



EU budget 2021-2027

Europe's future sacrificed to the status quo?

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Last week's special Council meeting on the next EU budget 2021-2027 ended without an agreement. When EU leaders left Brussels on Friday after close to 30 hours of negotiations, there was no timeline set for further talks. In our view, it would have been a surprise if the meeting had led to a big breakthrough, given the traditionally contested nature of negotiations between net contributors and recipients of the seven-year budget. This time, the situation is much more complicated, as Brexit leaves a sizeable gap of around EUR 60-75bn in the ~EUR 1tr budget. Still, despite the meticulous preparations of Council President Charles Michel, including a marathon of bilateral meetings with EU leaders ahead of the summit and a new compromise budget proposal, not even a preliminary agreement regarding the approximate size of the Multiannual Financial Framework (MFF) could be reached.

The budget negotiations – an allegory for the EU's dilemma

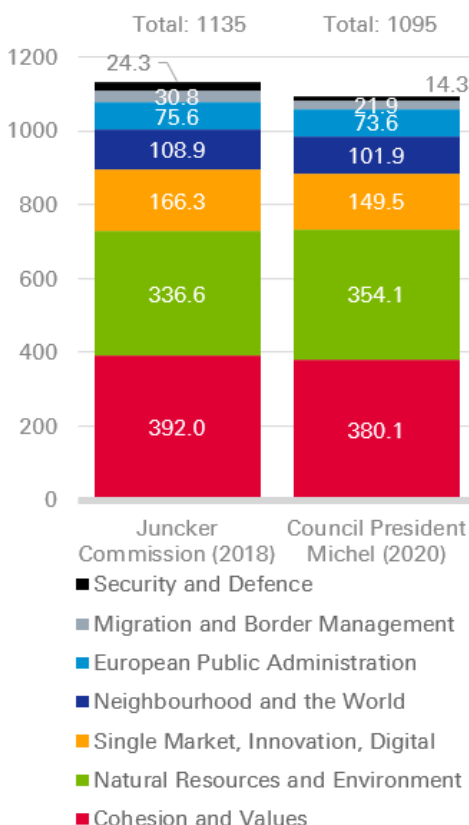
Political leaders in European capitals are more than aware of the manifold challenges that Europe is facing – whether it be climate change, the need to catch up in the global race for technology leadership, protecting democracy and the rule of law against internal and external threats, strengthening Europe's defense capabilities, or responding to migration and increased geopolitical uncertainty. They also believe that only in close collaboration will Europe have sufficient weight to secure its interests in the world and to produce economies of scale in order to remain competitive in the digital economy. Still, in terms of finding European solutions or allocating associated costs and immediate benefits, we believe that the European perspective is quickly being sacrificed to narrow national interests. Compared to national budgets, the ~1% spent on the EU budget is minor. Yet, totalling EUR 1tr over seven years, it is still a very large investment pot to be distributed. For some of the net recipients, there is much at stake, given that EU funding for them accounts for a major share of public spending and national investment. In addition, for all EU leaders, the budget is a sensitive political issue at home, one which goes beyond the symbolism of "succeeding" in the negotiations on behalf of their countries (see EU Monitor, published on 28 February, 2018).



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Figure 1: 2021-2027 budget proposals

EUR bn (2018 constant prices)



Source : European Commission, European Council

Compromise appears beyond reach – even on the downscaled proposal

In 2018, the Juncker-Commission had already come up with a proposal to reform the MFF and to create an EU budget, "rising to future challenges." Reforms to the budget are indeed necessary, as the majority of it (more than 70%) has traditionally been allocated to agriculture and regional policy. In order to avoid misunderstandings, we note that both areas are crucial in EU policymaking, and we believe that protection of European farmers' competitiveness and further convergence of EU members and regions should remain key priorities for any Commission. Yet, while the world has rapidly changed over the last few decades/years, we view the EU budget as having been rather unimpressive, as it has left other spending programs notoriously underfunded (see Figure 2). In our view, the Juncker Commission's budget proposal can hardly be called overly ambitious. It only increased the size of the budget to 1.1% of GNI (vs. 1% previously) while shifting more funding toward new spending priorities. Over the last few months, positions have hardened between some of the major net contributors (the "frugal four" 1 + Germany), who insist on keeping the budget at 1% of GNI, and the 17 "friends of Cohesion" – countries that include southern and central-eastern European members that reject cuts to traditional spending lines (see Figure 3). Thus, the Council President (and previously, the Finnish EU Presidency) had hoped to break the deadlock by proposing a compromise at 1.074% of GNI. Yet, apparently, the proposal was an impossible attempt, as it cut the overall size of the budget compared to the Commission's proposal while simultaneously softening the impact on regional and agriculture expenditure. This basically left only one possible solution: (already modest) proposals for new priorities, such as digital, defense, and migration/borders, which were overproportionally affected (see Figure 1). This is exactly what we had been concerned about all along. Yet, as we learned last week, even this scaled-down solution could not bring the opposing camps closer together.



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Modernizing the EU budget seems virtually impossible

In our view, the friction in the EU and the domestic primate politics on the leaders' agendas might simply be too strong, and in the end, (once again) we believe that Europe's future competitiveness and geopolitical standing could be sacrificed to the status quo, which we would certainly view as negative news. However, we have not yet considered many aspects of this muddled situation. Not only must leaders in the Council unanimously agree on the budget proposal, but the European Parliament (which calls for an increase in the budget to 1.3% of GNI) must also provide approval. We note that majorities shifted during last year's elections, which means that MEPs would need to provide consent across political groups.

The Eurozone budget is a new item in the budget negotiations upon which leaders agreed last autumn. Yet, due to its heavily scaled-down size (around EUR 17bn over seven years) compared to original proposals, it is unlikely to be among the most controversial issues. Original Commission plans to link budget payments to members' conduct with regard to the rule of law have been watered down. Yet, from the beginning, it was unclear how members that were likely to be affected by this proposal could be made to agree. In addition, the question regarding how the budget is to be financed (proposals for new EU resources apart from member contributions, such as financial transaction or plastic taxes) remains on the table.

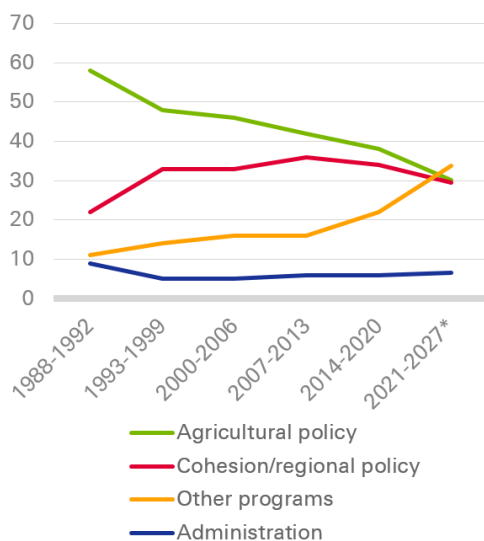
A Green Deal that meets its own ambitions

Last but not least, hovering above everything else is Commission President Ursula von der Leyen's European Green Deal, which foresees raising the share of the budget devoted to support the EU's climate objectives to 25% (from 20% currently). The importance of EU leaders and the Commission having put climate policy on top of their agenda cannot be overestimated. Yet, given the ambitious (and measurable) targets of reducing the EU's CO₂ footprint by 55% by 2030 and reaching (net) CO₂ neutrality by 2050, we believe that conflicts and infights regarding implementation are pre-programmed. We believe that the Just Transition Fund (which should receive EUR 7.5bn of fresh funds from the budget) is warranted in order to mitigate hardship in carbon-intensive regions due to the transition.

However, we believe that the EU must thoroughly control and assure that the funding actually fosters the required industry/energy transformation, and that it does not end up unintentionally subsidizing an industrial model that it then tries to overcome. If implemented in a target-oriented and sincere manner, we believe that the European Green Deal could lead to further shifts in funding within budget programs, such as agriculture and regional policy/cohesion. Therefore, we believe that the EU urgently needs to avoid the trap of 'greenwashing' existing spending lines in order to produce members' consent. In our view, future generations are likely to judge efforts to mitigate climate change by results, not by good intentions.

Figure 2: The EU budget over time

Budget expenditures, % of total



* Proposal of Council President Charles Michel
Source : European Council, Politico, European Parliament (2017) – "The next Multiannual Financial Framework (MFF) and its Duration", Deutsche Bank



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So what can be done?

We do not pretend to know a simple answer to the dilemma of multidimensional complexity. As a starting point, perhaps it would be productive to collectively recall the purpose of the EU budget, which is to finance the implementation of the EU's overall objectives. In our view, the budget should serve the interests of the EU as a whole, rather than being the EU's fiscal reallocation instrument for financing gifts for national electorates. We believe that the distribution of costs and the (immediate) benefits among members should not be a zero-sum game in which each party tries to bring home as much of the cake as possible.

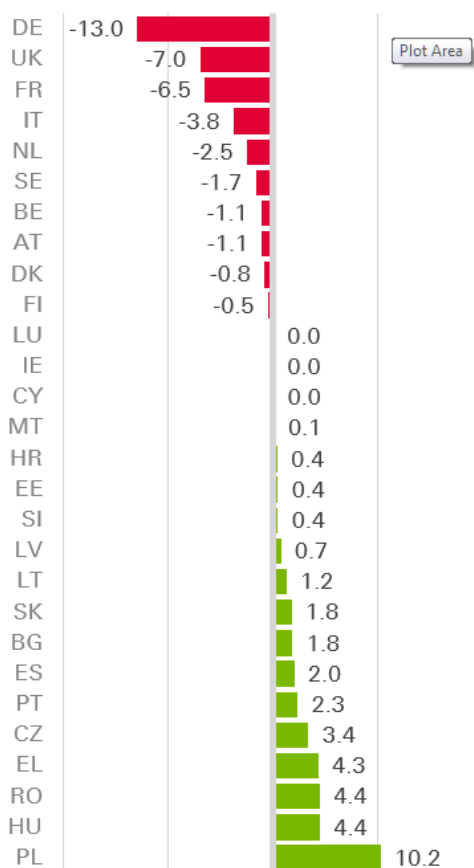
In our view, Brexit has left the EU vulnerable, and months of cumbersome negotiations with the UK regarding future relations likely lie ahead. We believe that the world has become more transaction- and 'deal'-based, which we believe opposes much of what the EU stands for. Our position is that EU leaders should use a swift agreement on the next EU budget as an opportunity to display unity and prudence in the face of this global trend. This means that net contributors will likely need to accept an increase in their absolute contributions to the budget. Yet, in order for net contributors to view this as acceptable, we believe that their focus on new EU priorities must be reflected more strongly. This means that beneficiaries from CAP (agriculture) and regional/cohesion spending would need to accept a reshuffling to other spending programs.



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Figure 3: EU members' operating budgetary balance in the current budget (MFF 2014-2020)

EUR bn (2014-2018 average)



Source : European Commission, Deutsche Bank

In our view, the rebates (a remnant of the UK membership) are a nuisance, and calls for them to be abolished after Brexit are understandable. However, this would require adjustments on the spending side of the budget in order to prevent increasing asymmetries in the relative per capita net spending of countries that are (compared to their GDP per capita) already the largest contributors to the budget.

Down the bumpy road...

Without another special summit, the next date to continue the discussions is 26-27 March at the regular Council meeting. If leaders reach a broad agreement on the budget's main pillars by then, we believe that the 18-19 June Council meeting could be a realistic date for a Council decision that can be presented to the Parliament.

If no agreement has been found after June, negotiations would overlap with the German (rotating) Presidency of the EU in H2 2020. The country holding the Presidency has traditionally played a mediating role in Council decisions. Yet, given that Germany is the bloc's largest budget contributor and that it is unwilling to increase its share of EU spending, negotiations could become even more tense. A last-minute agreement on a (suboptimal, from an EU perspective) compromise and disruptions to spending programs cannot be excluded.



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