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The EU's Multi-Annual Financial Framework for 2014-2020: an Old Construct Fit for a Changed EU?

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As a consequence of the 2008-2009 international financial crisis the European Union is undergoing perhaps its most difficult period since the beginnings of the European integration. The response to this challenge includes decisions and planned steps to strengthen fiscal discipline in the member states, safeguard measures against a falling-apart of the eurozone and the introduction of a Union-wide supervision of the European banking sector. A new fiscal capacity (budget) for the eurozone is under consideration. It seems that the extraordinary situation has triggered a wave of extraordinary reforms throughout the EU. In one area, the Community Budget, however, time seems to have stopped temporarily. The European Council of 22-23 November 2012 was unable to arrive at a compromise on the terms of the Multi-annual Financial Framework (MFF or the EU budget) and postponed the decision to 7-8 February. The contradiction between the decades-old unsolved budgetary problems and the rapidly changing environment cannot be greater as it is now.

1. What is new now compared to previous MFF preparatory periods?

1.1 Austerity programmes on the agenda of nearly all Member State governments

The fiscal collapse or near collapse of the GIIPS countries after 2008 and its interrelation with the survival of the whole eurozone forced the Commission to significantly strengthen the fiscal rules in the EU. First the 'Six Pack', then the Treaty on Stability, Coordination and Governance and finally the 'Two Pack' set new, stricter rules for budget deficits and public debt in the Member States (MS). Non-compliance will involve sanctions, in the form of fines to be paid. That means that rapid consolidation of national budgets, in several cases in a recessionary environment, has become priority in the MS with all the negative consequences. Among austerity measures hitting various strata of the population 'each cent lost to the EU budget' has a high political price for the governments of the net payer MS. [1] The same applies in the case of a not sufficiently martial attitude in the struggle for transfers from the EU budget by the net beneficiary MS governments.

1 A clear illustration of this attitude is the British PM's argumentation for freezing the EU budget.

1.2 European Stability Mechanism (EMS)

As a response to the crisis, in May 2010 two new financial support instruments were called into being: the European Financial Stabilization Mechanism (EFSM) and the European Financial Stability Facility (EFSF). The former became available for all the 27 MS with a lending capacity of up to EUR 60 billion and is guaranteed by the resources of the EU budget. The latter was accessible only to euro area MS and was backed solely by the guarantees of participating Member States.[2] Developments following these decisions inspired the euro area MS to make the existing support mechanism more robust and establish a permanent crisis resolution institution, the European Stability Mechanism (ESM), which was inaugurated in October 2012. The ESM will issue bonds or other debt instruments on the financial markets to raise capital to provide assistance to Member States. Unlike the EFSF, which was based upon guarantees, the ESM will have a total subscribed capital of EUR 700 billion provided by euro area MS. EUR 80 billion of this will be in the form of paid-in capital (in five equal instalments over five years) with the remaining EUR 620 billion as callable capital. This subscribed capital provides a lending capacity for the ESM of EUR 500 billion.[3] To put these figures into context: paid-in capital corresponds approximately to 8%, the callable capital to 65% of the total funds to be

[2] European Commission (2012), p. 7.
[3] European Commission website.

made available in seven years (2014-2020) via the next MFF.

While the interrelation of MS national budgets and the Community Budget has always been an issue during negotiations on the MFF, even if to a smaller extent than in the case of the 2014-2020 period, the setting-up of the safeguard fund EMS is a completely new element in the external environment of the EU budget negotiations. Although there is no direct relation between the MFF and the EMS, the pool of countries involved is highly overlapping. The costs of both systems are borne predominantly by the net payer countries of the Community Budget. In the case of the EMS the eurozone member net beneficiary countries (Cyprus, Estonia, Greece, Malta, Portugal, Slovakia, Slovenia, Spain) are added and non-eurozone net payer countries (Denmark, Sweden and UK) are exempted. Austria, Belgium, Italy, Finland, France, Germany, Luxembourg and the Netherland are those member states which are involved in both systems.

Austria's paid-in capital equals EUR 2.2 billion, the guarantees EUR 17.3 billion. Austria's average annual net financial position vis-à-vis the Community budget amounted to EUR 0.561 billion in the period 2007-2011, i.e. the country's paid-in capital is equal to 4 years' net financial contribution to the EU budget. The guarantees undertaken by Austria correspond to not less than the sum of 30 years' net financial position. For Germany, paid-in capital amounts to 2 years' net financial position and the guarantees to that of 18.5 years.[4]

1.3 A fiscal capacity for the Eurozone?

The crisis also opened a new chapter in fiscal governance issues within the EU. In December 2011 six legislative proposals were adopted (the 'Six-Pack') to strengthen the European budgetary surveillance framework through a significant reinforcement of the corrective arm of the Growth and Stability Pact.[5] Additional regulations were proposed by the Commission (the 'Two-Pack'). Nevertheless the EU's ambitions have not stopped here. After the measures introduced for a stricter control of MS national budgets, the call appeared for the establishment of a proper fiscal capacity for the EMU. Herman Van Rompuy, President of the European Council, pointed out that 'all other currency unions are endowed with a central fiscal capacity'.[6] The preparatory work for the fiscal capacity would begin after the (hoped for) swift adoption of the next MFF with the creation of a 'convergence and competitiveness instrument' within the EU budget to support rebalancing and adjustment. In the medium term (18 months to 5 years) a proper fiscal capacity for the EMU, separated from the EU budget, should be called into being.[7] It is planned to be autonomous, i.e. its revenues should rely on genuine own resources and it could eventually resort to borrowing. It is expected to provide sufficient resources to support important structural reforms in economies under distress.[8] Over a longer time horizon (beyond the next 5 years) a full fiscal and economic union should be achieved, which would involve a political union 'with adequate pooling of sovereignty with a central budget as its own fiscal capacity and a means of imposing budgetary and economic decisions on its members, under specific and well-defined circumstances'. The extent of this budget has not yet been defined, it would be a function of the depth of integration envisaged.

Currently we can see only a few features of the future central budget. While it should serve as a euro area stabilization tool to support adjustment to asymmetric shocks, it should not, however, become a source of long-term transfer flows, as in the planned construct strictly only short-term asymmetries will be targeted with the intention to affect cyclical developments. A stabilization scheme would require monetary net payments that are negative in good times and positive in bad times. Net contributions by MS may be calculated as a function of their output gap relative to the EMU members' average. Payments from the budget can be earmarked for spending targets with counter-cyclical effects. Cross-MS differences in net transfers should not depend on the absolute income differences but on differences in cyclical positions. While income differences may persist in the long run, cyclical positions are expected to change in the course of a decade.[9]

2. Where time seems to have stopped: negotiations of the 2014-2020 MFF

The failure of the 22-23 November 2012 European Council to find a compromise concerning the 2014-2020 MFF is a spectacular sign of frozen fronts between the protagonists involved. The contradiction is indeed astonishing between the unmovable positions concerning the EU budget and the Commission's justified statement 'The totality of measures taken so far amounts to a strong response to the crisis, particularly when compared with what was considered politically feasible only a few years ago'.[10]

The main axes of contradiction have remained unchanged in the last one and a half decades.

[4] Treaty Establishing the European Stability Mechanism, 2 February 2012; own calculations.

[5] European Commission (2012), p. 5.

[6] Van Rompuy (2012), p. 9.

[7] European Commission (2012), p. 12.

[8] European Commission (2012), p. 27.

[9] European Commission (2012), p. 32.

[10] European Commission (2012), p. 9.

2.1 Cohesion (primarily regional) Policy versus European value added

According to the definition of the Commission website, the 'EU regional policy is an investment policy. It supports job creation, competitiveness, economic growth, improved quality of life and sustainable development. These investments support the delivery of the Europe 2020 strategy. Regional policy is also the expression of the EU's solidarity with less developed countries and regions, concentrating funds on the areas and sectors where they can make the most difference. Regional policy aims to reduce the significant economic, social and territorial disparities that still exist between Europe's regions'.[11] The really important message is in the fourth sentence in the above citation, referring to the cross-Member State redistribution in the EU. Following complicated rules each Member State contributes approximately 1% of its GNI to the Community budget, which allocates funds to MS and beneficiaries in MS, respectively, in the framework of various European policies. While each policy has a redistribution effect, it is clearly the Cohesion Policy where this feature has been the strongest and the most visible.

Contrary to Cohesion Policy where the beneficiaries are easily identifiable, in projects with European value added the question of who the beneficiaries really are cannot be easily answered, if at all. Exactly that is why they are called projects with European value added. Continental transport routes, electricity grids, large research projects etc. bring both direct and indirect benefits to more than one Member States. Every participant wins, but it is not comprehensible to find out who wins how much.

2.2 Agriculture versus Europe 2020

In the EU MS agricultural subsidies are provided solely from the EU budget, i.e. there are no agricultural subsidies from the national budgets of the MS. That creates an unsolvable problem, as the Common Agricultural Policy (CAP) absorbs its resources from all MS proportionally and allocates its funds according to the stipulations of the CAP. As agriculture is of diverging significance for individual MS, the allocated funds largely differ from country to country. While agriculture is certainly not the engine of modernization, it absorbs close to 40% of the EU budget expenditures. This is often compared to much more limited resources for modernization in the framework of the Europe 2020 strategy, what is seen as the genuine carrier of growth and modernization: '… smart, through more effective investments in education, research and innovation; sustainable, thanks to a decisive move towards a low-carbon economy; and inclusive, with a strong emphasis on job creation and poverty reduction. The strategy is focused on five ambitious goals in the areas of employment, innovation, education, poverty reduction and climate/energy.'[12] This new competitiveness policy may absorb not more than 10% of the EU budget.[13]

2.3 Agriculture direct payments versus UK rebate and rebates on the UK rebate

The bigger part of transfers under the CAP falls on direct payments to farmers. Member States such as the UK where agriculture is of secondary importance receive substantially less transfers from this channel than countries such as France where this branch is relatively important. This situation was the starting point of the UK rebate[14] which has survived all the years that have passed since then. The UK governments are not ready to discuss the abolishment of the rebate as long as direct payments remain part of the EU budget changes. The UK rebate has been financed by all other MS; nevertheless, in 2007-2013 four countries (Austria, Germany, the Netherlands and Sweden) enjoyed a 'rebate on the rebate', a reduced contribution to the financing of the UK rebate. They were entitled to this reduction due to their extensively negative net financial position earlier. At the 22-23 November EU summit the UK position, while insisting on the preservation of the UK rebate, shifted to a reductionist direction, namely towards also insisting on a cut in the size of the future EU budget, freezing it at the current MFF's level.

3. What has changed in the Member States' attitude?

The question in the title is merely rhetoric, as the answer is that practically nothing has changed what concerns the essence: anticipated net financial positions have decisive influence on considerations, negotiation behaviour and decisions of the Member States. Andre Sapir's words have lost nothing from their actuality: '…the current budget is more the expression of different deals and attempts by governments to claw back in receipts as much of their contribution as possible… than a coherent set of measures aimed at pursuing EU objectives.'[15]

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[11] http://ec.europa.eu/regional_policy/what/index_en.cfm

[12] http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/priorities/index_en.htm

[13] Interview with Alain Lamassoure, chairman of the EP's Committee on Budgets, European Interview, No. 68, 20 November 2012/ Foundation Robert Schuman, p. 3.

[14] The UK is compensated for this situation via the reimbursement of about 2/3 of the value of its original negative net financial position. This is the UK rebate.

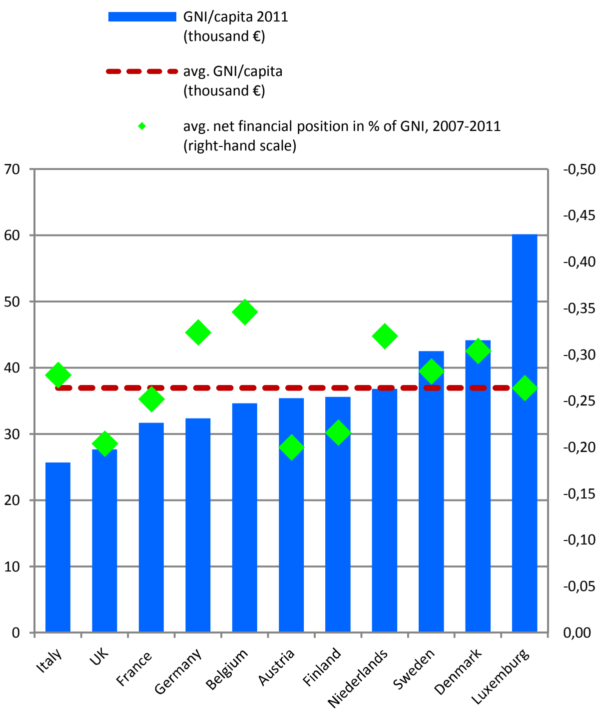
[15] Sapir (2003), p. 162.

What is a net financial position?[16]

In the broadest approach, the net financial position of a Member State is the difference between its contribution to and its transfers from the EU budget in a given year. What the net financial position of a Member State will be in practice is a question of the definition and methodology chosen. Depending on the assumptions made on the four issues above, not less than 30 to 40 perfectly defensible definitions for budgetary balances can be constructed.[17] The main issues to be addressed are as follows: the items to be included and the items to be excluded both in the case of contribution to and transfers from the EU budget; the way of accounting the unspent balances from the previous year; and, finally, adjusting (or not adjusting) the budgetary balances so that they sum up to zero. Due to expenditures spent outside the EU, revenues received from and expenditures allocated to Member States are not balanced, although the EU budget as a whole must be balanced each year. The Commission calculates the so-called operating budgetary balances, that is, the difference between the operational expenditures allocated to each Member State (less the administrative expenditures) and the adjusted national contribution of each Member State. The national contribution does not include the traditional own resources (customs duties and agricultural levies), as they are considered as pure EU revenue resulting from the customs union and the CAP. Another methodology with a sort of official status is used for calculating the UK rebate. This includes administrative costs, which results in completely different (much better) net financial positions for Belgium and Luxembourg, both relatively small Member States hosting important EU institutions. In this paper, the term 'net financial position' is used as equivalent for 'operating budgetary balances' as defined by the European Commission.

As Graphs 1 and 2 testify, the economic development level of a Member State and its net financial position vis-à-vis the EU budget are only in loose correlation. As we can see from Graph 1, some of the net payer countries, such as Austria, Finland and the UK, contributed in the already passed years (2007-2011) of the current multi-annual financial framework to the community budget substantially *below* the net payer MS group's average (-0.27% of the GNI), while Germany, Belgium[18] and the Netherlands substantially *above* the group average. These extreme positions are not in accord with the position of the net payer MS in a ranking by level of economic development. In Graph 2 the trend is correct, in the group of net beneficiary MS more affluent MS get generally less net transfers from the EU budget than the poor ones. The anomaly here is that individual MS net financial positions differ widely from each other in several cases, although the comparable levels of economic development do not justify that. While Poland and Lithuania have practically the same per capita GNI, the former's net financial position amounted to +2.13% of its GNI, that of the latter to +4.13%. A similar discrepancy can be seen in the case of Hungary (+2.73%) and the Czech Republic (+1.03) although here the difference in the level of development is greater than in the former case. These comparisons require qualification, however. The differences are partly explained by the diverging absorption capacity of the countries concerned, and a valid final balance can be drawn in 2016 at the earliest.[19] Additionally, Romania and Bulgaria joined the EU only in 2007, and in the initial years of their membership they had been in the 'phasing-in' period of several programmes, contrary to the 2004 enlargement, which completed phasing-in in 2006.[20]

Graph 1: Net payer Member States: per capita GNI and net financial position vis-à-vis the EU budget



Source: EU budget 2011 Financial Report, European Commission; Eurostat and own calculations.

[16] This is a shortened version of a definition in Richter (2008), p. 4.

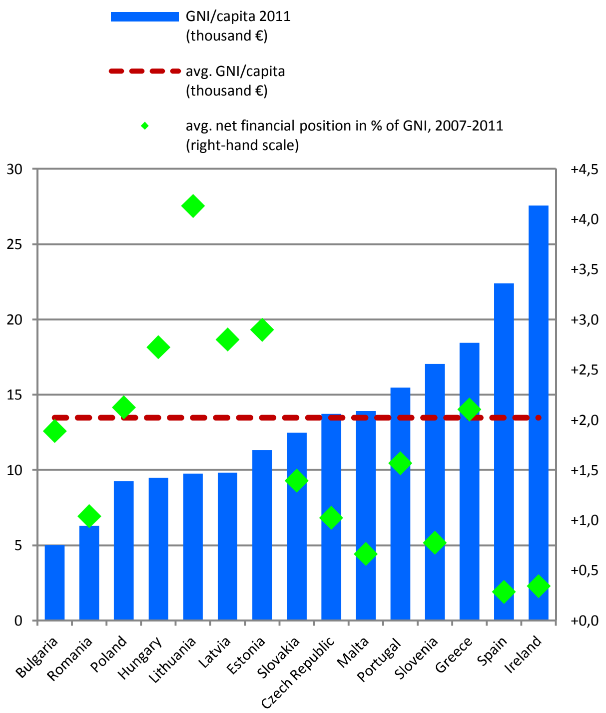
[17] European Commission (2004), Annex 3, p. 5.

[18] Belgium is a special case, just as Luxembourg, as these two MS gain to an enormous extent through hosting key institutions of the EU. Nevertheless, administrative expenditures spent there are not constituents of the operative balances used here.

[19] Payments can be disbursed up to two years after the end of the current MFN in 2013.

[20] Except CAP direct payments which will be completed in 2013 for the 2004 enlargement NMS and in 2016 for Bulgaria and Romania.

Graph 2: Net beneficiary Member States: per capita GNI and net financial position vis-à-vis the EU budget



Source: EU budget 2011 Financial Report, European Commission; Eurostat and own calculations.

The Commission's opinion is clear: 'Budgetary balances, while appealing in their simplicity, either invariably misrepresent or are inadequate measures of the benefits from membership in the EU'.[21] Without doubt, there are important advantages from EU membership beyond the net transfers from the EU budget, such as those arising from the Single Market. Not only recipients of transfers from the EU budget benefit from these flows; the expenditures concerned are often spent to finance imports of goods and services from other, typically highly developed and therefore net payer MS. Despite all these justified arguments the net financial position has remained in the focus of practically all discussions concerning the Community budget. Net payer MS try to keep their contribution low and watch other net payers in their 'weight category' whether they come off better. Net beneficiary MS are keen to maximize the resources allocated to them and are ready to block any changes which threaten their achieved net financial positions. Nevertheless, rhetorically each Member State loudly condemns the attitude focused on the net financial positions, and therefore the respective behaviour has become a sort of taboo. Though it should not exist, it persists undisturbed and appears in disguised form in discussions on various aspects of the EU budget.

[21] European Commission (1998), Annex 3, p. 1.

4. Conclusions

The crisis, which has triggered a series of reforms unseen in the EU in less turbulent periods, and which has led to the idea of establishing a new fiscal capacity for the EU to address cyclical and structural problems, will now perhaps create a momentum for reform in the traditional EU budget. Solutions that acknowledge the central importance of the net fiscal position instead of denying it may bring about a fundamental change. These reforms may approach the issue from two sides. First, a correction mechanism, similar to that enjoyed by the UK (the UK rebate), can be extended to all MS; this represents an *ex post* solution. Second, partially or wholly pre-fixed net financial positions can be introduced for each MS; this step would deliver an *ex ante* solution.[22] Both approaches would create a new situation, where the obsession of the Member States with the net financial positions would be eliminated, opening the door for a non-biased discussion on the modernization of both the revenue and expenditure sides of the traditional EU budget.

The probability that this reform will already be implemented in the next 2014-2020 MNF is negligible, unless a total collapse of negotiations takes place in early 2013. That means that the long due fundamental reform of the community budget can be elaborated and discussed without extreme time pressure.

The constituents of a future fiscal union are already subject to discussion. By the time it has been realized, the obsession of the Member States with their net financial position must belong to the past.

There are two additional issues which may largely affect discussions on the future of the EU budget. First, the lessons from the 'Greek tragedy' and the poor performance of Portugal and Spain are yet to be drawn. It must be cleared how it could happen that of all the EU members the most preferred beneficiaries of Cohesion Policy, namely the Member States on the southern periphery of the EU, performed the worst in the course of the crisis. Is that a coincidence or did the large transfers play a role in the current problems of these countries? Second, the possible exit of the UK may fundamentally change the rules of the game in the EU, and among several other important changes, it may accelerate the fiscal dimension of European integration. In case the UK remains in the EU and its government can push through that sort of decentralization of the EU the British politicians would like to achieve, the current structures of the EU budget have only a limited chance to survive.

[22] For ex post solutions see European Commission (2004a), Mrak et al. (2007), European Commission (2004b), Nunez Ferrer (2007), Heinemann, Mohl and Osterloh (2008). For the ex ante solutions see Padoa-Schioppa (1987), De la Fuente and Doménech (2001), Richter (2008), Wostner (2008), Santos and Neheider (2009).

5. Epilogue

The European Council of February 7-8 opened the door for a solution for the years 2014-2020 although the European Parliament will have to approve the Summit's decision and that is not guaranteed. Concerning the results of the European Council, for the first time in the history of the seven-year financial frameworks the budget for the forthcoming seven years will be smaller than in the respective previous period. As expected, the main features of the EU budget and those of the negotiations and the ways to find compromises have not changed. Although the substantial increase in funding for Chapter 1a, 'Competitiveness for Growth and Jobs' is without doubt an important step forward, the old construct of the EU budget in a changing EU has remained intact. Obviously the rapidly increasing cooperation in other areas of European integration and the EU budget are currently decoupled. Any hope for a fundamental change will thus be an issue for the period after 2020.

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