IN-DEPTH ANALYSIS

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The next Multiannual Financial Framework (MFF) and its Flexibility

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The next Multiannual Financial Framework (MFF) and its flexibility

Abstract

This briefing note provides some reflections on the challenges facing the next Multi-Annual Financial Framework (MFF) and discusses ways to enhance the flexibility of the EU budget. An analysis of the use of existing flexibility provisions in the current MFF is followed by some recommendations on how to enhance flexibility in the post-2020 MFF.

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This document was requested by the European Parliament's Committee on Budgets. It designated Ms Isabelle Thomas (MEP) and Mr Jan Olbrycht (MEP) to follow the study.

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EXECUTIVE SUMMARY

The negotiations on the next Multiannual Financial Framework will be particularly challenging. Brexit, if it finally happens, will leave a major hole in the EU finances, and there will be strong pressure to expand levels of EU spending in areas which were not an EU priority in the past, particularly migration and external security.

As in the last MFF negotiations, there will be a debate on how to enhance the flexibility of the EU budget. While the current MFF introduced new flexibility provisions, the multiple crises affecting the EU in recent years have shown the limits of such provisions and the need to do more to increase the capacity of the EU budget to adapt to unexpected events and changing circumstances.

An analysis of the use of flexibility provisions and instruments in the current MFF reveals that:

- The use of Special Instruments has been uneven so far. Whereas the Flexibility Instrument (FI) has been used extensively, the use of the other three Special instruments has been more variable, and particularly modest in the case of the European Globalisation Adjustment Fund (EGF).
- The Contingency Margin (CM) has proven to be a powerful instrument to accommodate additional needs, but if used extensively, it dangerously reduces the margins for subsequent years.
- The Global Margin for Payments (GMP) is very useful to align annual payment ceilings to payment needs and ensure maximum use of the MFF's overall payment appropriations.
- The Global Margin for Commitments (GMC) has been used mostly to accommodate changing EU policy priorities rather than react to unexpected external events.

Another general lesson from the current MFF is that the degree of flexibility depends very much on the existence of an appropriate level of ceilings. The low ceilings set for the current MFF have forced EU annual budgets to operate close to the spending limits, leaving few margins to cover sudden needs.

The paper explores different ways to enhance flexibility in the forthcoming MFF:

- Aligning the duration of the MFF with the mandate of EU political institutions and merging headings 1a and 1b.
- Strengthening Special instruments, particularly by eliminating limitations to carry over unused spending to subsequent years.
- Removing the obligation to offset amounts mobilised through the Contingency Margin against current and future margins.
- Establishing an EU Crisis Reserve financed by the amounts from de-committed appropriations and sanctions
- Setting mandatory margins in annual EU budgets and using these margins to fill a budgetary reserve for unexpected events or new policy priorities during the budgetary year
- Rendering EU spending programmes more flexible.

1. GENERAL APPROACH FOR THE NEXT MULTIANNUAL FINANCIAL FRAMEWORK

KEY FINDINGS

- In the forthcoming MFF negotiations, the EU budgetary authority will face the double challenge of adjusting the EU budget to the **permanent gap left by Brexit** while **increasing EU spending in new priority areas** (internal and external security).
- The introduction of a fully-fledged macroeconomic stabilisation function inside the MFF seems unrealistic, but the new MFF might incorporate some **stabilisation properties** and/or a **dedicated budgetary line to promote reforms.**
- The nature of the next MFF is uncertain and will depend on the level of political ambition. However, **if Brexit occurs, a marginal improvement of the current system is not an option**.
- A radical overhaul of the MFF, with fundamental changes in both the spending and the revenue side, also seems difficult given the tight schedule and expected political opposition. A more promising and realistic scenario is a **transitional MFF with some innovative features that pave the way for a more significant change in the future.**

1.1. CONTEXT AND KEY CHALLENGES

Even if the EU budgetary and economic situation is better now than in 2013, when the current Multiannual Financial Framework (MFF) was adopted, the forthcoming negotiations of the next MFF will take place in a difficult context. The EU budgetary authority will have to face two main challenges: adjusting the EU budget to the permanent gap left by the United Kingdom (UK)'s decision to withdraw from the EU and increasing EU spending in areas which were not a priority in the previous MFF (headings 3 and 4).

Brexit, if it finally occurs, will have different budgetary consequences for the EU. The outcome of the negotiations on the so-called 'UK financial settlement' will determine the extent to which the UK participates in the payment of the 'RAL' pending in 2020 and, by extension, the negotiations on the overall ceiling for payments in the next MFF. In addition to that, **Brexit will leave a permanent shortfall in the EU budget estimated at EUR 10 billion per year**[1]. This gap will have to be filled either through increasing Member States' GNI-based contributions, spending cuts, a combination of both or the introduction of new Own Resources. Since a rise of GNI-based contributions will hit net contributors hardest (particularly those benefiting from the 'rebate on the UK rebate') and spending cuts will mostly penalise net recipients, discussions on how to adjust to this gap may entrench the divide between net contributors and net recipients and complicate the outcome of negotiations.

Brexit may have other impacts on the forthcoming MFF:

- The departure of the UK may **change the dynamics of negotiations in the Council**. During the last MFF negotiations, the UK government played a crucial role in the last stage of the negotiation, forcing a significant reduction in the overall ceiling for payments;

[1] See Haas, J. and Rubio, E. (2017), *Brexit and the EU budget: Threat or Opportunity*, Jacques Delors Institute, Policy Paper 183, January 2017.

- Brexit will lead to an **increase of the EU budget in relative terms (as a % of EU GNI).** This is because it would reduce EU GNI by approximately 17% (the UK economy's relative weight in the EU) but the UK's net contribution is only about 7% of the EU budget (due to the rebate it receives). Under these circumstances, maintaining the EU budget at 1% of EU GNI (which was the Council's stance in the last two MFF negotiations) appears difficult, if not impossible[2];
- Brexit will put an **end to the UK correction mechanism and the related rebates**. This opens the possibility to remove all corrections in the EU financing system and abolish or reform the VAT-based own resource (on which the calculation of the UK rebate is based).

The new MFF will also have to deal with new EU spending needs. Between 2014 and 2017, the EU has dedicated EUR 17.7 billion from the EU budget to tackle the external and internal dimensions of the refugee crisis, more than doubling the initial planned allocations (EUR 7.6 billion)[3]. As migration flows and security threats will not disappear in the coming years, there will be **strong pressure to consolidate, or even expand, current levels of EU spending in these areas.** With regard to internal security, some experts recommend raising Home affairs spending from 1% to 10% of the MFF[4]. As for defence, the Commission has recently proposed including **a new EU budgetary line on defence research and development**. If the proposal is approved, its size would be equivalent to around 1% of the current MFF[5] and there will be strong pressure to maintain it into the next MFF.

Finally, an open question is whether there will be an agreement to create a fiscal capacity for the Euro area by 2020, what its nature and role will be and whether it will be placed within the EU budget. There are arguments to place a future macroeconomic function for the euro area into the EU budget, as suggested by the Commission's Reflection Papers on deepening the EMU and on the future of EU finances. This would require a major increase of MFF ceilings unless the new instrument is placed outside the MFF, as the Special instruments are (see section 2.1)[6]. It is also possible that EU Member States fail to agree on the establishment of a fully-fledged macroeconomic stabilisation capacity by 2021 but, nevertheless, decide **to strengthen the stabilisation features of the post 2020 MFF** (e.g. making EU cohesion policy more sensitive to cyclical fluctuations[7]) and/or create **a dedicated fund to provide incentives to Member States to carry out reforms**, conditioning the establishment of a future stabilisation function to the attainment of some degree of convergence.

1.2. THE NATURE OF THE NEW MFF IN THE POST-BREXIT SCENARIO

While the size and nature of the next MFF will depend on the level of political ambition and agreed vision about the future of the EU, the context described above poses particular constraints. If Brexit finally takes place, the idea of carrying on with very few changes (that is, the **scenario 1** in the Commission's White Paper) does not seem feasible. Maintaining the current level of EU spending and responding to new spending needs will not be possible in a context of falling revenue due to Brexit, unless there is a rise in Member States' contributions or a reform of the Own Resource system.

[2] According to our calculations, assuming the same level of GNI-27 as today, cuts amounting to around EUR 23 billion per year would be necessary to maintain the budget size unchanged in relative terms (see Haas and Rubio 2017, op.cit.).
[3] European Commission, *EU budget for the refugee crisis and improving migration management*, factsheet, 2017
[4] Enderlein, E. and Nicole Koenig, N (2016), *Towards Dublin IV: sharing norms, responsibility and costs*, Policy paper Jacques Delors Institute-Berlin, 29 June 2016.
[5] The Commission proposes a European Defence Fund with an annual budget of EUR 1.5 billion/year (EUR 0.5 billion for defence research and EUR 1 billion to co-finance the joint development and acquisition of military capacities). This is equivalent to EUR 10.5 billion over seven years, which corresponds to 0.96% of total commitments in the current MFF. See European Commission, *Defending Europe: The European Defence Fund*, factsheet, 2017
[6]See Repasi 2013 and Iara 2015
[7] See Dullien, S. and Schwarzer. D (2007) and Rinaldi, D and Nuñez Ferrer (2017) for options to strengthen the stabilisation properties of the EU budget

Narrowly focusing the EU budget on internal market functioning (**scenario 2**) also seems unrealistic. This would imply a radical departure from past and current MFFs, which is difficult to imagine given the strong status quo bias in EU budgetary decision making and the lack of consensus in favour of a smaller EU budget.

Pressure not to increase the size of the MFF, and to maintain the amounts of cohesion and agriculture broadly stable, may lead to a higher use of financial instruments and additional budgets outside the MFF (**scenario 3**). However, the current EU budgetary landscape is already highly fragmented and there will be resistance from some stakeholders to place more elements outside the MFF.

A combination of **scenarios 4 and 5** looks promising. It would imply:

- Major reforms in Cohesion and Agricultural policy to reduce their overall budget while making them more effective and maximising the impact of investment;
- Some re-allocation of resources from Cohesion and Agriculture to policy areas with high EU added value (research and development, trans-national infrastructure, mobility, common border management, defence and foreign policy);
- A major reform of the Own Resources System, with the elimination of all rebates and corrections and the introduction of new Own resources financing a significant part of the budget.

Such a scenario can, however, be difficult to put into place by 2021 in view of the tight schedule and expected political resistance to change. An alternative is a **transitional MFF with some reforms to reduce the Cohesion and CAP budgets** (e.g. introduction of co-financing in CAP) **and some re-allocation between headings, coupled with a serious (and as far as possible binding) political commitment to embark upon a major reform of the system of own resources in the future,** conditional on more relevant changes in the spending side as proposed by Nuñez Ferrer et.al. (2016)[8].

2. PRESENT FLEXIBILITY PROVISIONS AND ITS USE UNDER THE MFF 2014-2020

KEY FINDINGS

- The **use of Special Instruments has been uneven so far**. Whereas the Flexibility Instrument (FI) has been extensively used to react to the refugee crisis, the use of the other three instruments has been more variable, and particularly modest in the case of the European Globalisation Adjustment Fund (EGF).
- The **Contingency Margin (CM)** has proven to be a powerful instrument to accommodate additional needs which cannot be financed within the annual ceilings. However, an extensive use of the CM can reduce the margins for the years ahead and, thus, the capacity to use the other two flexibility provisions (Global Margin for Payments and Global Margin for Commitments).
- The **Global Margin for Payments (GMP)** has been very useful to align annual payment ceilings to payment needs and ensure maximum use of the MFF's overall payment appropriations.
- The **Global Margin for Commitments (GMC)** has been mostly used to accommodate changing EU policy priorities, rather than react to unexpected external events.

[8] Jorge Nuñez Ferrer et.al., *Study on the potential and limitations of reforming the financing of the EU budget*, Expertise commissioned by the European Commission on behalf of the High Level Group on Own Resources, 3 June 2016

It is usually argued that the practice of Multiannual Financial Frameworks, established in 1988, was an improvement in terms of stability but had the drawback of reducing the flexibility of the EU budget, defined as the capacity to accommodate EU spending in relation to new events or changing priorities. Debates to enhance flexibility were not salient during the first MFFs[9] but have become increasingly important since the 2000s, as a result of a combination of tighter financial constraints imposed on MFFs and growing unexpected challenges, particularly in external actions.

The degree of flexibility depends on at least four parameters: the duration of the MFF and the number of headings; the margins available within each expenditure ceiling and the capacity to make use of them; the existence of Special instruments to react to unforeseen circumstances and the degree of in-built flexibility in EU spending programmes. Previous MFF negotiations enhanced the flexibility of the EU budget with the changing mix of those parameters. **In the last MFF negotiations, the main novelty was the introduction of three new provisions to maximise the use of margins between headings and the strengthening of the Flexibility Instrument**. The MFF mid-term revision, adopted in June 2017, also introduced some changes (see table 4 in annex for an overview of changes over time). In spite of these improvements, there is general consensus that the EU budget's capacity to accommodate new circumstances remains too limited.

2.1. SPECIAL INSTRUMENTS OUTSIDE THE MFF

The current MFF counts four Special instruments placed outside the MFF to allow the Union to react to unexpected circumstances which cannot be financed with programmed spending. Except for the Flexibility Instrument, Special instruments can only be used for the specific goals they have been designed for. They also differ in the amounts potentially available (see Table 5 in annex for a description of the scope and amounts potentially available per instrument).

Table 1 below shows the extent to which each of the instruments has been used so far. **The Flexibility Instrument (FI) has been extensively used, mostly to react to the refugee crisis, up to the point that available funds were fully used by the end of 2016 (table 2).** In contrast, the use of the other three Special instruments has been more variable, and rather modest in the case of the European Globalisation Adjustment Fund (EGF). The 2017 mid-term revision has introduced some changes: the annual amounts for the Flexibility Instrument and the Emergency Aid Reserve (EAR) have been raised and the amounts of the EU Solidarity Fund (EUSF) and the European Globalisation Adjustment Fund (EGF) having lapsed in previous years can be now added to the Flexibility Instrument, thus reinforcing the capacity of this instrument even further.

[9] Even if it is worth noting that the first and second MFF (1988-1992 and 1993-1999) were revised or adjusted several times to accommodate new activities (e.g. provision of technical assistance to the republics of the former USSR, support to German unification).

Table 1. Use of Special instruments in current MFF (in EUR million, commitment appropriations)

YEAR	FLEXIBILITY INSTRUMENT	EMERGENCY AID RESERVE	EUROPEAN GLOBALISATION ADJUSTMENT FUND	EUROPEAN UNION SOLIDARITY FUND
2014	89.3	98	81	127
2015	145.8	84	43	83
2016	1 530	309	26	0
2017	530	0	0	973

Source: 2014, 2015 and 2016 figures from annual reports on budgetary and financial management of the European Commission, 2017 figures from amending budgets 1 and 4 (corresponding to the mobilisation of the EU solidarity Fund), and Decision 2017/342 (corresponding to the mobilisation of the Flexibility Instrument).

Table 2. Use of the Flexibility Instrument in the current MFF (EUR million, current prices)

	2014	2015	2016	2017
Max available per year	**500**	**510**	**520**	**1322**[1]
Carry overs from previous years	0	420.7	781.3	0
Mobilised under Heading 1	89.3	83.3	0	0
Mobilised under Heading 3	0	66.1	1506	530
Mobilised under Heading 4	0	0	24	0
TOTAL MOBILISED	**89.3**	**149.4**	**1530**	**530**
Remaining available	420.7	781.3	0	792

Source: own elaboration based on data from Statement of estimates of the European Commission for the financial years 2014, 2015, 2016, 2017 and 2018

[1]Includes the annual amount for the flexibility instrument (676 million in current prices, after 2017 revision of MFF regulation) plus amounts from the EU Solidarity Fund and the European Globalisation Adjustment Fund lapsing at the end of 2016 (646 million).

During the current MFF, **the treatment of payments related to the use of special instruments has been subject of disagreement**. The 2014-2020 MFF regulation is unclear on this point[10], and this has allowed the Council to defend the establishment of these payments within the ceilings. So far, the Commission has not endorsed the Council's position, arguing that the overall payment ceiling for the current MFF was fixed on the basis of programmed commitments, thus not taking into account possible unplanned expenditure derived from the use of Special instruments[11].

[10] Article 3.2. of the MFF regulation refers to the need to enter commitment appropriations "over and above the ceilings" when mobilising special instruments but does not mention which treatment shall be given to payment appropriations.

[11] SWD(2016) 299 final, p. 68

2.2. FLEXIBILITY PROVISIONS TO MAXIMISE THE USE OF MARGINS

The main novelty of the current MFF has been the introduction of new flexibility provisions allowing the EU to transfer margins between headings and years to a much larger extent than in the past. Two of them allow for specific flexibility measures to be applied in the first years of the MFF (art 15 and art 19 MFF regulation) whereas the remaining three are general flexibility provisions (table 3 in annex for a description of the objectives, procedure and conditions for use of these various provisions).

Table 3 below shows the use of the three general flexibility provisions so far[12].

Table 3. Use of flexibility provisions so far (EUR million, current prices)

	2014	2015	2016	2017	2018*
Global Margin for Payments	104 million available (carried over to 2015)	1 288 million available (carried over to 2018-2020)	13 991.3 million available (carried over to 2018-2020)	Not yet calculated	Not yet calculated
Contingency Margin	4 175 million available (of which 2818 million mobilised to reduce the backlog on payments from previous MFF)	4 175 million available, not used	4 438 million available, not used	4 496 million available (of which 1176 million mobilised for heading 3 and 4)	4 711 million available
Global Margin for Commitments	521.9 million available (transferred to 2016, allocated to EFSI)	1 383.2 million available (of which 1256 million transferred to 2017, allocated to EFSI)	2 090.2 million available (of which 351.4 million allocated to EFSI)	1 439.1 million available (of which 1 256 million allocated to EFSI)	2 090 million available (of which 891.7 million allocated to EFSI, European Solidarity Corps and YEI)

Source: own elaboration based on data from Commission's technical adjustment of the MFF for 2016, 2017 and 2018. Figures for 2018 come from the draft 2018 annual budget.

As seen in the table, **the amounts available from the GMP and the GMC vary a lot from one year to another whereas the Contingency Margin provides a sizeable and stable amount of resources to be mobilised (around EUR 4-4.5 billion per year).** This last instrument, however, is a last resort instrument. Moreover, as the volumes mobilised through the Contingency Margin have to be offset against the margins from current and subsequent years, the use of this instrument reduces the capacity to use the other two flexibility provisions (Global Margin for Payments and Global Margin for Commitments) in subsequent years.

[12] See Ollikainen, M (2017) for an analysis of the use of specific flexibility clauses.

This negative interaction between the Contingency Margin and the Global Margin for Payments was evidenced in the first years of the MFF. At the end of 2014, the Contingency Margin was mobilised for an amount of EUR 2.8 billion to reduce the backlog on payments from the previous MFF. This was offset by using the full payments ceiling in 2014 (leaving almost nothing to be carried over to 2015 through the Global Margin for Payments) and reducing margins for years 2018-2020. This negative impact has been recently corrected, as a higher than expected fall in payment claims has allowed the Commission to advance the offsetting of the 2014 mobilisation of the Contingency Margin to 2017 and to restore margins of 2018-2020 years.

The fall in payment claims has also translated into an important amount of unspent payments at the end of 2016. Thanks to the Global Margin for Payments, the Commission has been able to transfer all these unused payment appropriations to 2018-2020, something which will be very helpful to deal with the likely increase of payments at the end of the financial period. In this respect, one can argue that **the Global Margin for Payments has proven very useful to adjust annual payment ceilings according to payment needs and ensure maximum use of the overall payment appropriations** (see figure 1 in annex). In the past, unused payment appropriations were redistributed to Member States, and thus the final overall amount of payments implemented was lower than initially programmed (see figure 2 in annex).

Looking now to commitments, it is worth noting that the **Global Margin for Commitments has been used mostly to finance the guarantee supporting the European Fund for Strategic Investment (EFSI).** This is evidence that part of the need for flexibility stems from the need to accommodate changing EU policy priorities rather than react to unexpected external events.

2.3. IN-BUILT FLEXIBILITY IN EU SPENDING PROGRAMMES

Another way of increasing flexibility is by making EU spending programmes more flexible to adjust to unexpected events or changing circumstances. The MFF 2014-2020 has introduced some novelties in this respect:

- **The degree of legislative flexibility has been enhanced**: the EU budgetary authority can now deviate up to 10% (rather than 5%) with respect to the overall financial envelope set up in the legislative act concerning a multiannual programme (par 17 IIA);
- Art 7 of the MFF regulation has considerably expanded a provision introduced in 2007-2013 concerning the **adjustment of Member States' cohesion policy envelopes on the basis of more recent statistics**[13];
- There has been a **major increase in the use of Financial Instruments (FIs**). With the extension of the EU guarantee to EFSI from EUR 16 to EUR 26 billion, the total EU budget contribution to Financial Instruments in the current MFF will amount to approximately EUR 60 billion, which is almost four times the total EU budget's contribution to financial instruments in the 2007-2013 period[14].

Despite these changes, EU spending programmes are still very rigid and unable to adapt to changing circumstances. Most of them cover the whole seven-year period and around 70% of total EU spending is pre-allocated.

[13] In particular, the adjustment now applies to all Member States (and not only those subject to a capping of their global cohesion envelopes as was the case in 2007-2013). Following art 7 MFF, cohesion envelopes were all recalculated in 2016 on the basis of most recent statistics, and adjusted for years 2017-2020 whenever there is a cumulative divergence of more than +/- 5% between the original envelopes and the newly calculated ones.

[14] European Court of Auditors, *EFSI: an early proposal to extend and expand*, Opinion No 2/2016,

3. GENERAL LESSONS FROM THE USE OF FLEXIBILITY IN THE MFF 2014-2020

KEY FINDINGS

- The degree of flexibility strongly depends on the establishment of a sufficient level of overall commitments and payments.
- The post-2020 MFF regulation should clarify the treatment of payments derived from the use of Special instruments.
- The 2017 mid-term review/revision has been modest in its scope, due to legal restrictions, the unwillingness of various Member States to modify fixed ceilings and its misalignment with the EU institutions' political calendar

There are various lessons that can be drawn from the use of flexibility in the MFF 2014-2020.

A first lesson is that **the degree of flexibility very much depends on the existence of an appropriate level of ceilings.** The current MFF was negotiated in a context of fiscal consolidation. Against this backdrop, the Council agreed to keep a low level of overall commitments and a particularly low level of overall payments. The Parliament first contested these figures, but eventually decided not to challenge them, requiring in exchange - among other things - the introduction of new flexibility provisions and a mutual engagement to use "*maximum possible flexibility (...) to allow the Union to fulfil its obligations*" (recital 4 preamble MFF regulation). In practice, however, flexibility has been constrained by the lack of sufficient margins. EU annual budgets have operated close to the spending limits, leaving few margins to adjust to unforeseen circumstances.

A second lesson is the **need to clarify the treatment of payments derived from the use of Special instruments**. The vagueness of the 2014-2020 MFF regulation on this point allowed the Council to defend the establishment of these payments within the ceilings, an interpretation that, had it been endorsed by the Commission, would have severely restricted the degree of flexibility of the current MFF given the low overall ceiling for payments fixed in 2013. The new MFF should clarify how to treat these payments. Including them within the ceilings is acceptable only if the overall ceiling for payments is fixed at a level that provides enough margin to eventually cover these payment claims without endangering payments from planned spending.

Finally, a third lesson concerns the need **to provide the institutional means for a post-electoral re-definition of EU spending priorities**. The MFF 2014-2020 was subject to a compulsory post-electoral review and revision. However, the latter took place at the end of 2016, almost two years after the election of the new Commission. Besides, the scope of this revision was quite limited due to legal constraints and the Council's refusal to modify ceilings. Altogether, the review/revision has resulted in some increases in spending to respond to urgent priorities, rather than a general re-assessment of policy priorities through re-allocations and modifications of ceilings.

4. WAYS TO ENHANCE FLEXIBILITY IN THE POST 2020 MFF

KEY FINDINGS

- The need for flexibility would be reduced by aligning the duration of the MFF with the mandate of the EU institutions. **The big challenge for the 10-year MFF option is to set the conditions for a real post-electoral MFF revision**.
- **Reducing the number of headings would facilitate the re-allocation of spending between programmes and priorities**. While the number of headings is already low, one could imagine further reductions without endangering the overall political coherence and meaning of the headings, such as **merging Headings 1a and 1b**.
- There are **several options to strengthen the Special instruments outside the MFF**, such as merging the FI and EAR, expanding the scope of the EUSF or eliminating limitations to carry over unused spending from Special Instruments.
- It is also possible to improve and reinforce the use of existing flexibility provisions. The most significant change would be **removing the obligation to offset amounts mobilised through the Contingency Margin.**
- An **EU Crisis Reserve, financed with the amounts from de-committed appropriations and sanctions,** could have a significant size, but would only provide funding for crisis or major events with humanitarian and security implications
- Another interesting option is to set **mandatory margins** in annual EU budgets and use these margins to fill a **budgetary reserve for unexpected events or new policy priorities during the budgetary year**
- There is also potential to **increase flexibility of EU spending programmes.**

This section discusses different possible ways to enhance flexibility in the forthcoming MFF, which are not necessarily mutually exclusive.

4.1. CHANGES IN DURATION AND STRUCTURE OF MFF

The most straightforward solution is to modify the duration of the MFF and/or change its structure. As regards the duration, the shorter the MFF the lower the need to adapt EU spending to new circumstances. Aligning the MFF with the mandate of the European Parliament and Commission would also reduce the need for flexibility as it would ensure total alignment between EU spending allocations and EU policy priorities.

Two main options to reform the duration of MFF are under discussion: a five-year framework fully aligned to the EU political mandates or a ten-year MFF with a substantial/compulsory review after five years ("5+5"). **The big challenge for the '5+5' option is to set the conditions for a real post-electoral MFF revision.** The latter should allow re-allocations across headings and should foresee a 'soft' procedure to modify overall ceilings.

With respect to the structure of the MFF, the lower the number of headings the better in terms of flexibility, given that transfers within headings are much easier to apply than across headings (no need for approval of the two arms of the EU budgetary authority). The number of headings is already rather low today, but one could imagine some further reductions without endangering the overall political coherence and meaning of the headings, such as **merging Headings 1a and 1b**. In terms of flexibility, this would allow for recovering margins from heading 1b (e.g. stemming from de-commitments) and using them to further expand non-allocated growth-enhancing spending.

4.2. STRENGTHEN SPECIAL INSTRUMENTS OUTSIDE THE MFF

Another option to enhance flexibility is to strengthen the Special instruments placed outside the MFF. Several options could be discussed in this respect.

- **Merge the Flexibility Instrument (FI) and the Emergency Aid Reserve (EAR).** If there is an agreement to create an EU crisis reserve within the ceilings (see 4.4.), the need to keep a Special instrument outside the MFF to respond to external crises diminishes. Merging both instruments would result in a much bigger Flexibility instrument able to cover any type of unexpected financial needs.
- **Expand the scope of the European Union Solidarity Fund**. At present the EUSF only provides financial assistance for natural disasters. It could be permitted to provide assistance to EU Member States affected by other types of manmade disasters or shocks, e.g. major migrant flows.
- **Eliminate limitations to carry over unused spending from Special instruments.** De-commitment rules make sense for multi-annual programmes, which are prone to long implementation delays, but their use is less obvious for instruments which respond to unpredictable and highly variable demands of mobilisation from one year to another. Eliminating de-commitment rules would not lead to an over-use of these instruments, as their activation is submitted for joint approval by the European Parliament and the Council.

These various measures, particularly the elimination of de-commitment rules, could facilitate a greater mobilisation of special instruments. The drawback of this option is that, if combined with an agreement to place payments derived from the use of these instruments outside the MFF, it could make payment needs much more variable and thus Member States' GNI-based contributions to the EU budget much more unpredictable.

4.3. CHANGES TO EXISTING FLEXIBILITY PROVISIONS

It is also possible to reinforce the flexibility provisions to facilitate the use of margins across headings and years even more. Some of the options discussed in the context of the Mid-Term revision were to r**emove the annual caps** set for the use of the **Global Margin for Payments** and **eliminate all scope limitation** to the mobilisation of the **Global Margin for Commitments.** These reforms, however, will not have a much impact if the overall level of expenditure ceilings remains very low in the new MFF. In the current MFF, the maximum caps set for the use of the Global Margin for Payments were relatively high if compared to the volumes mobilised through the GMP[15]. As regards the Global Margin for Commitments (GMC), the Mid-term revision has already widened its scope to include migration and security needs.

A more significant reform could be to **remove the obligation to offset amounts mobilised through the Contingency Margin.** In practice, this would imply recovering the provision that existed in the 2007-2013 period[16], which allowed for the modification of MFF ceilings up to 0.03% of EU GNI, with the Council acting by qualified majority.

[15] The MFF regulation set maximum amounts of EUR 7 billion, 9 billion and 10 billion to be transferred to 2018, 2019 and 2020 through the Global Margin for Payments, whereas the maximum volume mobilised through the GMP was EUR 13 billion in 2016.

[16] Par 22 IIA 2007-2013

4.4. AN EU CRISIS RESERVE FINANCED BY SURPLUSSES, SANCTIONS AND DE-COMMITTED APPPROPIATIONS

Another way to enhance flexibility is by creating a new **EU crisis reserve** to allow the EU to provide financial assistance in cases of crisis or major events with serious humanitarian or security implications. This Crisis Reserve was proposed by the Commission in the MFF Mid-term review but was rejected by the Council.

Such a Crisis Reserve could be **financed with the amounts from de-committed appropriations, as proposed by the Commission, but also with amounts retained from fines and interests** on late payments imposed by the EU (which normally are re-distributed to the Member States).

The size of this Crisis Reserve could be significant. In 2015, for instance, a total amount of EUR 498.2 million was de-committed from EU cohesion policy alone[17] and more than EUR 1 billion was recovered from interests and fines[18]. However, the exact amount would vary from one year to another. **The introduction of this Crisis Reserve would require a rise in the overall ceiling for payments**. Payment appropriations are usually lower than commitments in the MFF, but this is based on the assumption that a number of commitments will be de-committed and thus will never translate into payment obligations.

4.5. MANDATORY MARGINS AND BUDGETARY RESERVE

Another possibility is to replicate a solution that we find in many national budgets: the establishment of a specific budgetary line in annual budgets reserved for unexpected events.

In particular, EU annual budgets would have to keep some **mandatory margins in both commitments and payments** (e.g. 5% of the budget left un-allocated). This money set apart would be used **to fill a budgetary reserve for unexpected events, which could be in the form of a general budgetary reserve or a line-by-line reserve (a percentage of each relevant budget line reserved for sudden needs).** This reserve would be mobilised through a joint decision of the two arms of the EU budgetary authority to respond to sudden events or new political priorities during the budgetary year. If not used, the reserved appropriations would fall into the Global Margin for Commitments and/or the Global Margin for Payments.

A budgetary reserve, as such, would ensure a sufficient amount of annual resources for unexpected needs. However, the establishment of mandatory margins, particularly if applied line-by-line, would reduce the actual amounts available for programmed spending if not accompanied by a rise in overall commitment and payment appropriations.

[17] European Commission, *Analysis of the budgetary implementation of the European Structural and Investment Funds in 2015*, May 2016

[18] European Commission, *Report on budgetary and financial management for the financial year 2015,* Brussels.

4.6. MORE IN-BUILT FLEXIBILITY IN EU SPENDING PROGRAMMES

The flexibility of EU spending can be also enhanced through changes in EU spending programmes. Here below some ideas to increase budgetary flexibility in the forthcoming MFF:

- **Reduce pre-allocated spending**. A large part of the EU funds are pre-allocated to Member States at the beginning of the financial period. This impedes moving funds quickly to new priorities or challenges. Pre-allocation is not only important in cohesion policy, but also in areas where the need for flexibility is particularly salient, such as migration[19]. Reducing the amounts of pre-allocated spending would allow for a more flexible adjustment of resources, according to changing circumstances and needs;
- **Adjust co-financing rates to changing conditions**. Another possibility is to allow for changes in co-financing rates to better adjust to changing circumstances and needs. In the case of cohesion policy, one could imagine a system allowing for more regular adjustments of co-financing rates to changes in Member States' economic conditions;
- **More use of Financial Instruments (FIs) and Guarantees to adjust EU support to changing economic circumstances**. Being market-driven, financial instruments and guarantees can be a useful instrument to adjust to changing economic circumstances. More can be done to simplify rules and facilitate their use, and to make them more responsive to the economic cycle. One option, for instance, could be to streamline all centrally-managed EU financial schemes providing support to SMEs, and introduce ways to modulate the intensity of support, according to changing country-specific economic needs.

[19] Around 88% of the resources of the Asylum, Migration and Integration Fund (AMIF)IF are pre-allocated to Member States that adopt multiannual national programmes and implement the Fund under shared management. See d'Alfonso, A. (2015).

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ANNEX

Table 4. Main changes to special instruments and flexibility provisions between 2007 and 2017

	MFF 2007-2013[1]	MFF 2014-2020	MID-TERM REVIEW (JUNE 2017)
SPECIAL INSTRUMENTS OUTSIDE THE MFF			
Emergency Aid Reserve (art 9)	EUR 244 million/year	EUR 280 million /year	Increase size up to EUR 300 million
EU Solidarity Fund (art. 10)	EUR1.1 billion/year	EUR 500 million /year	--
Flexibility Instrument (art 11)	EUR 220.8 million/year Unused amount carried over up to year N+2	EUR 471 million /year Unused amount carried over up to year N+3	Increase size up to EUR 600 million From 2017 on, the amounts of the EU Solidarity Fund and the European Globalisation Adjustment Fund which have lapsed in previous years will be added to the Flexibility Instrument
European Adjustment Globalisation Fund (art 14)	EUR 552 million /year	EUR 150 million /year	--
FLEXIBILITY PROVISIONS ALLOWING MAXIMUM USE OF MARGINS			
Global Margins for Payments (art 5)	Did not exist	Carry over unused portion of payment ceiling of one year to subsequent years. Subject to some maximum amounts per year.	Maximum amounts for 2019 and 2020 increased to EUR 11 billion and 13 billion respectively
Contingency Margin (art 13)	Did not exist[2]	Possibility to increase appropriations up to an equivalent of 0.03 % of the Union's GNI over and above MFF ceilings to react to unforeseen circumstances, under the condition of offsetting all amounts mobilised against margins available	---
Global Margins for Commitments (art 14)	Did not exist	Constitution of a reserve with margins left in years 2014-2017 to be used for policy objectives related to growth and employment in 2016-2020	Removal of temporal restrictions regarding the constitution of the GMC. Scope expanded to include migration and security

Frontloading of the Youth Employment Initiative, education and research (art 15)	Did not exist	Frontloading up to EUR 2.543 million in 2014 and 2015 in for specified policy objectives relating to youth employment, research, ERASMUS, and Small and Medium-sized Enterprises total allocation per heading or sub-heading over the period.	--
Exceptional re-programming/transfers of commitments for cohesion policy (art 19)	Already existed (art 48 MFF regulation)	Possibility to transfer unused cohesion policy allocations for first year to subsequent years in the event of delayed adoption of new cohesion policy rules or programmes	--

[1] Amounts in MFF 2007-2013 regulation were fixed in 2006 prices but the table shows them in 2011 prices.

[2] There existed however a provision in the Inter-Institutional Agreement allowing for the revision of the MFF up to 0.03 % of the EU GNI by qualified majority in Council. This provision was replaced by the Contingency Margin, as it was no longer applicable following the entry into force of the Lisbon Treaty, but the Council imposed the obligation to offset all amounts mobilised against margins available.

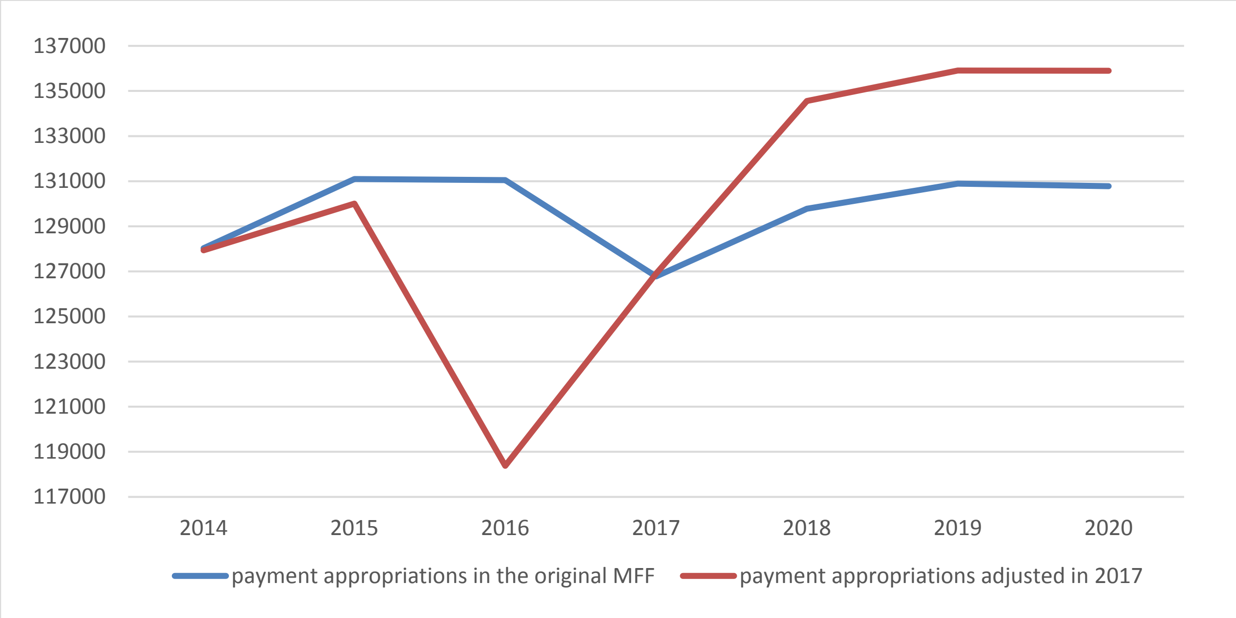
Table 5. Special instruments in current MFF: objective and available budget

	SCOPE	AMOUNT (AFTER 2017 MFF REVISION)
Emergency Aid Reserve (art 9)	Reserve designed to finance specific aid requirements for non-EU countries that were unforeseeable when the budget was drawn up. Used first and foremost for humanitarian operations, but also to finance civil crisis management and protection and situations of particular pressure resulting from migratory flows at the Union's external borders	EUR 300 million/year, unused amount carried over up to year n+1
EU Solidarity Fund (art. 10)	Aims to release emergency financial aid following a major disaster in a Member State or aspiring ("candidate") country. Aid is managed by the recipient country, and should be used to rebuild basic infrastructure, fund emergency services, temporary accommodation or clean-up operations, or counter immediate health risks.	EUR 500 million/year, unused amount carried over up to year n+1 On 1 October each year, at least one quarter of the annual amount shall remain available in order to cover needs arising until the end of that year.
Flexibility Instrument (art 11)	Provides funding in a given financial year for clearly identified expenses which could not be covered by one or more budget headings without exceeding their expenditure ceilings.	EUR 600 million/year, unused amount carried over up to year N+3
European Adjustment Globalisation Fund (art 12)	Provides specific, one-off support to facilitate the re-integration of workers into employment in areas, sectors territories, or labour market regions suffering the shock of serious economic disruption. Aid is managed by the recipient country	EUR 150 million/year

Table 6. Overview of provisions to maximise margins in the current MFF

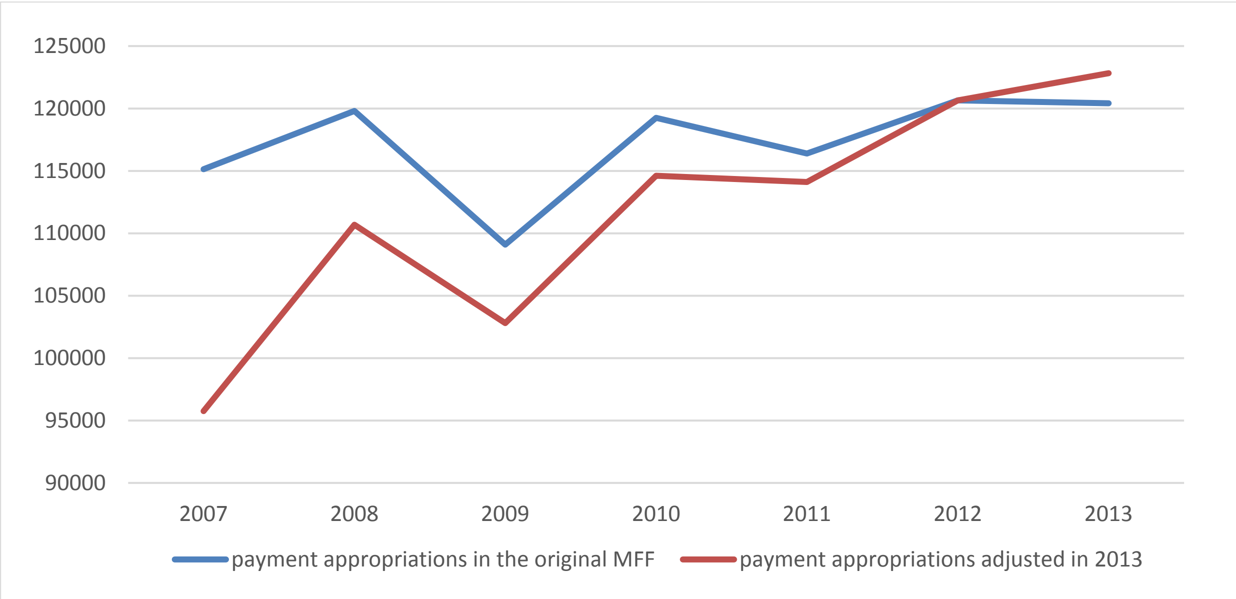
	DESCRIPTION	PROCEDURE AND CONDITIONS FOR USE
Global Margins for Payments (art 5)	Upward adjustment of the global payment ceiling for subsequent years by an amount equivalent to the difference between the implemented payments and the MFF payment ceiling of the year n-1	Adjustment is done unilaterally by COM every year, starting in 2015. Amount of GMP is calculated as part of the technical adjustment. Upward adjustments submitted to maximum limits: 7 billion (2018), 11 billion (2019) and 13 billion (2020) Any upward adjustment shall be fully offset by a corresponding reduction of the payment ceiling for year n-1.
Contingency Margin (art 13)	Possibility to increase commitment and payment appropriations up to an equivalent of 0.03 % of the Union's GNI to react to unforeseen circumstances (EUR 4-4.5 billion/year approximately)	The amount available for the contingency margin is calculated every year by COM as part of the technical adjustment. Mobilisation of the contingency margin is proposed by COM through the draft budget or amending budgets, approved jointly by the EP and the Council. Need to justify its use (shall be used as an instrument of 'last resort') Amounts mobilised must be fully offset against margins available in the current or later years
Global Margins for Commitments (art 14)	Possibility to use margins left available below the MFF ceilings for commitment appropriations for the years 2014-2017 to increase commitment appropriations for the years 2016 to 2020 for policy objectives related to growth and employment, in particular youth employment	Available margins calculated by COM every year, as part of the technical adjustment. Mobilisation of the GMC proposed by COM through the draft budget or amending budgets and approved jointly by the EP and the Council
Frontloading of the Youth Employment Initiative, education and research (art 15)	Frontloading of up to EUR 2.543 million in 2014 and 2015, as part of the annual budgetary procedure, for specified policy objectives relating to youth employment, research, ERASMUS in particular for apprenticeships, and Small and Medium-sized Enterprises	Frontloading for Youth Employment Initiative, Horizon, Erasmus and COSME was decided by EP and Council in June 2013 as part of the of the political agreement on the 2014-2020 MFF (Draft Joint Declaration on Article 15 of the Council Regulation laying down the multiannual financial framework for the years 2014-2020) Amounts frontloaded shall be fully offset against appropriations in subsequent years in order to leave unchanged the total allocations per headings or sub-headings over the period
Exceptional re-programming/ transfers of commitments for cohesion policy (art 19)	Possibility to transfer unused cohesion policy allocations for 2014 to subsequent years in the event of delayed adoption of new cohesion policy rules or programmes	Revision proposed by COM and jointly approved by the EP and the Council (by unanimity) The revision shall be adopted before 1 May 2015

Figure 1. Changes to payment appropriations 2014-2017 (EUR million, 2011 prices)



Source: own elaboration based on data from 2014-2020 MFF regulation and MFF technical adjustment for 2018

Figure 2. Changes to payment appropriations 2007-2013 (EUR million, 2004 prices)



Source: Own elaboration based on data from 2007-2013 MFF regulation and MFF technical adjustment for 2014

This briefing note provides some reflections on the challenges facing the next Multi-Annual Financial Framework (MFF) and discusses ways to enhance the flexibility of the EU budget. An analysis of the use of existing flexibility provisions in the current MFF is followed by some recommendations on how to enhance flexibility in the post-2020 MFF.

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