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How to make the most of the EU's financial potential ?

Fabian Willermain & Anca Cioriciu (Puie)

In the perspective of the post-2020 Multiannual financial Framework (MFF), this policy brief suggests three reforms that would improve the aim of the MFF as both an expression of EUs political priorities and budgetary planning tool. It looks into the potential overhaul of the MFF timeline, its structure in the context of new instruments such as the EFSI, and the strategic combination of different EU financial tools intended to stimulate and interconnect economies across the EU-27.

INTRODUCTION

Ever since the financial and economic crises, EU and national policy-makers have been preoccupied with enacting measures to aid economic recovery and the consolidation of EU Member States' economies. Today, investment gaps remain a concern when it comes to stimulating economies, in particular in Member States where the repercussions of the crises are still being felt. While there is no 'silver bullet' policy measure that will make EU economies function at their real potential, new financial stimulation mechanisms might prove efficient remedies against the poor competitiveness and economic sluggishness that affect the EU's overall economic performance. EU Member States – along with EU institutions – have shown a great deal of financial ingenuity in stimulating EU economies into becoming interconnected and competitive.

Two elements are relevant to the current debate over the concerted actions intended to close economic discrepancies and boost economic potential: the Multiannual Financial Framework (MFF) and the European Fund for Strategic Investment (EFSI). This policy brief will look into the potential overhaul of the MFF timeline, its structure in the context of new instruments such as the EFSI, and the strategic combination of different EU financial tools intended to stimulate and interconnect economies across the EU-27. These instruments have plenty of scope for improvement, in terms of their applicability as well as their implementation

Both the MFF and EFSI are primed to tackle investment deficiencies and boost sustainability in the EU's economic recovery plans. How can the EU make the most of the instruments it has at its disposal?

SYNCHRONISING POLITICAL AND BUDGET CYCLES IN THE NEXT MFF

In 1988, the European Commission, headed by Jacques Delors, put in place the first financial framework, which was originally dubbed the 'financial perspectives system'. These financial perspectives were meant to provide a clear and predictable picture of the EU's long-term spending plans. Initially it covered a period of five years (1988–1992). In 1993, the framework expanded from five to seven years, mainly because of the increased usage of multi-annual projects. However, a debate opened up over the MFF's timeline due to multi-annual sectoral agendas, increased competences of the Parliament, and the growing disparities between financial and political cycles (five years term of office for the European Parliament and the Commission vs seven years for the MFF). The Lisbon Treaty confers a legal basis on the MFF and, more importantly, specifies a minimum (and recommendable) timeframe of at least five years.

A switch from seven to five years is not, therefore, uncharted territory. The five-year planning span has already been used, and a reversion to that timeframe would be appropriate today. Firstly, it would result in considerable institutional relief – no treaty change is required as Article 312.1 TFEU already endorses the legality of such an action. Secondly, apart from the considerable budgetary reshuffle exercise triggered by Brexit, the prevailing timeframe and circumstances offer optimal conditions, as there are two more years remaining before the end of the current MFF.

Discussions over the post-2020 MFF are already brewing[1] among the institutional negotiators, such as the Commission, Parliament, national governments and current and future EU Council presidencies. As usual, each institutional party and each government brings their own vision to the negotiating table, and the debate goes up to European Council level. The Commission usually makes the most of the EU's annual budget of approximately 1% of the EU GNI; the Parliament focuses on spending on long-term projects, and each Member State approaches the negotiations mostly through the lens of its national spending preferences. The months needed to reach a political agreement on the post-2020 MFF make the debate around the MFF's timeframe essential for the future of EU finances.

Economic realities show that the reasons for a seven-year MFF are very likely obsolete. In practice, current planning is anything but functional, especially from a political point of view. Indeed, MFF negotiations tend to be acrimonious and time-consuming, and one might claim that a seven-year timeframe clears those negotiating tables for a longer period. However, the responsibility that comes with the adoption of a five-year financial plan obliges the holders of EU mandates to deliver on commitments and vision for EU progress that match their own decisions on policy spending. Each Commission and Parliament should carry their own political and financial commitments. With a five-year timeframe, national governments would not be able to sideline the views of their political competitors at home. The political debate could also water down the national-centered tendencies of the European Council as it engages in the usual horse-trading over the MFF.

The interplay between the MFF and the EFSI

In 2014, the European Commission targeted the private sector's aversion to risk when it launched EFSI 1, which drove the European Commission Investment Plan for Europe or 'Juncker Plan'. The fund was designed jointly by the Commission and the European Investment Bank (EIB) to encourage private sector contributions that would scale up the pan-European economic recovery. The encouraging first results confirmed that the plan seemed to be an inspired approach, and, in 2016, the European Commission put in place a 2.0 version of the EU Investment Plan ('Juncker Plan II' steered by EFSI 2), expanding its timeframe and capacity.[2]

Given the Member States' contributions to both EFSI 1 and 2 and MFF, another pertinent element of reform to pursue would concern the size and structure of the future MFF, in particular in relation to EFSI financing. Both EFSI 1 and EFSI 2 have used loan/debt guarantees to mobilise investments from the EU budget, whether from the Horizon 2020 or Connecting Europe Facility or other unallocated margins from the budget. This was a politically charged exercise in which institutional disputes made it difficult to decide which headings and financial instruments would be deprived of financing in favour of the EFSIs. If the Commission and the EU budget legislators have learned this lesson, they should consider including this new investment model of combining budget guarantees and actual contributions as a permanent feature of the next MFF

Contributions also raise the eternal issue Member States' worry about: the logic of return balance. In fact, Member States' participation in and understanding of this investment pattern of partnering with the EIB, the EU budget and Member States' contributions, is crucial for the future design and stability of European finances.

Since the Juncker Plan 1.0 came into force, national budget contributions to the EFSI have been deductible from the deficit ceiling imposed on Member States as part of the Fiscal Compact. EFSI 2 applies the same rule. Also, rather than contemplating the logic of return balance, governments should understand the greater leverage effect that a clearer view of the EU budget would bring versus caring exclusively for their national budgets. This would also facilitate the MFF negotiations and allow greater deductions from the deficit. If Member States realise the considerable advantages of thinking European when it comes to budget contributions, then these economies of scale will materialise only with the implementation of big interconnecting projects that are risky for their economies.

When public and private spending meet at the Commission

EU Member States have their own national public spending capital, but they also benefit from a multiplier effect provided by the EU through EU budgetary instruments. The European Commission and Member States share the management of these instruments (the European Structural and Investment funds or ESI; special financial instruments). In practice, it now seems more important to close the efficiency gap for public investment to ensure effects in the real economy. For this reason, the parallel approaches of the 2014 and 2016 Juncker Investment Plans in targeting private sector risk aversion are a solution that address market demands.

Emphasis should be placed on an approach that combines the two main types of EU financing mechanisms: the EU budget tools and the newly designed EFSI. The strategic and efficient complementarity between the EFSI through EU and EIB financing on one the hand and the traditional EU budget spending funds and instruments of ESI or other special financial instruments on the other, is another component intended to streamline the financing mechanisms.

Public spending always seeks a political purpose. Funds from the existing EU budget are currently designed to fill a public spending gap in what governments consider worthwhile to cover, while one requisite of a functional EU economy is responsiveness to the market's needs. The EFSI's objective is therefore to mobilise private spending to fill the private investment gap. The proposed mechanism aims to achieve this by encouraging investors to address riskier – but future-driven – projects while equally addressing the important dimension of the interconnectivity of markets in the EU.

The institutional EU framework of overall financing, be it at EFSI or EU budget levels, also needs special attention. The partnership between the European Commission and the EIB in the EFSI should streamline the entire process of managing the financing and awarding of investment projects throughout the EU. According to EFSI procedures, the choice of projects is now the prerogative of an investment committee that is part of the EFSI governance bodies. Committee members should only show impartiality and vision for cohesion throughout the EU, with real remedies for its disparities and real justifications for the EU added value. The management model should include transparency, in particular on issues such as publication of the criteria and the justification of the bidding project choice. This component is essential as beneficiary governments often tend to disagree with the practice, considering their sovereignty to be estranged by bureaucratic institutions that could be subject to political influences.

Given the difficulties certain private and public actors from Member States face in applying for projects, it is essential that the European Investment Advisory Hub (EIAH) is indeed the go-to source. It is important that it ensures fair assistance to the network of partner institutions, including national promotional banks, and that it takes into account actors from Member States where this type of bank does not exist.

Conclusion

The current system for coordinating European economies is no longer practical. Economic growth in the EU appears to be trapped in a slow-paced and unequal recovery. New financial solutions such as these investment incentives mentioned above have the potential to unlock this pattern. The EFSI financing model has proven itself in practice,[3] and efforts to improve its performance could result in it becoming a key financing model for a European economic relaunch.

Of course, the new instruments would need implementation adjustments. These could range from the simplification of access to funding procedures, to enhanced assistance for Member States with weaker records of financing applications.

In the future, the advantages of a shorter and restructured MFF, together with a strategic combination of the EFSI scheme aimed at private spending and the funds and instruments of the EU budget, greater simplification and less resource waste during the political negotiation processes on financial resources or the MFF.

Finally, Member States should be encouraged to manifest their genuine commitment to promote the schemes, explain the implications of new economic solutions, and, most importantly, apply the proposed improvements.

Fabian Willermain is Research Fellow in European affairs programme at Egmont – Royal Institute for International Relations.

Anca Cioriciu (Puie) is future Romanian diplomat writing in her own capacity and former Policy Analyst at the Open Society European Policy Institute.

ENDNOTES

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[1]General Affairs Council, Conclusions, 14424/16, 15-16 November 2016. file:///C:/Users/Fabianw/Downloads/st14424.en16.pdf , Speech by Vice-President Kristalina Georgieva at the EU Presidency Conference on the Multiannual Financial Framework, Amsterdam, 28 January 2016. https://ec.europa.eu/commission/commissioners/2014-2019/georgieva/announcements/speech-vice-president-kristalina-georgieva-eu-presidency-conference-multiannual-financial-framework_en, Speech by Magdalena Andersson Minister of Finance of Sweden at the EU Budget Focused on Results Conference, Brussels, 27 September 2016. http://ec.europa.eu/budget/library/budget4results/bfor-conference-2016-p4-speech-finance-minister-andersson.pdf

[2] Fabian Willermain & Quentin Genard, The Juncker Plan 2.0 : the Belgian view, European Policy Brief, Egmont Institute, 2016. http://www.egmontinstitute.be/publication_article/the-juncker-plan-2-0-the-belgian-view/.

[3] See projects financed by EFSI 1.0 : Ginko Advisor SARL (http://www.eib.org/projects/pipelines/pipeline/20150248) and Nobelwind offshore wind Inki Advisor SARL (http://www.eib.org/projects/pipelines/pipeline/20140251).