

# **EU Under Siege: Are National Budgets and the EU Budget Up To Challenges?**

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UBB, 2 March 2017

# **HIGH LEVEL GROUP ON OWN RESOURCES**

17 January 2017

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# Monti report recommends reform of EU budget (1)

- The EU budget needs reform - both on the revenue and on the expenditure side, to address current challenges and to achieve tangible results for European citizens.
- The recent crises have put extra pressure on the EU budget; they have also pointed at the areas where EU action is the most valuable and the most relevant: **internal and external security, the fight against climate change and move towards a low carbon economy, and investments to support growth and jobs.**

# Monti report recommends reform of EU budget (2)

- We need to change the way the EU budget is financed. The current system has created a vicious circle where "beneficiaries" and "contributors" are often pitted against each other in what citizens came to see as a zero-sum game.
- Possible new resources - which would then partially replace the GNI-based contributions – could be based on a carbon tax, a common tax on fuel or other energy or environmental tax, a common corporate income tax, a reformed VAT or a tax on the financial sector.

# Nine main recommendations:

1. The **reform of the EU budget is necessary** both on the revenue and expenditure side to address EU priorities and to help solve the challenges of our time, whether they are economic, security-related and geopolitical, social or cultural.
2. The EU budget needs to focus on areas **bringing the highest European added value**, for which European action is not only relevant but indispensable. A reform of own resources would impact only the composition of revenue, not the volume of the EU budget. It should **not increase the overall fiscal burden** for the EU taxpayer, and try to find **synergies** between the EU and national funding.
3. Some **elements of the current system** work well and **should be kept**: the fact that the EU budget must be in balance; the so-called traditional own resources (customs duties), which are directly related to the existence of the single market and customs Union; the gross national income (GNI) own resource, which serves as the balancing resource (it is calculated annually to cover the spending not already covered by other sources of revenue) but should be residual.

4. The most attractive **new own resources replacing the existing GNI contributions** would not only finance the EU budget but also: - improve the functioning of the Single Market and fiscal coordination: a reformed VAT-own resource, a corporate income tax-based own resource, a financial transaction tax or other financial activities' tax. - or relate to the Energy Union, environment, climate or transport policies: a CO2 levy, proceeds from the European emission trade system, an electricity tax, a motor fuel levy, etc.
5. **Other revenues** need also **to be explored**, for example revenue stemming from EU policies such as border control, the digital single market, the protection of the environment or energy efficiency. Such revenue would be based on sector-specific legislation and could be used to finance the general budget, create a reserve or finance the concerned sector.
6. **The costs and benefits from EU membership should be better reflected.** The current indicators, mostly net balances, ignore the added value of EU policies and participation in the largest single market. Additional indicators should be developed to give a more comprehensive picture of the costs and benefits of the EU.

7. All **correction mechanisms ("rebates")** should be abolished.
8. The **coherence of the EU budget and national budgets within the European Semester** should be reviewed. Better information channels should be opened so that shared objectives are better aligned between the national/European budget procedures and the European Semester. Information concerning national contributions to the EU budget in national budgets should be made clearer and harmonised so that they are understood and anticipated.
9. While the unity and universality of revenue should not be jeopardised, a **certain degree of differentiation should be allowed when some Member States are willing and able to go forward**, notably for the further development of the euro area or for policies under enhanced cooperation.

**M. ANTONIO TAJANI, PRESIDENT OF THE EUROPEAN PARLIAMENT**  
**M. JOSEPH MUSCAT, PRESIDENT OF THE COUNCIL OF THE UNION**  
**M. JEAN-CLAUDE JUNCKER, PRESIDENT OF THE EUROPEAN COMMISSION**

Brussels, 20 January 2017

Subject: Final Report and Recommendation of the High Level Group on Own Resources

Dear Presidents,

In line with its mandate, the High Level Group on Own Resources, jointly established by the European Parliament, the Council of the European Union and the European Commission, which I had the honour to chair, adopted its final report and recommendations in December 2016.

I hereby have the pleasure to submit to you this report, entitled 'Future Financing of the EU' (see document enclosed). It examines options to make the own resources system more transparent, equitable and democratically accountable but it also considers broader issues, as suggested by the three Institutions on the occasion of consultations held by the Group with each of them in the course of our work.

The report was published on 17 January 2017.



**A number of key challenges to the EU have emerged since the Group was established in 2014, like the need to cope effectively with the migration and refugees problems, with control of the external borders, with the implications of Brexit, with a new U.S. Administration likely to induce the EU to rely more on its own initiatives and resources if it wants to be master of its own future,** the political authorities of the EU and its Member States adopt a strategy to make the budget adequate, credible and adaptable to the varying needs of providing essential European public goods.

Mario Monti [signed]

Chairman of the High Level Group on Own resources

# 2016: a year of *game changers*

- **Brexit: a profound syndrome** and impact on the EU
- **US elections...** unrestrained globalization halted, protectionism on the rise (global trade slows down)
- A crisis of multilateralism
- **Fragmentation of societies and impact on politics**
- **EU budget: will “rebates” go away?**
- **More or better Europe? *Integration fatigue***
- **Political (Elites) *autism* in dealing with change?**  
Blaming citizens for their fears and votes is not smart...policies have to be questioned too

# 1. The global context

- **Mounting uncertainties**
- **Economic and social strain; technological change and labor markets...digitalization and robotization**
- **Rising protectionism (*New protectionism*)**
- **Policies sailing in uncharted territories...**
- **Geopolitical crises (what world order?)**
- **Shift of economic power (geopolitical too?);**
- **EU frantic search for better governance**

## 2. A Union beset by crises (1)

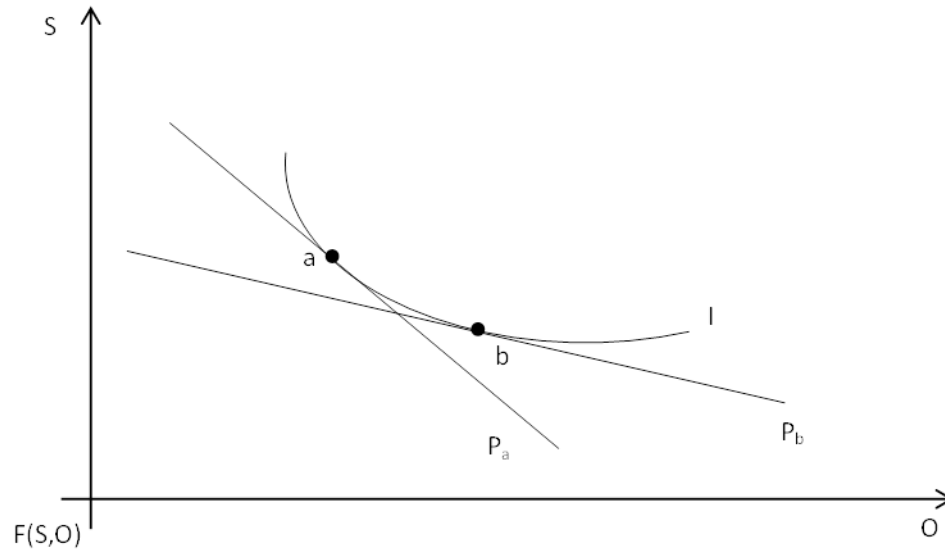
- **The most critical period in EU history**
- **Euro-area strain, over-debt, social strife (youth unemployment)**
- **Security threats:** fighting terrorism, growing turmoil in the Union's close vicinities, in the Arab world in particular, geopolitical risks;
- **Brexit, the migrants crisis:** key policy issues
- **A *trust* issue** ("Regaining citizens" hinges on redeeming what the EU means for Europe --Legitimacy
- ***All these show up in challenges for both national and the EU budget***

## 2. The Union (2)

- **More inward-looking EU member states...why?**
- - during hard times citizens ask for ***protection and less openness*** (see graph 1)
- - ***the social contract is with national states***
- - ***trust crisis*** between EU institutions, governments, citizens --the latter entrust public affairs mandate to national authorities
- - **the EU budget is very small (cca.1% of EU GDP) and fraught with disputes over allocation**

# Relation between protection (S) and openness (O)

Graph: The relation between protection (S) and economic openness (O)



# Indifference curve (S,O)

- Various combinations of (S) and (O) may be imagined so as to ensure a degree of citizens ' acceptance that would minimize discontent/discomfort in given conditions. An optimal combination is where the price line (S, O) is tangent to the preference (social choice) curve (I). The (a) point refers to an initial level of economic freedom –as flows of capital, workforce, investment, and the range and scope of regulations. At point (a) things are relatively good, calm, and this is revealed by the price line between (S) and (O); a steeper slope,  $P_a$ , shows that (S) is regarded as being sufficient (people feel safe) and economic openness as a public good is in high demand
- When times worsen a more inward looking society emerges; such a turnaround is revealed by the change in preferences in favor of (S). When the need for protection measures grows, the change is reflected by a less steep slope of the relative price, ( $P_b$ ), between (S) and economic openness (O); this may involve protectionism and other restrictive measures and their combination is indicated by point (b) on the indifference (utility) curve.

## 2. The Union (3)

- **The EU is a *public good* in itself**
- **Disputes over what are European public goods:** border protection, joint intelligence and security,...
- **EU budget spending:** some MSs question structural and cohesion funds
- **The solidarity/responsibility principle is under question even in stark cases (The Turkey Fund)**
- **Trust in the Union and investing in its future is essential in order to save it**
- **Leaders (in EU institutions too) should not take citizens for naives...**(corruption and ethics related scandals, double talk);



### 3. What is wrong with the way MSs view the EU budget?

- History of EU budget revenues: from mostly own resources to **GNI based contributions**
- “the way each MS defines its negotiating position (its budgetary balance), the European added value is missing entirely. Balances are calculated by the simple netting of what a MS is allocated on the expenditure side with its national contributions. Under this method, every euro spent in one country is considered a “cost” to everybody else. It ignores any European valued added which stems from EU policies....

# 3. What is wrong with the way MSs view the EU budget

- “Calculating one’s own “benefit” from the EU budget is not what is to be blamed here, it is rather a natural or at least inevitable endeavor. What is misleading and causes damages for the EU and MSs themselves is that a narrow and lopsided indicator becomes the only measurement of a cost-benefit relation”
- It reflects a declining trust in the EU –its institutions
- It belittles what EU enlargement has meant for “donor” MS –new markets and a pool of highly educated human capital
- It is myopic by underestimating fractures in society
- Replicated in debates over national budgets

# 3. What would be EU public goods?

- SM that enhances economic growth and convergence
- Regional policy that mitigates cleavages
- Energy policy + security
- Common security and foreign policy
- Climate change policy
- Protection of borders
- Combating terrorism
- Combating tax evasion and avoidance
- **EU budget: ironically, it is increasingly transactional**
- **A contradiction: EU public goods are badly needed while appetite to fund them is quite limited – an issue of *Trust***

# 3. Euroarea public goods

- **Financial stability:** the devil is in technical details, especially in “single currency area”
- **Macroeconomic policy stance** (managing aggregate demand and imbalances): a highly controversial issue in the euroarea
- **Capacity to deal with asymmetric shocks:** not yet solved at the euroarea level
- **Lender of last resort function (ECB):** a controversial issue until a few years ago

### **3. The Union: how to relate national budgets to the EU budget?**

- **All budgets under strain:** mounting challenges and limited resources
- **Synergies among budgets**
- **EU budget funding** (more own resources: transparency, efficiency fairness) and **spending (cost-effectiveness)**; focus on **EU value added**
- **How to meet major threats and enhance robustness/resilience** (economic challenges)
- **Short-term vs. long-term challenges (they mix)**

### 3. How national budgets and EU budget need to be?

- **Solid and versatile:** able to respond to emergencies
- **Buffers/reserves needed** (fiscal space is an embedded buffer)
- **Level of fiscal revenues** is critical (some MSs have very low capacity in this regard)
- **Prioritize and use resources cost-effectively**
- ***Security, migration, youth unemployment*** (education and jobs) –as high priorities
- **International aid (Africa)**

# 4. EU economic picture in a nutshell

- **Recovery sustained by ECB' non standard measures**
- **Growth rates of pre-crisis years are gone**
- Demographics, productivity gains, debt overhang (on average, cca 250% of GDP, both private ad public, in the EZ), functioning of the EZ, little investment handicap Europe
- **a/need to invest more (The Juncker plan is insufficient and there has been a big fall of I in all economies); b/ education; c/ R&D, an Union attuned to the digital world; d/ alter the deflationary bias of the euro-area (Buti, 28 November, 2017)**

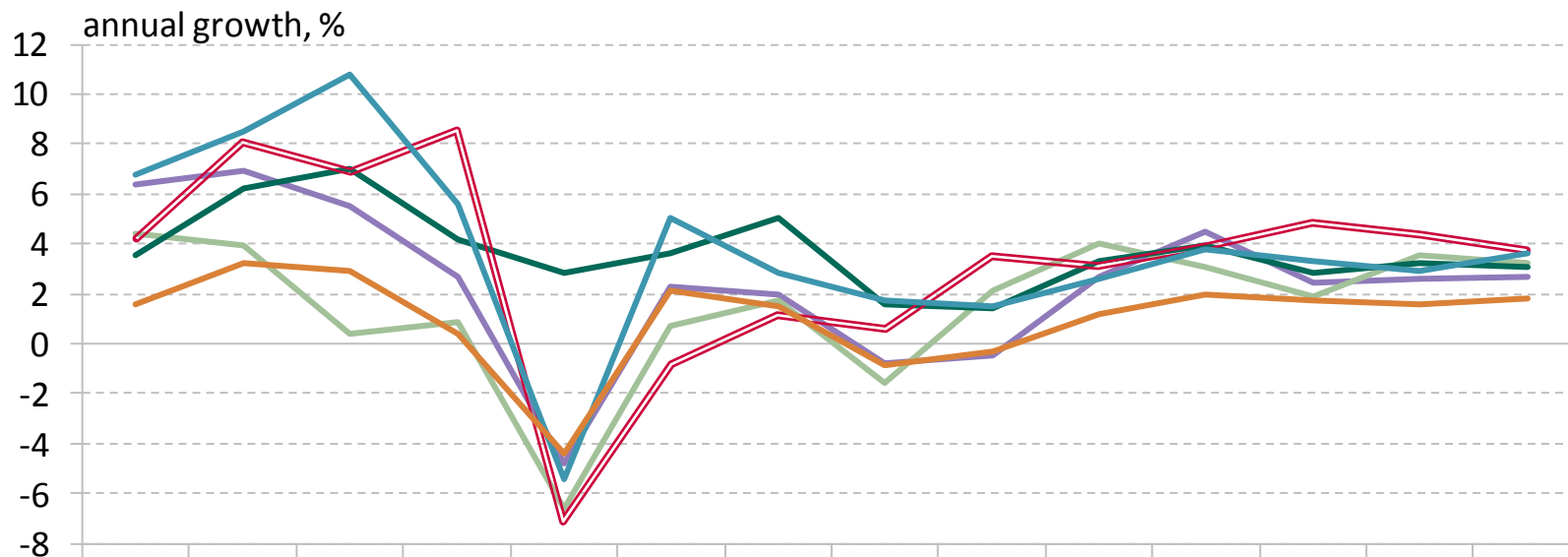
## 4. Where do CEEs stand economically?

- **Better macroeconomic shape:** imbalances, exposure to financial markets; less debt than in rich economies
- **Economic recovery underway, but...**
- Funding costs are related to ECB's policies
- Threat of *middle income trap*
- **Protectionism threat**
- **Fragmentation of EU markets:** labor, trade...
- The EZ functioning is of concern



# 4. From boost and bust dynamics to which path?

## Real GDP

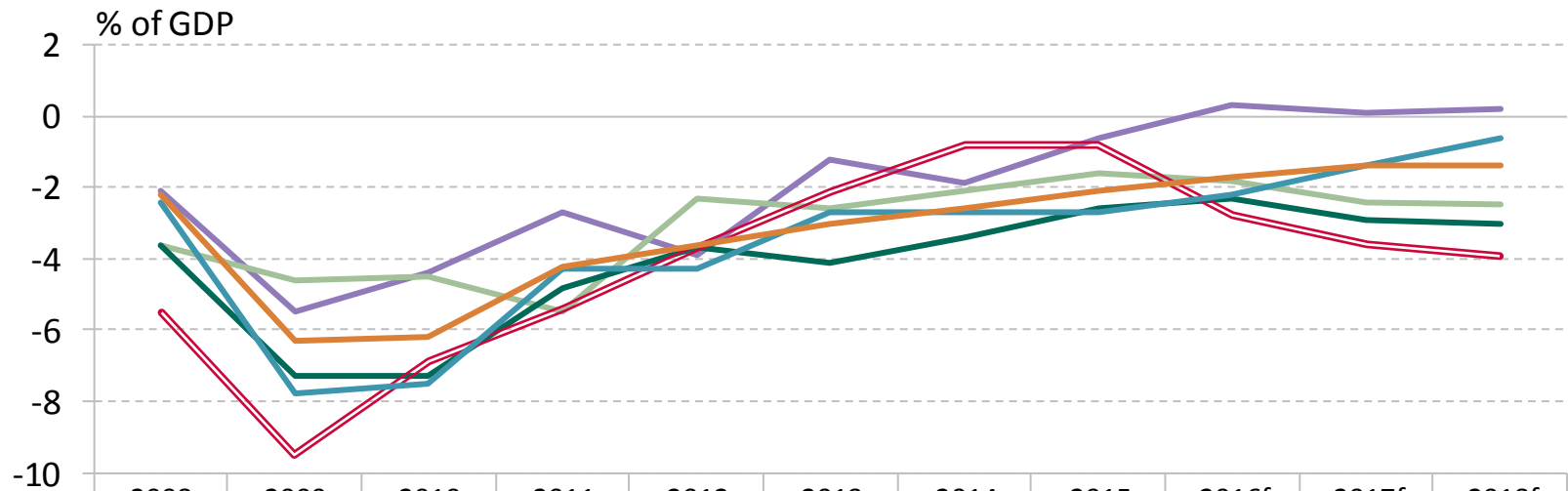


	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
Czech Republic	6.4	6.9	5.5	2.7	-4.8	2.3	2.0	-0.8	-0.5	2.7	4.5	2.4	2.6	2.7
Hungary	4.4	3.9	0.4	0.9	-6.6	0.7	1.7	-1.6	2.1	4.0	3.1	1.9	3.5	3.2
Poland	3.5	6.2	7.0	4.2	2.8	3.6	5.0	1.6	1.4	3.3	3.9	2.8	3.2	3.1
Romania*	4.2	8.1	6.9	8.5	-7.1	-0.8	1.1	0.6	3.5	3.1	3.9	4.8	4.4	3.7
Slovakia	6.8	8.5	10.8	5.6	-5.4	5.0	2.8	1.7	1.5	2.6	3.8	3.3	2.9	3.6
Euro area	1.6	3.2	2.9	0.4	-4.4	2.1	1.5	-0.9	-0.3	1.2	2.0	1.7	1.6	1.8

\*) 2005-2016: actual data  
f) forecast

# 4. Budget/fiscal consolidation is an ongoing challenge

## General Government Balance\*



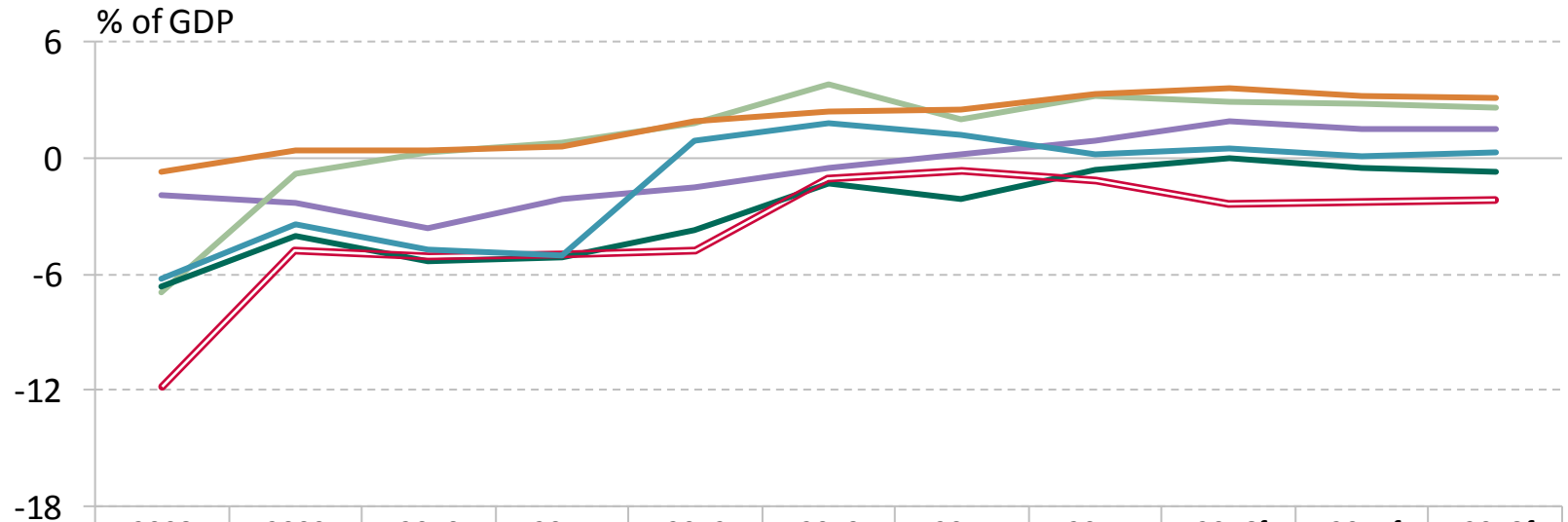
	2008	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
— Czech Republic	-2.1	-5.5	-4.4	-2.7	-3.9	-1.2	-1.9	-0.6	0.3	0.1	0.2
— Hungary	-3.6	-4.6	-4.5	-5.5	-2.3	-2.6	-2.1	-1.6	-1.8	-2.4	-2.5
— Poland	-3.6	-7.3	-7.3	-4.8	-3.7	-4.1	-3.4	-2.6	-2.3	-2.9	-3.0
— Romania	-5.5	-9.5	-6.9	-5.4	-3.7	-2.1	-0.8	-0.8	-2.8	-3.6	-3.9
— Slovakia	-2.4	-7.8	-7.5	-4.3	-4.3	-2.7	-2.7	-2.7	-2.2	-1.4	-0.6
— Euro area	-2.2	-6.3	-6.2	-4.2	-3.6	-3.0	-2.6	-2.1	-1.7	-1.4	-1.4

\*) ESA 2010 Methodology

f) forecast

# 4. Much lower current account imbalances

**Current Account Balance  
(BPM6 data)**



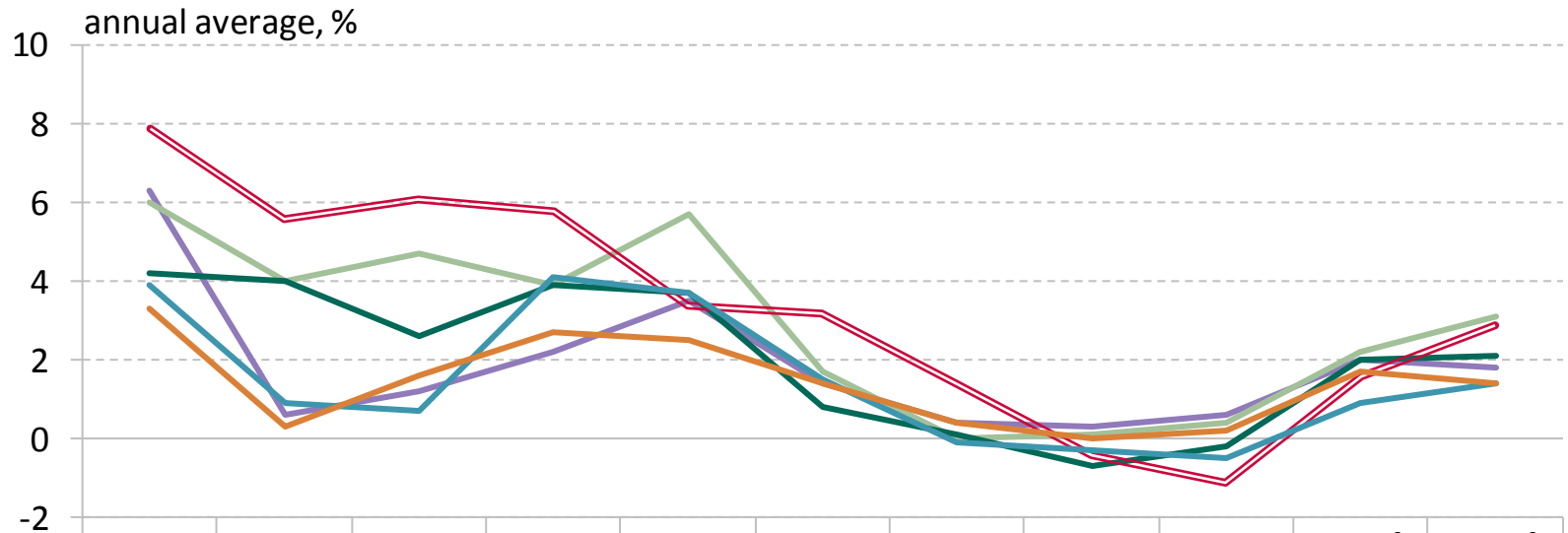
	2008	2009	2010	2011	2012	2013	2014	2015	2016f	2017f	2018f
Czech Republic	-1.9	-2.3	-3.6	-2.1	-1.6	-0.5	0.2	0.9	1.9	1.5	1.5
Hungary	-7.0	-0.8	0.3	0.8	1.8	3.8	2.0	3.2	2.9	2.8	2.6
Poland	-6.7	-4.0	-5.4	-5.2	-3.7	-1.3	-2.1	-0.6	0.0	-0.5	-0.7
Romania	-11.8	-4.8	-5.1	-4.9	-4.8	-1.1	-0.7	-1.2	-2.4	-2.3	-2.2
Slovakia	-6.2	-3.4	-4.7	-5.0	0.9	1.8	1.2	0.2	0.5	0.1	0.3
Euro area*	-0.7	0.4	0.4	0.6	1.9	2.4	2.5	3.3	3.6	3.2	3.1

\*) national accounts data

f) forecast

# 4. Overall disinflationary pressures

## HICP



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017f	2018f
Czech Republic	6.3	0.6	1.2	2.2	3.5	1.4	0.4	0.3	0.6	2.0	1.8
Hungary	6.0	4.0	4.7	3.9	5.7	1.7	0.0	0.1	0.4	2.2	3.1
Poland	4.2	4.0	2.6	3.9	3.7	0.8	0.1	-0.7	-0.2	2.0	2.1
Romania	7.9	5.6	6.1	5.8	3.4	3.2	1.4	-0.4	-1.1	1.6	2.9
Slovakia	3.9	0.9	0.7	4.1	3.7	1.5	-0.1	-0.3	-0.5	0.9	1.4
Euro area	3.3	0.3	1.6	2.7	2.5	1.4	0.4	0.0	0.2	1.7	1.4

f) forecast

# 5. What next for CEE?

- **Structural reforms** to enhance efficiency gains;
- **Inclusive institutions;**
- **Fiscal space, buffers**
- **More investment (domestic savings);**
- **Be in core industrial networks (supply chains)**
- **Upgrade output constantly: R&D, education spending; overcoming *middle income trap***
- **Macro-prudential policies for mitigating boom and bust**
- **The international policy regime**

# 6. Challenges for national budgets

- **Maintain macroeconomic stability**
- **Fiscal and policy space (adverse shocks)**
- **Assign resources to meet major challenges:**  
defense, security concerns, stem human exodus, education and R&D expenditure, infrastructure
- **Fight tax evasion and avoidance** (size of fiscal revenues is a major vulnerability in Romania)

# 6. Budget and fiscal revenues

Year	Euroarea		Czech Republic		Germany		Hungary		Poland		România,	
	fiscale	budget	fiscal	budget	fiscal	budget	fiscal	budget	fiscal	budget	fiscal	budget
2000	40.8	45.4	32.5	36.9	41.5	45.6	39.2	44.1	33.8	39	30.4	33.8
2001	39.9	44.7	32.4	37.2	39.6	43.8	38.1	43.2	33.8	40.2	28.8	32.6
2002	39.6	44.2	33.4	38	39.1	43.3	37.5	42.1	34.0	40.4	28.4	32.9
2003	39.6	44.1	34.1	42.1	39.4	43.6	37.5	42	33.4	39.6	27.9	31.7
2004	39.2	43.8	34.6	39.4	38.5	42.6	37.2	42.3	33.0	38.4	27.7	32.2
2005	39.4	44.1	34.2	38.7	38.5	42.8	36.8	41.7	34.0	40.3	28.3	32.3
2006	39.9	44.6	33.9	38.5	38.8	43	36.7	42.3	34.6	41	29.0	33.1
2007	40.0	44.7	34.4	39.3	38.8	43	39.7	45	35.5	41.3	29.6	35.4
2008	39.6	44.4	33.1	38.1	39.2	43.4	39.7	45.1	35.2	40.6	28.3	33.2
2009	39.3	44.4	32.1	38.1	39.6	44.3	39.2	46	32.3	37.7	27.0	31.5
2010	39.2	44.3	32.6	38.6	38.2	43	37.5	45	32.0	38.4	26.9	32.7
2011	39.7	44.9	33.7	40.3	38.7	43.8	36.9	44.2	32.5	39	28.1	33.7
2012	40.7	46.1	34.2	40.5	39.3	44.3	38.6	46.2	32.8	39	27.9	33.6
2013	41.2	46.7	34.8	41.4	39.4	44.5	38.2	46.8	32.8	38.4	27.4	33.3
2014	41.5	46.8	34.1	40.3	39.5	44.7	38.4	46.9	33.0	38.7	27.7	33.6

Source: Eurostat, 2016

# 7. EU budget in the future

- **Funding and spending are equally important**
- **Focus on what adds value to the Union**
- **Make it more transparent, fair, versatile**
- **Structural and cohesion funds are needed to a/reduce economic discrepancies, b/avoid winners' take all games, c/ *mitigate human capital exodus***
- **The Mid-term review: think in terms of EU public goods**
- **The logic of rebates will go away**



# 7. EU budget(s)

- **Variable geometry** has an impact on joint EU resources
- **EU budget and other facilities (Funds)**
- **EU budget and EA fiscal facilities**; would EA needs crowd out EU budget resources?
- An EU own defense capacity?
- **“Coalitions of the willing”** and pooled resources: dealing with complexity in a highly uncertain environment -would this fragment EU mobilization of resources?

# The future

- **Highly uncertain global environment**
- **Disruptions; social strain**
- **Multipolar world**
- **New technologies and impact on labor**
- **Rising protectionism; economic blocs?**
- **Systemic risks and financial fragility**
- **Robustness and resilience a big challenge**
- **Europe needs the EU**