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The EU Budget As an Opportunity in the Crisis

The EU Commission Proposal for a New Financial Framework and a Reconstruction Fund

Peter Becker

In response to the socio-economic consequences of the corona pandemic, the European Commission presented a comprehensive package of measures on 27 May 2020. It consists of two components. Firstly, the Commission's original proposal of May 2018 for the Multiannual Financial Framework (MFF) 2021–2027 is to be increased to €1.8 trillion. Secondly, the Commission is proposing a temporary economic budget of €750 billion under the title "Next Generation EU".

This far-reaching package, which the Commission drew up in just a few weeks, can have the effect of fundamentally reshaping European budgetary policy and redistributing competences and responsibilities between the EU and the member states. The result could be a significant deepening of European integration.

In May 2020 the Commission adapted and updated its original proposal for the next MFF 2021–2027 of May 2018 (see Table 1, p. 7). In many respects, it is thus breaking new ground:

(1) In addition to the revised MFF, the Commission is proposing an additional temporary auxiliary budget to boost the EU economy. This so-called Next Generation EU recovery plan is to amount up to €750 billion and will run until 31 December 2024. The extra money is to be channelled through the next financial framework and its programmes, meaning that the budget estimates in the actual MFF will increase dramatically. In the centre of this recovery plan stands the reconstruction and resilience facility and the increase in the European Structural Funds with the new REACT-EU programme.

(2) The Commission is proposing that the EU should take on debt of its own to finance the European Economic Recovery Plan. Although this is not a completely new measure, the volume of EU bonds to be issued by the Commission and their 30-year maturity are unprecedented.

(3) The increase in the ceiling of own resources of the EU budget needed for the issuance of these EU bonds is also to be limited to 30 years and to the financing of the recovery package. However, both the dura-

tion and the extent of the increase to 2 per cent of the EU's gross national income (GNI) are highly unusual.

(4) The overall package also includes proposals for new EU programmes that will allow for a gradual change in the distribution of competences between the EU and the member states, as laid down in the Lisbon Treaty. This applies, for example, to economic policy, aid for ailing businesses, and health policy.

With this proposal, the Commission is taking a great political risk. Until now, the function of the MFF has been to set and secure the financing of the EU budget and expenditure programmes for seven years. This stability of the budget guaranteed planning and predictability over the medium term for EU institutions and the member states. Consequently, the MFF is primarily a programme and investment budget for the medium term. Now, however, the Commission wants to use it as a stimulus for the economy and supplement it with additional temporary instruments. This would considerably extend its purpose.

The Commission was aware that it had only one single and decisive attempt to broadly anticipate the consensus of the European Council and the subsequent approval of the European Parliament. If the new MFF is to enter into force on 1 January 2021 as planned (and as absolutely necessary), and if the legal bases for the various European spending programmes are also to be adopted, the negotiations must now be concluded without major delays.

The Commission logically assumes that a political agreement will be reached in the European Council of Heads of State and Government by July 2020 at the latest, and that the Council and Parliament will then conclude the legislative negotiations by autumn. There is no time for fundamental and comprehensive negotiations by the member states on this new package and its medium- to long-term consequences. Only small adjustments can be expected at the decisive summit of Heads of State and Government.

The Commission is using two negotiating instruments:

(1) There is immense pressure on the member states and EU institutions to reach agreement in time. On the one hand, this is due to the increasingly obvious socio-economic consequences of the pandemic, i.e. increasing slumps in growth, and consequently drastically increased unemployment figures. On the other hand, the great time pressure no longer allows the member states to delay or even postpone negotiations.

(2) The Commission has clearly tried to take account of the conflicting national interests of the member states with its package, and thus largely sketched out a compromise solution. However, as the member states will also need successes in their national negotiations, the Commission has included some optional items in its package. They can be used for such symbolic successes without jeopardising the substance of the overall package. These undoubtedly include the enormous volume of the economic stimulus budget Next Generation EU, the partly significant increase of some programmes in the actual MFF compared to the intermediate stage of negotiations in the European Council of February 2020, and also the extent and duration of the increase in the ceiling of own resources.

All EU institutions and member states are therefore expected to show a high degree of willingness to agree and compromise in order to meet the tight timetable.

The Starting Positions for the Negotiations

However, there is no guarantee that the member states will reach agreement quickly or that the European Parliament will approve the plan in a smooth and timely manner. In order to minimise the risk of failure and to allow for a compromise solution without delay, the Commission had previously discussed its proposal with key stakeholders. The position papers presented by some member states in advance gave the Commission additional indications of national interests, and thus of a possible path for agreement. In its position paper of 19 April 2020 for the Eurogroup negotiations on the first corona aid package, the Spanish government already stated that the Mediterranean countries had a strong interest in European aid being provided in the form of grants rather than loans.

The Polish position paper of 8 May, on the other hand, provided indications that the central and eastern European member states are interested in substantial additional funds as part of a European economic stimulus package. As the main beneficiaries of cohesion policy, they are in favour of increasing the budget for the European Structural Funds. In their view, the existing socio-economic criteria should continue to be applied for the distribution of these additional funds. This would mean that the underdeveloped central and eastern European regions would automatically benefit more than others from the additional funds in the economic stimulus package.

In its non-paper of 8 May, the French Ministry of Finance outlined the country's ideas and objectives for a European reconstruction fund. Paris stressed that the member states hardest hit by the pandemic should receive the biggest share of subsidies. For a limited period of three years, the EU budget should be increased with additional funds of between €150 and €300 billion per year in order to give all European economies a tangible economic boost. This could be financed by collectively taking on debt, which would be repaid over a period of 40 years. The money should be used for existing European spending programmes with European added value, such as European research or investment support. The distribution of additional funding should be based not only on the usual socio-economic criteria, but also on the death tolls as well as the burdens on health systems as a result of the pandemic.

The Franco-German agreement was undoubtedly of particular importance and presented on 18 May during a joint video press conference by Chancellor Angela Merkel and French President Emmanuel Macron. The Franco-German tandem pleaded in favour of an ambitious — but limited in time and scope — fund for the economic recovery of European economies within the framework of the MFF. In total, an additional €500 billion is to be made available for the European Green Deal and digitisation. This bilateral initiative also advocated that the EU should take on debt and raise the ceiling of own resources for this purpose. Debt raising should remain a temporary exception and be linked to a binding repayment schedule in the European decision on own resources. Although the Franco-German paper was on many points much more vague than the proposals put forward by the French Ministry of Finance, this initiative — together with the package of proposals presented one week later by the Commission — has dominated the debate ever since. The other member states had to find their own positions on this Franco-German accord. The initiative also strengthened the European Commission's backing for its proposal.

The so-called Frugal Four — the Netherlands, Austria, Sweden, and Denmark, which have been advocating for an EU budget of 1 per cent of EU GNI for two years — had to react quickly to the Franco-German initiative. They therefore presented their own position paper as early as 23 May. With it, they also advocated for a temporary emergency fund to boost the European economies and strengthen the national health systems. Under no circumstances, however, should the fund be financed through Community borrowing. The money in the fund should only be used after a careful needs assessment and with strict commitments to implement structural reforms. At the same time, the Frugal Four maintained their basic positions for the upcoming MFF negotiations: They insist on an ambitious modernisation of European spending policies, on the conditionality of the rule of law, and on rebates for their contributions.

Prior to this, the European Parliament had also defined its negotiating position in several resolutions. Members of European Parliament also largely maintained their earlier demands for the MFF negotiations: They called for new European sources for own resources, for existing expenditure programmes to be significantly better equipped, and for a mandatory mid-term review of the MFF. As a contingency plan, they called for the expenditure programmes to be automatically extended in the event that agreement on the new MFF 2021–2027 cannot be reached in time. In addition, the European Parliament called for a permanent increase in the ceiling of own resources and for the issuance of EU bonds to finance the MFF. In this way, the Parliament wants to allow for additional investment in the European Green Deal, the digitisation of the internal market, and strategic investments.

Search for the Path to Compromise

Even before it finally presented its package on 27 May, the Commission thus had an insight into the positions of key players, and thus the most important cornerstones for a path to compromise. Its proposal takes up decisive elements of these positions. For example, Italy and Spain — the member states most severely affected by the pandemic — are to receive the largest shares from the recovery plan. In addition, the share of non-repayable grants clearly outweighs that of loans. This is in line with the expectations of the highly indebted southern European member states and the demand of the European Parliament. In favour of the central and eastern European states, the package contains a significant increase in the Cohesion Funds, which will already take effect in the last months of 2020 and apply for the next four years. According to expectations of the western Europeans, the Commission proposes to direct additional funds and the growth stimulus towards modernisation policies and the climate policy objectives of the European Green Deal as well as the digitisation of the internal market. The allocation of funds from the reconstruction and resilience facility for economic recovery shall be linked to the implementation of national reform programmes. All member states are to draw up such programmes by 30 April 2021 at the latest and submit them to the Commission for approval. These so-called National Recovery and Resilience Plans are intended to compile those reforms and investments that strengthen the growth potential and the economic and social resilience of the respective member states, and thus promote a sustainable economic recovery. To this end, measures for ecological and digital change in particular are to be listed. In the framework of the European Semester, the Commission is considering agreeing with the member states' concrete milestones and targets as well as a timetable for implementing the reforms and investments. Money will only be paid out if the member states have actually achieved these interim targets.

The European Economic Recovery Plan and the support policies are thus closely linked with the European Semester for economic policy coordination, the implementation of long-term structural reforms in the member states, and the continuous monitoring of the use of European funds in these countries. All this is in line with the demands of the net contributors from northern Europe.

Finally, with its supranational approach, the Commission is responding to the European Parliament's requests of integrating the recovery plan into existing Community instruments, such as the MFF and the European Structural Funds. In this way, the Parliament's rights of budgetary control are respected. The creation of a new health programme is also in line with the European Parliament's wishes and the Franco-German ideas.

The Continuation of the Budget Negotiations

Nevertheless, the MFF negotiations are not starting from scratch, but are following on from the unsuccessful negotiations that came to a temporary halt at an extraordinary European Council summit on 20–21 February 2020. The President of the Council, Charles Michel, now has three options for continuing the negotiations in the European Council:

(1) He could support the Commission's proposal and present it to the Heads of State and Government as the starting point for negotiations. Reductions or reallocations in some policies already agreed by the member states in their negotiations would have to be brought forward again and justified. This would make it more difficult for the Frugal Four to insist on a limited MFF and rebates for themselves.

(2) Alternatively, President Michel could take up the interim status of the negotiations at the special European Council summit of 20 February 2020 and add the Commission's proposal for an economic stimulus auxiliary budget. In their joint position paper, Berlin and Paris had already advocated for this by using the interim status of the February negotiations as a starting point. This would put the Commission's proposal for a temporary economic stimulus budget at the forefront of the negotiations. Any deviation from interim results that had already been agreed upon — as they had been fixed in the 14 February proposal of the President of the European Council — would have to be justified. The Commission's approach to also adapt the actual MFF to the challenges of the crisis could be examined in detail by the member states and would have to be justified in more detail by the Commission.

(3) The most likely option would be for President Michel to present a completely new proposal for the critical negotiations on the next MFF 2021–2027 in the European Council. Based on the state of play of the negotiations in February, Michel could use both the European Commission's new proposal and the positions of the member states to put together his own updated compromise proposal. Such an overall package — increased by the economic stimulus budget — could facilitate an agreement, as it would provide the Heads of State and Government with many new elements for the traditional European package deals and exchanges. The agreement to closely link payments from the European Structural Funds to the European Semester and to focus on the goals of the European Green Deal could thus be compensated for with higher payments from the temporary Next Generation EU economic stimulus budget. To this end, the new Just Transition Fund (JTF) could be used to cushion the costs in regions and sectors particularly affected by the phase-out of fossil fuels. The controversial distribution of grants and loans from the economic stimulus package between northern and southern European states could be balanced by changing the criteria for allocating the money.

However, this approach also involves risks:

- The total volume of the two elements — the MFF and the recovery stimulus package — is limited. Not all distributional conflicts can be resolved with additional funds. Moreover, the combining of the two money pots in the negotiations is likely to feed the expectations of potential recipients that they will receive additional financial compensation.
- Package deals between the two elements of the negotiation package has one major disadvantage: The downside of linking the two elements is that it would give rise to extensive veto possibilities for individual member states. If everything is connected with everything and must be agreed unanimously in the package, everything can also fail due to one minor point of the deal.
- The proposed criteria for distributing the funds from the stimulus budget among the member states appear to be open to criticism, as the Commission has clearly been pursuing an attempt to appease potential veto players with this instru-

ment. However, the criteria cannot necessarily be derived from the extent to which the member states are affected by the pandemic. For example, Belgium, whose infection and death rates are very high, would receive considerably less money than states with very low numbers. The criteria are therefore likely to be called into question during the negotiations. If the Commission cannot provide a convincing justification, this conflict could mark the beginning of the failure of the overall compromise.

- In order to avoid this, the European Council President must be able to have recourse to a traditional instrument of European budget negotiations, namely the ability to offer individual member states special payments or exemptions. To do this, he must have a certain degree of financial leeway that can allow for this solution. Since it is obvious that some member states want to make use of this possibility of special arrangements or payments, this option could further increase the overall volume of the package.
- The total foreseeable volume of the two elements, amounting to almost €1.85 trillion, can only be financed through (a) significantly higher national contributions from the member states, for which there is no indication whatsoever, (b) new sources for own resources that will not generate sufficient resources in the short term, and (c) the raising of debt, for which the Commission has made a proposal. However, the legal basis for loan financing on this scale seems highly questionable. Complaints can be expected, at least before the Federal Constitutional Court in Karlsruhe.
- The necessary adaptation of the European decision on own resources requires the rapid approval of all national parliaments. This seems extremely ambitious if the economic stimulus package is to be implemented as early as January 2021. This is why the French Ministry of Finance, in its non-paper of 8 May, proposed a political commitment and obligation of all Heads of State and Government to implement a new decision on own resources in advance. However, this idea is probably not very realistic, given the rulings of the German Federal Constitutional Court on European political rights and the obligation to make the Bundestag responsible. In this respect, possible borrowing by the EU remains subject to considerable uncertainties.
- The further course of the Brexit negotiations and a possible extension of the transition phase present additional disruption potential.

The Long-term Effects

As in previous EU budget negotiations, the European Commission has linked its proposal for a new MFF 2021—2027 to a major reform project — the transition of European economies to climate-neutral, sustainable, and digital growth models. In this respect, the Commission is using the Covid-19 crisis to implement these objectives more effectively and in a more targeted manner with the new EU budget.

The original proposal of May 2018 had been formulated by the previous Commission under President Jean-Claude Juncker, but it hardly took these new political priorities into account. For example, the European Green Deal, the JTF, the promotion of digitisation, and the project for a European defence policy had not yet been budgeted for, or not adequately. The Commission has now taken advantage of the European Council's invitation of 23 April 2020 to draw up a comprehensive recovery fund. In addition, there was a great necessity and high expectations in some member states that a demonstration of European solidarity was now needed — in the form of a massive economic stimulus package from the European budget. The new Commission took all of this on board in order to underpin its political priorities with appropriate budgetary proposals.

The proposal is expected to have long-term implications for the European integration process. The European solidarity that

Table 1: Evolution of MFF proposals

in EUR millions, (fixed prices 2018)	*1st proposal of the European Commission (May 2018)*	*Proposal of the FIN Council Presidency (December 2019)*	*Council President's proposal (February 2020)*	*2nd proposal of the Commission, incl. recovery budget Next Generation EU (May 2020) (thereof Next Generation EU)*	*Increase between the two Commission proposals (%)*	*Increase between the Council President's proposal and the 2nd proposal of the Commission (%)*
Total volume (appropriations for commitments)	1,134.6	1,087.3	1,094.8	1,850.0 (750.0)	715.4	755.2
in per cent GNI	1.08%	1.07%	1.074%	1.4%	(63.0%)	(69.0%)
1. Internal Market, Innovation, Digital	166.3	151.8	149.5	210.5 (69.8)	44.2 (26.6%)	61.0 (40.8%)
2. Cohesion and values	392.0	374.0	380.0	984.5 (610.0)	592.5 (152%)	604.5 (159%)
thereof cohesion policy	330.6	323.2	323.2	373.2 (50.0)	42.6 (12.9%)	50.0 (15.5%)
3. Natural resources and environment	336.6	346.6	354.1	402.0 (45)	65.4 (19.4%)	47.9 (13.5%)
thereof direct payments	254.2	334.3	335.7	348.3 (15)	94.1 (37.0%)	12.6 (3.8%)
thereof Just Transition Fund			7.5	40 (30)		32.5 (433.3%)
4. Migration and border management	30.8	23.4	21.9	31.1	0.3 (1%)	9.2 (42.0%)
5. Security and defence	24.3	14.7	14.3	29.1 (9.7)	4.8 (19.8%)	14.8 (103.0%)
6. Neighbourhood and world	108.9	103.2	101.9	118.2 (15.5)	9.3 (8.5%)	16.3 (16.0%)

was loudly called for at the beginning of the pandemic is now becoming clearly visible. The EU is prepared to spend huge sums of money to support the member states most affected. At the same time, it is determined to break up existing structures and procedures of the MFF negotiations, and thus to change itself. In addition, the scope for European action in health policy will expand considerably. With the proposed new programme, the EU would be able to act more quickly and with greater solidarity in this policy, too.

The use of the Community budget and cohesion policy instruments undoubtedly strengthens the economic policy options of the Community institutions, first and foremost the European Commission. At the same time, the control and participation rights of the European Parliament are respected. The proposal to take out debt jointly via the EU budget also strengthens the sentiment of solidarity in the EU. During the financial and debt crisis 10 years ago, the EU still chose the intergovernmental approach beyond the European treaties in order to establish new institutions such as the European Stability Mechanism and to be able to implement additional financing and rescue programmes.

Certainly, negotiations in the European Council and with the European Parliament will not simply lead to the adoption of the European Commission's proposal. But if the member states follow the basic approach and direction of the proposal, this package will mark a turning point in the process of European integration. It would be as drastic as the agreement on the European Single Market or European Monetary Union.

However, if the integration process is indeed deepened and broadened to such an extent, this also means that all actors bear much greater responsibility for the success of the EU. For all EU-27 member states and EU institutions, this increase in common policies also requires a greater willingness to compromise, mutual consideration, and an understanding of each other's national sensitivities, problems, and concerns. This applies both to the potential recipients of European solidarity and to those who provide the necessary financial resources.

Dr Peter Becker is a Senior Associate in the EU / Europe Division at SWP.

SWP
Stiftung Wissenschaft und
Politik
German Institute for
International and
Security Affairs

Ludwigkirchplatz 3 — 4
10719 Berlin
Telephone +49 30 880 07-0
Fax +49 30 880 07-100
www.swp-berlin.org
swp@swp-berlin.org

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