

Montoya, Lourdes Acedo

Article

Rethinking the EU Financial Architecture

Intereconomics

Suggested Citation: Montoya, Lourdes Acedo (2023) : Rethinking the EU Financial Architecture, Intereconomics, ISSN 1613-964X, Sciendo, Warsaw, Vol. 58, Iss. 6, pp. 289-294, <https://doi.org/10.2478/ie-2023-0060>

This Version is available at:

<https://hdl.handle.net/10419/281392>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



<https://creativecommons.org/licenses/by/4.0/>

Lourdes Acedo Montoya*

Rethinking the EU Financial Architecture

The multiannual financial framework (MFF) promotes and finances EU priorities across the member states and beyond the external borders of the EU. It provides for the financing of programmes and actions in all policy areas, from agriculture and regional policy, to research, enterprise and space, in line with the EU's long-term priorities.

The past, present and future of the long-term EU budget: Setting the scene

While faithful to its original endeavour to foster long-term investments, the EU must respond to the increasingly urgent calls to do something about cross-border needs and recurrent crises. The agreement on the MFF 2021-2027 together with the NextGenerationEU (NGEU) recovery instrument was a clear example thereof. The Union provided a timely and sizeable response to the COVID-19 pandemic and its economic fallout with a €2 trillion budget, the largest ever. It is also a transformative response with new and reinforced priorities accounting for 31% of the MFF (see Figure 1) and 50% when considering NGEU altogether.

The current MFF and NGEU brought further novelties. First, driving the climate and digital transformations is a common feature across the MFF and NGEU. Furthermore, with the Recovery and Resilience Facility (RRF), the EU finances reforms for the first time with a strong link to the European Semester and puts a stronger focus on performance-based spending. In another first on the financing side, the Union issues common debt with NGEU to finance spending programmes through the EU budget. This borrowing is guaranteed by a dedicated own resources ceiling fully enshrining the response to the cri-

sis in the “community method” – contrary to past experiences in which intergovernmental solutions were sought.

Over the past three years, the EU has faced a series of unprecedented and unexpected challenges: Russia's brutal invasion of Ukraine and its fallout; surging inflation on the account, notably of high energy prices; an unprecedented rise in interest rates; the resurgence of migration after the pandemic; natural disasters in several member states; and most recently the Israeli-Palestinian conflict with devastating humanitarian consequences.

The EU has successfully reacted to the various challenges and has achieved a great deal. The EU budget has been instrumental in powering the Union's response. On top of built-in budget flexibilities, there has been extensive use of redeployments and reprogramming. For example, cohesion funds were mobilised to support people fleeing from war in Ukraine as well as the destination member states. REPowerEU, which aims to end the EU's dependence on Russian fossil fuels and tackle the climate crisis, is financed mostly through repurposing other funds. In only three years, nearly three-quarters of the budget margins have been used or planned. The availabilities of the special instruments and programme specific flexibilities, like the Neighbourhood, Development and International Cooperation Instrument (NDICI – Global Europe) are also being rapidly exhausted. Against the backdrop of a fundamentally changed context and rapidly decreasing available resources, the Commission proposed a revision of the MFF on 20 June 2023.

In fact, compared to national budgets, the EU budget is very rigid. Expenditure ceilings are set for seven years, whereas national fiscal frameworks often last around three or four years and work with adjustable ceilings (European Commission, 2023). Under the MFF, there is virtually no flexibility across the different headings. Expenditures in the EU budget are often set for the whole period being pre-allocated to member states or to specific programmes with limited flexibility to adjust. This results in a setup where it is very difficult to reprioritise and ultimately to react to new circumstances and priorities. Predictability of investments and member states' contributions to the budget currently carry more weight than flexibility.

Challenges ahead

Moreover, with the repayment of NGEU and further upcoming challenges, the future EU budget will face in-

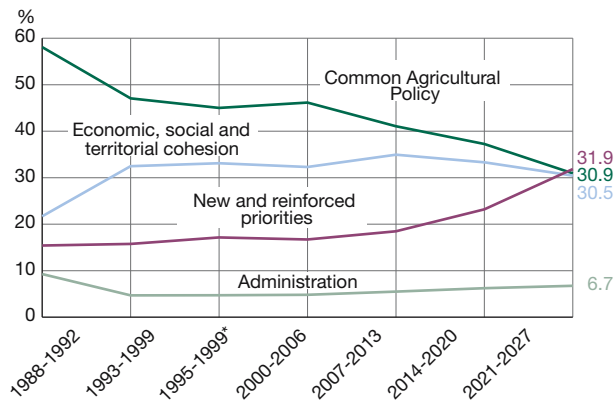
© The Author(s) 2023. Open Access: This article is distributed under the terms of the Creative Commons Attribution 4.0 International License (<https://creativecommons.org/licenses/by/4.0/>).

Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

* The opinions expressed are those of the author only and should not be considered as representative of the European Commission's official position. The author would like to thank Marlene Schörner, Marie Kristensen and Daphne Gerard for valuable research assistance.

Lourdes Acedo Montoya, European Commission, Brussels, Belgium.

Figure 1
Share of the main policy areas in the multiannual financial frameworks without NextGenerationEU



Note: * MFF revised due to enlargement.

Source: European Commission (2021).

creased pressure. The world is changing and there are several challenges ahead that require deep and far-reaching transformations that should guide the framing of the next MFF to optimise the possibilities of the EU financial architecture (see Figure 2).

Global changes

First, global competition is strong, and if the EU wants to avoid falling behind, action is needed. It will be necessary to future-proof the EU's economic model and build comparative advantages, which will require a reassessment of our budgetary instruments to adjust, as necessary, to this new reality. For instance, this could be done by achieving climate neutrality and reaping the benefits of the digital transition, as well as pushing the technology frontier and reducing technological gaps between the EU and the United States and China (Steinberg and Wolff, 2023). Furthermore, creating secure supply chains, including the safeguarding of open strategic autonomy in key economic sectors, is highly important. Finally, investments in skills and re-skilling workers will be crucial to implement these economic transitions.

The world is changing, with important geoeconomic and geopolitical transformations on the way. An assertive Europe in this new world requires changes in the status quo of the EU budget both for external and internal instruments. External instruments should become even more strategic. With global conflicts and tensions on the rise, joint financing for defence and space will likely necessitate larger financial support from the budget. Furthermore, the EU should reduce its dependency on strategic goods, such as energy, and make supply chains more

resilient overall. Additionally, migration has been an escalating challenge, both internally and externally. This is unlikely to disappear and could rather become an even more pressing issue in the future, which will require coordinated EU action. In general, the shifting geopolitical context requires the EU to clarify its role in the global system and develop a new vision for external and internal action. A common EU response will require financial resources that correspond to the challenges ahead. Furthermore, political discussions are ongoing about a potential EU enlargement. The timing and scope of such an enlargement are key variables that are impossible to foresee today. However, it is clear that a potential enlargement will bring additional challenges to the EU budget that need to be considered in the design of future policies, both for pre-accession financial support as well as for internal policies.

Cross-cutting transformations

The second challenge is the transformation of economies in view of digital innovation and climate change. For instance, the European Chips Act will bolster the EU's competitiveness in semiconductor technologies and applications (European Commission, n. d.). Actions taken by the EU to achieve a climate-resilient economy cover both climate change mitigation and adaptation (Council of the EU, 2021). Hence, efforts to promote the transitions of the economies are underway but the investment needs are very substantial and will span decades. The budgetary architecture of the future must be able to support these transformations through investments, while also providing flexibility in case of unforeseeable developments or crises.

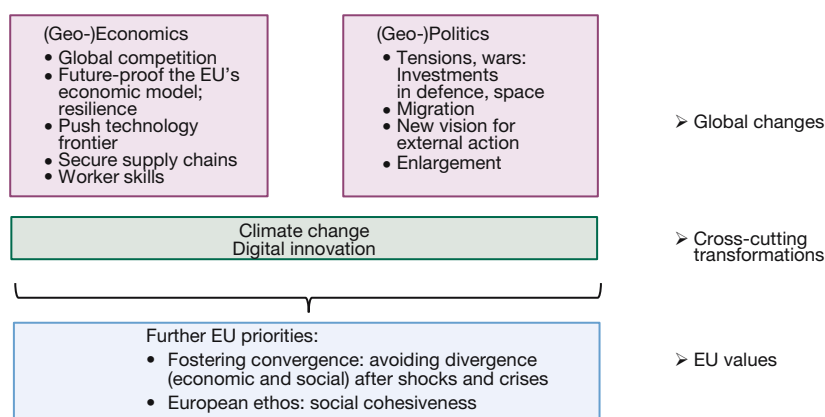
EU values

Third, even with the vast and many challenges, it remains important to safeguard central EU values and not overlook non-economic public goods. This includes fostering economic and social convergence between the member states and regions. It should continue to be a core EU value to mitigate economic and social divergence after crisis shocks as well as to promote stronger resilience of the economies to prevent bigger slowdowns and divergence. Social cohesiveness across Europe and support for EU values – e.g. rule of law, education, justice – will remain essential to a strong Europe in a fragmented world.

Optimising the EU financial architecture and financial possibilities of the Union will be necessary in light of these important needs. This means, first and foremost, that new own resources for the EU budget are key. It also means considerations as to how to best combine EU and member states fiscal efforts, as well as how to best use the EU budget to crowd in private investments or whether the

Figure 2

The next multiannual financial framework in context: Issues to address



Source: Own illustration.

provision of loans guaranteed by the budget bring an additional value in specific cases.

Reflections on future EU financial architecture

Reflections on future EU financial architecture could be organised along four blocks: areas of expenditure at the EU level, expenditure instruments, financing instruments and governance structures. These blocks also provide the structure for the remainder of this article.

EU added value: Areas of expenditure

There is consensus that the EU budget should finance areas of strong EU added value, which some call European public goods. These are areas that are best financed at a supranational level for several reasons. First, public goods are characterised by non-excludability and/or non-rivalry. That is, actors not contributing to the good cannot be excluded from its benefits, or its use by one more actor only has a marginal and decreasing cost (Buti et al., 2023). For the EU, this would mean that individual member states might have too little incentive – or capacity – to provide enough of these goods. Second, European public goods are characterised by economies of scale and scope, meaning that pooling the production will reduce the price. They include a cross-border dimension, which implies a less effective provision of the good by individual countries. These goods are key to pursuing the EU's strategic priorities. Thus, providing the public goods at the EU level would be more efficient.

The creation of EU added value also comes from coordination and spill-over effects, due to the high degree of economic integration within the EU. For instance, quantitative analysis suggests that the effect of NGEU on EU aggregated GDP is one-third larger when explicitly accounting for spill-over effects across countries (Pfeiffer et al., 2021).

To maximise the positive effects of EU spending, both economic efficiency and shared political objectives should be considered. The latter may include asserting Europe's role in the world and ensuring its open strategic autonomy, the means to combat economic divergence and macroeconomic instability, and achieving key transformations towards a future-proof Europe. The green transition and energy, for instance, can only be tackled meaningfully and efficiently if coordinated at the EU level. At the same time, despite all the new priorities arising from the changed geoeconomic and geopolitical context and large transformations, EU core values of convergence and cohesion must not be forgotten. The EU budget can also foster political priorities; for instance, it helps to safeguard the rule of law in the EU. Furthermore, the RRF has shown that the EU budget can also finance and stimulate reforms that contribute to the green and digital transition and also support economic and social cohesion. Both reforms and investments will be key for a competitive, resilient and cohesive Europe in the future.

The EU budget also contributes to economic stabilisation. There is a role for the EU to intervene in the event

of shocks, to counteract imbalances between member states and to help avoid sovereign debt crises. The SURE (Support to mitigate Unemployment Risks in an Emergency) instrument, which provides loans to member states, as well as the Recovery and Resilience Facility, are examples of an economic stabilisation function albeit of a temporary nature. On a smaller scale, cohesion policy or the European Globalisation Fund have also provided economic relief in the face of an economic shock. Going forward, it could be considered whether stabilisation brings EU added value and should be provided by the EU budget.

The EU budget can also create added value through the way it is financed. The new own resource based on non-recycled plastic packaging waste can serve as an example here. It is linked to the EU's policy objectives and can create an incentive for member states to improve recycling. NGEU also shows that the EU can borrow commonly to help counter financial imbalances and needs across member states. This suggests that revenue and expenditure should be considered jointly as both support political priorities, and coherence between them can create additional value.

Expenditure instruments

Not only the question of what the EU budget should finance is important, but also how it should be delivered. To reap the full benefits of the EU budget, the delivery method should be carefully crafted, and several factors should be considered. The policy objectives must come first, as they set the priority for what should be achieved. Then, the most efficient financing for achieving the stated objectives needs to be found. Paying close attention to the link between *what* and *how* money is spent is crucial.

There are several potential delivery tools. They include guarantees, grants, or loans, as well as the choice between different management modes (direct, indirect, or shared management). The different modes of spending should correspond to distinct spending logics: either pre-allocated envelopes based on national plans that consider the specific context of the member states or non-pre-allocated programmes based on competition between member states, organisations and other stakeholders. The latter are in principle equally accessible to all. Each delivery mode can – and should – create EU added value. In defining a delivery mode, different combinations of the discussed elements may be optimal depending on the policy area or priority.

The role of performance-based spending could also be strengthened. It has the potential to increase the effec-

tiveness of EU expenditure. The performance framework has already been upgraded in the MFF 2021-2027. However, there is still room for improvement. One option to explore could be to integrate performance considerations to a larger extent in the design of the annual budget as well as the next MFF. For this, an all-encompassing review of EU spending and its structure, including performance-based indicators, would be necessary. At the same time, it might be worth taking stock of and optimising the EU's different systems of tracking, monitoring and evaluation. The resulting insights may then be used to simplify the structure of the EU budget, for example, by reducing the number of programmes where it makes sense. This could also help reduce costs and increase efficiency, transparency and accountability.

Lastly, sound financial management could be further improved by enhancing coordination of the various control mechanisms. The MFF 2021-2027 already brought important changes to achieve sound financial management. The objective is to ensure effective budget protection at minimal cost.

Simplicity and efficiency should be the guiding principles of future financing instruments. This simplicity could take the form of a critical assessment of the number of instruments to reduce potential overlaps and exploit positive synergies. Simpler applications for beneficiaries and strong coordination between instruments that have similar policy objectives but that are implemented through different modes should also be further developed. Efficiency will ensure that funds can reach the ground as quickly as possible and that they are designed to deliver on their policy objectives and to ensure sound financial management.

Financing instruments

To leverage the full capacity of the EU budget, all possible sources of financing as well as their efficiency and fitness for purpose should be considered.

New own resources are key to balance the revenue structure of the budget in light of future expenditure needs. The Commission has proposed new own resources linked to the Emissions Trading System and Carbon Border Adjustment Mechanism as well as a new statistical own resource based on company profits. The earlier the agreement on these resources, the better. These proposed new own resources are closely aligned with our common policy objectives, and therefore have the potential to also bring EU added value through the revenue side of the budget.

While joint borrowing is not an objective on its own, it is an instrument that can contribute to the enhancement of the financial capacity of the Union and contribute to efficient delivery of spending instruments. Joint borrowing also brings side benefits insofar as it promotes the international role of the euro and deepens EU capital markets. It enables risk-sharing among member states and increases the financial capacity of the EU budget. For decades already, the Union has been borrowing to support member states and third countries with loans to address balance of payments crises. NGEU borrowing provides loans and grants for expenditure programmes in the EU budget, whether implemented by member states such as the RRF or the European Agriculture Fund for Rural Development or at the EU-level such as InvestEU or EU4Health. The EU budget headroom, which is the difference between the own resources ceiling and the expenditures of the EU budget, guarantees these liabilities, including with a dedicated own resources ceiling solely for the purposes of NGEU.

In the case of loans to third countries, the latest loans to Ukraine are covered by the headroom of the EU budget and in other cases a provisioning fund also provides first coverage via the budget. Finally, the SURE instrument provides loans to member states, which are partly guaranteed by member states and partly by the EU budget. While the repayment of loans is done by the beneficiary countries, the repayment of grants and in some cases an interest rate subsidy to Ukraine is done via the EU budget. All of those are examples of how borrowing can be an instrument to deliver on EU policies and needs which should be assessed in the next cycle with the same objectives of simplicity and efficiency.

External assigned revenue could continue to play a certain role. It has been highly important, with NGEU but also with the EU's Emissions Trading System financing the Social Climate Fund. External assigned revenue, however, deviates from the principles of universality and unity and should not be the norm. However, it could still play a role, ancillary to budget financing, for example, for member state's contributions to external action programmes or with third countries' contributions to Union programmes.

Crowding-in other sources of funding should also be further explored. Co-financing by member states or other beneficiaries can bring more complementarities between member states and EU-level expenditures and increase the available resources for European priorities. Private sector participation in programmes can also help deliver a higher share of investments with the backing of the EU budget.

Governance structures

The MFF includes many elements that are deeply inter-linked. Beyond the policy priorities and delivery mechanisms, important elements are the governance structure and the duration of the MFF. On the one hand, a certain length is required to enable long-term investments, which are underpinned by multi-annual programmes. On the other hand, a longer duration means a less responsive budget to react to crises and new needs and raises questions of democratic legitimacy.

Finally, the MFF and its programmes could be brought closer to existing EU governance processes, as has already been done in a few cases. The RRF brings the EU budget and the European Semester very close, and this can set a positive precedent for the future to guide the most important economic reforms and investments in member states that contribute to shared goals like the provision of European public goods or strengthening the long-term growth potential. The Social Climate Fund will rely strongly on the governance of the Energy Union and the national energy and climate plans. Similarly, a closer interlinkage between external policy objectives and EU external action instruments could also be sought in the future. A close coordination between governance structures and EU budget instruments can leverage the Union's overall impact within and outside of its frontiers.

Concluding remarks

The EU budget is the financial arm of the Union's policy goals. In assessing the MFF and looking ahead, several conclusions can be drawn. First and foremost, the added value created through the EU budget should be maximised by taking an all-encompassing view of the budgetary architecture, including the revenue side and the coherence between financing and spending elements. Second, spending on the EU level benefits all member states, and not just those directly receiving funding. Hence, the EU budget should not be seen as a zero-sum game. Third, flexibility, simplicity and efficiency will be guiding principles in the design of the next generation of programmes. The structure of EU spending should also be reviewed, e.g. the number of programmes, and the connection between the budget and other governance processes. Fourth, the budget architecture should optimise all financial means through a closer interlinkage between member states and EU-level expenditures, crowding in private expenditures. Most importantly, the introduction of new own resources is essential to better balance the revenue structure of the budget.

In conclusion, significant and important work lies ahead to ensure an EU budget that is better, more efficient, more flexible and policy-oriented. An EU budget with a bigger impact will be the task for 2027.

References

- Buti, M., A. Colocchia and M. Messori (2023, 9 June), European public goods, *VoxEU*.
- Council of the EU (2021, 10 June), Council endorses new EU strategy on adaptation to climate change, Press release, Council of the EU.
- European Commission (2021), The evolving nature of the EU budget, *EU budget policy brief*, 1.
- European Commission (n. d.), European Chips Act, European Commission, https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-chips-act_en (30 November 2023).
- European Commission (2023, 11 July), Domestic Medium-Term Budgetary Frameworks in the EU: Fit for Purpose and for the Future?, European Commission, *Discussion Paper*, 189.
- Pfeiffer, P., J. Varga and J. in 't Veld (2021), Quantifying Spillovers of Next Generation EU Investment, European Commission, *European Economy Discussion Papers*, 144.
- Steinberg, F. and G. Wolff (2023), Dealing with Europe's economic (in-)security, Global Policy, November, Presented at the informal meeting of EU finance Ministers at Santiago de Compostela, Spain in September 2023.