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A budget without lessons learned

Rushing through the EU Multiannual Financial Framework may not be so easy

Read this article in German.

In 2017 the European Union spent a while contemplating its future, publishing a white paper outlining five possible scenarios and five additional reflection papers, on topics including globalisation, the monetary union and the union's finances. The idea was to shore up the EU's foundations and unify the member states behind a common vision, following Britain's decision to leave.

Unfortunately, these debates seem to have made little impact on the European Commission's proposal for the seven-year EU budget, unveiled in early May and known as the Multiannual Financial Framework (MFF).

This is partly due to time pressure: the Commission needs approval from the European Parliament before elections take place in 2019. However, if the new budget fails to address growing economic, social and political concerns, its approval will be at risk.

We need to scrutinise both the size and the structure of the proposed MFF, and ascertain whether a small budget line can sufficiently address the question of eurozone fiscal capacity.

Brexit and the EU budget

The Commission is proposing a modest increase in the EU budget, bringing total spending to 1.11 per cent of the EU27's gross national income for the period 2021-2027. This approach seems to defy the discourse that emerged in the wake of the decision by the UK – a net contributor to the EU budget – to leave the EU.

At that time, the prevailing view was that Brexit by definition means less revenue and less funding for common EU policies. This notion, however,

has to be rejected, since a budget is not only a question of maths but also of politics. If it has common needs and objectives, the community can respond to the shortfall by raising more revenue from the remaining members.

Let us not forget that in 2013, the UK was one of four countries that insisted on reducing the EU budget in net terms, after the Commission had proposed a modest increase. At a time of recession and underinvestment, squeezing the EU budget sent the wrong message. Perhaps some governments believed the move would help them score political points at home, but it was bad economics at the EU level.

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Shortly afterwards, the Commission under Jean-Claude Juncker's leadership launched the European Plan for Strategic Investment to boost investment through common European financial instruments. The quick adoption of the 'Juncker Plan' revealed that the four 'friends of austerity' were wrong: more, not less, EU-level resources were needed in support of investment and growth.

An end to rebates

For economists, therefore, the real question is how big a share of the total EU GDP needs to be centralised, redistributed and invested to boost Europeans' prosperity and strengthen cohesion among member states. This is still an open question. Right-wing governments in Austria, Finland, Denmark and the Netherlands, however, have been quick to declare their opposition to any increase in the EU budget. This would result in huge cuts in hitherto key spending areas, given the need to finance new priorities such as defence and security, Eurozone stabilisation and the management of migration.

Brexit also means an end to the extraordinary rebate Margaret Thatcher won for the UK in 1984. Rightly, the Commission proposes phasing out similar rebates granted to other member states, such as Austria, Denmark, Germany, the Netherlands and Sweden. Ending this obsolete practice would significantly lower – perhaps even halve – the relative budgetary loss caused by Brexit, but a gap would still remain.

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Budget structure: old versus new

Assuming the MFF retains its overall size, what will matter will be how the budget is distributed among policy areas.

More than 70 per cent of the current EU budget is dedicated to the Common Agricultural Policy (CAP) and Cohesion Policy – which aims to promote investment in the union's underdeveloped regions. In the new MFF, the estimated reduction of CAP is 15 per cent and that of Cohesion about 10 per cent, which weakens the redistributive effect of the EU budget and could lead to a significant cut in rural incomes across Europe.

So, before giving the green light to such cutbacks of long-running policies, one would need to analyse the profound effect this may have on Europeans' wellbeing, especially in regions adversely affected by globalisation. The CAP has helped ensure food security, stabilise rural incomes and protect the natural environment. Slashing its funding or relying on national schemes could end up costing the EU more than it saves.

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Potential cuts to Cohesion Policy funding throw up similar issues. Redistribution through instruments like the European Structural and Investment Funds is key to maintaining a single market across countries with differing levels of development. Economic activity in large markets like the EU tends to be clustered around the centre. Transfers to the periphery are necessary for maintaining public goods, preventing major divergence in economic potential across the bloc and keeping living standards at an acceptable level. Cuts to Cohesion funding could prove damaging and counterproductive.

Economic stagnation

According to the latest Cohesion Report, published in April 2017, one in six EU citizens lives in regions with income levels less than half of the EU average, mostly on the bloc's eastern and southern periphery. Even with EU support, these regions are stagnating economically. Younger people are moving away to find work, generating further imbalances.

Whether in the UK, Poland or Italy, these are the places where anti-EU,

populist narratives find the greatest resonance. Our priority should be to tackle unsustainable business and social models in these regions. Less developed but seemingly prosperous regions need further assistance to get out of the middle-income trap and to turn around dramatic demographic trends aggravated by large-scale emigration. The way to achieve such economic and social recoveries must be discussed before overloading funds with a mass of conditions.

We need to look more closely at the territorial effects as well. Each change to the distribution of EU budgets will affect some regions more than others. Cutting spending on the CAP and Cohesion while increasing funding for eurozone and migration-related programmes will favour the South and reduce allocations to the underdeveloped East.

Amending the Berlin method – the main way Cohesion funds are allocated – as proposed in the new MFF will have similar consequences. If, for example, the youth unemployment rate is used to modify the allocation, the South would get more, but without the direct obligation to implement a particular European policy in favour of youth, which has been the case with the Youth Employment Initiative in the current period. Disconnecting the eligibility from a particular EU-level policy framework would favour those who want EU money without EU policy, which is not the best way.

Eurozone fiscal capacity

Since the 2011-12 eurozone crisis, a number of EU documents have pointed to the need for a fiscal capacity to stabilise the single currency and make it truly sustainable. Indeed, certain functions, such as cross-country risk sharing and counter-cyclical stabilisation, can be performed only through fiscal instruments in a monetary union. French president Emmanuel Macron has been pushing for an embryonic budget for the eurozone, as have the leaders of the European Central Bank. Provided it does not mean fiscal union, there are even some positive rumblings from Germany about the fiscal capacity.

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Jean-Claude Juncker announced in 2017 that the expected fiscal capacity will be integrated into the new MFF, but due to the small size and the bogus nature of this facility it has already been called homeopathic. Representing just a fraction of the budget, which itself is slightly more than 1 per cent of EU GDP, it may have a stabilising potential for only the smallest member states. Moreover, this would not work

through maintaining demand in the region experiencing a shock, but through supporting investment, which stabilises with a significant delay, or through supporting structural reforms, which has already proved to be a way to destabilisation before it can contribute to any real economic recovery.

It's imperative that we build a real fiscal capacity – and it needn't take a federal leap or treaty change. Political leaders must convince the public of the necessity of repairing European monetary union and preparing it for the next downturn by adding proper shock-absorption tools.

Now or never?

The small size of the proposed budget makes it necessary to explore whether the revenue side can also help with stabilisation by bringing in new incentives with a rebalancing effect. For example, it would be logical to impose a small levy on current account surpluses. The EU has named excessive current account surpluses as a destabilising factor since 2010, under the Macroeconomic Imbalances Procedure, but sanctions were not attached and prayer alone has not been effective. The new MFF provides an opportunity to enforce the rule that requires surplus countries – Germany and the Netherlands most of all – to increase investment and wages and thus boost aggregate demand for helping themselves as well as the whole community.

The Commission rolled out its proposals with the intention of bringing member states, as well as the European Parliament, to an agreement within one year; in other words, before MEPs go back to their constituencies to campaign for re-election. However, if it is now or never for a eurozone fiscal capacity, this issue alone could hold back the entire MFF debate.

In the absence of orderly fiscal transfers and transparent incentives, the monetary union could collapse. And if the current budget debate leads to a harsh reduction of investment resources by cutting European structural and investment funds, the single market could also disintegrate. The stakes are high and the sooner the member states stop playing chicken the better, especially if they take the one-year time frame seriously.



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