EUROPEAN BUDGET
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#EUROPEAN AGREEMENT
#BUDGET

A HISTORIC AGREEMENT, YET TO BE IMPROVED AND IMPLEMENTED

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The European Council has agreed on a recovery plan and a long-term European budget. The European Parliament will be tasked with making improvements to the budget while the European Commission will work with the Member States to implement the plan.

It's a potentially better-integrated and more united European Union which has emerged from the landmark agreement reached by the 27 Heads of State and Government in Brussels on the dawn of 21 July. The milestone recovery plan backed by the European multiannual budget was approved after more than four days and nights of bitter negotiations. The scale of the response set out by this agreement to aide the economies most affected by Covid-19 coupled with the signs of progress for European integration are most welcome. Now fast, visible and practical action is needed to ensure the astronomical sums which have been announced to Europeans are not just a distant promise. While the European Commission must get organised to put the agreement into practice, part of the stimulus package still needs to be ratified by each of the national parliaments. Consistency must also be ensured with the European Parliament as regards the multiannual budget. The resolution adopted by a large majority of MEPs on 23 July reflects their expectations. These offer an opportunity to improve upon a compromise which was reached through ambiguities that are not always constructive and to the detriment of policies that are key to the future of the EU bloc itself.

1 ■ A historic agreement on a highly anticipated stimulus package

The term "historic" is fully justified regarding the agreement of the Special European Council reached on 21 July. Not because it is the culmination of one of the longest sum-

mits in the history of European integration, but because it introduces further **financial solidarity**. The European Commission (EC) is being called upon to raise a large-scale €750 billion loan for the EU on financial markets as part of a recovery fund, that has been dubbed "NextGenerationEU". Over the next three years (2021-2023), this fund will finance the recovery of the European economy which has been adversely affected by the pandemic. The EC has already borrowed in the past but never on such a scale. Moreover, most of the fund (52%, €390 billion) will be paid as direct grants, meaning beneficiaries will not have to pay them back as such.

The fact that **Europe's institutions are going into debt to finance budgetary transfers** is unprecedented and thus historic with regard to the deepening of European integration. Up to this point, such a show of solidarity had been inconceivable for several Northern European countries. In reaction to the exceptional circumstances caused by the pandemic, the Twenty-Seven Member States have this time officially accepted such an agreement, on a temporary basis. That said, the commitment is now well underway with the agreement effective until 2058, the package's repayment deadline. The repayment in question also calls for future in-house resources (so called "own resources"). Just as the financial and sovereign debt crisis of 2008-2012 disrupted the role of the ECB, the health crisis and the ensuing recession are transforming EU budgetary policies, particularly through this agreement. With the other instruments created during Covid, particularly temporary Support to mitigate Unemployment Risks in an Emergency (SURE), a more united European integration, closer to Jacques Delors' ambitions, can begin to take shape. The euro itself will emerge transformed due to **increased international influence** through the EC's issuance of securities on the financial markets.

From a political standpoint, the agreement marks the **return of the Franco-German** power duo, spearheading the EU. The draft €750 billion recovery fund prepared by the EC is largely based on a proposal put forward jointly on 18 May by Emmanuel Macron and Angela Merkel. Both leaders advocated a €500 billion recovery entirely through grants. The French President was able to bring a German Chancellor, who had long been reluctant to move towards a kind of macroeconomic stabiliser, closer to his own views. Even if less than anticipated, **solidarity, mainly through transfers, prevailed,** despite fierce opposition during the summit from the Netherlands, Austria, Denmark and Sweden. These four self-proclaimed "frugal" countries, were joined by Finland. Coupled with the EC and European Council presidency, the regained strength of the Franco-German pairing, obvious all throughout the summit, favoured this European breakthrough, which was still unimaginable three months earlier.

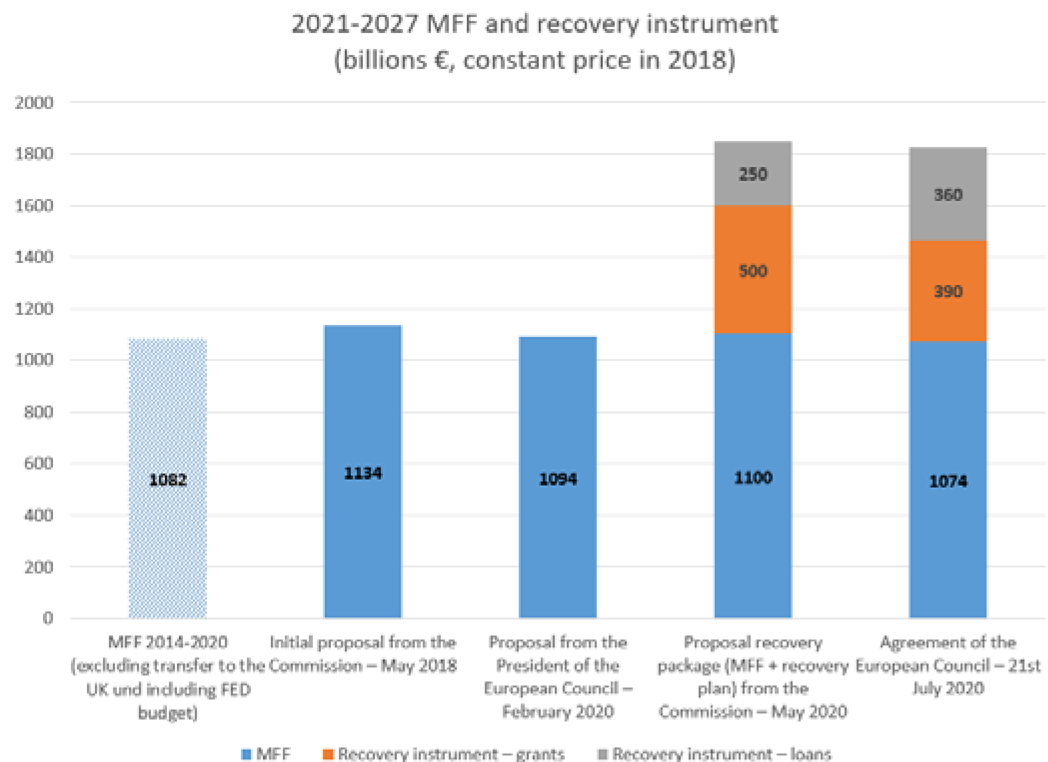
Such progress with federal features would have been impossible should the UK still have been a Member State. It marks the first **post-Brexit agreement in Europe** for all 27 Members, and not only the eurozone. While the British withdrawal remains an unfortunate initiative, this agreement further illustrates that Brexit has not broken up the EU. On the contrary, it has facilitated European integration.

2 ▪ An agreement at a high cost

The willingness of the EU-27 to unanimously sign the agreement drove a compromise which was reached at the cost of **a number of regrettable concessions.** The governance of the stimulus fund, which was hotly contested during the summit, has been resolved by a compromise that could complicate its management.

Above all, the injection of new money via the recovery fund is matched by deep cuts in the

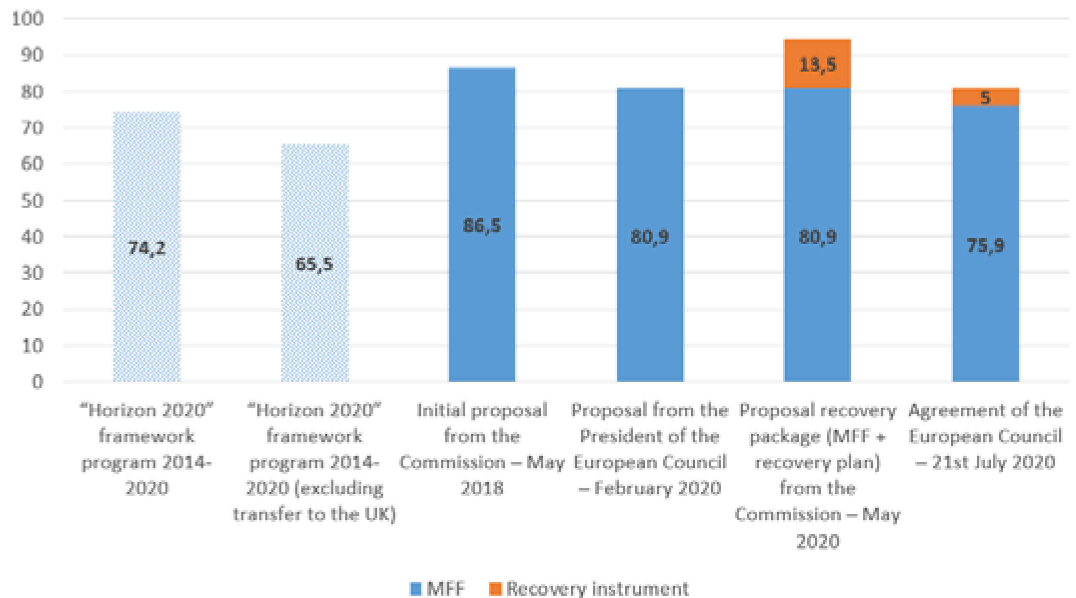
EU budget for the next seven years. To this end, the Multiannual Financial Framework (MFF) for 2021-2027 has been reduced to €1,074 billion (see summary table below). Though successful in practice, this joint negotiation was a daring gamble because it increased the number of opportunities for resistant parties to request that concessions be squeezed from the MFF, to its detriment. As most often, the programmes that do not have allocations previously distributed among Member States have been hit the most. In the end, **progress in terms of solidarity was secured on the back of investment programmes which are paramount** to the EU's collective future.



Source : Institut Jacques Delors

Paradoxically, despite an increase, the budget for **health** policy is no longer funded as it was in response to the pandemic: €1.67 billion was proposed versus €9.37 billion by the EC in the *EU4Health* programme.

The **research** budget has been reduced. *Horizon Europe* has expanded compared to the previous European research programme, *Horizon 2020*. Nevertheless, its total of €80.9 billion falls short of the EC's 2018 target of €86.5 billion for the EU-27 (see table below), in an area where the race is relentless the world over.



Source: Institut Jacques Delors

Future sectors, where the pooling of resources across Europe makes sense, are also suffering cuts. The new ***European Defence Fund***, prepared by the EC for an amount of €11.4 billion (at constant prices) has been reduced to €7 billion, while the *European Peace Facility* has been reduced from €9.2 to €5 billion. These cuts are all the more damaging since they betray the lack of collective ambition of the EU-27 for European defence at a time when the need has never been greater considering the current geopolitical context.

Equally unjustifiable is the fact that **European funds dedicated to cooperation and humanitarian aid** have been reduced by 9% compared with the EC's budget for 2018, while there is more need for them than ever[1]

Other swingeing cuts concern the programme to stimulate private investment, *InvestEU* (from €31.6 billion in the EC's latest proposal, thus totalling €6.9 billion in the agreement), the *European Agricultural Fund for Rural Development* and the new ***Just Transition Fund*** (from €40 to €17.5 billion) that strives to provide social support for the energy transition under the *European Green Deal*. The *Strategic Investment Facility*, which was specifically intended to fuel investment in new energies, will be completely phased out. Much like a solvency facility that was meant to support companies.

Another future investment cut: the budget for the famous ***Erasmus*** programme, has been increased to €21.2 billion (from €14.9 billion for 2014-2020), whereas the EC had initially proposed doubling it in 2018 to over €26 billion, with a view to making this exchange available to as many young people as possible.

As for revenue, the EU-27 compromise called for **maintaining discounts** for five countries (the four "frugal" countries and Germany) in terms of their EU budget contributions. Such rebates were to disappear in the wake of Brexit, which puts an end to the

1. Read *Policy Brief* by N.Koenig/E.Rubio, 22 July, 2020 for more on policy cuts and defence.

"British rebate". Not only will these discounts be maintained for the next seven years but they are sometimes even increased, much to the detriment of France, which, along with Italy, will be their main funder.

Another overly generous gift covers **customs duties**. The Netherlands and Belgium, which manage the major ports of Rotterdam and Antwerp respectively, will benefit from a higher percentage on the collection of these duties, that provide own resources directly paid into the European budget in the framework of the internal market.

In addition to these cuts and bonuses from the haggling Twenty-Seven which ignore European interests, the agreement offers clouded visibility on three key European issues.

First, Europe's **own financial** resources. New revenue needs to be generated to repay the widescale European loan by 2058. Next year, the only scheduled contribution concerns non-recycled plastics. Other projects, such as the welcome creation of a carbon adjustment mechanism at European borders[2] or a digital tax, are specified in the agreement but in a non-binding manner, thereby jeopardising the long-term repayment of the substantial loan.

Another foggy area is the wording concerning the condition of respecting **the rule of law** in order to benefit from European funding. The European Council has certainly not gone so far as to require unanimity to suspend funds. Where necessary, it specified qualified majority voting by the Member States to trigger a suspension. Conversely, the EC suggested such a majority would be necessary to prevent deadlock, which would be a more practical way of complying with the rule of law.

Lastly, the agreement seems inadequately developed with regard to **urgent climate-related matters.** It does not oblige Member States to ensure the necessary coherence between their recovery plans and their climate-energy and just transition initiatives. The compromise does, however, set aside a target of 30% total climate spending through the budget and the recovery fund. Based on the "do no harm" principle, it prohibits negative impact expenditure. Nonetheless, meeting this target and respecting this principle will demand the utmost vigilance. In practical terms, the partial issue of a widescale loan as green bonds[3] will at least oblige that these sums be allocated to investments which meet the conditions laid out in the European taxonomy.

3 ▪ An agreement which requires improvements and quick execution

The ball is now in the European Parliament's court to bolster the overly depleted multiannual financial framework, thereby improving the terms of the agreement. When acting as such, the European Parliament is no threat to the recovery fund, which fully depends on the Council. The European Parliament is also working within its scope when it comes to the European budget. As the authority on budget, its consent by an absolute majority is crucial. And in regard to the texts that provide the framework for sector-based programmes, the MEPs act as co-legislators. In doing so, they may seek to marginally increase many portfolios.

European elected representatives are also expected **to get clarified abovementioned ambiguities**, specifically regarding the rule of law. In terms of Europe's future own resources, which the Parliament has long sought, its July 23 resolution subjects the approval of the new MFF to a timetable which requires their introduction. Finally,

2. Policy Paper P.Lamy, G.Pons, P.Leturcq, EJD (Bruxelles), *Greening EU trade policy: A European border carbon adjustment proposal*, June 2020

3. Blogpost Jean-François Pons, EJD (Bruxelles), *Recovery plan: time for social and green bonds*, 24 July, 2020

the European Parliament should **act in the governance of the recovery fund**[4], helping to monitor its use.

The European Commission must now get ready to work, as it must suddenly manage five times the annual European budget. The challenge will be to prevent the processing of grant applications and their disbursement from turning into a bureaucratic behemoth. At the same time, it needs to prevent funds from being wasted or diverted, a risk which will increase with the new amounts to be managed.

The mammoth task also represents a challenge for EU Member States themselves, which in turn, will have to manage this European budgetary windfall. As in the case of France, EU Member States already experience difficulties spending all the funds made available. With the recovery plan now added, it is up to them to **ramp up their capacity** to absorb funds in record time.

However, this challenge is not solely organisational. First and foremost, it is economic. The aim is for the recovery plan to have an impact as quickly as possible in the countries and sectors most affected by the crisis. Politically, it is equally important for citizens to quickly see the promised sums paid across Europe in order to avoid the risk of costly disappointment and discontent. The issue is particularly sensitive in Italy, which is meant to be the biggest beneficiary of the new recovery instrument. During the outbreak of the pandemic, which hit their country hard, Italians expressed strong disappointment towards with the EU for its lack of solidarity.

Finally, the **European Council** must consider reinventing itself. While the leaders'institution has acted swiftly to respond to recent crises and has demonstrated its ability to compromise, the sometimes acerbic negotiations among heads of State and government, reported in the media, have left traces in the public's collective memory that will take time to fade. Serious perspective is required to develop a common solution between the 27 Member States. Endless haggling is certainly not on the way forward, which requires an enhanced and better shared European mindset.

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4. Policy Brief Lucas Guttenberg, Thu Nguyen, JDC (Berlin), *How to spend it right: a more democratic governance for the EU recovery and resilience facility*, 11 June, 2020

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