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BLOG POST

MFF NEGIOTIATIONS : TOWARDS THE END?

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With the decision by the President of the European Council, Charles Michel, to call a special summit on the European budget on February 20, negotiations on the next EU's long-term financial framework are moving to their final stage. Ahead of this crucial summit, it is worth recalling the importance of these negotiations, analysing some of the most divisive issues under negotiation and discussing what may happen afterwards, when the European Parliament will come into play.

Why the MFF negotiations are important

Over the last years the European Union has been immersed in a never-ending reform debate. However, the EU´s reform process has been rather disappointing, with a lot of "agendas" and "roadmaps" endorsed by the European leaders but very little real change. The negotiations of the next Multiannual Financial Framework (MFF) offer a great opportunity to introduce substantial changes in how the EU works and what it does. Covering a period of seven years (2021-2027), the decisions concerning the size and composition of the new MFF will decisively shape the EU´s spending priorities over the next decade.

The next EU long-term budget is particularly important to deliver on the strategic "Agenda for Europe" set out by the new President of the Commission. This includes, among other priorities, an ambitious "Green deal agenda" to make Europe climate neutral by 2050. To support this goal, the Von der Leyen Commission has pledged to mobilise up to €1 trillion of additional climate-related investments over the next decade. Half of this investment is expected to come from the next seven-year EU budget.

The EU budget is also key to addressing the bloc's other policy challenges. For instance, there is consensus on the need to increase European investment in disruptive research and innovation in key

technologies such as Artificial Intelligence or facial recognition. This is essential both to bolster the ability of EU industries to compete head-on with those from the United States and China and to preserve the Union's technological sovereignty. There is also broad agreement that a more unstable geopolitical context requires a stronger role of the EU in foreign and security policy. As for migration policies, the 2015 refugee crisis revealed the pitfalls of having a common EU border controlled by national officers and the need to build up a reliable common border control management force, as proposed by the former Juncker Commission.

It is also worth noting that MFF negotiations are strongly interlinked with the negotiations of the legislative basis of most EU spending programmes, which expire at the end of 2020. Thus, **it is not only about how much money we want to spend in each policy area but also how we want to spend it in core EU areas such as agriculture, cohesion policy or research**.

A process that started in May 2018…

The budgetary negotiation officially started in May 2018 with the presentation of the Commission´s MFF proposal. Tabling a new proposal is always difficult but the task was harder this time as the Commission had to make up for the gap left by the departure of the UK, a revenue loss estimated at €12bn per year –a non-negligible amount for an annual budget of €150-160 billion. The choice was between reducing spending by an equivalent amount, increasing Member States' contributions to fill up this gap or doing a bit of both.

The Commission chose the first option. It proposed to keep EU spending constant for the remaining 27 Member States in real terms (that is, adjusted for inflation). In relative terms, however, the size of the MFF would jump to 1.11% of EU GNI. The apparent contradiction between an MFF kept constant in absolute terms and an increase in terms of percentage of EU GNI can be explained by the fact that Brexit shrinks the EU's GNI. As a result, **the exit of the UK automatically increases the relative size of the MFF.** In fact, the Commission's proposal represented a slight decrease in the relative size of the MFF compared to the current programming period. Today, EU spending represents 1.16% of the EU's GNI if we take the UK out of the picture (that is, if we compare total EU spending minus transfers to the UK with the EU27 GNI).

To obtain the net payers' consent for an increase of their contributions as well as to give room for new spending needs, the Commission also proposed an important re-balancing of spending priorities. Traditional spending areas were reduced significantly in real terms, particularly the Common Agricultural Policy (- 15%) and the budget for the European Regional Development Fund (ERDF) and Cohesion Fund (-11%), while major increases were foreseen in spending on research, innovation and digital (+43%), migration and border control (+200%), and security and defence (+80%).

Finally, the Commission proposed the introduction of new revenue sources, such as a small contribution based on the volume of non-recycled plastics and a share of the proceeds from the EU Emissions Trading System. It also suggested to profit from the end of the UK rebate to eliminate all the corrections and rebates on the revenue side to render the system more transparent and fairer across Member States.

Since the publication of the MFF proposal, the Council has been discussing and negotiating it, first in the General Affairs Council meetings and later on in the European Council. The former President of the Council, Donald Tusk, originally aimed to reach a deal by October 2019 but deep divisions on sensitive questions as well as delays in the setup of the new Commission postponed the decision.

In early December 2019, the Finnish presidency of the Council published the first MFF negotiating document (the so-called "negotiating box") with figures ahead of the European Council meeting of mid-December. The proposal reduced the size of the EU budget from 1.11% to 1.07%. It also altered the spending re-allocations per headings proposed by the Commission. Most notably, despite the overall smaller size of the MFF, it increased the budget for the CAP by 3% in real prices compared to the Commission's proposal. As for the rest of the programmes, the largest reductions were foreseen for "migration and border management" (-24% vs. the Commission proposal) and "security and defence" (-40% vs. the Commission proposal). Finally, the Finnish government also proposed to reduce cohesion spending by 2% compared to the Commission proposal, something that was widely criticised by the so-called "Friends of cohesion" (a group of 17 Member States primarily from Eastern and Southern Europe that fights to maintain EU cohesion spending in real terms).

The Finnish proposal did not secure sufficient backing among Member States to be seriously discussed in the December European Council. Since then, its new President, Charles Michel, has taken the lead in the negotiations. Over the last weeks he has held bilateral discussions with all the EU leaders to clarify red lines and potential concessions.

Notwithstanding the efforts to prepare the ground**, the general mood is that this summit will not be the final one as Member States´ positions are still too far apart**. A look at the past also shows that EU leaders normally need two summits to converge and reach an MFF agreement. However, it is also true that MFF discussions in the European Council usually start much earlier in time. In the previous MFF negotiations, for instance, there was a special EU summit on the MFF in November 2012 and the final agreement was reached in February 2013. Now we are left with just 10 months before the current EU budget expires in December. If EU leaders do not reach a deal now, they will probably have to do it before the summer to leave enough time for the negotiations with the European Parliament.

The size of the MFF: 1%, 1.07%, 1.11% or something else?

One of the key elements that will be negotiated in the Council is the overall maximum size of the budget for the new financial period. As said above, the Commission has proposed a MFF equivalent to 1.11% of EU GNI but a group of net payers (known as the 'frugal five´: Austria, Denmark, Germany, Netherlands and Sweden) wants to limit the overall size of the EU budget to 1%.

The request to keep the EU budget at 1% is not new. Already in 2003, a group of six net payers (Germany, France, the Netherlands, Austria, Sweden and the United Kingdom) had sent a letter to the then President of the Commission, José Manuel Barroso, asking to keep EU spending at 1% of EU GNI. The fear at the time was that the accession of ten new and poorer EU member states would lead to an explosion of EU spending in the absence of a clear political limit. The famous 2003 "1% letter", however, did not specify

whether the 1% related to commitments (that is, legal pledges to spend in new projects or activities) or to payment appropriations (expenditure actually paid to beneficiaries). This opened a margin of negotiation as the level of payments is always lower than that of commitments. In the end, the final Council´s 2007-13 MFF agreement fixed commitments at 1.06% and payments at 1%. These percentages, however, would move up to 1.12 % and 1.06 % at the end of the MFF, as a result of lower than foreseen economic growth following the economic and financial crisis.

In fact, the only time the MFF has been strictly capped and maintained at 1% of total EU GNI has been in the current 2014-2020 MFF. Negotiated under austerity, the request from the net payers at the time was to fix EU spending at the level of 2013 and adjust it over time at a growth rate below the inflation rate, in order to support "the required stabilisation of budgetary contributions of Member States". As then Council President Herman Van Rompuy declared at the end of the negotiations, the result was a "a budget of moderation" which, for the first time ever, entailed a real cut in the volume of commitments and payments in absolute terms compared to the previous MFF.

It does not seem logical to maintain a "budget of moderation" today, when the economy goes well and there are important investment needs ahead. Net payers insist that the EU budget should be smaller after the UK departure. While this is true in absolute terms, it is not immediately obvious why the Union should spend less in relative terms – that is, as a share of its wealth – after Brexit. Besides, as pointed out above, with the exit of the UK the current EU budget has increased to 1.16% of EU GNI. Fixing an MFF 2021-27 at 1% of EU GNI would imply a sharp reduction in absolute terms with respect to the current MFF's spending level.

The issue of rebates

The negotiations on the overall size of the MFF will be very much connected to the discussion on the future of rebates. As said above, the Commission aims to eliminate the various compensatory mechanisms that have been introduced over time to limit the contributions richer countries pay into the EU budget. Due to these corrections, these countries pay less to the budget as a percentage of GNI (0.70%) than the rest of Member States (0.81%). The Commission´s idea is to move to a system in which all Member States make a similar contribution to the EU budget as a share of GNI, of roughly 0.90%.

There are various compensatory mechanisms on-going today and they basically benefit the 'frugal five´. In this respect, it is probable that any concessions on the overall size of the EU budget from these five countries will be conditioned to the maintenance of these benefits. **It is also possible that the MFF Council deal includes new compensatory mechanism**s. In the last two MFF negotiations there were some lump-sum reductions to certain countries' GNI-based contributions introduced at the very last minute to secure unanimous agreement in the European Council. New corrections may be necessary, for instance, if the Council agrees to introduce new "Own Resources" disproportionally affecting some countries.

Re-balancing spending priorities

Another big issue will be the distribution of spending per headings. Traditionally, at the request of net recipients, the European Council tends to preserve pre-allocated spending (aka the CAP and cohesion policy) from major cuts at the expense of non-pre-allocated spending programmes, which are drastically reduced to keep the overall level of EU spending low.

The Finnish "negotiating box" already reduced the cut to agriculture to -13% in real prices (instead of -15% in the Commission's MFF proposal) by adding €10bn to expenses on rural development (so-called pillar two). This will not fully satisfy those Member States that call for maintaining the CAP budget in nominal terms, but it is hard to imagine further increases in agriculture spending. For countries such as France, which receives most of CAP support for direct payments to farmers (so-called pillar one), it will not make sense to ask for further increases to the CAP budget if these are concentrated on "pillar 2". **Rather than on the overall size, we can anticipate intense discussions on how this CAP budget will be distributed between the Member States**, and particularly on how much and at which rhythm direct payments to farmers should be equalized across the EU— an issue that deeply divides Eastern and Western European countries.

Net recipients will be more combative on cohesion spending. As said above, the Finnish ´negotiating box´ reduced the cuts proposed by the Commission even further, and this is something that the "Friends of cohesion" will try to revert. The alliance recently met in Portugal on February 1st and came up with a document asking to maintain cohesion spending at real prices. Charles Michel will most probably increase the resources for the sub-heading "regional development and cohesion", at the very least with the inclusion of the additional €7.5bn funding for the new "Just Transition Fund".

As regards other EU spending programmes**, it is likely that the final deal will significantly reduce the budget for "migration and border control", the new European defence fund, the neighbourhood and development instrument, and/or the Budgetary Instrument for Competitiveness and Cohesion** (BICC, regarded as the possible premise of a "euro zone budget"). Spending covering single market, innovation and digital was cut by 24% compared to the Commission´s proposal in the Finnish presidency´s proposal. If this reduction is maintained, it will compromise the budget of important programmes such as the InvestEU Fund (the successor of the "Juncker Plan") and the new Digital Europe Programme. In theory, net payers are in favour of spending more in these areas to "modernise" the EU budget. Yet, they will not support further spending increases if this runs against their main priority, reducing their contributions to the EU budget.

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What will happen next?

According to the Treaty of Lisbon, the MFF only comes into force following a decision by the Council after the European Parliament has granted its consent. In practice, this means that the Parliament shall approve or reject the Council's MFF deal by simple majority, but it cannot make amendments to it.

An open question is how many concessions will the Parliament obtain, and on which aspects. The MEPs in charge of the negotiations have insisted several times that their consent should not be taken for granted. Besides, the Parliament is quite unsatisfied with the previous MFF negotiations. Taking place in a context of budgetary austerity, it was not able to challenge the Council´s MFF figures and had to accept an historically low level of commitments and payments in exchange for some minor compensations - the strengthening of flexibility instruments, the introduction of a mid-term review or the establishment of a high-level group of experts to discuss new Own Resources. At the same time, they have a long list of requests which seems impossible to satisfy – increase overall EU spending up to 1.3% of EU GNI, keep cohesion and CAP spending in real terms, significantly increase spending in areas such as research, youth, climate, secure the allocations proposed by the Commission for migration and border control or defence, maintain the unity of the EU budget, introduce new Own Resources, abolish all rebates, etc.

Sooner or later, the Parliament will have to settle for a clear negotiation strategy, identify its own red lines and the issues in which it will be open to compromise. Otherwise, it will not be able to obtain any meaningful concessions from the Council.

For all these reasons, expect MFF negotiations to go on well after February 20. Even if the Council reaches a deal before the summer, the negotiations with the Parliament will take place under the German presidency of the Council. This will complicate things, as the current German political crisis will not invite the largest net contributor to take bold decisions paving the way for a compromise.

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