EUROPA briefing

EU budget: What's the cost of Europe?

The European Union's budget is relatively small but how it is financed and for what purpose it is used is controversial. The debate around this issue is coming to a head with the pending departure of the United Kingdom. Where does the EU get its money from? Who benefits from the spending? And what ideas are there for a more transparent and effective budget?

JACQUES DELORS INSTITUT BERLIN | BertelsmannStiftung

What does the European Union cost?

The EU budget totals just under 150 billion euro a year, roughly one percent of European economic output. Whether this sum is large enough depends on one's view of what the budget should cover. This matches roughly the budget of the German Federal Ministry for Employment and Social Affairs of just under 140 billion euro per year.

The EU finances most of its budget through contributions by the member states. Although originally customs duties were planned to be the main source of revenue, these bring in only roughly an eighth of today's revenue. In general, the amount contributed per individual member state depends on that country's economic strength. But over the years multiple exceptions have been established for member states that considered their regular payments to be disproportionately heavy, for example Germany, the Netherlands and the United Kingdom.

Member states set the amount of money available to the EU in the so-called ➔ Multiannual Financial Framework. The current framework runs until the end of 2020. For a long time, increasingly large amounts were provided to cover the EU's growing areas of responsibility. The current framework, however, contains very small increases when adjusted for inflation.

Calculating the relationship between the costs and benefits of EU membership is highly controversial. The main benefits of the EU arguably come from its policies rather than its expenditures. However, the value of the European Single Market, a coordinated economic policy or an effective foreign policy is difficult to translate into concrete terms for individual states and citizens. Therefore, the budget debate often concentrates on the ➔ net balance. This netting is problematic because it inevitably portrays some EU members as winners and others as losers.

➔

Multiannual Financial Framework (MFF)
Every seven years, the EU member states renegotiate the priorities of the EU budget and fix them in the MFF. This requires a unanimous agreement, often leading thereby to very tough negotiations. Minor adjustments are made annually.

Net balance
The difference between the funds that a member state receives through EU programmes and its contributions to the budget. This balance is sometimes used to illustrate the benefits of EU membership for a country, perhaps a misleading assessment.

"Every euro that we provide for the EU budget comes – directly or indirectly – back to us many times over."

Sigmar Gabriel, German Foreign Minister
in Frankfurter Allgemeine Zeitung
on 21 March 2017

"The EU budget is one of the main tools for the EU [...] and needs in depth rethinking. It should focus more on common challenges such as securing our external borders, stabilizing our neighbourhood or tackling climate change."

Mario Monti, former Prime Minister of Italy
at the presentation of recommendations to the High Level Group "Own Resources" in Brussels on 17 January 2017

What does the EU spend its money on?

The EU budget is slowly changing. In 2000, the EU still spent half its funds on supporting agriculture. This proportion has fallen by more than ten percentage points since then. Today, the focus is more on European infrastructure, research and a common foreign policy, although these new areas still account for less than a quarter of total spending. Roughly a third goes to so-called structural funds that provide support for economically weaker regions of the EU.

Setting spending priorities is highly disputed. Net contributors such as Germany often argue for a greater concentration on areas such as research, defence or migration policy. They view this as an opportunity to generate European added value through EU expenditures. Countries such as Poland and Hungary contest this, arguing that a focus on structural policies is necessary to hold the EU together and compensate for the fact that economically stronger countries exploit the Single Market for their own advantage.

The EU budget is not a Eurozone instrument. It is not designed to cushion economic shocks that may put the currency union at risk. That would require a common unemployment insurance or flexible investment fund, for example. Even the European Stability Mechanism is outside the EU budget.

It is difficult to integrate new tasks within the budget. Most EU funds are allocated to specific member states and areas of responsibility at the beginning of any MFF. Therefore, it is difficult for the EU to supply funds rapidly to meet unanticipated challenges. This was seen, for example, in the euro crisis and during the refugee crisis.

European added value
In some areas, the bundling of responsibilities at European level is more effective than separate national efforts. Classical examples of European added value are the joint spending on defence policy or basic research. The exact definition is controversial.

European Stability Mechanism (ESM)
This is a financial institution that is controlled by the Eurozone countries. It allows for members of the currency union to be supported with loans in the event of a real or likely sovereign debt crisis. The ESM can award loans of up to 500 billion euro.

“The cohesion policy, i.e. those billions of euro […] most often invested directly into infrastructure, is the most efficient tool for growth that the EU has today.”

Donald Tusk, Prime Minister of Poland
in Bucharest on 1 June 2012

“If the UK leaves [the EU], then the budget must be reduced commensurately. Otherwise, the countries that already pay the most will be left to cover the bill alone.”

Stefan Löfven, Prime Minister of Sweden
in Sveriges Radio on 27 March 2017

EU BUDGET

EUROPA briefing

A look ahead

SCENARIO 1

Business as usual

The member states are currently trying to keep the limit of the EU budget to roughly one percent of overall GDP. Such a budget is right for an EU developing slowly and shedding old tasks in parallel with gaining new ones. In order to make the budget more flexible, new funds could be set up outside the multiannual financial framework. EU finances would then become even more complex and opaque, however.

The UK's departure from the EU will represent a test of the one-percent target mark since EU economic output will shrink by a nominal 17 percent as a result of Brexit. Keeping the budget as it is (as measured by economic output) would require over 20 billion euro in annual savings. That would greatly limit the EU's ability to act and would meet with strong resistance from net recipients, as the latter must approve any change.

SCENARIO 2

A true European budget

If additional tasks are transferred to the EU in future, a much larger budget will be necessary to address them. This could include help with handling economic shocks; or providing welfare benefits at a European level; or financing a stronger common foreign policy – to name but a few options.

Such a budget would ideally be financed less from member state contributions, as to date, and more from sources of revenue that are hard to attribute fairly to an individual member state. Corporate taxation here provides an example: Companies can do business everywhere in the EU thanks to the single market, but they only pay taxes on their profits in the member state in which they are headquartered. If the corporate tax base were harmonised and a portion of the tax yield paid into the EU budget, that would reduce the incentive to avoid taxes and let the entire Union share in the success of the Single Market.

A larger budget could also stabilise the Eurozone and help win back citizens' confidence in the EU. Politically, however, such a reform would currently not command majority support. Neither do the member states want to reduce their domestic spending so as to finance a larger EU budget, let alone agree on the purpose to which these funds could be put.

SCENARIO 3

Small but agile

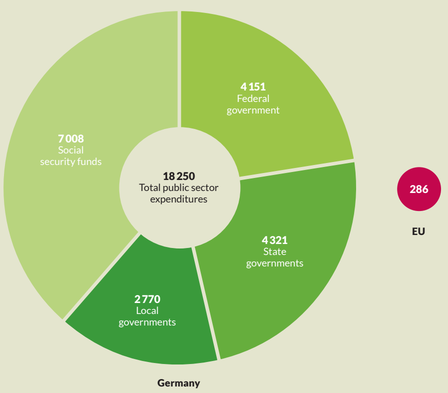
If the member states facilitate an ambitious budget reform, even a small budget could be more effective. In this regard, Brexit offers an opportunity. It brings an end to old opt-outs and exemptions and makes adjustments inevitable. A reform could consist of three elements: first, somewhat higher contributions to compensate for the loss of British contributions; second, fewer allocations of funds fixed in advance; and third, a greater focus on areas where European coordination creates clear added value – such as research and cross-border infrastructure.

If there is a reform, the European Parliament could play a greater role in deciding on distribution of funds, a task that remains the domain of member states today. This would ensure that expenditures can be adjusted on a flexible basis to meet current crises and funds can be spent in the interest of the entire EU. The member states would continue to set the upper spending limit, however.

In addition, a separate Eurozone budget could be created. It could cover areas that are crucial for preserving the currency union. This would include, for example, investment funds that can be allocated as a reward for economic reforms undertaken or supportive measures paid to countries temporarily in crisis. As a result, the currency union would be more stable over the long term with less social upheaval in the short term.

FACT #1

How large is the EU budget in comparison to Germany's?
Expenditures in euro per capita



Compared to Germany's public sector expenditures, the EU budget is very small. The expenditures on the German federal level alone are fourteen times higher per capita than those of the EU.

Source: German Federal Statistical Office, European Commission, author's calculations. As of 2016.

FACT #2

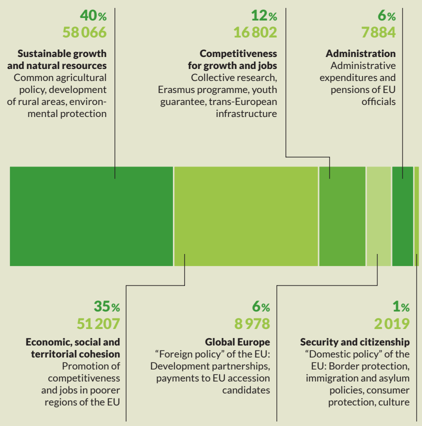
Contributions by member states and revenue from EU programmes
In euro per capita

The amount of funding received from the EU is different for every member state. How much money a country contributes to the common budget depends mainly on its economic strength.

Source: European Commission, Eurostat, author's calculations. As of 2015.

FACT #3

What does the European Union spend money on?
Expenditures in million euro



The majority of the EU budget is used for subsidizing poorer regions and agriculture. At the same time, the focus today, more than in the past, is on the expansion of European infrastructure and research as well as the common foreign policy.

Source: European Commission, author's calculations. As of 2015.

"Not all items in the EU budget are effective but they are part of a larger compromise. The EU gives Germany a stable political environment, access to a huge market and international influence, for example. In comparison to these advantages, the amount that Germany contributes appears more than justified."

Jörg Haas
The author is a Research Fellow at the Jacques Delors Institut – Berlin.

EUROPA briefing

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