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First thoughts on the EU's budget plans

The European Commission's proposals for the post-Brexit budget includes interesting and probably somewhat controversial new tools placing pressure on both CEE and Western countries. Getting these proposals through the negotiation process will be anything but easy



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Today, the European Commission presented its proposal for the so-called multi-annual financial framework 2021-2027. In short, the EU budget for the post-Brexit era.

From a general perspective, the main takeaways are that despite Brexit, the EU budget will increase, which will lead to higher individual contributions by all member states; a very small Eurozone budget through the backdoor and the introduction of the so-called "rule of law."

As regards to the increase of individual contributions, the proposal will struggle to find positive feedback from most member states. In the run-up to today's proposals, many governments have already voiced their concerns or opposition against higher net contributions.

These proposals are another attempt to create a more integrated Europe. But higher contributions and more conditions for money for Eastern European countries, will make it hard to get the

| required unanimity

With regards to the Eurozone budget, the European Commission makes another step in putting pressure on the member states. Further reforms of the monetary union will be on the agenda of the next European Summit in June. But with the proposed multi-annual financial framework, the EC now presents two admittedly small programmes only for Eurozone member states.

Firstly a reform support programme with an overall budget of 25bn euro basically following the idea of “money for reforms” and secondly a European Investment Stabilisation Function to absorb asymmetric macroeconomic shocks by giving loans. The entire facility should amount to up to 30bn euro.

Even though the two proposals regarding the Eurozone are very small in terms of size and are not much more than a drop in the bucket, they clearly shed light on the broader Eurozone reform debate. In our view, the two proposals could already be as-good-as-it-gets combined with morphing the ESM into an EMF. They could be a good face-saving compromise between France and Germany as they cannot be called a Eurozone budget, while at the same time fulfilling the conditions of what the proponents of a Eurozone budget have always had in mind.

As regards to the “rule of law,” the European Commission proposed to link EU funding to the rule of law. The new proposed tools would allow the EU to suspend, reduce or restrict access to EU funding for countries which have rule of law deficiencies. A measure clearly aimed at some Eastern European countries and Poland and Hungary come to mind. This could be a new way to impose 'more Europe' on member states. But the question is whether this conditionality will really succeed in creating a more pro-European spirit.

Due to the rule of law clause, the EU budget proposal has been particularly in focus for the CEE investors. Many investors have seen it as a downside risk to selected CEE countries' outlooks. However, we see a very high bar for the EU countries to lose access to the cohesion funds given that the new budget plans require unanimity. We also have a hard time seeing how the EU could stop the payment of funds to one country while keeping the payments to other counties flowing under the current rules. The experience of the Article 7 and the need for a unanimous agreement is a point in case - as long as there is no agreement on a new medium-term budget. As far as CEE investors are concerned, we don't see the budget plans as CEE negative. At least not for now.

The European Commission's proposals are another attempt to create more integrated Europe. Higher contributions and more conditions for money for Eastern European countries, however, will make it hard to get the required unanimity.

Don't forget these proposals will now be negotiated between the European Parliament and the European Council. Eventually, the European Council will have to adopt them with unanimity. If the Council does not manage to take a decision, the budget lines of 2020 will be extended for as long as needed. Be prepared for tough and long negotiations.

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