PISM | POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

Policy Paper

No. 26
March 2012

PAWEŁ TOKARSKI, PATRYK TOPOROWSKI*

The EU Budgetary Chess Game, the Polish Presidency and the Shadows of the Debt Crisis

The negotiations of the EU's funding periods have constituted a repeating political process since the late 1980s when the first middle-term financing period was created. Nevertheless, the current budgetary battle for the new EU Multiannual Financial Framework for 2014–2020 (MFF), which started in June 2011 and is expected to conclude at the end of 2012, will take place in a different context. This is due to several factors. The talks will be held among the highest-ever number of Member States and under the growing ambition of the European Parliament in the new post-Lisbon institutional order. The current budgetary battle is also distinctive since the chair of the first negotiation phase was in the hands of one of the newest Member States and one of the union's largest net beneficiaries—Poland. However, the most significant fact is that the current cycle of talks will be held during the worst crisis ever experienced in the European integration process and at a time when the notion of solidarity, which underlies the construction of the EU budget, is being questioned. All of these elements may lead to a long and harsh battle that threatens a smooth start for the next financing period.

Despite the new context of the negotiations, anyone who expects major changes in either the expenditure or income sides of the new MFF may feel disappointed with the end result. The budgetary disputes resemble a game of chess in which the major players are blocking each other, leaving very little room for changes to the chessboard. This stalemate, which has lasted since 1988 when the last ambitious changes were carried out, is another of the symptoms that reflects the current weakness of the EU. At stake this time is whether funding for the next period will be approved on time or whether the current crisis of confidence in the EU deepens.

* Analysts at the Polish Institute of International Affairs (PISM).

Prelude to Negotiations

It would be trivial to say that the whole issue creates a disproportionate amount of political excitement. Even before the formal beginning of the talks over the new financing period, several attempts by stakeholders were made to influence the bargaining process. During the preparatory phase of the negotiations, the Commission's draft proposal of the budget review was leaked online in 2009 to the delight of analysts and commentators. Its final version was published in October 2010. In addition, during the October 2010 European Council summit, the issue of the new MFF was unexpectedly discussed. As a consequence, the meeting's conclusions mentioned that the fiscal consolidation efforts of the Member States must be taken into account for the new funding period. This would translate into a reduction in the new MFF of less than 1% of EU GNI, in line with the net contributors' intentions. A similar request was contained in a letter in December 2010 signed by five net contributors (France, the UK, Germany, Netherlands and Austria), which raised the temperature of the discussion.

The European Parliament also had a voice in the negotiations. Against the backdrop of the row over the EU annual budget for 2011, the Belgian presidency declared in December 2010 (and two subsequent presidencies upheld it) that the EP's input would be taken into account during the talks on the MFF. As a consequence, the European Parliament, wanting to influence the discussion, issued a statement on 8 June 2011, just before the Commission's proposal was issued. The EP raised items that are controversial for some Member States: the size of the budget, the system of revenues, the importance of the cohesion and innovation policies, the evolution of the common agricultural policy (CAP) and stricter rules and conditions for using EU money. The EP's position is a far-reaching one because it is not responsible, as the Commission is, for laying the foundations of the negotiations. Neither is it an honest broker, such as the presidency strives to be. Instead the EP aspires to become a party with its own viewpoint on the EU's future. Although it is questionable whether the EP has gained the budgetary powers conferred by the Treaty of Lisbon, these changes have emboldened it to articulate its point of view, which is to represent the interests of the EU as a whole.

The Commission's Proposal

As an impartial initiator of the talks, the European Commission had to be much more cautious when preparing its communication, which was issued at the end of June 2011, in order for it to be accepted as the basis for the negotiations. Thus, the aim of the Commission was to link the expenditure structure to the principles of the Europe 2020 strategy, which had been backed by all Member States. In particular, common public funds are intended to have a strong pro-growth, catalytic impact, and serve to improve the environment. There is also a strong emphasis on producing European Added Value (EAV)—additional gains that would result from projects conducted at the EU level.

However, the proposed overall structure of the next financial perspective does not differ significantly from the current one. This means that the hottest issues to be discussed remain the same as during the last negotiations: the size of the budget, own resources, the cohesion policy and the CAP. The other items are much less controversial because of their lesser magnitudes.

The overall size of the budget (including instruments from outside the budget) has been proposed to be a little above 1% of EU GNI, which amounts to nearly €1 trillion for the entire funding period 2014–2020. It is no bigger than the planned size of the budget for 2013—the last year of the current financial perspective—multiplied by seven (years) and modified by the expected inflation rate. The cohesion policy—considered by the EC to be a tool of the Europe 2020 strategy—is proposed to become the biggest spending item, standing for 37% of expenses (about €376 billion for 2014–2020), which is only slightly larger than the CAP expenditure. Within the cohesion policy, the EC put forward a new sector-specific fund, "Connecting Europe", focusing on transport, energy and ICT infrastructure. In line with the EP's approach, the Commission suggests two major reforms in the own-resources system. First, it calls for the introduction of genuine new own-resources (such as an FTT or new EU VAT revenue) that to some extent may replace direct national contributions to the EU budget, which now stand for almost 80% of total revenues. Second, the EC also wishes to simplify the revenue system by transforming the current, complex corrections-and-rebates mechanism into simple lump sums and, ultimately, to eliminate them.

The Big Players' Game in the Shadows of the Crisis

The Commission's proposal, despite being called "the good, the bad and the ugly", can be considered a moderate success. In general, it was not as strongly criticized as may have been expected because the main points were probably presented in consultations with the most-influential Member States in order to meet their demands, which to some extent actually were heeded. The rules of the negotiations remain the same—the big net contributors, Germany, France and the UK, will have the decisive voices on the budget, and they will use the context of the current crisis to strengthen their arguments.

German politicians criticized the document but also have accepted it as the basis for further talks. France insisted on defending the CAP while also acknowledging the general shape of the MFF. Since the document came before the presidential election in France, that reaction seemed understandable given the strength of the country's agricultural lobby. The Commission's proposal was also met with moderate approval from the other Member States. Interestingly, few noticed that Italy is the third net-contributor and that its role in forming the final deal has traditionally been disproportionately low. This can be explained by Italy's internal political problems, the state's inefficient political representation at the EU level and its lacunae in creating and executing a consistent European policy. This attitude is gradually changing under Mario Monti, Italy's technocratic prime minister, who is trying to restore investors' confidence by implementing fiscal adjustments.

A nightmare scenario for the Commission would be if there were an agreement among the biggest net contributors about the shape of the future MFF but which sets aside the EC proposal entirely. However, such a course of events haven't materialised and the document will stay on the table as the basis for further talks. Nevertheless, the possibility of a net payers' background alliance casts a shadow on the negotiations. This is because of the French interest in maintaining the current CAP rules and the UK's reliance on its rebate—a mutually supportive agreement between the two seems natural. In order to forestall that outcome, it looks as if the EC's goal was to meet the French postulate on the CAP and the German position on limiting the size of the budget, maintain a significant role for the cohesion policy, which pleased the new Member States, and emphasize the role of "smart growth", which could gain support from the Nordic countries. The traditional leader of proposals to cut the size of the budget is the United Kingdom. When examining the past MFF negotiations, one may see that in 2004 and 2005 during the talks over the current financial perspective, the EC's offer was initially rejected and the whole agreement was delayed mostly because of the UK's rigid position on the issue.

The current British expectations (concerning the overall size of the budget, the rebate and financial transaction tax) are so high that the Commission seemed unable to satisfy them. It is quite probable the UK will seek to soften (with the assistance of other net contributors) most of the Commission's proposals from 29 June 2011. The prelude for that was a non-paper by eight net contributors (Germany, the UK, France, Austria, Finland, Italy, the Netherlands and Sweden), which was revealed during the GAC meeting on 12 September 2011. The UK's recent alienation, as shown at the December 2011 summit, may point to a stiffening of the British position towards the common budget. Additionally, the appointment of Sir Jon Cunliffe from Treasury (an expert in economic and financial affairs and a former advisor to Prime Ministers Blair and Brown) as the UK's Permanent Representative to the EU may be a signal of this strategy. He took office in January 2012, at a time when the negotiations were accelerated.

The big question mark is Germany's negotiating strategy, since its position will be crucial to the negotiations. So far, it has been a moderate member of the net payers' club, but the GAC meeting of 27 January witnessed Germany express a firm demand to cut the Commission's proposal by €100 billion. This was backed by the UK, Austria, Sweden, the Netherlands, France, Finland and the Czech Republic.

It would be a truism to say that the domestic politics in most countries is now largely influenced by the eurozone crisis. It is serving as the rationale for a tougher course during the budgetary battle, reinforcing a *juste retour* logic as a result, even if any changes in the net positions of these countries would have a minor impact on their fiscal situations. The eurozone is in the most serious crisis since its creation, and all political efforts are focused on finding a way "out of the woods".

Even if the expected national fiscal consolidation encourages the net payers to press more fiercely for cuts in EU expenditures, the link between the austerity measures and the EU budget is not so obvious. First, in 23 out of 27 Member States there was an increase in expenditures in 2011, so the consolidation is a very "conventional" term in this case. Second, the changes in their contributions to EU finances will not significantly affect the fiscal situation of the Member States. The MFF talks should be negotiated by taking into account a longer perspective, especially given the fact that in the first year of the new funding period, the times of hard fiscal austerity will likely be over for most of the Member States. Third, because of the EU's investment nature and its resistance to the so-called "austerity paradox" (that is, a propensity to cut spending in the short-term, which yields higher returns), expenditures via the EU are often perceived as providing greater returns to Member States than via national budgets.

The Polish Presidency and the MFF Negotiations

When it held the EU Council presidency, Poland had to forget about its role as a regional leader. At the same time, however, Poland had the unique opportunity to familiarize itself with the other EU members' positions, not least of which included know-how, which is necessary during the talks. What should also be positively noted is the fact that at the beginning of the negotiations Poland managed to create a common schedule with the other parties of the presidency trio, Denmark and Cyprus.

Poland has chosen the most sound strategy it could to maintain the negotiations on a technical level and focus on providing a level playing field for all the Member States, even the smallest ones or the most inexperienced, which would otherwise be neglected during the negotiation process. For instance, on 15 November 2011, it presented data on the cohesion policy and CAP. On 5 December 2011, the presidency published a detailed report about ongoing works and it was approved by the Member States. As it turned out, the strongest part of this entire strategy was that once the political phase of the negotiations has started during the Danish presidency, these smaller countries had already gained sufficient understanding of the fact that their economic interests are linked with the EU budget and will be able to more successfully oppose the biggest Member States. Another strong point is that during the political phase, Poland will no longer be required to be an honest broker, and can instead act as a regular negotiating party. As such, it may try to use many bargaining tactics, such as assembling a coalition of sorts of cohesion policy friends.

But the greatest success of Poland's presidency was that it managed to keep the entire EC proposal intact as a basis for negotiations, unlike a similar draft that framed the current financial perspective but which was abandoned at the ECOFIN level. The recent activity of the Polish presidency "rescued" the proposal and maintained a fairly balanced discussion among all the negotiation parties, including items that are sensitive for less-influential Member States.

As previously mentioned, the timing of the launch of the MFF negotiations coincided with the formation of the new institutional environment after the entry into force of the Lisbon Treaty, which will affect further inter-institutional changes related to the financial perspective talks. Since then, the negotiating parties have needed to take Parliament's expectations more into account. During the Hungarian presidency and just before the formal launch of the negotiations, the parties agreed that before the General Affairs Council (GAC) meetings there would be consultations between the presidency and the European Parliament. The Polish presidency made the next step and confirmed an enhanced role for the EP, inviting the MEPs to participate in the first informal GAC meeting on the MFF in Sopot. This action was understandable since the EP may be a counterweight to the biggest Member States' impact on the final deal and because it may bring new light to the discussion about the financial perspective. Nevertheless, Poland should be aware of the fact that this change is rather irreversible and the European Parliament will not give up its influence on such a sensitive and wide area. Moreover, the MEPs may concentrate on issues that have little chance to be included in the final version.

Perspectives

Taking into account all the determinants discussed above, the following conclusions can be drawn for the upcoming negotiations phase.

To begin with, even if the EU budget is always a hot topic, the eurozone crisis—unprecedented in the history of European integration—will remain subject Number One for a long time. During the next several months, public opinion and media coverage will be focused on the fiscal situation in the eurozone countries. The influence of the debt crisis on the shape of the new financial framework may not be as significant as expected. Contradictions in the Member States' interests will exclude any visible changes to the MFF structure. Most likely, the philosophy of the MFF will simply petrify, as the Commission has proposed.

So far, the Commission also followed the *status quo* thinking. Demands for changes to the obsolete construction of the EU's finances will unfortunately have to remain for a long time on paper. Items that are innovative and ambitious, such as the creation of a new EU-wide tax, seem to be tactical games.

There is no doubt the discussions will be dominated by the big Member States. A key role belongs to Germany. Its latest demands to slash the Commission's proposal may indicate its willingness to finish the talks as soon as possible, even at the expense of the "cohesion club".

The first round of talks, held by the Polish presidency, had a rather technical character and was not electrifying to the public. Nevertheless, under the Danish presidency the pace has increased since the beginning of 2012. The Danes continue to maintain GAC as the only platform to prepare the conclusions of the European Council. Thank to this, the process will be more transparent. The Danish presidency has had a difficult task of creating a “negotiating box”, a situation which may continue to be challenging. However, it would be optimal to complete the GAC phase in June, since the Cypriots would have difficulties finishing the process.

On the one hand, in the second half of 2011, Poland had to forget about its role as cohesion-club leader. Afterwards, however, Poland dumped the presidency robe and will defend its interests during the main (political) phase with full determination. On the other hand, the experienced Danish presidency, having no “newcomer” complex, more openly voices its interests, especially in the area of “greening”.

Perhaps crucially, the dispute on the next funding period has already been used for internal political purposes, as has happened many times in the past, which complicates the whole discussion. Even if the final changes in agreed contributions will have a minor influence on the net contributors’ fiscal positions, the struggle will be bruising—as always—since the whole problem is highly politicised and occupies a central place in the European policies of the Member States. It has become easy and tempting to use EU issues to achieve domestic interests, even if it narrows the possibility to achieve a quick compromise.

What follows is that the discussion about the MFF will be held within the rhythm of national politics. It seems doubtful that the outcome of the process will be known before the presidential elections in France, which are scheduled for April and May. The only time for a possible agreement will be between the elections in France and those in Germany in September 2013, or earlier. Therefore, the ultimate round of talks will probably be held by the European Council during the Cypriot presidency.

All in all, the entire discussion on the new financial framework does not look too optimistic. The prevailing stalemate and constant attachment to national interests have a detrimental effect on the EU’s ability to take on new challenges. Even events such as maintaining the EC’s proposal as the negotiations base have not eased talks about future spending.

Despite a difficult negotiating context and the reliance on an unstable “cohesion club”, Poland should take more bold steps in the budgetary battle. Its position on the MFF is coherent with the EU institutions’ approach, which is to represent the interest of the EU as a whole. Therefore, it is a valuable figure on the chessboard. Moreover, its determination would profit in the future by increasing the weight of Poland’s words. In the EU, sometimes the one who is listened to is the one who pounds his fist on the table. Poland cannot play submissively or be pushed by the logic that a delay in the adoption of the MFF will have a negative impact on the beneficiaries of EU funds. A lack of agreement by the end of 2012 while overlapping the current eurozone crisis would further limit the confidence of financial markets. This scenario is not welcomed by any of the Member States.

The eurozone crisis cannot be an excuse for postponing a real debate about the reform of EU finances. It seems that one should not think of the common budget in the short- and mid- terms but should try to look at it in a much broader sense. The challenges for the EU remain the same as ever: to make it a sufficiently competitive organism in the global economy and thus gain benefits for all participants in the deal. This is not only crucial now when the eurozone finds itself in the shadows of the debt crisis but also in the longer term when considering the competitiveness of the Member States. The future of the European project is only whether to develop or disintegrate. It is still hard to believe that a black scenario in the debt crisis would come to pass, which would result in the annihilation of the eurozone and even the EU, so the only option is to continue deepening integration. This, however, will be inconceivable without a considerable adjustment in EU finances.