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LESSONS FOR A FUTURE-PROOF EU BUDGET

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CONTENT

1. INTRODUCTION

SUMMARY

This policy brief discusses how the 2021-2027 Multiannual Financial Framework (MFF) and NextGenerationEU contribute to the EU's priorities, including the green transition, digitalisation, and recovery from the COVID-19 pandemic. Despite its substantial impact on the ground, the MFF has encountered some implementation challenges, and has been put under strain by being adapted to respond to several crises. This brief draws lessons from these experiences and underlines the importance of flexibility and strategic foresight in financial planning. The mid-term revision of the MFF was a crucial step towards reallocating and boosting resources for the most urgent new priorities. A more streamlined, policy-driven approach that increases the EU's ability to respond to emerging challenges should guide the upcoming MFF proposal.

The adoption in 2020 of both the NextGenerationEU recovery package and the MFF for 2021-2027 marked a pivotal moment in the financial and political trajectory of the EU budget. These two budget plans are not only the largest package ever adopted for the EU budget (they have a combined value of EUR 2 trillion) but they also saw the EU break new ground in its use of policy. With NextGenerationEU, the EU is issuing common debt to fund expenditure. The 2021-2027 MFF also introduced a new 'own resource' [(1)] based on non-recycled plastic packaging waste, and a commitment to introduce additional own resources. Another significant innovation introduced in the MFF was the establishment of the respect for the rule of law as an essential precondition for sound financial management and thus as a requirement for receiving EU funding.

The core ambition of the 2021-2027 MFF is to bolster the EU's priorities, such as the green transition, digitalisation, and recovery from the economic and social shock caused by the COVID-19 pandemic. As the framework moved into implementation, it brought back to light several important issues, including the complexity of the MFF funding structure and challenges related to the timely deployment of funds.

Moreover, many crises and shocks have tested the EU budget's robustness since the adoption of the MFF and NextGenerationEU. The EU budget has been pushed to its limits by: (i) Russia's war of aggression against Ukraine and its effects (including an energy crisis and an unprecedented surge in inflation and interest rates); (ii) natural disasters; (iii) irregular migration; and (iv) global competitiveness challenges. These challenges have also served as catalysts for the mid-term revision of the MFF, underscoring the importance of flexibility and the ability to reallocate resources in the face of new needs and priorities.

An assessment of the strengths and limitations of the current MFF will inform policymakers' reflections on the next multiannual budget. A complete analysis would require a comprehensive review of the current spending programmes in the EU budget, which goes well beyond the scope of this policy brief. The discussions in this briefing should therefore be seen as a preliminary contribution to reflections on the future of the EU budget.

[(1)] The EU's own resources are the main sources of revenue for the EU budget. Its annual expenditure may not exceed its revenue (i.e. it operates a balanced budget). For a detailed explanation, see [Own resources - EUR-Lex (europa.eu)]

Against this background, this policy brief presents a review of the MFF's implementation, from its adoption in 2020 until the agreement on the mid-term revision in February 2024. This analysis aims to provide an understanding of the current state of play and reflect on possible future paths for the MFF by discussing: (i) how it finances the EU's priorities; (ii) its concrete impact on the ground; (iii) operational challenges it faces; and (iv) how it responds to crises. Section 2 discusses the estimated impact of the 2021-2027 MFF and NextGenerationEU in terms of economic and financial stabilisation, support to investment and structural change. Section 2 also identifies challenges in the current structure and implementation of the two instruments. Section 3 discusses the available flexibilities in the MFF and their use since the adoption of the multiannual budget, as well as the recently adopted MFF mid-term revision. Section 4 concludes by looking forward to the future MFF.

2. THE 2021-2027 MFF: FROM ADOPTION TO IMPLEMENTATION

The 2021-2027 MFF and NextGenerationEU, both of which were adopted in 2020, provided the EU with an unprecedented financial package to support Europe's recovery from the COVID-19 crisis[2]. In the paragraphs below, the economic impact of these two instruments is assessed under three main headings: (1) macroeconomic and financial stabilisation; (2) support to investment; and (3) structural change through the green and digital transition.

The 2021-2027 MFF and NextGenerationEU have helped to stabilise EU economies in the wake of the pandemic. In 2020-2022, the EU launched the temporary instrument 'Support to mitigate Unemployment Risks in an Emergency' (SURE), which provided loans of almost EUR 100 billion backed by the EU budget to 19 Member States[3] for short-time work schemes and similar measures. SURE helped to temper the rise in unemployment in the EU-27 following the pandemic to a level below what would have been expected given the decline in domestic production. It also allowed Member States to save, on average, EUR 9.0 billion in interest payments due to the financing conditions enjoyed by the EU and the long average duration of the loans[4]. For NextGenerationEU, European Commission simulations indicate the instrument will give rise to a growth stimulus of up to 1.4% of GDP in 2026. Between a quarter and a third of the total estimated GDP impact from NextGenerationEU is due to positive spillovers arising from the simultaneous investments in all Member States. The simulations also suggest that NextGenerationEU could increase EU employment by up to 0.8% in the short run and lead to higher real wages in the medium term due to potential productivity gains from the supported investments[5]. The fact that NextGenerationEU and the MFF are joint instruments that apply to all countries in the EU may also have helped the EU to avoid both a sharp divergence in the financing costs of individual countries on the financial markets and renewed tensions in the monetary union (Graph 1). All in all, the EU reached its pre-pandemic level of GDP in less than 2 years, compared to 7 years after the 2008 financial crisis, a swift recovery that was no doubt helped by the MFF and NextGenerationEU.

[2] For a detailed review, see European Commission (2021), "The evolving nature of the EU Budget", EU Budget policy brief # 1.

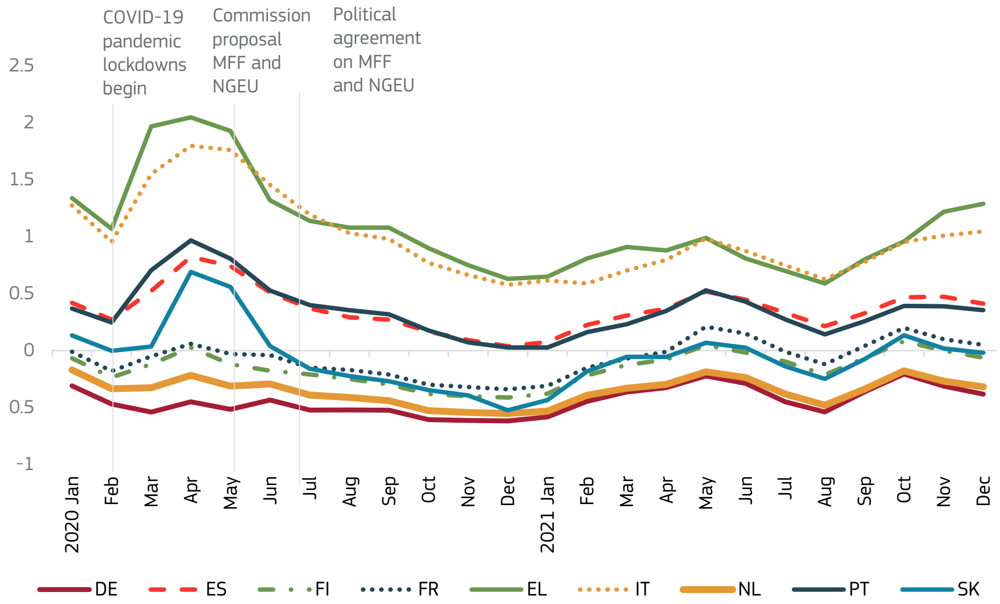
[3] Belgium, Bulgaria, Cyprus, Estonia, Greece, Spain, Croatia, Hungary, Ireland, Italy, Lithuania, Latvia, Malta, Poland, Portugal, Romania, Slovenia, Slovakia, Czechia.

[4] COM(2023) 291 final, Report on the European instrument for Temporary Support to mitigate Unemployment Risks in an Emergency (SURE) following the COVID-19 outbreak pursuant to Article 14 of Council Regulation (EU) 2020/672, 'SURE after its sunset: final bi-annual report'.

[5] COM(2024) 82 final, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: 'Strengthening the EU through ambitious reforms and investments'.

Graph 1. Financing costs across selected euro area Member States in 2020-2021

Note: 10-year government bond rates, 2019-2021. Source: European Central Bank.



In addition to the rapid economic recovery, both NextGenerationEU and the MFF incentivise investment and support resilience and transformation. Unlike in previous crises, public investment in Europe increased during the COVID-19 pandemic and the energy crisis that followed Russia's war of aggression in Ukraine, rising from 3.0% of GDP in 2019 to an estimated 3.3% in 2023. Around half of the increase in public investment expected in the EU between 2019 and 2025 is estimated to result from investments financed by the EU budget [6]. In addition to investments, the Recovery and Resilience Facility (RRF) [7] represents a shift in EU budgetary policy, as it marks the first time the EU budget supports key reforms that are aligned with the European Semester. This entails a new incentive whereby financial support is contingent upon Member States implementing key economic, social, and environmental reforms as per the country-specific recommendations (CSRs) outlined within the European Semester framework. Moreover, several spending programmes under the MFF seek to leverage EU public investment by encouraging co-financing with other public and private investors, through both national co-financing and financial instruments that 'crowd in' funds from partnering institutions and private investors.

The share of investment funding in the EU budget is expected to increase from around 40% in 2000 to about 63% in the current period (MFF and NextGenerationEU combined), with cohesion policy and the RRF accounting for the largest share [8]. While cohesion policy pursues the long-term objective of convergence, the RRF is a temporary instrument to respond to the economic and social challenges posed by the COVID-19 pandemic, with commitments running until 2023 and payments until 2026. The RRF legislation provides for complementarity between the RRF and support from other funds. Member States were obliged to explain in their national recovery and resilience plans how they intended to use other funds [9]. At the same time, similar investments can be financed under the MFF and NextGenerationEU.

The 2021-2027 MFF presented some novelties in its composition on the side of revenues and expenditures. For the first time, modern priorities have the same share as traditional policies like cohesion and common agricultural policy.

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(6) European Commission (2023), European Economic Forecast: Autumn 2023, European Economy, Institutional Paper 258.

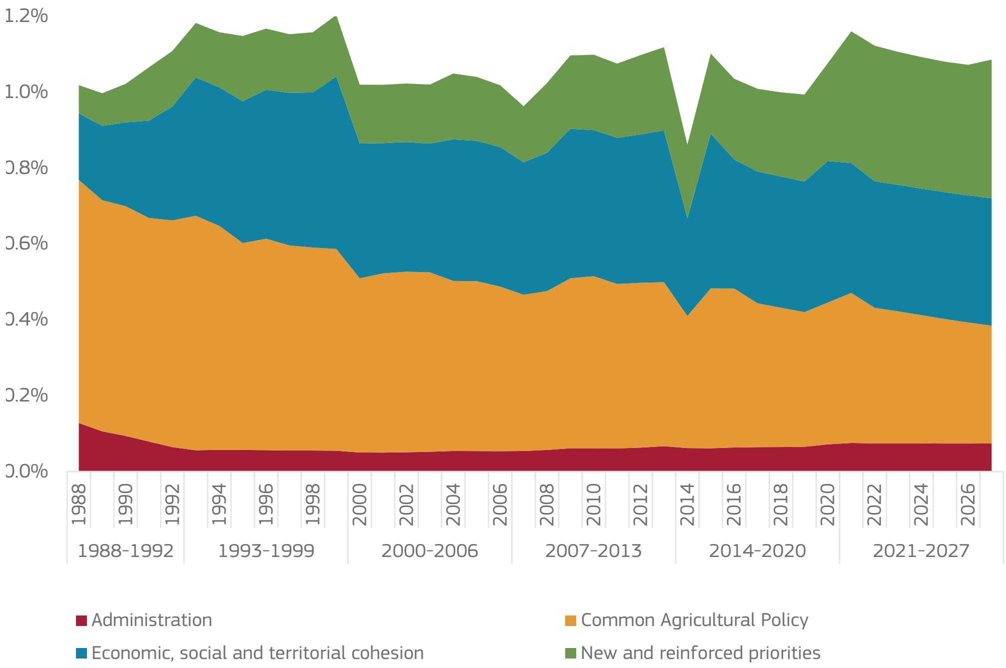
(7) The RRF is a temporary instrument that is the centrepiece of NextGenerationEU - the EU's plan to emerge stronger and more resilient from the COVID-19 crisis. For details, see European Union Recovery and Resilience Facility | EUR-Lex (europa.eu)

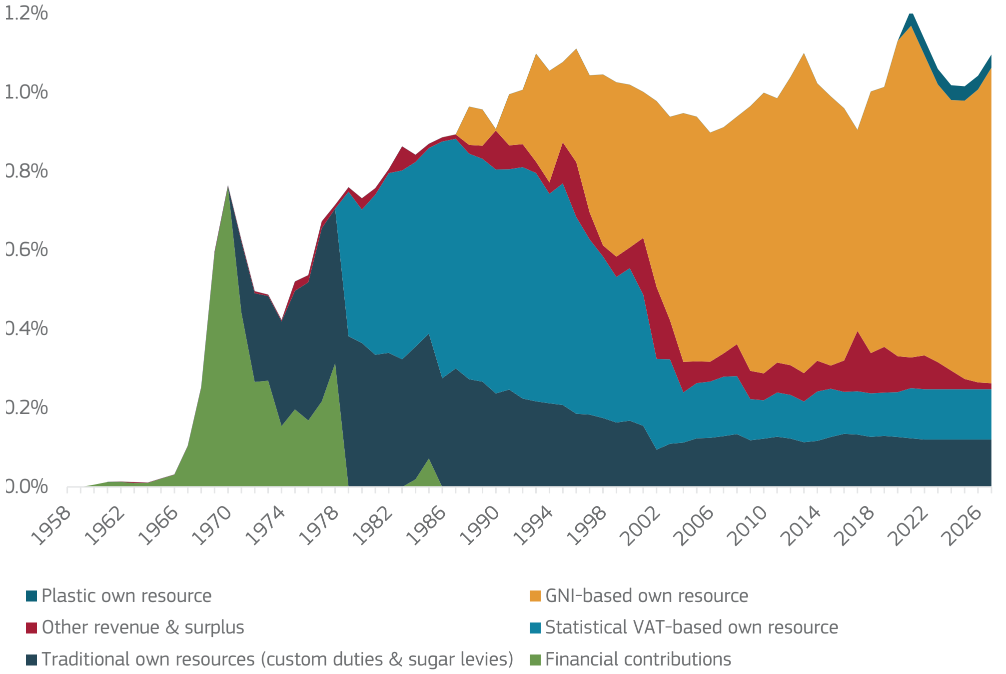
(8) The selected EU programmes promoting investments are: (i) the Structural and Cohesion funds, which include the European Regional Development Fund, as well as the European Social and the Cohesion Funds; (ii) the European Agricultural Fund for Rural Development; (iii) the various framework programmes for research and development; (iv) large infrastructure projects (TEN in 2007-2013 and CEF in 2014-2020); and (v) funding devoted to key, strategic projects such as Galileo, the nuclear programme, EFSI or the EU space programme.

(9) Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility.

On the side of expenditure, a new own resource based on plastic packaging waste was introduced (Graph 2).

Graph 2. Distribution of expenditures in the MFF, % EU GNI; commitments (up) and revenues (down)





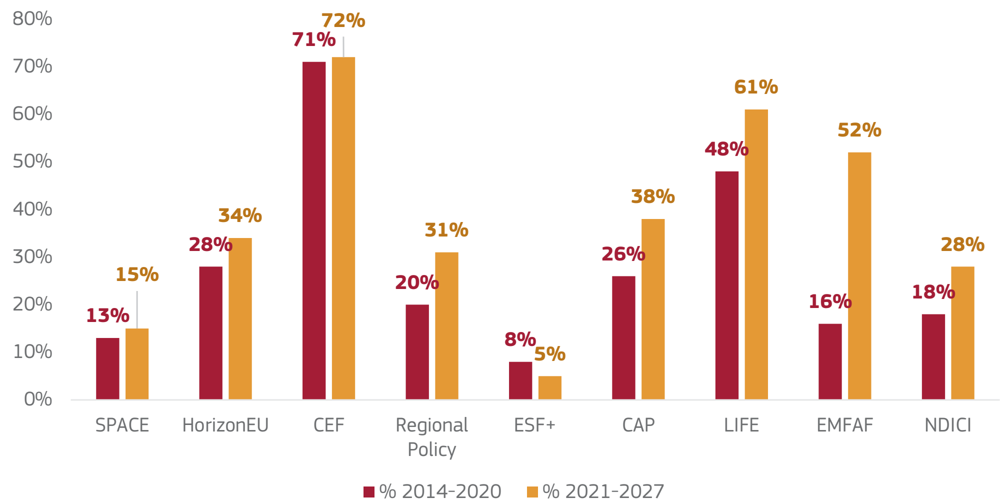
Support for structural transformation and the green and digital transition is also promoted through ambitious 'mainstreaming'[10] targets and specific new programmes. The Commission's target is that at least 30% of the MFF should be spent on climate change in 2021-2027, up from the 20% target in 2014-2020. In 2026 and 2027, the Commission is working towards the ambition of spending 10% of the MFF on halting and reversing the decline of biodiversity. Expenditure on climate goals under cohesion policy increases from 20% in 2014-2020 to 31% in 2021-2027, and cohesion policy in the 2021-2027 MFF also supports the Green Deal industrial plan. The 2021-2027 MFF also requires Member States to include more ambitious environment and climate measures in the new

[10] 'Mainstreaming' refers to how the Commission tracks and reports on what is spent on specific policies and on horizontal priorities, such as digital an green transition, through the EU budget programmes.

common agricultural policy strategic plans. The overall target was for climate spending to account for 30% of spending under the 2021-2027 MFF and current projections indicate that this 30% target will now be exceeded. The EUR 578 billion allocated to climate objectives in the 2021-2027 MFF and NextGenerationEU will be more than double the climate expenditure of the 2014-2020 MFF (the 2014-2020 MFF had climate expenditure of EUR 220.8 billion or 20.6 % of MFF spending) (Graph 3). In addition, the RRF supports measures that contribute to the European Pillar of Social Rights, the Union of Equality, and the 2030 targets for employment, skills, and poverty reduction – with almost 30% (EUR 138 billion) of the allocation in the recovery and resilience plans (individual plans produced by Member States indicating how each Member State intends to spend its portion of funding under the RRF) dedicated to social expenditure.

Graph 3. Projection of spending on climate goals by selected funds (as a percentage of their total funding)

Source: European Commission.



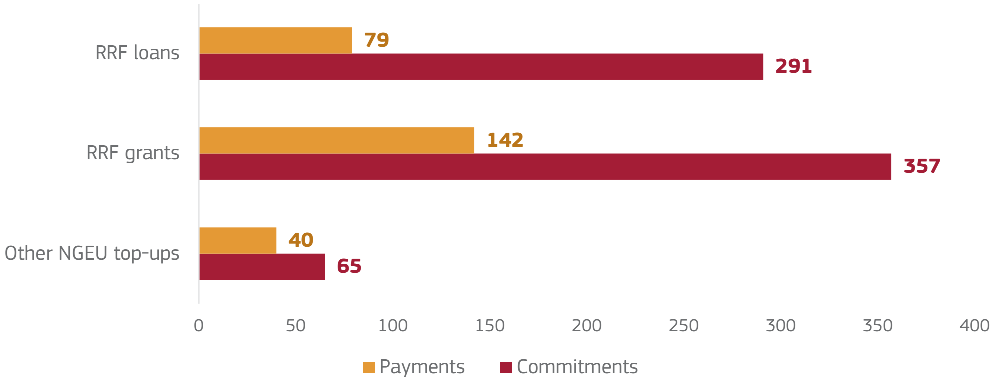
The 2021-2027 MFF also provides more funding for Europe's digitalisation. The Digital Europe programme invests in: (i) common data spaces; (ii) trustworthy artificial intelligence technologies; and (iii) cybersecurity, including secure quantum communication infrastructure (EuroQCI). 31% of Horizon Europe's budget is dedicated to the digital transformation. The digital strand of the Connecting Europe Facility also supports high-performance infrastructure and its transport strand is giving special support to the European Rail Traffic Management System. The EU's Chips Act, with a budget of EUR 3.3 billion, is expected to mobilise more than EUR 43 billion in public and private investments in semiconductor technologies and applications until 2030. In 2021-2022, the EU budget including NextGenerationEU contributed EUR 131.9 billion [11] to the digital transition.

The implementation of the RRF is well underway, despite some delays. Overall, close to EUR 650 billion in financial support has been committed under the RRF, EUR 357 billion in grants and EUR 291 billion in loans (Graph 4). EUR 225 billion has already been disbursed, including EUR 67 billion in pre-financing and EUR 157.2 billion upon the achievement of milestones and targets, reflecting the progress with reforms and investments. Around 75% of the milestones and targets to be achieved by the end of 2023 have either already been assessed as satisfactorily fulfilled by the Commission or reported as completed by the Member States. Moreover, the share of the 2019-2020 European Semester

[11] The estimate aggregates the contributions of the EU budget programmes using different tracking methodologies. A fully-fledged digital tracking methodology will be put in place in the coming years. The contributions are based on the annual voted budget, contributions from partners and third countries and NextGenerationEU. The overall amount may be larger because – due to methodological limitations – some programmes' contributions are underestimated (i.e. InvestEU, CAP).

country-specific recommendations (CSRs) on which Member States had made at least 'some progress' increased between 2021 and 2023 from 52% to 69%, a significant improvement in comparison with previous years [12]. However, after early disbursements (in particular thanks to pre-financing) and continuous payments in 2021 and 2022, disbursements slowed down in the first half of 2023, as Member States focused on the revision of plans and the addition of REPowerEU chapters to the RRF national plans. As implementation is still catching up in some Member States, the anticipated administrative simplification resulting from the RRF has not yet fully materialised [13]. Overall, by the end of 2023, 27% of the RRF loans and 40% of RRF grants had been paid out, whereas over 61% of the other NextGenerationEU funds (top-up to other EU budget programmes) [14] had been paid.

Graph 4. State of implementation of NextGenerationEU as of end-2023 (including REPowerEU, EUR billion)



The implementation of some programmes in the current MFF has started slowly, especially in the area of cohesion policy. It is quite common for cohesion-policy implementation to be slow in the early years of an MFF and to accelerate in the later years due to improvement in on the ground implementation of projects. However, amounts paid out in pre-financing and first interim payments by 2023 are far behind amounts paid out in pre-financing and first interim payments at the same point in the previous programming period (Graph 5). This is partly due to the late adoption of the 2021-2027 programmes for different funds at both regional and national level, which were mostly adopted towards the end of 2022 or even at the beginning of 2023. Another reason for delays in disbursements has been the priority to finalise the 2014-2020 programmes, including the pandemic-response measures [15] and the programming of additional funds, and the fact that some national or regional authorities might have prioritised implementation of the RRF, which has a shorter timeframe and had to be designed and programme in parallel. The implementation of the Just Transition Fund is also facing significant delays [16].

[12] COM(2024) 82 final, ibid.

[13] SWD(2024) 70 final, Commission Staff Working Document, 'Mid-term evaluation of the Recovery and Resilience Facility'.

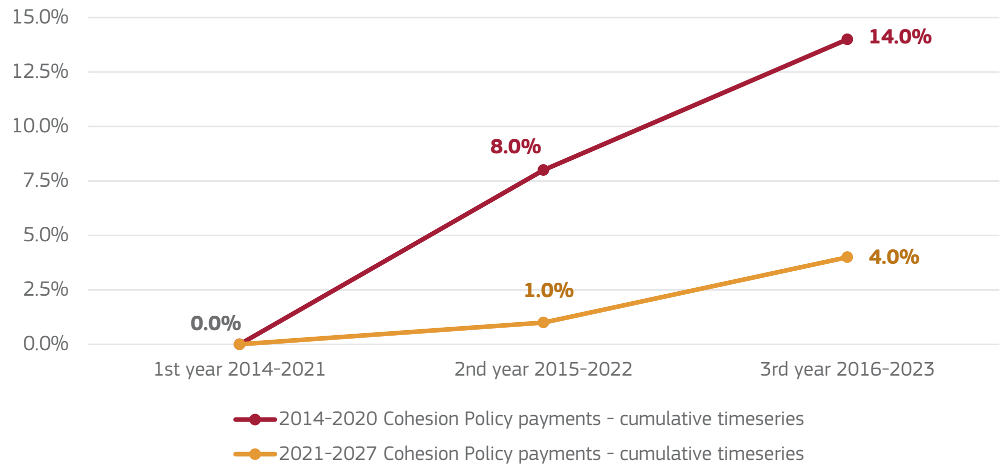
[14] These are Horizon Europe, InvestEU, REACT-EU, the EU Civil Protection Mechanism, the European Agricultural Fund for Rural Development, and the Just Transition Fund.

[15] For instance, the Coronavirus Response Investment Initiative - CRII, CRII+, Recovery Assistance for Cohesion and the Territories of Europe – REACT-EU.

[16] COM(2023) 390 final, Report from the European Commission to the European Parliament and the Council – Long-term forecast of future inflows and outflows of the EU budget (2024-2028)

Graph 5. Implementation of cohesion policy in the 2021-2027 MFF and the 2014-2020 MFF [17]

Source: European Commission, Cohesion open data platform. Note: includes ERDF, ESF+, Cohesion Fund and Just Transition Fund for 2021-2027, and ERDF, ESF, Cohesion Fund and Youth Employment initiative for the period 2014-2020.



For most directly managed programmes, implementation has been in line with expectations, with high execution rates reflecting strong demand. The execution rate is currently nearly 99% of the voted commitment appropriations at the end of 2023[18] for programmes such as Horizon Europe, the Digital Europe programme, or the Connecting Europe Facility-Digital. This is despite the late adoption of the relevant legal bases, which required postponing by several months actions initially planned to start in 2021 and 2022. Similarly high or improved implementation patterns can be observed for CEF-Transport (including for projects related to the war in Ukraine), the European Defence Fund, and Military Mobility, but also for programmes with a skills dimension, like Erasmus+.

Despite the significant simplifications accomplished in the 2021-2027 MFF, the EU budget remains very complex. The MFF still contains more than 50 programmes, and is itself split up into 15 policy clusters and 7 headings. New instruments were created in the 2021-207 MFF to address specific challenges, and in some cases, there are overlaps in the scope of objectives across instruments and programmes. For instance, infrastructure investments (albeit with somewhat different scope) can be supported under the EU cohesion funds, the Connecting Europe Facility, the RRF and, for dual-use infrastructure, Military Mobility. Support for health-related aspects is provided in different ways under EU4Health, Horizon Europe, the EU cohesion funds, the Digital Europe programme, the single market programme, and the Union Civil Protection Mechanism. In the area of skills and education, support is provided under Erasmus+, Creative Europe, the Digital Europe programme, and the Marie-Sklodowska-Curie actions under Horizon Europe as well as the European Social Fund+. This can make it difficult for beneficiaries to identify and apply for suitable funding opportunities. It also creates additional administrative burden for authorities implementing the programmes. The fragmented budget structure also limits flexibility as funds cannot be easily reallocated to changing priorities. The potential to increase the effectiveness of the MFF by tying its disbursements even more broadly to the implementation of relevant national reforms, as is already the case with the RRF, may also not be yet fully exploited.

(17) The implementation of cohesion policy in the 2021-2027 MFF does not include NextGenerationEU amounts.

(18) Provisional data pending the adoption of the annual accounts for 2023.

3. THE MFF: READY FOR THE UNEXPECTED? RESPONDING TO CRISES AND SHOCKS

3.1 Flexibilities in the 2021-2027 MFF

The EU budget has facilitated the EU's response to new political priorities and crises in the past decade. However, pressure on the EU budget has been increasing, as the crises faced have become larger, more complex and more frequent, and the EU has been increasingly called on to respond to these crises, especially through its budget. This requires an EU budget that can adapt to rapidly evolving landscapes.

Predictability is as critical as flexibility, as it enables multiannual planning and investments. Predictability facilitates long-term planning for managing authorities, co-financing entities, final beneficiaries and national treasuries. It also provides clear funding for EU priorities. However, the design of the MFF (including nationally pre-allocated funds, pre-defined spending programmes and multiannual planning) introduces rigidities which hamper the flexibility of the EU budget.

In response to the need for flexibility, the MFF has different types of tools. Firstly, it has the possibility of mobilising additional funding through unallocated margins and special instruments, which in turn can be divided into thematic and non-thematic instruments. Unallocated margin refers to commitments under a heading that are not earmarked to a specific area or programme, thereby providing some flexibility to allocate additional resources to programmes within the different headings. Thematic instruments provide limited flexibility, as they can be mobilised only in the specific situations laid down in their legal basis. Non-thematic instruments provide the possibility to address more generally unforeseen circumstances or new/emerging priorities throughout the duration of the MFF.[19] The MFF also includes provisions that allow redeployment and re-allocation between budget headings and programme envelopes (i.e. transfers within and across programmes). In addition, a few EU programmes have an in-built reserve to respond to evolving and unforeseen needs, which have been used extensively. These programmes with an in-built reserve include: (i) the cushion under NDICI; (ii) the thematic facilities under the three HOME funds (AMIF, BMVI and ISF); and (iii) a crisis reserve under the common agricultural policy.

[19] For more details on flexibility and special instruments, see Flexibility and special instruments - European Commission (europa.eu).

The initial flexibilities in the 2021-2027 MFF allowed up to a 2.4% increase in total expenditure for unforeseen events (Table 1) through unallocated margins and special instruments. The overall amounts in special instruments are higher than in the previous MFF but well below the amount suggested in a Commission proposal in May 2020, both for special instruments and unallocated margins, and ultimately fell short of actual needs. In particular, the agreement in the European Council and the Council in 2020 to finalise the 2021-2027 MFF reduced the overall amounts of both the special instruments and that of the margins, while reducing the headings ceilings as well compared to the Commission proposal [20]. Margins within headings were further cut following negotiations with the European Parliament, at unchanged ceilings, to increase the financial allocation of several programmes [21].

As a result, the design of the MFF translates into a rather rigid EU budget, as most of the budget is de facto earmarked for specific priorities or – in the case of nationally pre-allocated programmes – legally committed to Member States. This structure means that, even if these funds are not immediately utilised, shifting them to address emerging needs or priorities is especially difficult or in some cases can only be done on a voluntary basis. This inherent rigidity underscores the challenge of dynamically responding to unforeseen developments or shifting priorities within the MFF or even within the same programmes and funds.

Table 1. Flexibilities in the 2021-2027 MFF at the time of adoption (2020)

Source: COUNCIL REGULATION (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027 and The EU's 2021-2027 long-term budget and NextGenerationEU - Publications Office of the EU (europa.eu)

Flexibility Instrument	7 219
Solidarity and Emergency Aid Reserve (SEAR)	9 467
European Globalisation Fund (EGF)	1 467
Brexit Adjustment Reserve (BAR)	5 470
Unallocated Margin	5 489
Total MFF ceilings	*1 210 894*
Initial flexibility available as a % of MFF	**2.4%**

(In current prices, EUR million)

In recent years, all flexibilities in the EU budget have been used to the fullest to address the emerging challenges and needs that arose at the beginning of the MFF [22]. For instance, the two main special instruments – the Flexibility Instrument and the Solidarity and Emergency Aid Reserve (SEAR) - were fully deployed in 2021-2023. The Flexibility Instrument was mobilised to: (i) strengthen existing instruments; (ii) provide financing for new initiatives (e.g. the European Defence Industry Reinforcement Through Common Procurement Act (EDIRPA)); and (iii) address the increase in the borrowing costs of NextGenerationEU. The full operational budget of the SEAR was mobilised to: (i) respond to natural disasters (e.g. forest fires in Portugal and floods in Italy); (ii) further support Member States facing migratory pressures; and (iii) address the fallout from Russia's war of aggression against Ukraine.

[20] See resource.html (europa.eu)

[21] Horizon Europe, EU4Health, Erasmus+, Migration Agencies and Humanitarian Aid.

[22] See, for instance, COM(2023)336 final and SWD(2023) 336 final.

In addition to using the existing flexibilities to the full extent, EU programmes were amended to provide urgent financing to face unexpected events and crises. Through re-programming, the EU has been able to provide liquidity to Member States in the event of major recent crises, in particular the fallout from Russia's war against Ukraine. For instance, cohesion policy, given its ability to deploy substantial means at regional and local level, was the main vehicle of EU's response to the COVID-19 pandemic (CRII and CRII+, REACT-EU) and the fallout from Russia's war of aggression in Ukraine (Cohesion's Action for Refugees in Europe - CARE and CARE+ and SAFE to support SMEs and vulnerable households facing high energy costs).

Since 2021, borrowing at EU level to on-lend to other countries has been a useful, efficient and cost-effective tool to allow the EU budget to respond to crises, especially by supporting Ukraine. In addition to the SURE programme and NextGenerationEU, Macro-Financial Assistance (MFA) was fundamental in providing much-needed liquidity to Ukraine, first to support it while geopolitical tensions were increasing before Russia's invasion, and then to finance Ukraine's immediate funding needs following the unprovoked and unjustified aggression by Russia. In 2023, the Macro-Financial Assistance+ (MFA+) to Ukraine was the biggest MFA programme backed by the EU budget ever performed (EUR 18 billion) and was also the first time that the headroom of the EU budget was used to back a loan to a non-EU country financed via borrowing. Overall, in 2022-2023, the EU provided EUR 25.2 billion in MFA to Ukraine, and this financial support will increase further by 2027 thanks to the recently adopted Ukraine Facility [23].

The scope of NextGenerationEU, and the RRF in particular, was extended to respond to the economic fallout of Russia's war against Ukraine. To accelerate Europe's independence from Russian fossil fuels, the EU adopted REPowerEU, and dedicated chapters to promote Europe's energy independence have been introduced in the RRF national recovery and resilience plans [24]. REPowerEU: (i) provides additional grants funded by the auctioning of Emission Trading System allowances for up to EUR 20 billion; and (ii) makes it possible for funds to be transferred from both other programmes pre-allocated to Member States and loans from the RRF that had not been previously requested (Graph 4).

The pressures on the EU budget and on available flexibilities were further increased by the steep increase in inflation in 2022, which reached its highest level in over 40 years, exacerbated by both the bottlenecks in the post-pandemic recovery and Russia's invasion of Ukraine. Inflation has declined since then, but its current level of 2.8% (February 2024) is still higher than the 2% inflation rate assumed in the MFF [25]. The ceilings of the MFF are set in constant (2018) prices, and then adjusted annually with a fixed deflator of 2%. A fixed deflator has several advantages, in particular predictability for the EU programmes and their available budgets over the MFF period. However, with actual inflation way above the reference deflator of 2%, the value of the EU programmes has been reduced in real terms. In addition, interest rates have increased, in part as a result of the monetary-policy tightening that was necessary to curb inflation.

(23) Regulation (EU) 2024/792 of the European Parliament and of the Council of 29 February 2024 establishing the Ukraine Facility

(24) Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC

(25) Art. 4(2) of the MFF Regulation.

NextGenerationEU borrowing costs also became substantially higher than initially planned at the time of adoption of the MFF [26].

3.2 The MFF mid-term revision

As mentioned in the previous sub-section, in response to the unprecedent crises the EU has faced, the budgetary flexibilities have been stretched to the maximum. With most of the budget already pre-allocated, the EU has continued to face challenges in reallocating resources to further address unexpected needs such as: (i) supporting Ukraine; (ii) bolstering EU competitiveness; and (iii) addressing the increase in unexpected borrowing costs (see Section 3.1). As a result, in June 2023 the Commission presented a proposal for a mid-term review of the MFF accompanied by a proposal for its revision [27]. In presenting this proposal, the Commission's aim was to address the most urgent needs while ensuring the EU could meet its legal obligations and support emerging priorities since the MFF's adoption. The Commission proposal was limited to a targeted increase of the EU budget ceilings as well as some necessary increases in flexibilities.

There was an early consensus among the institutions and Member States on the shared challenges. At the European Council meeting in October 2023 [28], there was a common understanding and acknowledgement of these challenges among the Member States, highlighting the shared commitment to addressing the pressing needs, despite initially different views on the budgetary means to address them.

The discussions around the mid-term revision also highlighted the interplay between national contributions to the EU budget and national fiscal-policy considerations. The focus of Member States during the discussions on the MFF revision remained mainly on the contributions that would be made by each Member State based on that Member State's gross national income. This creates a persistent challenge for the financing of newly emerging priorities, such as continued support for Ukraine, and as Member States request EU intervention in an increasing number of areas. At the same time, strengthening the EU budget requires careful balancing. Member States must strive for an equilibrium between contributing to shared EU goals and the need for fiscal consolidation.

Constructive – and sometimes complex – discussions with both Member States and the European Parliament finally led to the adoption of the revised MFF in February 2024, which marked the first time that the ceilings of the MFF were revised at mid-term. Moreover, the broad agreement among Member States and the European Parliament over the priorities identified in the Commission proposal facilitated the negotiations.

[26] SWD(2023) 336 final, Chapter 2.11.1.

[27] COM(2023) 336 final.

[28] [20241027-european-council-conclusions.pdf (europa.eu)]

The MFF revision exemplified the EU's forward-looking strategy in financial planning during an era marked by complexity and uncertainty, but revisions of this sort cannot by themselves provide a structural solution. By addressing the limitations exposed by recent crises and recalibrating its budgetary framework, the EU aimed to bolster its resilience, effectively support strategic priorities, and maintain its course towards achieving long-term objectives. The MFF revision had to be targeted to few pressing priorities, and the structural limitations of the current budgetary architecture will remain. This means that, for the remainder of the MFF, the most pressing needs will need to be met by extremely limited available resources.

The outcome of the revision of the MFF offers insights that could help to inform future EU budgetary reflections. The creation of the Ukraine Facility as part of the MFF mid-term revision underscores the EU's commitment to long-term assistance and reconstruction efforts. It could also provide inspiration for future financial support that, in addition to addressing short-term rehabilitation needs, provides an incentive for the adoption of investment and reforms that are necessary to facilitate the path to EU membership for candidate countries. This is also the case for the strengthening of financing for western Balkan countries, which will be channelled via the proposed Western Balkans Growth Facility [29] once it is adopted.

The Strategic Technologies for Europe Platform (STEP) is a first move towards the better pooling of EU funding aimed at strengthening the EU's competitiveness. STEP makes it possible to combine and use EU funds to support investment in critical technologies, which can increase the leverage capacity of current instruments. This approach not only underscores the need to maintain a competitive edge through technological advancement, but also provides a solution by streamlining funding mechanisms.

Finally, the introduction of the EURI instrument acknowledges the difficulty of catering for volatile financial conditions within a multiannual budget. The impact of uncertainty over the future path of borrowing costs will be felt in particular under the current MFF, and net issuances of EU bonds will continue until 2026. With the EURI instrument, the MFF mid-term revision provides a solution to address this uncertainty by using existing flexibilities while at the same time ensuring budgetary transparency over how possible increases in interest costs would be addressed.

[29] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on establishing the Reform and Growth Facility for the Western Balkans COM/2023/692 final

4. CONCLUSIONS

This policy brief has examined the 2021-2027 MFF and NextGenerationEU, focusing on their economic and structural impacts, the challenges encountered in their implementation, and the outcome of the MFF's mid-term revision. The importance of the MFF and NextGenerationEU in both supporting the recovery from the COVID-19 crisis and driving the EU's green and digital transitions was significant. Although in some cases the impact of these two instruments on the ground has been somewhat hampered by delays and operational complexities.

The context within which the current MFF operates has changed substantially since its adoption. New geopolitical tensions, the challenges of migration, and an urgent need for technological sovereignty have profoundly influenced the EU's strategic direction. This evolving landscape underscores the importance of a budget that is not only adaptable but also strategically oriented, enabling the EU to navigate current predicaments while laying a solid foundation for future challenges.

Amid these challenges, the MFF's mid-term revision was an effort to reallocate resources towards the most urgent needs, illustrating the EU's ability to adapt its policies in response to unforeseen events, while still delivering on its initial priorities. Although the mid-term revision represents an important achievement, it did not resolve the structural issues with the EU's budgetary system. Deep reflection will be needed in the future to thoroughly address the identified shortcomings. The next MFF proposal is set to be adopted in 2025. As the EU plans for the future, it must consider how to adapt its financial mechanisms to better reflect the geopolitical and economic uncertainties of our times. The challenges highlighted in this brief point to **four key objectives** that should be among the main priorities for the preparation of the next MFF proposal to ensure the EU budget is equipped to handle future demands. These four priorities are discussed in the paragraphs below.

The first priority is to build a policy-based MFF. The next MFF should move away from a focus on programmes and towards a full focus on policies. This implies that the policy priorities set by the EU should fundamentally shape the design and structure of the next generation of programmes. Thus, every aspect of programme design, from goals to implementation mechanisms, should be directly informed by – and contribute to – the EU's policy agenda, marking a decisive move away from the mere continuation and adaptation of the status quo. The effectiveness of the EU budget is currently diluted due to its fragmented application, weakening its impact. Incorporating EU governance methods, such as the European Semester, could ensure a more integrated approach to the MFF. Additionally, as the global landscape becomes increasingly complex, it is crucial to ensure that there is coherence between internal and external policy objectives. In other words, the EU's external environment will require an adaptation of the EU's internal policies, to enhance its adaptability and effectiveness on the global stage.

The second priority is to ensure that the MFF is simpler and more agile. The MFF suffers from complexity due to the many programmes it contains and the structure of these programmes. In some cases, these programmes have an overlapping scope. To make matters worse, complex participation and implementation rules and requirements can discourage or delay access to fundings. By streamlining EU budget programmes and the entire budgetary process from the adoption of the programmes to disbursement and follow-up with the beneficiaries, the EU can ensure that its financial resources are used more effectively. Reducing complexity not only makes it easier to direct funds towards strategic priorities but can also create synergies and improve administrative efficiency. Striving for agility means prioritising swift implementation, drawing lessons from the identification of the most pressing needs. Simplification facilitates directing funds toward strategic priorities. It fosters synergies and enhances administrative efficiency.

The third priority is to make the MFF more flexible. The current budget framework of the EU is under considerable strain, facing challenges that stretch its capacities to their limits. This situation underscores the need for a more dynamic and flexible financial structure that can readily adapt to new needs and unforeseen challenges. Flexibility not only implies having greater budgetary margins but also having the ability to adjust expenditure to evolving priorities. Additionally, it is fundamental to ensure sufficient flexibilities are built into the MFF so that it can effectively tackle unforeseen challenges. As this policy brief discussed, the MFF can contribute to macroeconomic stabilisation, and lessons from successful initiatives like SURE should be exploited. A stabilisation role for the MFF of this sort would not only increase the EU's ability to weather economic shocks but also strengthen its support for Member States during crises, while upholding long-term financial sustainability.

The fourth priority for the MFF is to further optimise resources. The EU budget alone is still relatively small compared to national budgets. To maximise its impact, a consistent approach to the EU's overall financial architecture is necessary. This must include maximising the financial capabilities of the EU by: (i) developing new funding sources; (ii) improving co-financing arrangements; (iii) using blending options; and (iv) using budgetary guarantees effectively. Such approaches can significantly increase the EU's financial resilience and effectiveness. Moreover, it can increase the consistency between the fiscal policies of the Member States and the EU's budgetary framework.

This policy brief underscored the need for an open and frank discussion on the future orientation of the EU budget, considering what it should finance and how it should be financed. It aims to trigger a conversation around the next EU budget and questions like *"What strategic shifts in budget priorities are necessary to ensure that the EU remains resilient and competitive in an increasingly complex and interconnected global landscape?", "In what ways can the EU budget* *serve as a catalyst for fostering European integration, innovation, and sustainable development in the coming decades?"*, or *"How can the EU budget be strategically leveraged to enhance the Union's global role, while promoting stability, prosperity, and sustainable development beyond its borders?"*. Given the timeline for the MFF proposal, with the upcoming European Parliament elections and the appointment of a new Commission, these questions and many beyond will be high on the political agenda.

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