The revised EU budget and EU’s recovery plan: Ten questions from the CPMR General Secretariat

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Rarely have expectations run so high ahead of the publication of a European Commission legislative proposal. The European Commission is due to publish a reviewed version of its proposal for a Multiannual Financial Framework for 2021 – 2027 on May 27th, three weeks later than the original date set on May 6th. This new version is expected to be updated to include fresh proposals to mitigate the impact of the Coronavirus crisis on the European economy, as part of a broader and much anticipated EU stimulus and recovery plan.

This note summarises the information at our disposal a couple of days before the awaited publication of the proposal and raises key questions from a regional authorities’ perspective.

CONTEXT | Where do we stand?

EU Council provides mandate to the Commission on 23 April

The virtual summit of Heads of States and Governments on 23 April did provide a few clues as to what the EU response towards addressing the impact of the crisis on the economy might look like. In a rather unusual show of unity, Member States provided a mandate to the European Commission to prepare an updated version of its proposal for the 2021-2027 multiannual financial framework (MFF) based on the following elements:

- An increased ceiling for own resources, from roughly 1.2% today to 2%, for the first ‘two or three years’
- The extra funding will allow the Commission to ‘raise funds’ which will be channeled back into the EU budget through a ‘recovery programme’
- The recovery programme will be concentrated into four areas of the EU budget. The bulk of the funding will go to ‘support for investment and reforms in Member States and cohesion’. Some of the funding will go towards supporting the European Green Deal, digital transition and increased strategic autonomy; improving the resilience of the EU’s common crisis response tools; and increasing support to the EU’s neighbours and partners
- The recovery programme will be based on a mix between grants and loans

Two European Commission documents (a Technical Note on the EU recovery fund and an internal note on the Multiannual Financial Framework Plus) made their way to the media on the margins of the summit to put flesh on the bones of these new proposals.
The Franco-German recovery plan initiative

On Monday 18 May, France and Germany held a joint press conference to announce a French-German initiative for the European recovery from the Coronavirus crisis. The main elements of the plan include the following elements:

- The Recovery Fund would include EUR 500bn of funding which would be financed by debt issued by the EU (and backed by the EU Member States), which would be invested through the European Budget in the form of grants.
- The Recovery Fund would boost a ‘frontloaded MFF’ (this suggests that the Fund would be spent within the first two to three years of the 2021-2027 EU budget).
- Funding from the Recovery Fund would target ‘the most affected sectors and regions’ in line with European priorities.
- The distribution of the funding would be linked to a clear commitment from Member States to sound fiscal policies and structural reforms.
- It would cover investments in ‘digital and green transitions and strengthen research and innovation’.
- The Recovery Fund and the MFF would need to be adopted ‘swiftly’ and ‘build on progress reached until February’.

The Frugal Four ‘non paper’

On 23 May, four national governments within the now infamously named ‘Frugal Four’ group published a non-paper to propose their own flavour of the European Recovery Fund so that countries are ‘better prepared for the next crisis’ on the basis of a ‘loans for loans’ approach. The non-paper argues that:

- The Recovery Fund should be a ‘one-off’ measure and should not lead to debts being mutualized across EU Member States.
- The Recovery Fund would make loans available to Member States on more favourable terms than normal but would come with strings attached, such as that loan recipients would carry out structural reforms.
- Financing arising from the Recovery Fund would be spent to support research and innovation, enhanced resilience in the health sector and ensuring a green transition that underpins the EU’s ambitious climate, growth and digital agendas.

10 QUESTIONS on the revised EU budget and EU recovery plan

1. Will the European Commission table a genuinely ambitious proposal?

The meeting of Heads of States and Governments on 23 April provided a clear mandate for the European Commission to develop a proposal that is ‘commensurate with the challenges that we are facing’.

There has been no shortage of proposals in the run up to the 23 April meeting: from the Spanish proposal for a EU 1.5 trillion Recovery Fund based on perpetual debt using the EU budget as a guarantee, the Gentiloni/Breton variant based on a lower amount (EUR 1 trillion) and composed of loans to be provided to Member States, or modest injection of liquidity as proposed by the Eurogroup early in April.
But the 18 May Franco-German proposal (see above) has to promise of a genuine European breakthrough, partly because it already builds on the Commission plans to increase the size of the EU budget for 2021-2027 and to frontload much of the extra funding at the start of the programming period through existing EU programmes. It does need backing by the whole of the 27 EU Member States which at the time of writing is far from a done deal, but many senior MEPs (including former CPMR Vice-President Erik Bergkvist) from the BUDG Committee have already lauded the proposal as a first step in the right direction.

2. Which balance will be reached between addressing the short-term effect of the crisis and realising existing long-term objectives at EU level?

Despite remarkable shows of disunity across EU Member States – the most memorable being the 27 March summit of EU leaders leading Jacques Delors to state that the EU was at risk of ‘mortal danger’ the following day – in recent weeks, there seems to be a growing consensus that any new recovery initiative from the EU should embrace and support the EU Green Deal. The view shared early on by Hungarian Prime Minister that the EU should give up on its 2050 carbon neutrality objective to focus on short term economic recovery measures is an isolated one. However, the dangerous divide between the North and the South certainly puts key European values of unity and solidarity at risk.

The above-mentioned question was partly answered by European Commission President Ursula Von Der Leyen on 28 April who echoed a previous statement from German Chancellor Angela Merkel stating that the European Green Deal will be at the centre of the EU’s recovery plan.

Having said so, question marks remain regarding the relationship between the EU recovery plan and the MFF proposal, particularly when it comes to objectives.

The Jacques Delors Institute recently proposed that EU leaders first agree on a recovery package addressing the impact of the COVID-19 crisis before moving on to adopting a long term EU budget starting in 2022, with the current MFF being extended by one year (as advocated by the CPMR).

3. Will the EU budget for 2021-2027 be adopted ‘swiftly’ or will the 2014-2020 EU budget be extended?

The press release detailing the French-German initiative for the European recovery from the Coronavirus Crisis pleads for a ‘swift’ agreement on both the post-2020 EU budget proposal and the Recovery Fund, generously alluding to ‘progress reached until February 2020’ regarding EU budget negotiations whilst omitting to refer to the fact that such negotiations have yet to formally involve the European Parliament. For comparison, in 2013 the European Parliament gave its consent to the Council deal on the current MFF only after 9 months of tense inter-institutional negotiations.

A similar scenario could not be ruled out this time around. On May 15 the European Parliament set the bar very high by adopting a resolution calling for a €2 trillion recovery package to be financed “through the issuance of long-dated recovery bonds” and be “disbursed [...] mostly through grants. This size is certainly much higher than what the Commission could realistically propose, and Member States would be ready to approve.

The frugal four counterplan to the French-German initiative proposed on 23 May is a stark reminder that a deal at the next Council on 18-19 June cannot be taken for granted. At the same time, securing the endorsement of the European Parliament is not an easy win either. For comparison, in 2013 the European
Parliament gave its consent to the Council deal on the current MFF only after 9 months of tense inter-institutional negotiations. Moreover, a modification of the own resources ceiling to borrow extra money on the markets would require the ratification of national parliaments, which could complicate and delay the process further – or in the worst-case scenario derail it altogether. All things considered, the full adoption of the recovery plan and revised MFF could require several months despite the urgency of the circumstances.

But even a swift agreement in June would still lead to significant delays when it comes to setting up 2021-2027 EU programmes, particular for those under shared management.

An extension of the current MFF as per article 312.4 TFUE as an ‘emergency budget’ or at the very least an extension of shared management programmes along the lines of the transition provisions proposed for the rural development fund would appear preferable in such a context.

This is a highly complex issue. As raised by a European Policy Centre Article published on 27 March, extending the current MFF would leave a ‘Brexit gap’, and the UK contribution to an hypothetical 2021 ‘emergency budget’ would need to be somewhat filled by the other 27 EU Member States. Existing corrections and rebates would presumably still apply too. An extension of the Brexit negotiations would change matters (and presume a UK contribution to the EU budget) but it is early days to be assuming such a scenario will take place.

4. **Will the contraction of the economy affect the EU budget in volume terms?**

For simplicity’s sake, let’s define the EU budget as being largely made up of national contributions from EU Member States calculated on the basis of their Gross National Income (GNI). Since the EU’s overall economy is forecast to shrink by 7.4% in 2020, this will lead to an automatically lower EU budget in terms of volume.

It is already clear that the European Commission will propose an EU budget based on a higher ceiling for own resources (2% as opposed to 1.2% today) which should provide some additional headroom and perhaps compensate for the expected drop in Gross National Income across EU Member States due to the crisis. But will the revised proposal suggest a shift as to how much of the EU budget will be based on ‘new’ own resources, such as the three additional own resources suggested in the May 2018 European Commission proposal?¹

5. **Will the extra funding be delivered in the way of grants or loans?**

A key aspect of the Recovery Plan concerns the way in which the extra funding will be spent.

Commissioner Dombrovskis announced on 19 May that ‘we are talking about both in loans and grants’ when it comes to the Recovery Plan. National governments from the now infamously named ‘frugal four’ group have already come out stating that they would favour a Recovery Plan which would hand out loans rather than grants, in direct contrast from the Franco-German initiative or the Spanish proposal for a EUR 1.5 trillion Recovery Plan.

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¹ The first one would be based on revenues from the Emissions Trading Scheme, the second one on national contributions based on the Common Consolidated Corporate Tax Base (CCCTB) and the third one on a national contribution based on the quantity of non-recycled plastic packaging waste produced in each Member State.
The balance between the two is expected to be one of the major sticking points of the negotiations within the Council.

6. How will ‘frontloading’ work?

It is already clear from various speeches and leaked information from the European Commission that much of the Recovery Plan will be invested within the first few years of the new MFF. This was also supported in the Franco-German press release (see above).

The way in which the extra funding will be frontloaded raises numerous questions: will it imply a change in terms of the timeframe for the new MFF (start date, future decommitment rules), could there be a two-phases MFF with a mid-term review, and when would that frontloading of funds precisely occur? Last but not least, how would the frontloading of funds work in the event that the current MFF is extended?

7. What will be the relationship between the EU recovery plan and the BICC and the Reform Support Programme and will the recovery plan be linked to EU economic governance?

According to the European Commission’s various announcements and leaked documents, both the Reform Support Programme (RSP) and the Budgetary Instrument for Convergence and Competitiveness for the euro area (BICC) could have a central role in the recovery plan. It remains unclear how. Will the two instruments form the backbone of the new Recovery and Resilience tool announced by Von der Leyen in her most recent speech to the European Parliament? Will their envelopes be beefed up compared to the previous MFF proposal where EUR 25 bn and EUR 17 bn were earmarked for the RSP and BICC respectively?

A key question is whether the Commission will propose an overhaul of the two instruments’ provisions to best reflect the objective of supporting the recovery. To be sure, adjustments would be needed to ensure that an adequate share of funding is directed towards the most affected Member States, perhaps via a dedicated mechanism. To this end, the current criteria proposed for the BICC, namely inverted GDP per capita and population, may need at the very least to be revised. At the same time, it seems that a key feature of the EU recovery strategy might be the Recovery and Resilience Facility which is aimed at helping Member States rebuild their economies funding key public investments and reforms will be built in on the BICC/CRI and could become active from 1 January 2021.

Besides, a potential matter of contention could be the connection with the EU economic governance framework, in which the two instruments are originally rooted. In their current fashion the RSP and the BICC would link the disbursement of their funding to the implementation of structural reforms recommended in the context of the European Semester.

In other words, the resources would be released only after specific commitments made by Member states are fulfilled and in accordance with a monitoring and assessment mechanism in place. The application of this “conditionality” for the access to the recovery instrument, which was recently confirmed by Commission’s VP Valdis Dombrovskis and espoused by the French-German initiative, is essential to persuade the reluctant frugal four to sign up to the recovery plan. But it is certainly going to meet the resistance of Southern Europe countries. In particular the Italian government is very wary of any proposal entailing a ‘funds-for-reforms’ mechanism as shown by re-negotiation of the European Stability Mechanism within the Eurogroup.
Last but not least, the complementarity between the EU recovery plan and the recently proposed SURE initiative (which is due to complement ESF actions) remains to be seen. SURE is a temporary instrument which provides up to EUR 100 billion of loans to Member States to protect jobs against the risk of unemployment and loss of income.

8. How will the extra funding be spent within Cohesion policy?

One of the ‘givens’ of the Recovery plan (as explained by Ursula Von der Leyen in her speech to the European Parliament on 13 May and echoed more recently in the Franco-German proposal) is that there will be a top-up for Cohesion policy in the proposal next week. Although this will certainly be most welcome and in line with positions put forward by the CPMR in recent months, it will be interesting to understand how the ‘extra’ funding will be spent in relation to already existing objectives for Cohesion Policy, and whether the architecture of the policy will change to adapt to these developments (e.g, the Policy objectives).

A longer-term question regards the role of Cohesion policy and whether the policy is gearing up to be a ‘swiss-army knife’ to address short term emergencies or longer-term goals like the Green Deal, or a mixture of both.

9. Will the Cohesion policy allocation methodology evolve to target the most affected territories, and which indicators will be used?

Besides the balance between loans and grants as raised under question 5., the other critical aspect of the Recovery Plan concerns the methodology that will be followed to allocate the extra Cohesion policy funding across EU Member States. The Franco-German initiative clearly states that the extra funding should be distributed ‘to the most affected regions’. Notwithstanding political considerations and the obstacles ahead to reach an agreement across Member States, defining criteria and indicators to encompass the most affected territories by the COVID-19 crisis is not mean feat in itself.

There are different ways this could be realized. One option could see a new ‘COVID’ fund with its own allocation methodology (with its own allocation methodology based on the impact of the crisis on regional economies). A second option could lead to the current allocation methodology for Cohesion policy (ANNEX XXII of the CPR) being modified to include new indicators to steer funding towards the most affected regions.

Regardless of which option is picked, changing the allocation methodology would raise a series of questions. The first obvious one concerns the balance of funding across EU Member States: to what extent would it lead to a shift of funding from Central and Eastern European Countries down to countries such as Spain or Italy which have had more COVID-19 cases than other countries?

The designation of ‘the most affected regions’ carries in itself an intrinsic dilemma. In countries such as Spain, Italy or France the virus has hit in large part the more well-off regions (e.g. Lombardy, Madrid, Ile de France). Given that these areas represent a sizeable portion of the national GDP, supporting their recovery is essential to put the whole economy of their countries back on track. On the other hand, the generalized lockdown measures are going to cause even more pain to the economically weakest areas of these countries with an expected spike in territorial disparities. The allocation methodology should strike a delicate balance in addressing these two distinct issues.
Another important consideration is the impact of the crisis on the eligibility of regions under Cohesion Policy. Will the crisis cause a large reshuffle across the categories of regions, with several regions being downgraded? How the Commission expects to take this into account, considering that data on regional GDP for 2020 will be available no earlier than February 2021, when EU Budget negotiations and specific regulations are expected to have come to a close? Will the Commission restore the technical review to best reflect changes in GDP in the longer run?

10. **What impact on the programming of Cohesion Policy funds?**

Finally, at a more technical level, on top of the delay in agreeing the MFF (as raised above), the revised EU Budget and new Recovery Plan will most likely have implications on the programming of Cohesion policy funding for 2021-2027.

Will the changes expected to be included in the revised Common Provisions Regulations be substantial enough to deserve a new legislative procedure, with the risk that this might lead to more delays? Will the European Commission propose to extend to future programmes part of the flexibility measures put forward under CRII and CRII+?
The Conference of Peripheral Maritime Regions (CPMR) represents more than 150 regional authorities from 24 countries across Europe and beyond. Organised in Geographical Commissions, the CPMR works to ensure that a balanced territorial development is at the heart of the European Union and its policies.