The budget of the European Union – prospects for 2021 - 2027

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Abstract: *Although the process on the elaboration of the next Multiannual financial framework for 2021 – 2027 is still at an early stage, there are some important changes envisaged both on the revenue side and the expenditure side. The present paper outlines the possible options for reforming the system of own resources intended to reduce the national contributions based on gross national income and to increase the share of "genuine" own revenues related to the common EU policies. It also focuses on the most important changes considered on the expenditure side. Traditionally, the largest part of the financing has been devoted to the common agricultural policy and the cohesion policy. But it is increasingly recognized that more resources need to be allocated to macroeconomic stabilization in order the ensure the viability of the common currency and to mitigate the effects of possible economic shocks on the Member States. The deepening integration and the territorial expansion of the EU require an increase of expenditure, on the one hand, but they also allow the Member States to pool their resources and achieve economies of scale and scope. After the accession of the countries from Central and Eastern Europe, the EU budget has increased in nominal terms to more than 1 trillion euro (around 160 billion euro per year), but in proportional terms it amounts to around 1% of the annual gross national income and around 2% of total public expenditure of the Member States. However, in the years after the global crisis there is a growing nationalism and, in this context, the negotiations on the next multiannual financial framework are expected to be difficult.*

Key words: *EU budget, Multiannual financial framework, economic integration*

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1. Introduction

The budget of European Union is the basis for the allocation of its financial resources among Member States and the development of economic integration. Therefore, the process of its elaboration and adoption is complicated and requires conciliation of the often-conflicting interests of the stakeholders. The present paper focuses on the preparation of the next Multiannual financial framework (MFF) for 2021 - 2027. Although the procedure is still at an early stage, there are significant changes proposed by the European Commission on both the revenue and expenditure sides. These changes are required by the necessity to address the economic, social, geopolitical and other challenges faced by the European Union. The second part of the paper outlines the main changes envisaged on the expenditure side of the EU budget in the next MFF; the third part examines the most important proposals to reform the system of own resources; and the fourth part concludes.

The budget of the EU has its specifics and, despite the deep integration in Europe, is still complementary to the national budgets of Member States. Its most important characteristics can be summarized as follows:

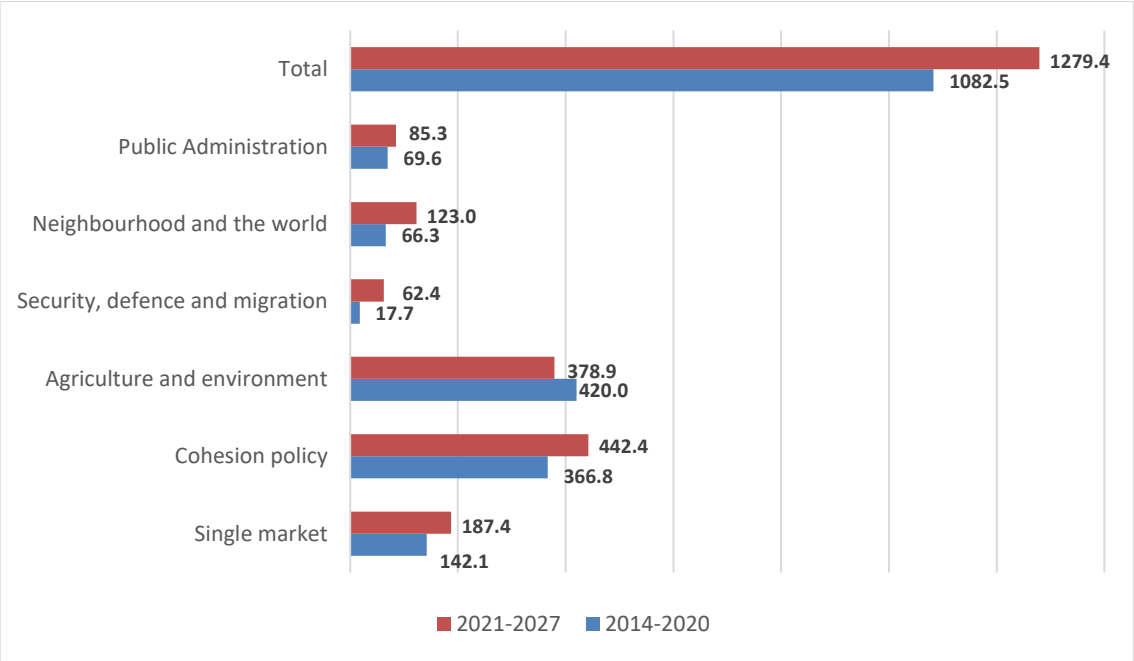
- *Longer planning period* – the EU budget is based on a 7-year Multiannual Financial Framework. The longer horizon facilitates the adoption of the annual budget, ensures the predictability of EU public finances and mitigates economic fluctuations (Council of the European Union, 2018).
- *Financing entirely with own resources* – the EU budget cannot be financed with debt. Own resources must not exceed 1.2% of EU gross national income (GNI) for the respective year.
- *Fiscal balance* – annual expenditure must be covered with the annual amount of revenue. A surplus or deficit is not allowed. The fiscal discipline is ensured also through expenditure ceilings.
- *Subsidiarity* – spending is focused only on the activities that are not financed by the Member States.

2. Changes on the expenditure side in MFF 2021 - 2027

The expenditure side of EU budget is based on the political priorities negotiated between the Member States and the European Commission for the respective seven-year period.

The proposal for MFF 2021 - 2027 differs from the current multiannual financial framework and it includes new headings. MFF 2014 - 2020 is based on the implementation of "Europe 2020" Strategy, whereas the next MFF will focus on new priorities, such as digital economy, migration, border management and defence. This shift in priorities is reflected in respective changes in the amount of funds (European Parliament, 2018, p. 3). Figure 1 compares the expenditure appropriations under the current MFF 2014-2020 and the projected appropriations in the next multiannual budget. In 2021 - 2027 total expenditure is planned to increase from 1.08 trillion euro to 1.28 trillion euro, or in percentage terms - from 1% to 1.1% of gross national income (GNI).[2]

Figure 1: Comparison of expenditure appropriations in MFF 2014-2020 and MFF 2021-2027 (billions of euro, in current prices)



Source: European Commission, own calculations

Some changes are envisaged in the distribution of the funds among the various expenditure headings. Traditionally, around 70% of total budget has been allocated to the Common agricultural policy (CAP) and Cohesion policy (European Commission, 2014, p. 8). In 2021 - 2027 the funds allocated to CAP will decrease by EUR 41 billion – from EUR 420 billion to EUR 379 billion. On the other hand, the financial resources allocated to Cohesion policy will increase by EUR 76 billion, thus it will become the most

[2] The indicator gross national income (GNI) includes GDP plus net factor income.

important expenditure heading. Under this heading the largest share of funds will be devoted to regional development and territorial cohesion, but more resources will be allocated also to strengthening the Economic and Monetary Union, including the creation of new financial mechanisms. The new *Reform Support Programme* (with an overall budget of EUR 25 billion) will assist Member States, through technical and financial support, in conducting reforms in product and labour markets, education, taxation, capital markets development, etc. As part of this mechanism, a *Convergence Facility* will also be established to support non-euro area Member States seeking to adopt the single currency. Also, the *European Investment Stabilisation Function* is expected to mobilise up to €30 billion in loans to help stabilise public investment levels and facilitate rapid economic recovery in cases of large asymmetric economic shocks (European Commission, 2018, p. 12).

Expenditures related to the functioning of the single market will also be increased by around EUR 45 billion. Under this heading a new investment fund, *InvestEU*, will be established, which will provide budget guarantees for private investments in the fields of environmentally sustainable infrastructure, development of small business, research and innovation and social investment and skills. With a contribution from the EU budget of EUR 15.2 billion, InvestEU is expected to mobilise more than EUR 650 billion of additional investment across Europe (European Commission, 2018, p. 7).

In percentage terms, the strongest increase (by more than 250%) is projected in the heading Security, defence and migration – from EUR 17.7 billion to EUR 62.4 billion.

Despite the projected reforms on the expenditure side, the EU budget has still limited possibilities for macroeconomic stabilization required by the deepening integration and the functioning of the single currency. First, the requirement that the budget must be balanced each year precludes the operation of automatic fiscal stabilizers. Second, the EU budget is too small (in proportion to GDP) to make a visible macroeconomic impact. In a study published in the MacDougall Report (1977) it was suggested that for an economic and monetary union, it should be 5-7% of GDP to be able to contribute to macroeconomic stabilization (Begg, 2016, p. 4). The EU budget contributes to macroeconomic stabilization indirectly, through the longer planning horizon which guarantees a constant level of investment independent of the economic phase. In addition, the amount of national contributions depends on the state of national economies – during recessions the contributions automatically fall and vice versa.

Table 1: Institutional structure of EU financing mechanisms

Existing mechanisms	Activities
European Investment Bank	Loans for investments
European Structural Funds and Investment Fund	Grants for economic and social cohesion
European Stability Mechanism	Loans for euro area countries experiencing financing problems
New mechanisms	**Activities**
Reform Support Programme	Technical and financial support for reforms; Grants for non-Euro area countries to support the adoption of the euro.
Invest EU Fund	Public guarantees for private investments
European Investment Stabilization Function	Loans for public investment and recovery in cases of asymmetric shocks.

Source: European Commission

3. Changes on the revenue side in MFF 2021 - 2027

The sources of financing of the EU budget have undergone significant changes during the integration process. Since the establishment of the European Steel and Coal Community (ECSC) in 1951 until the end of the 60's funding was provided by the six founding Member States through the financial contributions. The introduction of new policies and the territorial expansion required an increase in the common budget. In 1970 the Luxemburg decision introduced the System of own resources, including customs duties, agricultural levies and part of national VAT revenues (Matthijs, 2010, p. 6). The system of own resources entered into force in 1971 and the intention was to gradually replace the financial contributions of Member States with own tax resources stemming from the common policies. At the end of the 70's customs duties became the principal financing tool. However, the process of worldwide trade liberalization led to a significant decline in these receipts by the end of the 80's. At that time the main source were national contributions based on gross national income (GNI) followed by contributions based on value added tax (VAT). Also, at the end of the 80's a maximum ratio of revenue to gross national income of Member States of 1.2% was established.

In 2018 over 70% of total revenue is accumulated by national contributions based on GNI although the original idea was these contributions to serve as an additional financing

method. GNI-based contributions have their advantages. Most importantly, they are related to the ability to pay of Member States and they generate stability in the revenues over the medium-term. Nevertheless, some Member States have been discontented with the allocation of the financial burden among them. The countries from Northern Europe, whose economies do not rely on agriculture due to their climate, have complained that their national contributions exceed the benefits received. In the 1980's the United Kingdom managed to negotiate a rebate, i.e. a reduction of its national contribution, but the shortfall had to be compensated by the other Member States. In the following years, Germany, Austria, Sweden and the Netherlands also negotiated deductions from their contributions, which further complicated the financing of the EU budget.

Against this background, the United Kingdom's withdrawal is expected to affect revenues both positively and negatively. The contribution of UK in the EU budget in 2010 - 2017 has averaged to around EUR 13 billion per year and this loss must be compensated either with the increase of national contributions of the other Member States or with the introduction of new own resources. On the other hand, Brexit will lead to simplification in the calculation of national contributions due to the abolishment of the rebate for UK and the related compensations for other Member States. However, the elimination of rebates (except for the UK) would not have immediate effect but would instead be phased out over a five-year period and it will be fully implemented only in 2026. The aim is to avoid a 'significant and sudden increase' in those countries' contributions (European Parliament, 2018, p. 15).

The EC has proposed significant changes on the revenue side in MFF 2021 – 2027. The ceiling of own resources for payments and commitments will be raised to 1.29% and 1.35% of the EU-27 GNI, respectively (European Commission, 2018, p. 28). In the next place, a diversification of financing sources is envisaged with the aim to link revenues more closely to EU common policies. The possible new methods of financing were elaborated by the High-level group on own resources (Monti, 2016). Consequently, the following three new types of own resources were included in the proposal for MFF 2021 - 2027:

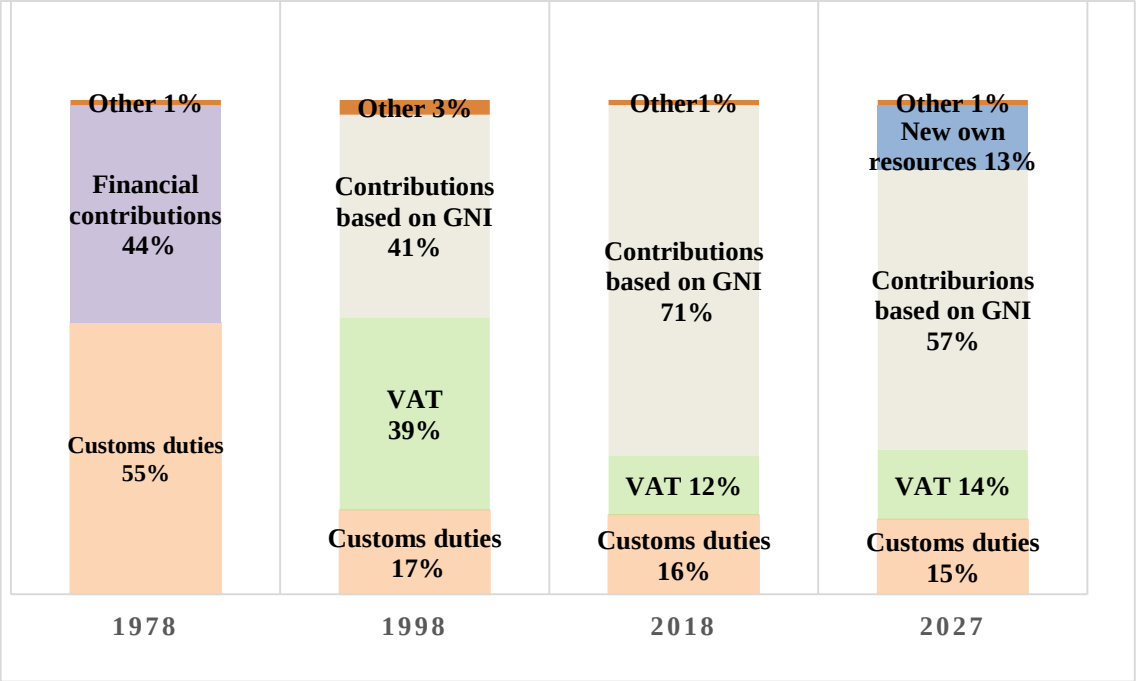
- *European Emissions Trading System* – the proposal of the EC is to allocate 20% of the revenues from emissions trading to the EU budget.
- *A national contribution calculated on the amount of the non-recycled plastic packaging waste* – this method is also related to negative externalities. Its introduction is expected to create an incentive for Member States to reduce

packaging waste and stimulate the transition towards a circular economy (Monti, 2016)

- *The Common Consolidated Corporate Tax Base (CCCTB)* – this is a project for corporate income tax coordination in the EU, which, if implemented, will change the mechanism for calculation and allocation of the taxable profits of companies operating in more than one member-state. The adoption of the CCCTB aims to reduce the possibilities for multinational enterprises to avoid taxes and at the same time to reduce administrative burden. However, the previous attempt to adopt the CCCTB in 2011 has failed due to the opposition of some Member States. The current proposal is pending approval by the Council of the EU.

The new own resources are expected to contribute around 13% of total EU budget revenue per year. This would allow for reduction of GNI-based contributions to 57% of total revenue in 2027 in comparison to 71% in 2018.

Figure 2: Structure of own resources of EU budget



Source: European Commission, European Parliament

4. Conclusion

The proposal for the Multiannual Financial Framework 2021 – 2027 does not provide for radical changes in the EU budget in comparison to the current MFF. This is due to the fact that the EU budget is complementary to national budgets and its main purpose is to

finance investments contributing to the development of the Single market. Moreover, there are limitations regarding both revenue and expenditure. Nevertheless, the proposal of the European Commission for the next MFF contains several important changes.

As regards the expenditure, an increase is projected in funds allocated to Cohesion policy, Single market, defence and migration. Also, new financial mechanisms will be established in addition to the already existing in order to strengthen the common currency and streamline public investments. However, despite these measures, the EU budget is still insufficient for the purposes of macroeconomic stabilization and remains mainly an instrument for redistribution of income between old and new Member States.

On the revenue side, the main challenge in the next seven-year period will be to compensate the loss of the national contribution of the United Kingdom and to increase the share of genuine own revenues related to EU policies. The EC has proposed the introduction of three new sources of financing, which are related to environment and corporate taxation. As a result of the introduction of these new own resources, GNI-based contributions of the Member States will be decreased.

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