BRIEFING

Pre-European Council Briefing

European Parliament

Outlook for the European Council video-conference of 19 June 2020

The European Council meeting on 19 June, to be held by video-conference, will be almost exclusively dedicated to the next Multiannual Financial Framework (MFF) and the proposed new EU recovery fund, dubbed 'Next Generation EU'. The two European Commission proposals are now to be considered as one package for the purpose of negotiation, since the recovery fund is in effect embedded within the revamped EU long-term budget. This has increased the pressure on Member States to reach a political agreement on the MFF, but also multiplied the issues of disagreement among the EU leaders. In addition to the MFF-specific issues, on which divergences could not be overcome at the special European Council meeting in February 2020 – namely the overall size of the EU budget, the use of rebates and the funding allocation per policy area – the proposal for the recovery fund raises sensitive new questions, notably on the balance between loans and grants, the allocation criteria for funding and the modalities for repayment.

EU leaders are not expected to reach agreement at this stage, but rather to have a first exchange of views on the new proposals from the Commission. The outcome of this discussion will provide pointers for the European Council President, Charles Michel, on further steps and the possible timing for an in-person meeting of leaders in the course of July, with a view to reaching an agreement on the EU budget package. To this end, the video-conference meeting of 19 June could produce a statement in which EU Heads of State or Government express their commitment to finding a political agreement before the summer break. In addition, this statement might also address foreign policy issues, such as Turkey's drilling activities in the Mediterranean or sanctions on Russia.

1. The next Multiannual Financial Framework and the EU recovery fund

The European Council's video-conference on 19 June 2020 will be its fifth virtual meeting since the start of the coronavirus crisis, but the first devoted mainly to the next MFF. EU leaders have discussed the 2021-27 long-term budget on numerous previous occasions (see EPRS's The European Council and the 2021-27 Multiannual Financial Framework). Yet, at the special European Council meeting of 20-21 February 2020, no political agreement could be found between the Heads of State or Government on the negotiating box presented by Charles Michel. The video-conference of 19 June will be the first opportunity for EU leaders to discuss together the European Commission's revised proposal for the 2021-27 MFF, including its proposal for an EU recovery fund, called 'Next Generation EU', which Commission President Ursula von der Leyen presented in the European Parliament's plenary session on 27 May 2020.

'Next Generation EU'

The proposed recovery fund amounts to €750 billion, of which €500 billion would be in grants and €250 billion in loans. According to the proposal, the money for the recovery plan would come from the financial markets. The Commission would issue bonds with a maturity of up to 30 years to raise funds, and the money would be paid back over time through future EU budgets and possible new own resources, such as a digital tax. One of the corner-stones of the plan is the Commission's current strong credit rating, which might however, according to some experts, be at risk in the future.

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The money would be invested through three pillars: (i) supporting the Member States to recover; (ii) kick-starting the EU economy and helping private investment; and (iii) learning the lessons from the crisis. The key element of the proposal is the new €560 billion Recovery and Resilience Facility, which aims to help Member States tackle the challenges identified in the European Semester process.

Initial reaction to the European Commission's proposals

While most Member States have reacted positively to the Commission's proposals, some national governments have expressed criticism. These latter voices include Finland and the 'frugal four' group (Austria, Denmark, the Netherlands and Sweden) of net contributors to the EU budget (that is, countries contributing more to the EU budget than the amount of EU funding they receive), which insist on budgetary discipline and on maintaining a relatively small EU budget. They have called for changes to the Commission's proposals, notably as to the size of the EU budget, the balance between grants and loans, and the length of time for paying back the loans.

During the debate in the Parliament's plenary session, most MEPs welcomed the Commission's new proposal. The President of the European Parliament, David Sassoli, was pleased that 'the European Commission's plan takes on board [the Parliament's] proposals'. He will address the European Council at its meeting on 19 June, and relay the Parliament's views on the EU budget.

2. Main discussion points at the European Council video-conference

Since the MFF and the recovery fund proposals will be considered as one package, EU leaders will need to address simultaneously two sets of sensitive issues, on which diverging views persist. Regarding the MFF, the traditional dividing lines concern mainly (i) the size of the budget, (ii) the rebates, and (iii) the balance between policy areas. Other delicate issues include the question of conditionality and the introduction of new own resources. The recovery package adds additional sensitive points to the discussion, notably (iv) the balance between loans and grants, (v) the allocation criteria for the funding, and (vi) the length and modalities of repayment.

Total amount

The new MFF proposal envisages a total of €1.1 trillion (in 2018 prices) in commitments, which represents a reduction compared to the €1.279 trillion in the 2018 Commission proposal, but a small increase compared to the €1.095 trillion in Charles Michel's negotiating box discussed at the special European Council meeting of 20-21 February 2020. Together with the €750 billion envisaged under the new temporary recovery instrument, Next Generation EU, this would present an overall budget of €1.85 trillion. Some Member States, such as Denmark, have indicated their preference for a 'slim and modern budget' and have argued that the current proposal is too high.

Rebates

Certain Member States (Austria, Germany, Denmark, the Netherlands and Sweden) benefit from rebates or 'budget correction mechanisms' to compensate for what is, in their view, 'a budgetary burden which is excessive in relation to [their] relative prosperity'. The Commission argued in its 2018 MFF proposal that the elimination of all rebates would increase the fairness of the MFF, and proposed to phase out the current rebates over time. In its new proposal, the Commission has softened its previous stance and argues that the current rebates could be phased out over a much longer period than previously proposed. As all 'frugal four' Member States would benefit from this solution, this could be a crucial argument to convince them to agree on the new MFF. Charles Michel's proposal in February already included the idea of retaining a lump-sum correction mechanism.

Balance between policy areas

Another highly debated issue is the balance between the funding of 'traditional' and of 'modern' EU policies. Traditionally, the biggest share of MFF expenditure has been ear-marked for the Common Agricultural Policy (CAP) and cohesion policies, representing respectively 38 and 34 per cent of the overall 2014-20 MFF. The 'friends of cohesion', a group (currently encompassing Bulgaria, Cyprus, Czechia, Croatia, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia and Spain) which defends a strong level of cohesion funding and opposes cuts in this area in the 2021-27 MFF, has reiterated its opposition to a reduction in the appropriations devoted to these policy areas.

Conditionality

Conditionality can be defined as the requirement that all EU spending should comply with a set of Union policy standards, with funding withdrawn in the event of lack of compliance. The European Commission has already been using conditionality requirements for many years, in particular in the field of cohesion policy. In its 2021-27 legislative proposals, the Commission has reinforced existing requirements such as 'macro-economic conditionality' and 'infringement conditionality'. It has also introduced new ones, such as 'rule-of-law conditionality', which would seek to protect the Union's budget in cases of generalised deficiencies as regards respect of the rule of law in a Member State. The measures to be applied to the failing Member State would have to be approved by the Council by 'reverse qualified majority' (that is, a qualified majority to block the proposal rather than to approve it). This approach is supported by some Member States (notably Belgium, Germany, France, Sweden and the Netherlands), while others (such as Bulgaria and Romania) are more critical.

New own resources

The European Parliament has repeatedly, most recently on 15 May 2020, called on EU leaders and the Commission 'to take bold decisions regarding the reform of the EU own resources system, including the introduction of a basket of new own resources'. These could include 'a common consolidated corporate tax base, digital services taxation, a financial transaction tax, income from the emissions trading scheme, a plastics contribution and a carbon border adjustment mechanism.

On 27 May, the Commission indicated that it would propose additional new own resources at a later stage in the 2021-27 financial period. Options include a new own resource based on non-recycled plastics packaging waste; an emissions trading system-based own resource extended to the maritime and aviation sectors; a carbon border adjustment mechanism of some kind; an own resource based on the operations of companies drawing huge benefit from the EU single market, and a digital tax on companies with a global annual turnover of above €750 million.

Balance between loans and grants

Initial discussions among EU leaders on a long-term response to the socio-economic consequences of the Covid-19 crisis concentrated on two issues: (i) on whether or not to issue joint debt instruments, or 'coronabonds'. These would keep borrowing costs down, but spark fears in some Member States of 'opening the door to mutualisation of members' debt under the banner of the EU'; (ii) on the delivery method for recovery support, i.e. in the form of grants or loans. Grants would not need to be paid back, whereas loans would. Some countries have strongly advocated a grants-based solution as opposed to loans, which would only lead to an increase in the debt burden. Others, especially the 'frugal four', consider grants to be an inefficient use of money, which could leave the EU budget in a situation of permanent deficit; thus, they have strongly backed a loan-based recovery approach, with clear conditions and criteria attached.

The Commission proposal, which includes both loans and grants, attempts to find a compromise between Member States calling for a grant-based recovery fund, such as Germany and France, and those preferring a recovery fund based on loans, such as the 'frugal four'. Nevertheless, as indicated by the Chancellor of Austria, Sebastian Kurz, this point is expected to be a crucial issue for discussion and trade-off in the negotiations. Even if only used as 'an exceptional and temporary emergency mechanism', as stated by the European Commission, policy analysts and financial experts argue that the introduction of a possibility to borrow on capital markets would be 'a radical change for the EU'.

Allocation criteria for the recovery funding

Criticism has been expressed about the targeting of the recovery fund support, with some experts and Member States suggesting that the proposed support allocation criteria are outdated and not fit for purpose. In the Recovery and Resilience Facility, the Commission plans to take into account

Member States' population, GDP per capita and unemployment figures from 2015 to 2019. The Commission insists, contrary to views of critics, that this allocation key 'will be particularly beneficial to the countries most affected by the crisis, notably those with low per capita income and high unemployment'. The biggest potential recipients would be Italy, Spain, and Poland.

Length and modalities of repayment

The Commission proposes that 'the funds raised will be repaid after 2027 and by 2058 at the latest'. However, some Member States, such as Finland, argue that 'the repayment period in the recovery instrument should be shorter than the proposed 30 years, and the financing facility must comply with the principle of a balanced budget, laid down in the Treaty'.

3. Steps towards reaching agreement

Following the presentation of the updated MFF proposal, President Charles Michel urged 'all Member States to examine the Commission's proposal swiftly and work constructively towards a compromise in the best interests of the Union'. In his opinion, 'everything should be done to reach an agreement before the summer break'. The European Commission invited 'the European Council and the co-legislators to examine these proposals rapidly with a view to reaching a political agreement at the level of the European Council by July'. In order to see if there is enough room for an agreement, Charles Michel has held numerous bilateral or group meetings with Member States to discuss their assessment of the Commission's proposals. In order to involve all relevant actors in the MFF negotiations, Charles Michel attended the meeting of the European Parliament's Conference of Presidents on 11 June, to discuss with EP group leaders the state of play of the negotiations.

Based on his consultations and the results of the video-conference, if Charles Michel sees the potential for reaching the 'landing zone' of the negotiations, he is expected to call for an extraordinary European Council meeting in early July in Brussels, with the aim of reaching a 'global compromise' (i.e. MFF and recovery fund). Observers and practitioners agree that, in order to reach an agreement, a physical meeting is required, as video-conferences are less effective due to the limited possibility for side-discussions, the lack of interpretation, and the reduced confidentiality resulting from the increased number of people 'in the room'.

4. Other items

In the statement expected following the video-conference, the European Council could possibly also touch upon foreign policy issues. In light of recent developments regarding Turkey's drilling activities in the Mediterranean, EU leaders might once again express their solidarity with Cyprus and Greece. Imposing new sanctions on Russia, as well as renewing the existing economic ones which will expire in July 2020, would also require the green light of the European Council.

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