co-financed from national sources, but not the CAP, with obvious implications for the Member States which receive relatively more from one of these policies than the other. The somewhat tentative suggestion in the Reflection Paper that CAP might be co-financed in future will unavoidably have knock-on effects on net positions in the budget. While this is bound to trigger vociferous objections, it could also mitigate one of the sources of imbalance between net contributors and net recipients.

Increased resort to loans has regularly been canvassed and as has been demonstrated in the past and reiterated by the HLGOR, loans can multiply the impact of the EU budget. This sort of leveraging effect has been central to the operation of the European Fund for Strategic Investment (EFSI), as well as certain initiatives under successive EU research programmes. However, it tends to favour the more creditworthy Member States and may also discriminate against investments with more dubious appeal to the market.

Conditionality

The 2014-20 MFF saw a significant intensification of conditionality, especially in relation to Cohesion Policy. In particular, there was a stronger link to the broader economic governance processes now embodied in the European semester. Despite a rearguard action by the European Parliament, resulting in ‘macroeconomic conditionality’ being rendered as ‘measures linked to sound economic governance’ in the Common Provisions Regulation, the principle is now established that payments can be suspended if a Member State does not comply with economic governance obligations.

For the next MFF and the associated regulations, the issue is, consequently, how such conditionality is framed and what its scope should be. The matter is raised in the Reflection Paper and would respond to some of the points highlighted in the White Paper, but there are few clues about the options likley to be preferred. In general, net contributors would be expected to be most attracted to tougher conditionality: for instance, Germany is reported to be keen on it. However, national positions on rules-based policy as part of the wider economic governance framework will also intrude. A particular concern is that conditionality can be inequitable, for example by punishing regions in weaker Member States for transgressions by their national governments. There may also be a form of double jeopardy because sanctions are already provided for in the Stability and Growth Pact and the Excessive Imbalances Procedure (Bachtler et al., 2014). Yet it is also argued that the connections between overall economic governance and use of spending from the EU budget is beneficial by creating conditions under which the policy can be more effective (Tomova et al., 2013).

One budget or several?

The Commission White Paper continues the debate started in the Bratislava declaration of September 2016 on how the EU should evolve and plainly goes beyond Brexit to include a wide range of options for European integration. Several plausible developments could have budgetary implications, requiring either additional resources or expenditure switching. An especially awkward issue would be the possible extension of “differentiated integration” implicit in the scenario under which certain countries agree to do more together, while others do not participate.

Under differentiated integration, and also to some extent under the scenario of “doing less better” (also set out in the white paper), the Commission foresees a number of areas in which closer cooperation requiring spending

might take place. They include some obvious ones, such as Eurozone insurance mechanisms or border control, but could even extend to military cooperation. Non participants would surely object to common funds being used for these activities, but if ad hoc budgets have to be developed for each form of cooperation, the EU's fiscal arrangements would become ever more complex and open to challenge.

It is easy to imagine new or enhanced approaches to common policies (for example in dealing with Schengen border security) giving rise to budgetary demands, but enacting these might prove difficult if the spending were only for a sub-set of Member States. There was a foretaste of the problems when the European Commission sought to revive the European Financial Stabilisation Mechanism (EFSM, a key feature of which was the use of EU budget to guarantee loans) as a bridging mechanism for a further Greek bailout in 2015. The UK, Sweden and Poland all objected even though the prospect of money from the budget being used was slender. It nevertheless led to a messy compromise in which the Eurozone Member States had to cobble together an assurance that there would be no risk to tax-payers in non-Eurozone countries.

Any move to opt-in budgets will raise questions of legitimation. The European Parliament is representative of all Member States, hence its entitlement to monitor budgets for a sub-set will be open to challenge. Some grouping of national parliaments or an ad hoc committee might be needed. The Commission's role would also have to be clarified, as would the legal base. The MFF is enshrined in a regulation, but it is far from obvious how, for example, a complementary Eurozone stabilisation capacity or a Schengen area border control budget would be formally established. A stabilisation instrument for the Eurozone would complicate the governance of EU finances, probably leading to spillover effects between Member States, and could well create tensions between participating Member States and those outside the euro around burden-sharing.

4 Scenarios

The implications for the budget of the five scenarios on the future of Europe in the white paper were summarised by the Commission[5] and have been expanded upon in table 1 by adding lines on possible tensions and plausibility. The indications for how spending will evolve are consistent with the scenarios, in all of which there is expected to be a squeeze on CAP and Cohesion Policy,

Table 1 Budgetary implications and concerns of different 'futures' for the EU

Scenario / *Implications*	1 Status quo	2 Doing less together	3 Some do more	4 A refocused EU	5 Much closer integration
Budget size	No change	Much smaller	Small increase	Small cut	Much bigger
Effects on CAP & Cohesion	Slight decline in share	Reduction in spending	Slight decline in share	Slight decline in share	Cash increase; share lower
New priorities	Slight increase in share	Not supported	Some increase; more for willing	Much higher share	Significant new spending
New fiscal capacity?	No	No	Possible: fiscal stabilisation	No	Yes
Revenue	Current system; end to rebates	Current system; end to rebates	Differentiated contributions	New resources; end to rebates	Major shift to new resources
Sources of possible tension	Usual *juste retour* concerns	Lack of EU added value	Relations of 'ins' to 'outs'	Scope for wins and losses	Moral hazard concerns
Plausibility	Fairly high	Very unlikely	Most (?) likely	Fairly high	Low

Source: Elaborated from Commission (2017a)

[5] http://ec.europa.eu/budget/library/biblio/publications/2017/Factsheet_FutureEUfinances_FiveScenarios_en.pdf

more on competitiveness, external action and on security, defence & migration (except in the pretty unlikely second scenario of the EU reverting to little more than the single market). Only the 'doing much more together' scenario (in effect a move towards a more federal Europe and, as such, also pretty unlikely) would entail a significantly higher budget.

In his 2017 State of the Union speech[7] Jean-Claude Juncker signalled his preference for a sixth scenario entailing closer integration in a number of areas, although from what he said it overlaps substantially with the original fifth scenario. Many Member States were, however, quick to raise objections to the implicitly pro-federalist undertone in the speech. He was explicit about the need for Treaty change to achieve some of the aims. Given how long it takes to agree and ratify a new Treaty, the betting must be that it will take longer than the probable duration of the next MFF. Some measures trailed in the speech, such as establishing new funds for investment or stabilisation purposes could emerge, but would be best analysed as part of scenario 3.

The Commission inferences about the revenue side under the different scenarios are more political. There is an emphasis in all cases on ending rebates and on introducing new own resources in two of the scenarios. The obvious comment on this is that although they might be politically attractive, they are not necessary to deliver the scenario. For the differentiated integration scenario, the table refers to new policies being financed only by participating Member States, leaving open whether this would mean a single budget or several, as discussed above. Since one of the ambitions is to establish an EMU fiscal stabilisation capacity, there would need to be a source of revenue big enough to be macro-economically significant. How this would be financed and administered is unclear.

A different perspective on scenarios comes from looking directly at the EU finances and considering whether and, if so, how they might evolve in adapting to a post-Brexit context and the various new demands. Three are now considered.

Status quo: the base scenario

The evidence from previous rounds of MFF bargaining of a strong status quo bias in the budget is compelling, and it is also instructive that the mid-term review of the 2014-20 MFF resulted in very little change (Becker, 2016). Consequently variants on the status quo should be considered the base case for what will happen next. Several elements of a (largely) 'status quo' outcome can be listed:

- First, even without the UK, the requirement to maintain the truce between net contributors and net recipients suggests there is unlikely to be much appetite for increasing the amount spent during the MFF beyond the 1% or so of GNI in place since the late 1980s.
- Second, the bulk of the money will continue to go the CAP and Cohesion Policy.
- Despite much pressure, a third feature will be an inability to reduce administrative expenditure more than minimally
- A fourth likely element will be national contributions continuing to provide most of the revenue and, although there may be a will to end 'corrections' it will be hard to escape them completely.
- There may, in addition, be further moves towards the use of 'financial instruments' – code for loans backed by, or complementing payments.

The power of the status quo derives in part from the success of past MFF deals in achieving compromise. Net contributors are mollified by keeping the overall size of the budget low, such that even a sizeable gap between contributions and receipts is tolerable. At the same time, because poorer Member States are generally smaller economies, what is a low share of GDP for net contributors can become fairly substantial for net recipients. This serendipitous conjunction allows annual transfers to some of the central and eastern European countries in particular, to reach as high as 5 percent of GDP. Figure 2 on the next page shows the outcomes as measured by the net operating balances (one of a number of – often contested – means of calculating net positions) calculated by the European Commission (2016).

Moderate reform

A moderately radical scenario would be for fairly wide-ranging reform of the budget, although with little change in its scale and, as a corollary, its economic function within the EU public finance framework. In this scenario, there would still be targeted interventions for a mix of allocative and distributive purposes, but it would entail reorientation of spending towards new priorities and encompass many of the wishes of the Monti HLGOR on the revenue side.

In a moderate reform scenario, a new OR could, at last, become reality. Although it would be contentious, the difficulties are arguably second-order compared to the expenditure side. There is general agreement on the folly of correction mechanisms (tempered by the political necessity of having them so long as the expenditure side is seen by net contributors to be unfair). Keeping the GNI

[5] https://ec.europa.eu/commission/state-union-2017_en

resource will be supported because its role as the residual resource is essential to balance revenue and expenditure. Introducing new EU resources will be more problematic, but not inconceivable.
By contrast, some of the ideas mentioned in the Reflection Paper will face more profound opposition. For example, a move to national co-financing of the CAP would require countries with larger agricultural sectors to incur a new budgetary commitment in their national budgets. Equally, to the extent that imbalances in CAP receipts lie behind overall net budgetary imbalances, a cut in the share of the budget going to the CAP could make it easier to end corrections. It would also allow release resources to be spent on new priorities.

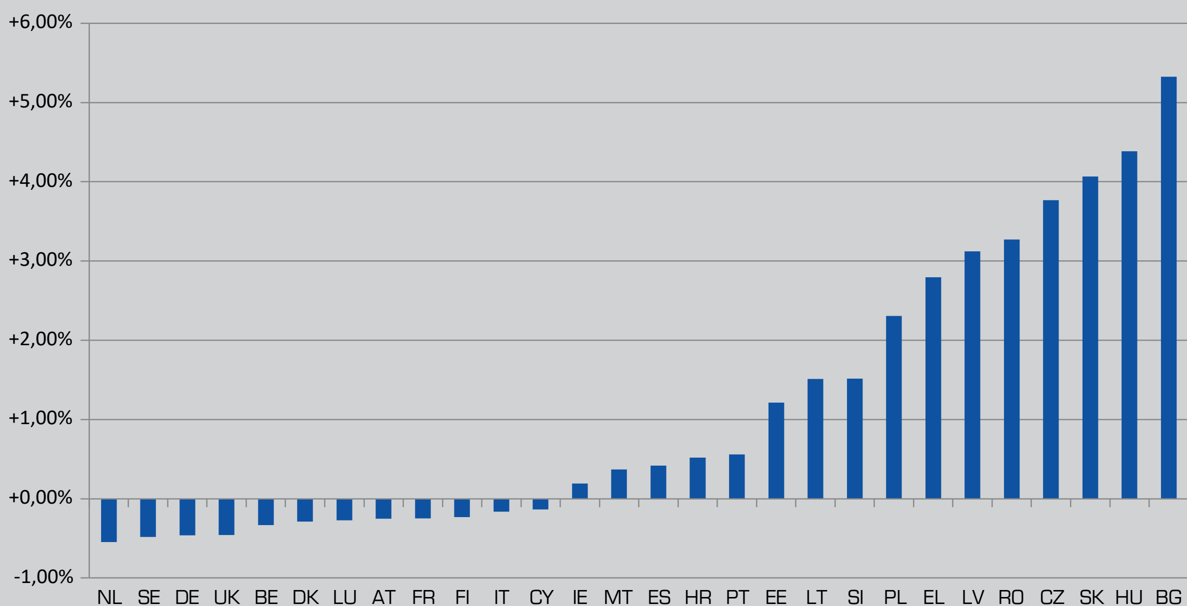
Reform of Cohesion Policy will have to reconcile new thinking on its underlying purposes with the more hard-nosed question of net receipts. As emphasised in the 6th Cohesion Report, the Commission sees it as the investment instrument of the European Union, intended to deliver the goals of the Europe 2020 strategy and to underpin public investment at a time of constrained national public finances (European Commission, 2014). However, budget negotiations will not easily avoid the awkward issue of juste retour and experience suggests that cohesion budgets tend to be used to achieve the last minute adjustments needed to conclude the MFF.

Nevertheless, in a moderately radical reform scenario, the challenge will be to spell out what Cohesion Policy is meant to achieve, not how much money each Member State obtains. Recent analyses of the rationale for EU regional policy have explored possible reforms and the tensions inherent in them. As Iammarino et al. (2017) stress, there are various forms of trade-off between aggregate economic efficiency, seen through the lens of what is good for the EU as a whole, and equity objectives.

Radical reform

A truly radical scenario would start from a reassessment of the role of the EU budget in the overall mix of European public finances. While the EU is not a federation and even the most committed federalists have largely given up on it becoming one, the sort of budgetary functions carried out by the federal level elsewhere could be a starting-point. The MacDougall report (European Commission, 1977) set out some of the contours of such a development, including the estimation (for what was then a more homogenous EU in terms of prosperity) of needing a budget of five to seven percent of GDP to stabilise the economy under monetary union. In describing this third scenario, it should be stressed that, in the present state of

Figure 2 Net operating balances of EU Member State vis-à-vis EU budget (% of GNI, 2015)



Source: European Commission Financial Report 2015
Note: for explanation of how the balance is calculated, see the Commission report.

development of the EU, a genuine federal level budget is politically inconceivable, but it can nevertheless illustrate some of the analytic challenges inherent in budgetary reform.
Instead of a limited role in providing a highly selective set of public goods, a radical approach would ask, first, what functions of public finances it makes sense to locate at the supranational level. In particular, macroeconomic stabilisation has hitherto been largely incidental in the EU's public finances, with at most a slight effect from the timing of Cohesion Policy spending and co-financing. Yet elsewhere, it is the norm for the highest level of government to fulfil this role. In the light of the parallel debates – and, in some respects, far-reaching ambitions for new stabilisation instruments – around completing monetary union, it is a theme which cannot be ignored. Some relatively limited options (a rainy day fund or a European unemployment insurance fund) are discussed in the Reflection Paper, but they would, at best, only partly address the issue.

On the supply-side of the EU, weak investment has been a concern, especially since the crisis years. Latterly, EFSI has become a flagship policy of the Commission. In a recent report, the European Parliament (2017) has expressed some concerns about how the EFSI is coordinated with other EU spending or lending programmes. The report raises doubts about the extent to which the Fund supports risky investments, as originally envisaged, and about the uneven geographical spread of its lending. Even so, substantially stronger support for investment could be envisaged in a radically different EU budget.

Radical reform would, in addition, need to look at the political economy of the budget. Could it be time to align the budget explicitly with the quinquennial mandates of the Commission and the European Parliament, opening the way to political choice on the budget at the expense of Member State control?

5 Conclusions and predictions

Despite the opportunity afforded by Brexit, extensive changes in the EU budget would be a surprise because it will be so difficult to re-engineer the delicate balance of forces crucial to an agreement.

However, if more extensive differentiation occurs, as seems likely, the EU may need to devise new mechanisms to fund initiatives or policies in which not all Member States participate, rendering the EU's finance more complex. Some form of Eurozone fiscal capacity may be a first step, but others could follow, such as for security or dealing with the inflow of migrants. On the revenue side, there could be differentiated use of potential new own resources, albeit at the expense of increased complexity.

While there is general support for spending to be concentrated on policy areas where, to quote a briefing paper from the European Court of Auditors (ECA, 2016: 3) it 'can add most value for the EU and its citizens', the lack of agreement on what constitutes added value is a major obstacle.

Enhanced flexibility in spending, similarly, is considered by many to be attractive, but risks being at odds with the rationale for having the MFF. It also requires effective mechanisms: a review of the flexibility instrument by the European Parliament services (European Parliament, 2017) shows how limited it has proved to be in practice, with an annual outlay of barely a tenth of a percentage point of the overall budget.

The political reality may be that the scope for radical shifts in the money allocated to 'envelopes' for different headings of EU expenditure will be narrow, implying that the effort should go, instead, into how the policies within the envelopes evolve. There is, though, likely to be a willingness to rethink some of the principles behind key policies such as economic development. More emphasis should go on outcomes and the usefulness of spending, as opposed to its short term effects (Bachtler et al., 2016).

Despite the customary clamour for better implementation of the budget, delays in launching spending programmes (especially in Cohesion Policy) and an overhang of commitments from the previous MFF are again likely after 2020 (ECA, 2016).

Both the HLGOR report and the Reflection Paper from the Commission are adamant that all 'corrections' should end and manifestly see Brexit as the opportunity to achieve this long-held goal. Given the bizarre and opaque nature of the system, the aim is unambiguously laudable, but the more intractable issue is whether it is politically feasible.

In spite of the optimism expressed by the HLGOR (2016) and reiterated in the Reflection Paper (Commission, 2017a), expectations of extensive reform of the budget are unlikely to be fulfilled. As the 18th century writer and satirist, Alexander Pope, put it: 'blessed is he who expects nothing, for he shall never be disappointed'.

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