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Pre-allocated return flows vs. European public goods: How the veto impairs the quality of the EU budget

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Summary

Although exceptional in size and innovative in several respects, the budget package adopted by the European Council on 21 July 2020 confirms a general trend in MFF negotiations: to make room for final concessions and compromises, late cuts are always made in the allocations for genuinely common European interests. As national trophies must be secured for each prime minister, savings are undertaken in the spending for research, development cooperation, security, neighbourhood policy, external affairs, common institutions and other expenditures not earmarked for particular Member States.

This finale of the Council's bargaining process seems inevitable as long as each country has a veto right and negotiators perform exclusively for their national audiences. A wider use of qualified majority voting (QMV) could help reorient EU spending towards a greater emphasis on programmes meeting truly collective needs.

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1 Introduction

The sixth round of MFF negotiations is not completed yet – as the consent of the European Parliament and national ratifications of the Commission's extended credit competence remain to be secured – but it has nevertheless passed the crucial needle eye of the European Council. With varying degrees of elation and relief, all governments have expressed their satisfaction of some results obtained and regrets about other demands not met. Similar signals have been heard from the EU parliamentarians. Some reshuffling and earmarking can be foreseen in its further process, but the basic framework set down on 21 July 2020 is likely to survive this scrutiny.

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The most spectacular innovation in the deal of 2020 is doubtless the quantum jump in EU financial capacity achieved through the combination of the MFF with a loan-financed recovery package, to be used both for grants and loans to Member States. Details in the conditionalities remain to be settled in the further specification of the principles agreed upon. At this stage, the initiative has been sold as a one-off and strictly time-limited arrangement, but EU history is as replete with implementation delays as fiscal history is with the perpetuation of levies first launched as exceptional and extra-ordinary. Much remains to be seen.

2 Four stages in the MFF negotiations

Looking back at the negotiations preceding the 21 July 2020 Council decision, both the initial standpoints and the subsequent retreats of the various actors were highly consistent with their traditional movements. The recurrent patterns in three decades of MFF negotiations have been examined in impressive detail by Brigid Laffan (EUI), Eulalia Rubio (Notre Europe), Jorge Núñez Ferrer and Daniel Gros (CEPS), Zsolt Darvas (Bruegel), Iain Begg (LSE), John Bachtler (EPRC), Fabian Zuleeg (EPC), Peter Becker (SWP), Margit Schratzenstaller (Wifo) and Friedrich Heinemann (ZEW).[1]

The picture emerging from these studies is one of great stability. As in commedia dell'arte, the characters perform their habitual roles and express their habitual views. The Commission consistently aspires to get moderate increases in EU spending while bending it towards more future-oriented investments and projects with a high dosage of European public goods. The Member States split along familiar lines, with the "friends of cohesion policy" in one camp, more or less coextensive with the defenders of CAP. The "friends of better spending", now also known as the frugals, insist on a smaller budget and a tighter grip on outlays with weak European value added.

How much conditionality, how much leeway for governments to influence the national distribution of EU funds? These questions crop up time and time again as governments seek to employ EU contributions for patronage in the domestic arena. As Putnam (1988) and others have observed, this kind of negotiations tends to evolve into "two level games" where governments bargain simultaneously with the other Member States and their own internal interest groups.[2] In the European Parliament, each committee defends its own turf while also pleading for some increments in the next long-term budget. As the committees have little incentive to fight among themselves, the EP's

1 Each one of these authors has analysed several negotiation rounds. Some pertinent sources covering different periods are Laffan, *The finances of the European Union*, 1997; Koenig & Rubio, *What the European Council's MFF/Recovery deal tells us about the EU's global ambitions*, 2020; Núñez Ferrer & Emerson, *Good bye Agenda 2000, Hello Agenda 2003*, 2000; Gros & Núñez Ferrer, *The MFF where continuity is the radical response*, 2018; Darvas, *The EU's recovery fund proposals: crisis relief with massive redistribution*, 2020; Begg, *Deals, deals, deals: who needs them?* 2020; Bachtler & Mendez, *Cohesion and the EU budget: is conditionality undermining solidarity?* 2020; Zuleeg, *Squaring the MFF circle*, 2018; Becker, *A new budget for the EU: negotiations on the multiannual financial framework*, 2019; Schratzenstaller, *The next MFF, its structure and the own resources*, 2017; Heinemann, *Strategies for a European EU budget*, 2016.

2 Robert D. Putnam, *Diplomacy and domestic politics: the logic of two-level games.* International Organization vol. 42, no 3.

consolidated positions tend to summarise such claims. Meanwhile, the autonomy and the budgets of the sub-national jurisdictions are defended by the Committee of the Regions.

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Facing this massive onslaught from all different quarters, the negotiations on the next multiannual financial framework moves through four stages:

1. To test the water, the European Commission first presents different scenarios for discussion. In the latest 2017 version it submitted five alternatives, some very far from its own preferences.[3]
2. Next comes the Commission's much-awaited starting proposal for the next multi-annual framework, with a distribution of funds based on some fairly sophisticated mathematical formulae.[4] Once these have been put on the table, they are very difficult to revise or withdraw, but exceptions can always be made.
3. In a third stage there is a long dead-lock in the Council, whereupon the President undertakes to negotiate bilaterally with each prime minister – the famous "confessionals" which give the Member States an opportunity to add emphasis to some of their demands while playing down others, with limited and selective communication to the home front.
4. In this fourth phase a great many creative addenda are inserted into the proposed agreement so that every national leader can go back home to the tune of Verdi's "ritorna vincitor".[5]

3 Bespoke concessions to forge consent

Some of the late changes reduce the contributions to the Union, others earmark allocations within the various envelopes already proposed. In line with the strong demands of the frugals, the rebates first planned to be scrapped and then to be phased out more slowly were finally set at €377 million for Denmark, €1.921 million for the Netherlands, €565 million for Austria and €1.069 million for Sweden. In addition, Germany was granted a rebate of €3.671 million. Another reduction on the income side was the increased national deduction for the administration of customs duties from 20 to 25 percent, of particular importance for the Netherlands and Belgium due to the large volume of imports transiting through Rotterdam and Antwerp.

On the expenditure side, particular targeted allocations were set aside within several envelopes. To "support the most important sectors that will be crucial to lay the basis for a sound recovery following the COVID-19 crisis", Luxembourg was granted €100 million and Malta €50 million. To meet the challenges posed by the situation of island Member States and the remoteness of certain parts of the EU, Malta and Cyprus received an additional envelope of €100 million each from the Structural Funds under the "investments for growth and jobs" goal, while the northern areas of Finland were granted an additional envelope of €100 million. From the same source, and with no explanation as to the selection of recipients, ten states received special grants "to boost competitiveness, growth and job creation in certain Member States".[6]

Within CAP, a large number of special allocations were granted Member States "facing particular structural challenges in their agricultural sector, or which have invested heavily in Pillar II expenditure,

[3] European Commission, Reflection paper on the future of EU finances, https://ec.europa.eu/commission/publications/reflection-paper-future-eu-finances_en

[4] European Commission, EU budget for the future, https://ec.europa.eu/commission/future-europe/eu-budget-future_en

[5] European Council conclusions, 17–21 July, https://www.consilium.europa.eu/media/45109/210720-euco-final-conclusions-en.pdf

[6] €200 million for Belgium, €200 million for Bulgaria, € 1.550 million for the Czech Republic, €100 million for Cyprus, €50 million for Estonia, €650 million for Germany, €50 million for Malta, €600 million for Poland, €300 million for Portugal and €350 million for Slovenia.

or which need to transfer higher amounts to Pillar I so as to increase the degree of convergence".[7]

Other grants were made to support the decommissioning of nuclear plants: €490 million to Lithuania, €50 million to Slovakia and €57 million to Bulgaria. Within the external action envelope, €444 million were set aside for overseas countries and territories, including Greenland.

In summarising these allocations, it should be borne in mind that some of them are not new but rather continuations of grants within the current MFF. But the same is true of the rebates. All in all, the earmarked increments and decrements included in the MFF to facilitate agreement among the Member States add up to at least €17 billion.

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4 The obsession with net balances

When earmarking is done within a particular heading or budget line, the remaining sum available for distribution among all the Member States is normally reduced accordingly. The cost of rebates is similarly shared. But in the final stage of the negotiation process, there were as usual also reductions in allocation for several collective goods.

Comparing the Commission's May 2020 proposal with the European Council's decision on 21 July 2020 on the complete package (MFF and Next Generation EU), Núñez Ferrer notes total cuts in the allocations for the following headings: Single market, innovation and digital with €67,1 billion, for Natural resources and environment with €27,5 billion, for Migration and border management with €8,4 billion, for Resilience, security and defence with €15,9 billion, for Neighbourhood and the world with €19,8 billion and for European public administration with €1,5 billion. The allocation for the recovery and resilience facility was increased with €112,5 billion, the lion's share in loans following the adjustment requested by the frugals.[8]

For the sixth time in an MFF negotiation process, we can thus note the unbroken persistence of the "national net balance" perspective. In their coverage of the negotiations, the media cling to a division of Member States between payers and beneficiaries, losers and winners. Scant attention is paid to the many-headed chorus of economists repeating that the best European "added value" of EU spending is *not* created through return flows to Member States but by genuinely common investments in European collective goods that cannot be ascribed to particular countries. While there is broad support for this line of reasoning in the European Parliament, the European Commission and parts of academia, its impact on national governments and parliaments remains very limited. Following widespread media reporting, member state politicians and their respective constituencies tend to assess the outcomes of the budget negotiations based on strictly national criteria.

5 The national veto and the quality of EU spending

There is little doubt that the established voting rules in the Union's budgetary process play a decisive role in perpetuating this state of affairs. On the one hand, it can be argued that the national veto on financial issues is a fundamental cornerstone in the construction of the European edifice; without this precondition union membership would probably have been inconceivable for important segments of the European body politic. On the other hand, its impact on the balance of the EU agenda should not be neglected. By giving so much influence to national politicians accountable to national constituencies and endowed with veto powers, *reflexive spending* – resources sent back to Member States for expenditures that are essentially national

[7] Belgium €100 million, Germany €650 million, Ireland €300 million, Greece €300 million, Spain €500 million, France €1.600 million, Croatia €100 million, Italy €500 million, Cyprus €50 million, Malta €50 million, Austria €250 million, Slovakia €200 million, Slovenia €50 million, Portugal €300 million and Finland €400 million.

[8] Reading between the lines of the Council Agreement on the MFF and The Next Generation EU (CEPS 2020).

in character – tends to squeeze out *spending for genuinely common and collective purposes*.

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Thus, there is no guarantee that the leap in the *quantity of EU spending* made possible through the recovery package will lead to a corresponding upward shift the *quality of EU spending*. Quite the contrary. The unchanged design of the voting rules ensures a continued emphasis on redistributive expenditures with limited allocative benefits.

To understand how the unanimity rule weakens the European Union, a thought experiment might be called for. Consider what the federal budgets would look like in the United States or Germany if each of their 50 or 17 states could bargain based on a veto! There is little doubt that this would lead to massive budget reshuffles from common-interest type programmes to redistributive packages benefitting the various states – and a subsequent loss of national action capacity in a great many areas.

A spectre in European constitutional discussion was long the 16–18th century Polish Szlachta where single noblemen could block the common decisions, and many did. The EU institutions have learnt to live with such a rule, but with high collateral costs to the quality of their policies.

6 Spending for collective needs makes every state a net beneficiary

Proposals to change the voting rules have always met with strong resistance. This matter concerns both the legitimacy and the efficiency of the union, as well as its appeal to political constituencies in various corners of the continent. But with a growing number of external, even existential challenges facing us – from climate threats and pandemics to increasingly assertive great powers, both political and commercial – we can expect ever stronger calls to beef up our capacity for collective action, above the level of the nation state. If a significant portion of redistributive spending is needed to make the EU acceptable to different strata of citizens, this may be the price we have to pay for a union with enough firepower to deal with our collective concerns. But the recovery package, largely pre-allocated to the Member States – whether as grants or as loans – is no substitute for reinforced joint action in many important areas. Assessing the quality of EU spending item by item is very difficult, but if all the expenditures figuring in the net balance calculations are lumped together there is little doubt that they provide much less European value added than does the money spent on programmes that cannot be ascribed to particular Member States.

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The frugal four have long stood for a more restrictive budget. But as expressed more clearly in their previous label "the friends of better spending", they have also called for more attention to budgetary quality. This message should not be forgotten in the continued work on the EU multiannual financial framework. The greatest benefits from the EU budget come from expenditures that do not return to particular countries but serve a variety of common causes. If well targeted, such spending can make every member state a net beneficiary.