Future-proofing the European Budget

Edited by
Lukas Sustala

NEOSLAB

FUTURE-PROOFING THE EUROPEAN BUDGET

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Introduction

The European Union (EU) stands at a crossroads, facing unprecedented challenges that demand a fundamental rethink of its budgetary framework. The war in Ukraine, the green transition, digital transformation and geopolitical tensions are reshaping the global landscape, requiring a budget that is not only reactive but also anticipatory. However, the EU's fiscal capacity remains constrained in international comparison, limiting its ability to fully address these pressing concerns.

For decades, the EU budget has played a critical role in fostering cohesion. Yet, its structure remains influenced by political compromises that often prioritize national returns over strategic efficiency. While initiatives such as NextGenerationEU have introduced new tools, they have also underscored the need for more systematic, future-oriented financial planning.

This publication argues that reforming the EU budget is essential to ensuring long-term resilience and competitiveness. A key proposal is the adoption of a **Future Share** approach—an assessment metric that evaluates the proportion of public spending dedicated to long-term investments in areas such as education, research and development, and green infrastructure.

The chapters ahead will explore the evolution of the EU budget, its current limitations, and the structural changes necessary to align fiscal strategies with 21st-century challenges and the provision of European Public Goods. The EU can build a financial framework that is not only robust but also forward-looking.

Abstract

Fiscal policy plays a dual role in stabilizing economies and fostering long-term growth through strategic public investments. This publication investigates the critical distinction between productive and unproductive government spending, emphasizing its implications for economic resilience and competitiveness. Productive spending—targeting education, research and development (R&D), infrastructure, and health—enhances the economy's capacity for sustained growth. Conversely, unproductive expenditures, such as untargeted subsidies or excessive administrative costs, often address immediate concerns without yielding long-term benefits. This analysis integrates insights from neoclassical and endogenous growth models, highlighting how government spending influences innovation, human capital, and structural transformation.

This contribution introduces the "Zukunftsquote" or Future Share as a key tool for aligning fiscal strategies with future-oriented objectives. The Zukunftsquote is an important metric for future-oriented investments which quantifies the share of budgets allocated to investments with lasting societal and economic impacts. The application of this metric in European fiscal governance could optimize the allocation of resources, ensuring alignment with strategic goals like the European Green Deal and digital transformation.

The study also explores the challenges of embedding such frameworks, including data inconsistencies, political resistance, and methodological complexities.

As the EU prepares for its 2028–2034 Multiannual Financial Framework, this publication underscores the urgency of reform. Discussing the added value of European Public Goods, expanding the budget, institutionalizing borrowing mechanisms, and embedding future-oriented metrics like the Zukunftsquote are critical for addressing global challenges and ensuring sustainable growth. These measures represent not only a path to resilience but also an opportunity for the EU to set a global standard in innovative and inclusive fiscal governance.

Chapter 1

Fiscal Policy and Future Growth – The Role of Productive Government Spending

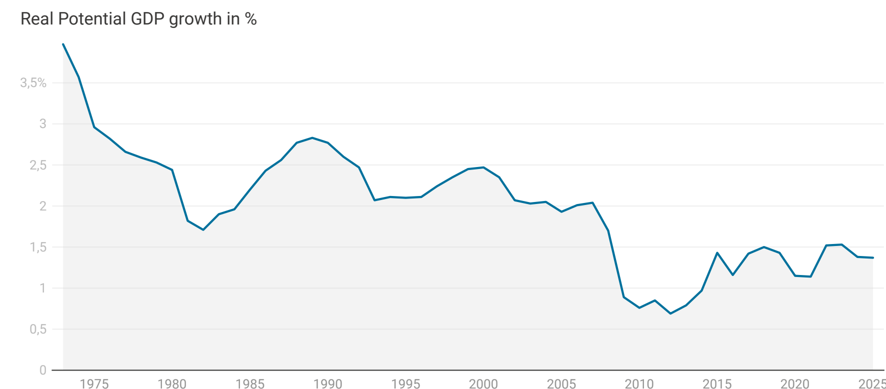
The Strategic Role of Fiscal Policy

Fiscal policy—defined as the use of government spending and taxation to influence economic activity—has long been a cornerstone of public economic management. While its immediate impact on aggregate demand is well understood, fiscal policy also plays a pivotal role in shaping the long-term growth trajectory of an economy. Effective fiscal policy ensures economic stabilization during periods of volatility while channeling resources into investments that enhance resilience, competitiveness, and sustainable development.

Historically, economic theory has debated the long-term significance of fiscal policy. Classical and neoclassical perspectives often attribute long-term growth primarily to factors like technological progress, with limited emphasis on fiscal policy's role. Conversely, endogenous growth models underscore the ability of government actions to directly influence growth through targeted investments in public goods like education, infrastructure, and research and development (R&D). However, not all government spending is equally impactful, underscoring the importance of distinguishing between productive and unproductive expenditures.[1]

This chapter explores the theoretical foundations of fiscal policy and its growth implications, the distinction between productive and unproductive spending, and the empirical evidence supporting these concepts. It also examines policy challenges and trade-offs while presenting case studies that highlight successes and failures in leveraging fiscal policy for long-term growth. This is increasingly important, given that Europe's potential growth has fallen significantly in the past decades.

Potential GDP growth in the European Union has fallen sigificantly



Source: EU Commission, AMECO.

1 Compare Aschauer, D. A. (1989). Is public expenditure productive?. *Journal of monetary economics, 23*(2), 177-200.

Fiscal Policy and Economic Growth: A Theoretical Framework

The relationship between fiscal policy and economic growth is complex, influenced by the structure of government expenditures and the means of financing. Two major schools of thought provide the theoretical backdrop for understanding this relationship:

Neoclassical Growth Models

Pioneered by Robert Solow[2] in the mid-20th century, neoclassical models argue that fiscal policy influences growth primarily through transitional dynamics rather than the steady-state growth rate. These models emphasize the diminishing returns to capital and attribute long-term growth to exogenous factors like technological innovation. Within this framework, government expenditures, particularly those financed by distortionary taxes, may reduce private sector savings and investment, thereby dampening economic output in the short term.

However, these models recognize the importance of transitional effects. For instance, public investments in infrastructure can temporarily boost growth by enhancing productivity and facilitating private sector activities.

Endogenous Growth Models

Emerging in the 1980s, endogenous growth theories (e.g., Barro, Lucas, Romer) expanded the understanding of fiscal policy's role by highlighting its capacity to influence innovation, education, and infrastructure development—factors intrinsic to long-term growth. By addressing market failures and leveraging positive externalities, government expenditures in certain categories can raise the economy's growth potential. For example, public investment in R&D or education creates spillover effects, enhancing private sector productivity and fostering innovation.[3]

2 Compare Blinder, A. S., & Solow, R. M. (1973). Does fiscal policy matter?. *Journal of public economics, 2*(4), 319-337.

3 Compare Aschauer, D. A. (1989). Is public expenditure productive?. *Journal of monetary economics, 23*(2), 177-200.

Endogenous growth models underscore the importance of strategic fiscal interventions, particularly in economies facing constraints on private investment due to market failures or lack of access to capital.

Productive vs. Unproductive Government Spending

Central to the debate on fiscal policy's growth effects is the distinction between productive and unproductive government spending. While productive expenditures contribute directly to an economy's productive capacity, unproductive spending typically provides short-term benefits without fostering long-term growth.

The allocation of government resources plays a pivotal role in shaping economic outcomes. Distinguishing between productive and unproductive government spending is critical for optimizing the growth and resilience of an economy.[4] While productive expenditures enhance the economy's capacity to generate goods and services, unproductive spending often caters to immediate needs or political objectives without contributing to long-term growth. Understanding the characteristics, impacts, and trade-offs associated with these two categories of spending is essential for policymakers aiming to maximize the social and economic returns on public investments.

The relationship between fiscal policy and economic growth has been extensively explored in economic literature, providing valuable insights into the mechanisms and outcomes of productive government spending. Early theoretical frameworks, such as Keynesian economics, emphasized the role of government expenditures in stimulating aggregate demand, particularly during periods of economic downturn. Neoclassical growth models initially downplayed the long-term impact of fiscal policy, attributing sustained growth to exogenous factors like technological progress. However, endogenous growth theories shifted the fo-

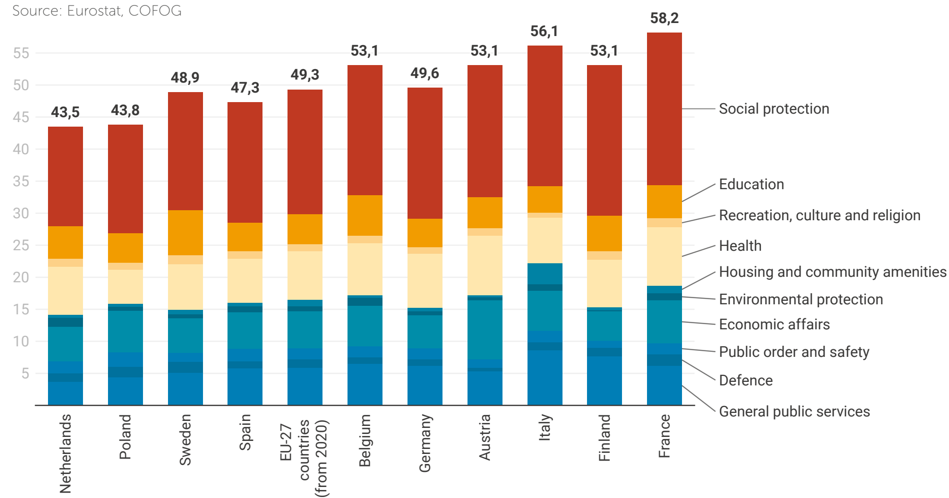
4 Aschauer, D. A. (1989). Is public expenditure productive?. *Journal of monetary economics, 23*(2), 177-200.

cus toward the direct role of government investments in fostering innovation, human capital development, and infrastructure expansion. Empirical studies consistently support the view that productive government spending—particularly in education, research and development (R&D), and infrastructure—yields high social returns by enhancing productivity and fostering economic resilience.[5] During the past crises research by the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) demonstrated that investments in R&D and education have multipliers significantly above one, meaning that they generate more than proportional gains in output. This literature underscores the importance of aligning fiscal policies with growth-enhancing priorities to maximize their long-term impact. However, looking at a selection of European economies, it becomes rather obvious that spending patterns differ greatly in the European Union. Some countries have significantly higher expenditures on social spending or general public services, generally associated with lower impacts on long-term growth, whereas others emphasize education spending.

Government Spending in various EU economies varies greatly

Government expenditure, in % of GDP

Source: Eurostat, COFOG



5 Compare Kneller, R., Bleaney, M. F., & Gemmell, N. (1999). Fiscal policy and growth: evidence from OECD countries. *Journal of public economics, 74*(2), 171-190.

Productive Government Spending: A Catalyst for Economic Growth

Productive government spending refers to expenditures that enhance the productive capacity of an economy. By building infrastructure, investing in human capital, and promoting innovation, these expenditures create conditions for sustained growth, improved living standards, and greater economic resilience.

Infrastructure Investments

Infrastructure is a cornerstone of productive government spending. Investments in transportation, energy, and communication networks reduce logistical costs, facilitate trade, and attract private sector investment. For example:

- **Transportation:** Roads, railways, and ports lower the cost of moving goods and services, improving market efficiency and fostering economic integration.
- **Energy:** Renewable energy projects enhance energy security and reduce dependency on fossil fuels, supporting environmental and economic sustainability.
- **Communication:** Broadband and digital infrastructure enable technological adoption, boosting productivity and innovation across industries.

Studies highlight the high return on investment (ROI) associated with infrastructure spending, particularly in economies where inadequate infrastructure constrains private sector growth.

Education and Training

Spending on education and training builds human capital, the foundation of long-term economic development. By improving workforce skills and competencies, these investments increase labor productivity and foster innovation. Examples include:

- Universal access to primary and secondary education, which establishes a baseline for literacy and numeracy.
- Vocational training programs aligned with industry needs, addressing skills gaps and reducing unemployment.
- Higher education funding that supports research and knowledge creation, contributing to technological advancement.

Countries that prioritize education often experience higher economic growth rates, reduced income inequality, and improved social mobility.[6]

6 Thöne, Michael (2022) : The quality of public finances, *FiFo Discussion Paper, No.22-2,* Finanzwissenschaftliches Forschungsinstitut an der Universität zu Köln (FiFo Köln), Köln

Research and Development

Public funding for research and development (R&D) addresses underinvestment in innovation, particularly in areas with significant externalities. For instance:

- Renewable energy R&D can accelerate the transition to a sustainable energy system.
- Advanced technologies, such as artificial intelligence and biotechnology, can enhance productivity and competitiveness.

Public R&D spending often has a multiplier effect, attracting private investment and creating spillover benefits that extend beyond individual firms or industries.

Unproductive Government Spending: A Drain on Economic Resources

Unproductive government spending typically involves expenditures that do not contribute to an economy's productive capacity. While some unproductive spending may serve short-term social or political purposes, its long-term economic impact is often negligible or negative.

Subsidies and Transfers

Subsidies and transfers, such as agricultural subsidies or cash benefits, are often criticized for distorting market signals and perpetuating inefficiencies. Examples include:

- **Energy Subsidies:** Subsidizing fossil fuels can discourage investment in renewable energy, hindering climate goals.
- **Agricultural Subsidies:** While intended to support farmers, these subsidies can lead to overproduction, waste, and environmental degradation.

Reallocating funds from subsidies to productive investments, such as education or infrastructure, could yield higher returns and reduce fiscal waste.

Excessive Administrative Costs

Governance and administrative spending are necessary for public service delivery, but excessive costs in this area divert resources from more impactful uses. Examples include:

- Bureaucratic inefficiencies that increase the cost-of-service delivery without improving outcomes.
- Overstaffing or duplication of roles in public administration.

Streamlining administrative processes and adopting digital tools can enhance efficiency, freeing up resources for productive investments.

Debt Servicing

High levels of public debt necessitate significant allocations for debt servicing, which consumes resources that could otherwise be used for growth-enhancing projects. While borrowing is sometimes necessary to finance investments, excessive reliance on debt can crowd out productive spending and increase vulnerability to economic shocks.

Empirical Evidence: Comparing Productivity Impacts

The distinction between productive and unproductive spending is well-documented in economic research. Studies consistently show that reallocating resources toward productive expenditures enhances growth and stability. For instance:

- Research by the European Commission reveals that public investment in infrastructure and education has a strong positive correlation with GDP growth.[7]
- Cross-country analyses indicate that economies with higher shares of productive spending, such as Nordic countries, achieve better long-term economic and social outcomes than those prioritizing subsidies or consumption.

Conversely, high levels of unproductive spending are associated with slower growth, higher deficits, and reduced fiscal flexibility.

Theoretical Foundations

Fiscal multipliers, a key concept in understanding the effectiveness of fiscal policy, measure the change in output resulting from a change in government spending or taxation. Their impact varies significantly depending on the state of the economy. In times of recession or economic slack, multipliers tend to be larger because idle resources, such as unemployed labor or underutilized capital, are mobilized by government spending. For instance, infrastructure projects initiated during economic downturns not only stimulate demand but also create long-term productivity gains. Conversely, during periods of robust growth or full employment, fiscal multipliers are smaller as increased spending can crowd out private investment or lead to inflationary pressures.

The size of fiscal multipliers also depends on the type of expenditure. Public investments in infrastructure, education, and R&D typically yield higher multipliers because they generate enduring productivity enhancements. Conversely, tax cuts or subsidies, though politically expedient, often produce lower multipliers unless targeted at low-income households with high marginal propensities to consume. Understanding these nuances is critical for designing countercyclical fiscal policies. For instance, Germany's fiscal response to the COVID-19 crisis, which included infrastructure investments and household support, demonstrated how targeted measures in a recession could achieve both short-term stabilization and long-term growth.

Countries with robust fiscal policies—characterized by strategic planning, transparent allocation, and efficient execution—consistently outperform those with weaker frameworks in economic resilience and growth. For

7 Cepparulo, A., & Mourre, G. (2020). How and How Much? The Growth-Friendliness of Public Spending through the Lens. *European economy, Discussion paper, 132.*

example, Nordic countries like Sweden and Denmark maintain high levels of productive public spending on education and innovation, fostering strong social outcomes and competitiveness. In contrast, countries with fragmented fiscal policies often struggle to achieve similar results. Greece, during the European debt crisis, faced significant economic contraction partly due to poorly structured spending and an overreliance on politically driven subsidies. This comparison underscores the importance of fiscal governance and strategic prioritization. Robust fiscal frameworks not only ensure efficient resource utilization but also enhance a nation's capacity to respond effectively to economic shocks, supporting sustained development.

The Political Economy of Spending Allocation

Despite the clear benefits of productive spending, governments often allocate significant resources to unproductive categories. This misallocation can be attributed to:

Short-Term Political Incentives: Politicians may prioritize visible and immediate benefits, such as cash transfers or subsidies, to gain electoral support.

Lobbying and Special Interests: Pressure from interest groups can lead to entrenched spending patterns that benefit specific sectors or regions, even when they are economically inefficient.

Administrative Inertia: Institutional resistance to change can perpetuate inefficient spending practices.

Addressing these issues requires robust fiscal governance, transparency, and accountability mechanisms.

Strategies for Rebalancing Government Spending

Policymakers can adopt several strategies to reallocate resources from unproductive to productive spending:

Adopting **transparent metrics tools** like the Zukunftsquote, which measure the share of future-oriented spending, can help governments evaluate and prioritize investments based on their long-term impact.

Implementing **performance-based funding** linking budget allocations to measurable outcomes ensures that resources are directed toward initiatives with proven benefits.

Enhancing **fiscal discipline rules** that limit unproductive spending, such as caps on subsidies or administrative costs, can create fiscal space for growth-enhancing projects.

Strengthening **institutions** Independent fiscal councils can provide objective assessments of spending efficiency and guide resource allocation.

Engaging **stakeholders public engagement** and transparency can build support for reallocating resources to productive uses, countering resistance from special interest groups.

Empirical Evidence on Fiscal Policy and Growth

Even though our focus remains on the expenditure side, it is important to note, that empirical research provides valuable insights into the impact of different types of fiscal policy interventions:

Taxation and Growth

- **Distortionary Taxes:** Taxes on income or corporate profits are associated with slower growth as they reduce incentives to work, save, and invest.
- **Non-Distortionary Taxes:** Consumption taxes have fewer adverse effects and can complement growth-enhancing expenditures when appropriately balanced.

Expenditure Composition

- **Reallocation Toward Productive Spending:** Studies consistently show that reallocating government spending from unproductive to productive categories—such as from subsidies to infrastructure—can significantly enhance growth.
- **Cross-Country Evidence:** Economies with higher shares of spending on education and R&D tend to experience faster growth, highlighting the importance of prioritizing these areas.

Financing Considerations

- **Debt-Financed Spending:** Excessive reliance on public borrowing can crowd out private investment, particularly if it raises interest rates. However, debt-financed investments with high social returns, such as green infrastructure projects, can yield net-positive outcomes.
- **Fiscal Discipline: S**ustainable fiscal policies that prioritize high-return investments while maintaining budgetary discipline are more likely to foster long-term growth.

Policy Challenges and Trade-offs

While the case for prioritizing productive spending is clear, governments often face significant constraints:

- **Political Economy:** Short-term political incentives often favor visible and immediate benefits, such as subsidies or transfer payments, over long-term investments in education or infrastructure.
- **Budgetary Constraints:** High levels of public debt in many advanced economies limit the fiscal space available for new investments.
- **Governance Challenges: I**nefficient allocation of resources, corruption, and poor institutional capacity can undermine the effectiveness of public spending.

International experience

Fiscal policy decisions significantly influence a nation's economic trajectory, with strategic investments fostering growth and ill-considered expenditures leading to stagnation. Examining international examples provides valuable insights into the outcomes of various fiscal approaches.

The Nordic Model: Prioritizing Education and Research

Nordic countries, including Sweden, Finland, Denmark, and Norway, have consistently prioritized investments in education and research and development (R&D), leading to robust economic growth and enhanced social welfare.

- **Education Investments:** These nations allocate substantial resources to education, ensuring universal access to high-quality schooling and higher education. This focus has resulted in a highly skilled workforce, driving innovation and productivity.
- **R&D Expenditures:** The Nordic countries maintain high levels of R&D investment relative to their GDP.

This strategic emphasis on education and R&D has fostered economic resilience and social equity, demonstrating the effectiveness of aligning fiscal policy with long-term developmental goals.

Post-Recession Recovery in the EU: NextGenerationEU Initiative

In response to the economic downturn caused by the COVID-19 pandemic, the European Union launched the NextGenerationEU (NGEU) program, a €750 billion recovery plan aimed at promoting sustainable recovery through investments in green and digital transitions.

- **Green Investments:** NGEU allocates funds to renewable energy projects, energy efficiency, and climate resilience, supporting the EU's goal of climate neutrality by 2050.

- **Digital Transformation:** The program invests in digital infrastructure and skills development, aiming to enhance competitiveness and technological sovereignty.

By focusing on productive spending, NGEU has bolstered economic resilience and set the foundation for long-term growth, illustrating the benefits of coordinated fiscal policy in addressing systemic challenges. It is abundantly clear however, that this tool either needs a successor or the regular budget needs reform.[8]

Israel: Leading in Research and Development

Israel stands at the forefront of research and development (R&D) investment, allocating 6.02% of its GDP to R&D activities as of 2022, the highest globally. This substantial investment has fostered a robust high-tech sector, earning Israel the moniker "Start-up Nation." The government's support for innovation has been instrumental in cultivating a dynamic ecosystem of technological advancement and entrepreneurship.

South Korea: Emphasis on Education and Technology

South Korea's commitment to education and technological innovation has been a cornerstone of its economic development. The government allocates significant resources to education, resulting in a highly skilled workforce. Additionally, South Korea invests approximately 4.93% of its GDP in R&D, positioning it among the top countries globally in this domain. These investments have propelled South Korea to become a leader in industries such as electronics, automotive, and information technology.

8 Bakker, A., Beetsma, R., & Buti, M. (2024). Investing in European Public Goods While Maintaining Fiscal Discipline at Home. *Intereconomics, 59*(2), 98-103.

China: Infrastructure Development and Technological Advancement

China has prioritized large-scale infrastructure projects and technological innovation as key drivers of its economic growth. The government's investments in high-speed rail networks, highways, and urban development have significantly improved connectivity and efficiency. Moreover, China is enhancing its R&D capabilities, with government initiatives supporting scientific research and technological advancements to develop the country's "new productive forces."

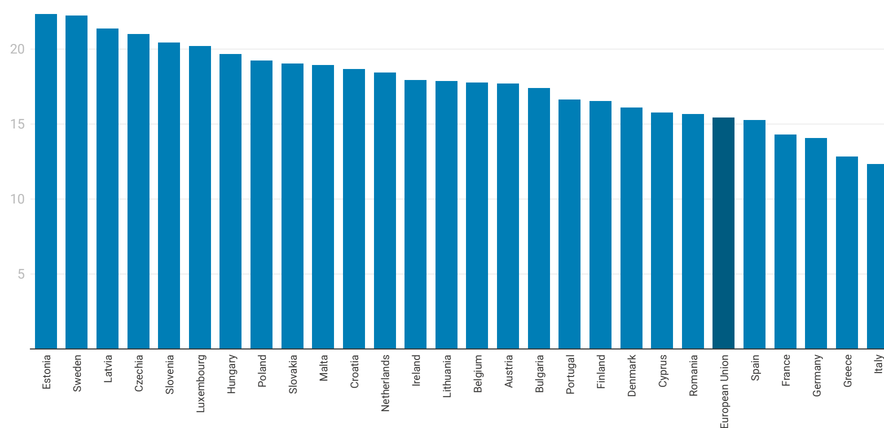
However, several European countries continue to underinvest in key areas such as education, research and development (R&D), and infrastructure, limiting their ability to foster innovation and resilience. Romania, for instance, allocated only 3.2% of its GDP to education in 2022, one of the lowest levels in the European Union, while its R&D investment stands at a mere 0.52% of GDP, far below the EU's 3% target. Similarly, Bulgaria, with education spending at 3.9% of GDP and R&D investment at 0.79%, struggles to build the human and technological capital necessary for sustainable growth. Greece also exhibits significant gaps, with education expenditure at 3.8% of GDP and inadequate focus on R&D funding, leaving the country less prepared to compete in an increasingly knowledge-driven global economy. Even Ireland, a high-income EU member, allocated only 2.7% of its GDP to education in 2022, the lowest in the bloc, and shows modest progress in R&D investment relative to its potential.

This underinvestment has far-reaching implications for economic and social outcomes. Limited funding for education restricts opportunities for skill development, exacerbates inequalities, and reduces overall workforce productivity. Inadequate R&D spending stifles innovation, constraining technological advancement and the capacity to adapt to global economic shifts. Countries that fail to prioritize productive spending face slower economic growth, weaker competitiveness, and diminished ability to address long-term challenges like the green and digital transitions. While fiscal pressures and competing priorities may explain these choices, the consequences are profound, highlighting the need for a strategic reallocation of resources. Policymakers must recognize the transformative potential of investments in human capital and innovation, not only to drive economic growth but also to enhance social cohesion

and resilience. Addressing these gaps is essential for ensuring that European nations can fully participate in and benefit from the opportunities of a rapidly evolving global economy.

The share of future-oriented spending

Expenditure on Education, R&D, Transport and Communications, in % of overall spending



Data according to COFOG, 2022.

Source: Eurostat, own calculations

Towards a Future-Oriented Fiscal Framework

To ensure that fiscal policy aligns with long-term growth objectives, policymakers must take several strategic actions:

1. **Adopt Transparent Metrics: T**ools like the "Zukunftsquote" measure the share of future-oriented spending in public budgets, improving accountability and guiding resource allocation.
2. **Strengthen Institutions:** Robust public finance institutions can depoliticize budgetary decisions and ensure prioritization of high-return investments.
3. **Leverage EU-Level Resources:** For Member States, accessing shared resources for pan-European public goods—such as cross-border infrastructure—can enhance fiscal efficiency and impact.

Distinguishing between productive and unproductive spending is fundamental for designing fiscal policies that foster sustainable growth. By reallocating resources toward investments in infrastructure, education, and innovation, governments can create the conditions for long-term prosperity. However, achieving this requires addressing political, institutional, and fiscal challenges. As economies face mounting global pressures, adopting a strategic, future-oriented approach to fiscal policy is imperative for ensuring sustainable development and resilience.

Chapter 2

Understanding the EU Budget – Role, Extent, and Challenges

The European Union Budget: A Pillar of Integration and Collective Action

The European Union (EU) budget represents a unique financial framework that supports the bloc's collective goals and aspirations. Unlike national budgets, which serve as comprehensive financial plans for individual countries, the EU budget is more narrowly focused. It acts as a complementary financial instrument, providing resources for areas of transnational importance, such as cohesion policy, research and development (R&D), and large-scale infrastructure projects. This distinction between national and EU fiscal responsibilities defines the latter's structure and constraints, setting it apart from traditional sovereign budgets.

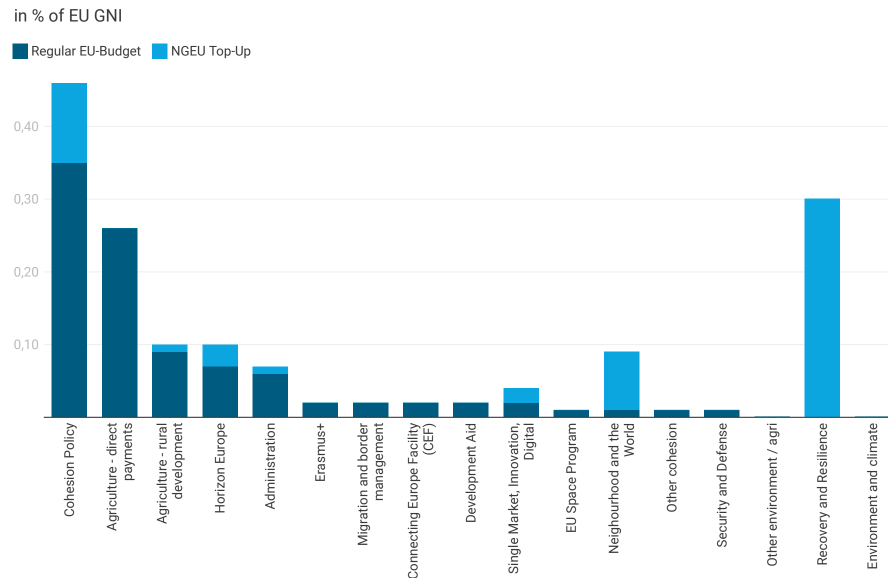
At approximately 1% of the EU's Gross National Income (GNI), the EU budget is modest in size compared to the national budgets of its Member States. Nevertheless, its impact is significant, especially in fostering growth, reducing disparities, and financing collective priorities like the European Green Deal and the digital transition. At the same time, the EU budget faces criticism for its limited scope and its reliance on politically negotiated contributions from Member States. This introduction explores the budget's role, its extent, and the challenges it faces in achieving efficiency and alignment with strategic goals.

The history of the European Union (EU) budget is deeply intertwined with the evolution of the Union itself, reflecting its shifting priorities and the balance of power between its institutions and Member States. Established in 1958 as part of the Treaty of Rome, the European Economic Community (EEC) began with a budget focused on administrative costs and the nascent Common Agricultural Policy (CAP), which quickly became a dominant component. The CAP aimed to stabilize markets, ensure food security, and support farmers, consuming a substantial share of the budget. Over time, the budget framework evolved to address the growing complexities of integration, including the need for regional development, which led to the creation of the European Regional Development Fund (ERDF) in 1975. The introduction of the Single European Act in 1986 further expanded the EU's scope, leading to increased funding for research, technological development, and the completion of the single market.

The Multiannual Financial Framework (MFF), introduced in 1988, marked a pivotal moment in the EU budget's history. This long-term planning tool provided stability and predictability, enabling the EU to align its expenditures with its strategic priorities. Over the years, successive MFFs have reflected the Union's response to emerging challenges, from the financial and sovereign debt crises of the late 2000s to the COVID-19 pandemic. The budget's structure has gradually diversified beyond agriculture and cohesion policy to encompass climate action, digital transformation, migration, and security. The NextGenerationEU (NGEU) recovery fund, introduced in 2020, exemplifies the EU's capacity to adapt its fiscal tools, allowing for unprecedented borrowing to finance pandemic recovery efforts. However, the budget remains constrained, capped at approximately 1% of the EU's Gross National Income (GNI), and continues to face criticism for its reliance on Member State contributions and political negotiations that often prioritize equitable returns over efficiency. This historical trajectory underscores the EU budget's dual role as both a financial instrument and a symbol of European solidarity and integration.

Items of the EU budget, disbursements 2022

in % of EU GNI



Source: Gabriel Felbermayr, EU-Commission

The Role of the EU Budget in European Integration

The EU budget embodies the principle of solidarity among its 27 Member States. Its primary function is to finance initiatives that individual nations cannot effectively undertake alone, such as cross-border infrastructure or climate resilience. These initiatives, referred to as European Public Goods (EPGs), address common challenges and promote shared prosperity.

Complementarity to National Budgets

Unlike national budgets, which allocate resources to a wide array of functions including healthcare, defense, and social security, the EU budget focuses on areas with significant transnational benefits. It does not duplicate the role of national budgets but rather complements them by addressing issues that require collective action or economies of scale.

For example, investments in the Trans-European Transport Network (TEN-T) improve connectivity across borders, benefiting the EU as a whole rather than individual Member States. Similarly, funding for Horizon Europe, the EU's flagship R&D program, fosters innovation through collaborative research that would otherwise face underinvestment at the national level.

Strategic Priorities of the EU Budget

The Multiannual Financial Framework (MFF), a seven-year planning cycle, provides the structural foundation for the EU budget. It sets spending ceilings and priorities based on strategic goals. The 2021–2027 MFF, for instance, emphasizes:

- **Cohesion Policy:** Reducing disparities between regions through investments in infrastructure, education, and employment.
- **Agriculture and Rural Development:** Supporting farmers and ensuring food security under the Common Agricultural Policy (CAP).
- **Green and Digital Transitions:** Advancing climate goals through the European Green Deal and accelerating digital innovation through programs like Digital Europe.
- **Global Role and Security:** Enhancing the EU's influence globally by funding humanitarian aid, development cooperation, and border management.

The NextGenerationEU (NGEU) initiative, launched as a response to the COVID-19 pandemic, marked a pivotal shift in the EU's fiscal landscape. This temporary recovery instrument, financed through joint borrowing, underscores the potential for the EU budget to adapt to crises and finance transformative investments. However, a mere continuation of the current MFF would be insufficient to deal with the historic challenges that the EU faces in terms of Defense, Security, and Transformation.[9]

9 Felbermayr, G. (2024). *Europa muss sich rechnen.* Christian Brandstätter Verlag.

The Structure and Revenue Sources of the EU Budget

The EU budget is distinct in its reliance on "own resources" and Member State contributions. This structure ensures fiscal discipline but also limits the budget's flexibility and scope.

Revenue Sources

The EU budget draws its revenue from three primary sources:

1. **Traditional Own Resources (TOR):** Customs duties on imports from outside the EU and sugar levies.
2. **VAT-Based Contributions:** A portion of Member States' value-added tax (VAT) revenues.
3. **GNI-Based Contributions:** Payments from Member States based on their GNI, which account for the largest share of the budget.

While these mechanisms ensure predictable funding, they also tie the budget's size to political negotiations, often resulting in debates about net contributions and "juste retour" (fair return). For example, wealthier Member States frequently push for rebates or reduced contributions, complicating budgetary discussions.

Expenditure Allocation

The EU budget is allocated across several broad categories, including:

- **Cohesion Policy:** The largest component, aimed at fostering economic, social, and territorial cohesion.
- **Agriculture:** Another significant share, focused on supporting farmers and rural development.
- **Research and Innovation:** Programs like Horizon Europe receive funding to drive competitiveness and sustainability.
- **Administration:** A smaller but necessary portion covers the functioning of EU institutions.

While these allocations reflect the EU's priorities, they also reveal inherent trade-offs. For instance, critics argue that the CAP, which consumes a substantial portion of the budget, could be restructured to prioritize environmental sustainability over direct subsidies.

Challenges in Distinguishing Productive and Unproductive Spending

Determining whether EU budget expenditures are productive or unproductive is a complex task, influenced by differing national interests, political priorities, and temporal horizons.

Political Pressures

EU budget negotiations often devolve into debates about net contributions, with Member States prioritizing funding that directly benefits their domestic economies. This focus can lead to allocations that favor immediate political gains over long-term growth. For instance, while cohesion funds aim to reduce disparities, their effectiveness depends on the capacity of regions to absorb and implement these investments.

Measurement and Accountability

The absence of standardized metrics for evaluating spending productivity further complicates classification. Tools like the Future Share, which measures the share of future-oriented spending, remain underutilized at both the EU and national levels. Without such frameworks, it is challenging to assess whether government spending in areas like R&D or digital infrastructure deliver the expected returns.

Temporal Trade-Offs

Productive investments, such as those in renewable energy or education, often require long gestation periods to yield benefits. Policymakers operating on short electoral cycles may prioritize projects with immediate visibility, such as subsidies or administrative expenditures, over these long-term initiatives.

The Potential of the EU Budget for Growth and Resilience

Despite its constraints, the EU budget has significant potential to drive growth and enhance resilience. By reallocating resources toward high-return investments, the budget can address pressing challenges such as climate change, technological transformation, and geopolitical instability.

Aligning with Strategic Goals

Reforms to align the budget with the European Green Deal and Digital Decade objectives could maximize its impact. For instance, increasing allocations for renewable energy and digital connectivity would support the EU's twin transitions while reducing dependencies on external actors.

Enhancing Fiscal Coordination

The interplay between the EU budget and national fiscal policies underscores the need for greater coordination. Tools like the European Semester and performance-based funding models can help align spending across governance levels, ensuring that resources are used effectively.

Conclusion: A Call for Reform

The EU budget is both a symbol and a tool of European integration, representing solidarity and shared purpose among Member States. However, its current size and structure limit its ability to fully address the bloc's challenges. To realize its potential, the EU must reform its budgetary framework, expanding its fiscal capacity and embedding principles like the Future Share to prioritize future-oriented spending.

Achieving these reforms will require overcoming political resistance and institutional inertia. Yet, the benefits—enhanced resilience, sustainable growth, and a stronger global role for the EU—far outweigh the challenges. As the EU prepares for the next Multiannual Financial Framework (2028–2034), it has an opportunity to create a budget that reflects the ambitions of a united, forward-looking Europe.

Chapter 3

The Future Share – A Benchmark for Future-Oriented Budgeting

Introduction: The Need for a Future Share

Governments worldwide face mounting fiscal challenges: climate change, demographic shifts, and technological advancements require bold, long-term investments. Yet, traditional fiscal strategies often prioritize short-term goals due to political pressures or structural biases, neglecting the importance of sustainability and growth-enhancing investments. This "present bias" undermines long-term prosperity, a concern especially pronounced in Europe, where public debt and aging populations further constrain fiscal flexibility.

The **Zukunftsquote** (Future Share) emerges as a solution. Developed from German fiscal policy discussions and further advanced by economic institutions like ZEW (Leibniz Centre for European Economic Research), this metric evaluates the share of public budgets dedicated to future-oriented spending.[10] By assessing investments in areas such as education, research, and green infrastructure, the Future Share ensures a focus on long-term goals, offering a framework to counterbalance the inherent short-termism of fiscal policies.

10 Compare ZEW (Leibniz Centre for European Economic Research). *Future Share: Eine Methodik für zukunftsorientierte Haushaltsplanung.* Mannheim: ZEW, 2021.

Conceptual Foundations of the Future Share

The Future Share embodies a shift in fiscal philosophy. It advocates for a budgetary focus that does not merely sustain current consumption but actively builds "public capital" to enhance productivity and sustainability over time. Public capital encompasses various dimensions, including human, physical, natural, and technological capital.

Investments in human capital, such as education, healthcare, and skills development, improve workforce productivity and foster innovation. Similarly, spending on physical and digital infrastructure—like transport systems, renewable energy networks, and broadband connectivity—reduces transaction costs and accelerates economic growth. Investments in natural capital, including climate initiatives and biodiversity projects, preserve resources essential for future generations. Finally, funding for R&D addresses market failures, driving technological progress and enhancing competitiveness.

Unlike traditional fiscal metrics like public debt-to-GDP ratios or investment shares, the Future Share evaluates the quality and impact of expenditures. By emphasizing long-term goals over immediate consumption, it aligns public spending with strategic objectives like the European Green Deal and the Digital Decade.

Methodology for Calculating the Future Share

The Future Share employs a robust methodology that categorizes public expenditures based on their potential to enhance future-oriented goals. Budgets are divided into productive categories, such as education and R&D, and less productive categories, such as subsidies or debt servicing. Investments are further weighted by criteria such as their contribution to capital accumulation, their spillover effects, and their alignment with national or regional policy priorities.

This flexible approach allows the Future Share to reflect diverse economic contexts while maintaining comparability across jurisdictions. It ensures that governments can adapt the metric to their specific needs while still adhering to its overarching principles.

The Future Share: Evolving the Concept of Productive Spending

The Future Share, or Future Share, builds upon the concept of productive spending by introducing a structured metric for evaluating public expenditures based on their contribution to long-term growth and resilience. Traditional approaches to productive spending focus broadly on categories such as infrastructure, education, and research and development (R&D). The Future Share refines this framework by explicitly quantifying the proportion of a government's budget allocated to future-oriented investments. This metric accounts not only for traditional productive spending but also for emerging priorities like climate action, digital transformation, and sustainable resource management. By emphasizing forward-looking expenditures, the Future Share shifts the focus from immediate consumption to building durable economic and social capital.

The value of the Future Share lies in its ability to provide a transparent and standardized tool for assessing fiscal policies across regions and timeframes. Unlike general classifications of productive spending, the Future Share incorporates detailed weighting criteria to evaluate expenditures based on their impact on human, physical, and natural capital. For instance, funding for green energy projects or digital infrastructure receives higher priority under this framework than subsidies or debt servicing. This methodological rigor helps policymakers identify inefficiencies and reallocate resources toward high-impact areas. Moreover, the Future Share's focus on quantifiable outcomes aligns fiscal policies with strategic goals like the European Green Deal and the UN Sustainable Development Goals, enabling governments to justify investments based on measurable contributions to long-term growth and sustainability. By evolving the concept of productive spending, the Future Share serves as a vital tool for modern fiscal governance.

Empirical Insights from Future Share Applications

Germany's application of the Future Share offers valuable lessons. In 2021, the broad variant of the metric stood at 17.02%, while the narrower variant was 13.85%. Both measures fell short of the recommended 25%, indicating a need for increased investments in future-oriented sectors. High-priority areas like education, climate initiatives, and R&D accounted for most productive spending, whereas pensions and healthcare dominated less productive categories.

Comparative studies across Europe reveal significant disparities. Nordic countries consistently lead in rankings due to their emphasis on green energy and education, while Southern and Eastern European nations lag behind, constrained by fiscal deficits and a reliance on consumption-based expenditures. These variations highlight the importance of tailored fiscal strategies to address unique economic and social contexts.

Policy Implications of the Future Share

The Future Share enhances fiscal transparency and accountability, allowing policymakers and citizens to evaluate whether budgetary allocations align with strategic priorities. By identifying inefficiencies, the metric encourages governments to shift resources from less productive to more productive uses. For example, reallocating subsidies to infrastructure projects or renewable energy initiatives can yield significant long-term benefits without increasing fiscal deficits.

At the EU level, the Future Share could complement existing fiscal tools, such as the Stability and Growth Pact and the Multiannual Financial Framework. Integrating this metric into these frameworks could strengthen alignment between EU and national policies, ensuring a consistent focus on future-oriented investments across governance layers.

Challenges and Limitations

Despite its clear advantages, the Future Share faces several challenges and limitations that complicate its adoption and implementation. One significant issue is the methodological difficulty of classifying expenditures as future-oriented. This process often involves subjective judgments, which can lead to inconsistencies across regions and timeframes. Political resistance also presents a major hurdle; reallocating resources from politically sensitive areas such as pensions or subsidies frequently meets opposition from vested interests and electorates, making meaningful reform difficult. Institutional capacity constraints, particularly in less developed regions, further limit governments' ability to adopt and effectively monitor Future Share-based frameworks, undermining their potential impact.

Another critical challenge is the problem of data availability and timeliness, which is essential for informed, day-to-day budget governance. Many governments lack comprehensive and up-to-date data on budget allocations, making it difficult to evaluate spending in real time against Future Share criteria. This data gap hinders the ability to adjust expenditures dynamically in response to evolving economic and social priorities. Without robust data systems and analytical tools, policymakers risk basing decisions on incomplete information, potentially misclassifying expenditures or failing to capture their true long-term benefits. Addressing these challenges will require investments in digital infrastructure for public finance management, improved data collection mechanisms, and enhanced institutional capacity to integrate real-time insights into fiscal decision-making.

Future Directions for the Future Share

To address these challenges a cross-country analysis of the future share would be of interest with standardized guidelines ensuring comparability. Dynamic criteria, including real-time data and forward-looking indicators, can refine assessments and improve accuracy. Institutionalizing the metric within fiscal governance frameworks, such as linking it to performance-based funding mechanisms like NextGenerationEU, could incentivize governments to prioritize future-oriented spending.

Conclusion

The Future Share offers a transformative approach to fiscal policy, prioritizing long-term investments over short-term consumption. By focusing on public capital, it aligns fiscal strategies with the challenges of the 21st century, from climate change to technological innovation. While its implementation faces political and methodological challenges, its potential to enhance transparency, accountability, and growth is unparalleled.

As the EU and its Member States navigate global uncertainties, integrating the Future Share into fiscal governance could secure a more sustainable and prosperous future.

Chapter 4

Applying the Future Share to the European Union Budget

Introduction: Future-Proofing the EU Budget

The European Union (EU) stands at a critical crossroads as it prepares the Multiannual Financial Framework (MFF) for 2028–2034. The budget's primary purpose, ensuring the provision of European public goods while fostering cohesion and resilience, has become increasingly complex as global and domestic challenges intensify. Climate change, the digital transformation, geopolitical instability, and social inequality demand a fiscal framework capable of both addressing immediate needs and investing in long-term priorities. Yet, the EU budget remains constrained, capped at approximately 1% of Gross National Income (GNI), which limits its capacity to tackle these multifaceted issues comprehensively. To future-proof its fiscal strategy, the EU must embrace bold reforms that expand its fiscal capacity, prioritize future-oriented investments, and enhance its ability to respond flexibly to crises.

Future-proofing the EU budget involves shifting from a reactive to a proactive approach, ensuring that resources are allocated strategically to address evolving challenges. A key aspect of this transformation is the integration of frameworks like the Future Share, which emphasize investments in areas with long-term growth potential, such as renewable energy, digital infrastructure, and cutting-edge research. These forward-looking investments not only bolster economic resilience but also ensure that the EU can maintain its competitiveness in a rapidly changing global environment. Tools such as performance-based funding and conditionality mechanisms, proven effective in initiatives like NextGenerationEU, offer practical methods for aligning expenditures with strategic objectives and ensuring accountability.

However, achieving a future-proof budget requires overcoming entrenched political and institutional barriers. Resistance from Member States, often focused on preserving traditional spending priorities like agricultural subsidies, poses a significant challenge to reallocating resources toward modern imperatives. Institutional capacity and administrative complexity further complicate the implementation of innovative fiscal mechanisms. Despite these obstacles, the MFF for 2028–2034 presents a pivotal opportunity to redefine the EU's fiscal framework, align its spending with contemporary priorities, and secure a more resilient, sustainable, and competitive Union for the future. Given the geopolitical challenges that Europe faces, the next European budgets needs bold reform rather than small adjustments.[11]

Aligning the Future Share with EU Budget Priorities

The EU budget is structured to fund European public goods (EPGs), support cohesion, and foster collective progress in areas such as research, innovation, and infrastructure. Its priorities, encapsulated in instruments like the Multiannual Financial Framework (MFF) and NextGenerationEU (NGEU), already emphasize future-oriented goals like the green and digital transitions. The Future Share can enhance these initiatives by:

1. **Prioritizing Investments:** Quantifying the share of EU spending dedicated to transformative areas, such as renewable energy, digital infrastructure, and cross-border projects.
2. **Enhancing Accountability:** Offering a transparent mechanism to evaluate the alignment of EU expenditures with strategic objectives like the European Green Deal.
3. **Fostering Coherence:** Encouraging harmonized fiscal strategies among Member States by providing a standardized metric for evaluating investment quality.

11 Buti, M., Darvas, Z., & Steinbach, A. (2024). Memo to the commissioner responsible for the European Union budget. *Unite, defend, grow, 2024,* 234.

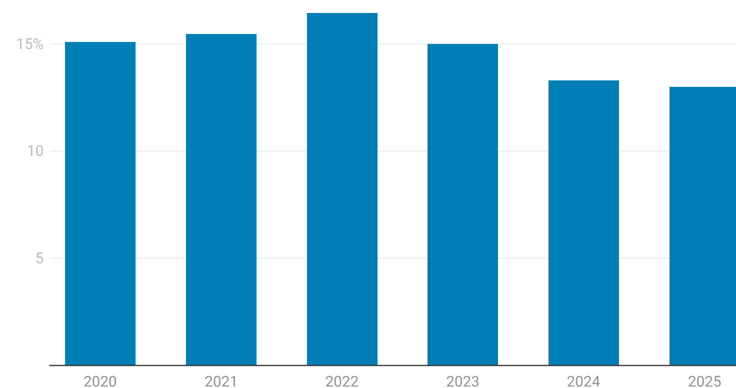
Calculating the Future Share for the EU Budget

Applying the Future Share to the EU budget involves several methodological steps:

1. **Classifying Expenditures:**
    - Future-oriented spending includes allocations for research and development (R&D), climate resilience, and trans-European networks.
    - Consumption-oriented spending encompasses administrative costs and subsidies without substantial long-term benefits.
    - Mixed categories, such as cohesion funds, require nuanced assessment due to their varied impacts.
2. **Weighting Investments:** Each expenditure is evaluated based on its alignment with EU strategic goals, spillover effects, and time horizon. For instance, green energy initiatives may receive higher weights than administrative outlays.

The Future Share in the EU budget declined recently

Spending on R&D, Education, Infrastructure and other Future Share categories, in % of overall spending



Source: EU, own calculations.

3. **Evaluating Cross-Border Impacts:** Projects like the Trans-European Transport Network (TEN-T), which facilitate integration and reduce economic disparities, score highly due to their pan-European benefits.
4. **Embedding Performance Metrics:** Performance-based funding models, as seen in the NGEU, complement the Future Share by linking allocations to measurable outcomes.

Application of the Future Share

The NextGenerationEU (NGEU) initiative, launched as a temporary recovery instrument in response to the COVID-19 pandemic, represents one of the EU's most ambitious fiscal efforts. With a total budget of €750 billion, it focused on accelerating the green and digital transitions while promoting economic resilience across Member States. However, despite its strategic objectives, the implementation of NGEU lacked a comprehensive framework like the Future Share to systematically evaluate and prioritize future-oriented expenditures. Incorporating the Future Share could have enhanced the program's focus and accountability, ensuring that resources were consistently directed toward investments with the highest long-term impact.

For example, under NGEU, Member States were required to submit national recovery plans detailing how they intended to use the allocated funds, with a focus toward climate goals and toward digitalization. While these directions were commendable, the lack of a standardized evaluation metric such as the Future Share made it difficult to assess whether the proposed projects were genuinely transformative. Some Member States, for instance, allocated significant funds to traditional infrastructure projects that, while necessary, offered limited long-term value compared to green or digital investments. Others might have used European funds to finance projects that would have happened in any case, thus reducing future-oriented spending in national budgets.

Embedding the Future Share into NGEU's design would have provided a clear, quantifiable benchmark for identifying projects with the highest future-oriented potential, such as renewable energy grids, AI research hubs, or green mobility systems.

Moreover, a Future Share-based approach could have facilitated more consistent monitoring and transparency across Member States. By requiring all national recovery plans to include a Future Share analysis, the EU could have ensured greater comparability in how funds were utilized. This structured approach would have reduced the risk of misallocations and allowed for dynamic adjustments, reallocating resources to projects with demonstrable progress toward long-term goals. Such a system would have not only amplified the impact of NGEU but also established a model for integrating future-oriented fiscal planning into broader EU budgetary practices, ensuring lasting value from large-scale financial interventions.

Challenges in Implementation

Implementing the Future Share in the EU budget presents significant hurdles:

Political Resistance

Reallocating funds to future-oriented investments may involve reducing politically sensitive expenditures, such as agricultural subsidies. Member States heavily reliant on these allocations could oppose such changes.

Methodological Complexity

The classification of expenditurnproductive categories requires subjective judgments. Divergent national priorities and institutional frameworks further complicate the standardization of the Future Share.

Regional Equity Concerns

The EU budget must balance efficiency with equity, ensure regions receive adequate support while prioritizing future-oriented investments. This dual objective could create tensions in resource allocation.

Chapter 5

Outlook for a New European Budget 2028–2034

Introduction: A Decisive Moment for European Fiscal Policy

The European Union (EU) is at a pivotal juncture as it prepares the Multiannual Financial Framework (MFF) for 2028–2034, necessitating reforms to address emerging challenges and align with strategic priorities. The European Commission has proposed a more focused budget that links reforms with investments to bolster key areas such as defense, security, sustainable prosperity, competitiveness, and social fairness. This approach aims to streamline existing programs, reducing bureaucracy and enhancing flexibility to respond effectively to unforeseen events like climate disasters and geopolitical crises.

A significant aspect of the current debate is the proposal to condition EU subsidies on the implementation of national economic reforms, drawing inspiration from the NextGenerationEU program. This strategy seeks to ensure that EU funds are utilized efficiently to advance competitiveness and resilience across member states. However, this proposal has encountered resistance from some member states concerned about potential infringements on national sovereignty and the dilution of traditional policies such as cohesion and agricultural funding.

Financial considerations are central to the discussions, with calls to overhaul the EU's €387 billion agricultural subsidies by basing them on farm income rather than size, thereby supporting smaller farmers and promoting equitable growth. Additionally, think tanks like Bruegel advocate for doubling the EU budget to effectively address contemporary challenges, suggesting that national governments assume a greater share of direct payments to farmers. These proposals underscore the necessity for a comprehensive reevaluation of budget allocations to ensure the EU is equipped to tackle future challenges and maintain its global competitiveness.

The forthcoming Multiannual Financial Framework (MFF) for 2028–2034 represents a critical juncture for the European Union. As global challenges intensify, including climate change, technological transformations, and geopolitical instability, the EU's capacity to deliver on its strategic priorities hinges on a modernized and resilient fiscal architecture. The expiration of temporary measures like NextGenerationEU and the lessons learned from the 2021–2027 MFF highlight the importance of adopting a more robust, forward-looking framework.

Drawing from recent policy analyses, this chapter outlines the strategic priorities, necessary reforms, and implementation challenges for the 2027–2034 EU budget, emphasizing the adoption of innovative funding mechanisms and future-oriented frameworks such as the Future Share.

Strategic Priorities for the 2028–2034 Budget

The formulation of the European Union's (EU) Multiannual Financial Framework (MFF) for 2028–2034 has ignited a robust debate among policymakers, stakeholders, and member states regarding its strategic priorities. A central point of contention is the proposal to condition EU subsidies on the implementation of national economic reforms, a concept inspired by the NextGenerationEU program. Proponents argue that this conditionality would enhance the effectiveness of EU funds by ensuring alignment with broader economic objectives, thereby promoting competitiveness and resilience across the Union. However, critics express concerns about potential infringements on national sovereignty and the dilution of traditional policies, such as cohesion and agricultural funding, which have historically constituted significant portions of the EU budget.

Another focal point in the debate is the allocation of resources toward emerging challenges, including defense, security, and industrial growth, especially in light of evolving geopolitical tensions. The European Commission has proposed the establishment of a Competitiveness Fund to support strategic sectors and bolster the EU's position in new technologies, aiming to reduce dependencies on external actors. This proposal underscores the necessity for substantial investment in technology to maintain the EU's global standing. Nonetheless, it faces resistance from member states wary of joint EU borrowing and the reallocation of funds from established programs. Balancing these diverse priorities within a constrained budget remains a complex challenge, necessitating careful negotiation to achieve a consensus that addresses both traditional commitments and contemporary imperatives.

Economists like Gabriel Felbermayr emphasize the necessity of reorienting the EU budget to focus on projects with clear European added value, particularly in areas that generate positive transnational externalities. His perspective highlights the importance of investments in public goods such as trans-European infrastructure, border security, and cutting-edge research.[12] According to Felbermayr, these projects inherently align with the subsidiarity principle by addressing challenges that individual Member States cannot effectively resolve alone. Examples include the development of pan-European transport and energy networks, collaborative space programs, and joint research initiatives. These areas not only provide tangible benefits to citizens but also enhance the EU's global competitiveness and economic cohesion.

Felbermayr also advocates for expanding the EU budget to at least 4% of Gross National Income (GNI) to enable meaningful contributions to shared challenges. He argues that a larger, more flexible budget would allow the EU to smooth idiosyncratic economic shocks across the Union while providing an automatic stabilization function during crises. This approach, Felbermayr contends, would alleviate the fiscal pressures on national budgets while increasing the visibility and impact of European investments. He strongly criticizes the entrenched debate over net contributors and recipients, describing it as counterproductive. Instead, he proposes reallocating funds towards European public goods that deliver broader benefits, making the advantages of EU membership more tangible for all citizens.

12 Felbermayr, Gabriel. *Europa muss sich rechnen: Budgetfragen im Fokus.* NEOS Lab Policy Presentation, 2023.

European Public Goods: A Core Rationale for EU-Level Spending

European public goods (EPGs) represent shared benefits that transcend national borders, making them essential for addressing collective challenges and enhancing integration within the European Union (EU). These goods include trans-European transport and energy networks, climate action, border security, and research initiatives. Their provision often requires cooperation and funding at the EU level, as individual Member States lack the resources or incentives to fully address these issues independently. For instance, investments in cross-border rail infrastructure, like the Rail Baltica project, facilitate regional connectivity and economic integration, yielding benefits that extend beyond the contributing nations. Similarly, joint research programs under Horizon Europe enable cutting-edge innovation by pooling expertise and financial resources from across the Union.

Despite their critical importance, the funding and prioritization of EPGs remain limited within the current EU budget framework, which is constrained to approximately 1% of the EU's Gross National Income (GNI). Critics argue that this underinvestment undermines the EU's capacity to tackle major transnational challenges effectively. Expanding the focus on EPGs in the upcoming Multiannual Financial Framework (MFF) for 2027–2034 is not only a necessity but also an opportunity to strengthen European solidarity and resilience. A greater emphasis on EPGs can help balance traditional funding areas, like agriculture, with modern imperatives such as the European Green Deal and digital transformation. By doing so, the EU can enhance its strategic autonomy, support sustainable development, and provide tangible benefits to its citizens, reaffirming the value of collective action.

The Evolution of the European Public Goods Debate

Historical Development

The concept of European public goods (EPGs) has been a cornerstone of EU policy discourse, evolving alongside the Union's expansion and the deepening of its integration. Initially, the focus was on creating a shared market through the foundational "four freedoms": the free movement of goods, services, capital, and labor. As Felbermayr and Pekanov highlight, the Single Market itself can be viewed as a form of public good, fostering economic growth by removing barriers and standardizing regulations across Member States.[13] However, the debate has since expanded to include other transnational challenges, such as environmental sustainability, energy security, and technological innovation, which require coordinated EU-level action.

Jacques Delors famously observed that "nobody falls in love with the Single Market," emphasizing the need for the EU to provide tangible benefits that resonate with its citizens. This perspective catalyzed efforts to identify public goods with clear European value added, such as trans-European networks in transport and energy, collaborative research through programs like Horizon Europe, and shared defense initiatives. Each of these areas exemplifies the necessity of centralized provision to achieve efficiency gains and address externalities that individual nations cannot manage alone.

Current Priorities and Challenges

In recent years, the debate on European public goods has intensified, driven by global and regional challenges. Climate change, the digital transformation, and heightened geopolitical tensions underscore the need for expanded and coordinated EU action. The provision of EPGs is not only about meeting current demands but also about preparing for

13 Felbermayr, G. and Pekanov, A. (2023): *Pan-European Public Goods: Rationale, Financing and Governance.*

future shocks. For example, the Letta Report and other studies advocate for strategic sectors like energy, defense, and research to be more integrated at the EU level. Such integration would optimize resources and strengthen the Union's resilience in facing global competition.

Despite these advances, significant challenges remain. The persistent "juste retour" debate, where Member States focus on net contributions and receipts, continues to impede consensus on expanding EU funding for public goods. Additionally, the lack of a robust Capital Markets Union limits private sector involvement in financing these initiatives, making the case for a larger EU budget even more pressing. Addressing these issues requires not only financial resources but also institutional reforms that enhance transparency, accountability, and citizen engagement in decision-making processes. The ongoing evolution of the EPG debate reflects the EU's commitment to advancing collective benefits while navigating complex political and economic landscapes.

To address its core objectives and global responsibilities, the EU must align its fiscal priorities with the following key areas:

Green Transition

Climate action remains at the forefront of EU policy. Achieving net-zero emissions by 2050 requires continued investment in renewable energy, energy efficiency, and biodiversity conservation. The current allocation of 30% of the EU budget to climate goals, while commendable, will need to be expanded further to address the scale of the transition.

Digital Transformation

Technological sovereignty and competitiveness depend on significant investments in digital infrastructure, artificial intelligence, and cybersecurity. Programs like Horizon Europe and the Digital Europe initiative have laid the groundwork, but further funding is required to address gaps in digital literacy and the deployment of advanced technologies.

Geopolitical Stability and Security

The EU must bolster its role in global security through increased spending on defense, border management, and strategic autonomy. The Strategic Compass for Security and Defence underscores the need for collective resilience and a cohesive response to external threats.

Economic Cohesion and Inclusion

Reducing regional disparities and promoting social inclusion are long-standing EU objectives. Targeted investments in education, healthcare, and employment, particularly in underdeveloped regions, will enhance economic convergence and social stability.

Proposed Reforms for the 2028–2034 MFF

Key insights from the recent ELF conference on the European budget highlighted the necessity for deep reforms in the Multiannual Financial Framework (MFF) for 2028–2034 to address both systemic inefficiencies and emerging global challenges. Monika Köppl-Turyna, in her keynote address, criticized the reactive nature of past budget adjustments, particularly the ad-hoc responses during crises such as COVID-19. She emphasized that the EU budget must evolve into a more structured and proactive tool for tackling long-term priorities, including climate action, technological innovation, and economic convergence. Köppl-Turyna proposed implementing a simplified, performance-based funding model that directly aligns expenditures with measurable outcomes. This approach, she argued, would increase accountability and ensure that spending contributes meaningfully to European public goods and shared strategic goals.

She emphasized that geopolitical challenges such as the war in Ukraine demand coordinated fiscal strategies to strengthen European security. One way forward was proposed by reallocating resources from traditional areas, such as agricultural subsidies, to forward-looking investments to equip the EU to remain competitive and resilient in a rapidly changing global landscape. Overall current proposals

Expanding the EU Budget

The current budget, capped at approximately 1% of GNI, is insufficient to meet the EU's growing challenges. Proposals suggest increasing the budget to 2–4% of GNI to adequately fund European public goods (EPGs) such as infrastructure, research, and security.

Reforming Borrowing Mechanisms

Building on the success of NextGenerationEU, the EU needs to establish permanent borrowing capabilities for large-scale, long-term investments. Such mechanisms would provide fiscal flexibility to address crises and strategic goals without overburdening national budgets. At the same time, it needs to reform borrowing mechanismus and own resources quick, in order for debt repayments for the NGEU not to overburden the regular EU budget.

Embedding the Future Share

Integrating the Future Share into the MFF would ensure that a substantial portion of the budget is dedicated to future-oriented expenditures. This framework can enhance transparency, efficiency, and accountability in resource allocation.

Reforming Revenue Sources

Diversifying the EU's revenue streams is essential for long-term sustainability. Innovative mechanisms, such as an EU-wide carbon border adjustment mechanism, digital taxes, and revenues from Emissions Trading Schemes, could supplement traditional revenue sources.

Challenges to Implementation

Embedding the Future Share into the EU and national budgetary frameworks involves several technical challenges, primarily stemming from the complexity of classifying expenditures. Accurately distinguishing between future-oriented investments and consumption-oriented spending requires robust methodologies, yet this classification often involves subjective judgments. For instance, expenditures on healthcare or education may include components that are both consumption and investment in nature, making it difficult to allocate these appropriately under the Future Share. Furthermore, certain categories, such as defense spending or administrative costs, may have indirect long-term benefits that are challenging to quantify. This ambiguity in classification risks inconsistencies across Member States, undermining the comparability and reliability of the metric.

Another significant challenge lies in data availability and integration. Effective implementation of the Future Share requires real-time, granular data on public expenditures, which is not consistently available across EU Member States. Many countries rely on outdated or incomplete data systems, which limit their ability to evaluate budget allocations dynamically. Additionally, the lack of harmonized budget reporting standards complicates cross-country comparisons, as expenditures classified as future-oriented in one country may be categorized differently in another. Without comprehensive, standardized, and timely data, embedding the Future Share at both national and EU levels risks becoming a superficial exercise rather than a transformative tool for fiscal governance.

Overcoming the Challenges

Addressing these challenges requires a multifaceted approach, beginning with the development of a robust and transparent classification framework for expenditures. The EU could establish clear guidelines for categorizing spending under the Future Share, incorporating input from experts and stakeholders to ensure that the criteria are objective and comprehensive. For instance, creating a weighted scoring system based on the expected time horizon, externalities, and alignment with strategic EU goals could help standardize classifications. Independent fiscal bodies at the EU and national levels could oversee the implementation of these guidelines, ensuring consistency and credibility in the application of the metric.

Improving data systems and harmonizing reporting standards across Member States is another critical step. Investments in digital public finance management systems could enable real-time tracking and evaluation of budget allocations. The EU could also facilitate technical assistance and funding for less-developed regions to upgrade their fiscal data infrastructure. Establishing a centralized EU database for Future Share-related metrics would support comparative analyses and enhance transparency, allowing policymakers to identify best practices and adjust strategies dynamically. By fostering collaboration between Member States and EU institutions, these technical barriers can be overcome, ensuring that the Future Share becomes a powerful tool for future-oriented fiscal planning.

Further challenges include:

Political Resistance

Reaching consensus among Member States on budgetary reforms remains challenging. Divergent national priorities and the potential reduction of politically sensitive allocations, such as agricultural subsidies, may encounter opposition.

Administrative Complexity

Expanding the budget and introducing new funding instruments will strain existing administrative structures, necessitating reforms to streamline processes and enhance efficiency.

Balancing Immediate and Long-Term Goals

While addressing pressing issues like inflation and energy security, the EU must maintain a strategic focus on long-term objectives, requiring careful planning and governance.

Opportunities for Innovation and Growth: A Vision for 2028–2034

The next MFF provides a unique opportunity to position the EU as a global leader in sustainability and innovation. Cross-border projects, public-private partnerships, and performance-based funding models can maximize the impact of investments. Prioritizing green and digital transitions will further enhance competitiveness and resilience.

The 2028–2034 MFF offers a pivotal opportunity to reshape the EU's fiscal strategy for a rapidly evolving world. By embracing bold reforms, expanding fiscal capacity, and embedding future-oriented principles like the Future Share, the EU can enhance its ability to address global challenges while fostering economic growth and social cohesion.

Overcoming political, methodological, and institutional barriers will require concerted efforts from all stakeholders. However, with a shared vision and commitment to innovation, the next MFF can lay the foundation for a resilient, inclusive, and forward-looking Europe.

Chapter 6

Conclusions – Towards a Resilient and Future-Oriented EU Budget

The Strategic Role of Fiscal Policy

The European Union (EU) finds itself at a pivotal juncture, grappling with an evolving landscape of global and domestic challenges. Climate change, technological disruption, geopolitical tensions, and widening social inequalities demand a comprehensive and forward-thinking response. The EU budget—traditionally constrained in size and scope—requires fundamental reform to remain fit for purpose in addressing these pressing issues.

This publication has demonstrated that the EU's fiscal architecture must evolve to prioritize investments that yield long-term societal and economic benefits. Concepts like the **Future Share,** which emphasize future-oriented expenditures, provide actionable frameworks for achieving this transformation. By rethinking its fiscal strategy, the EU has the potential to emerge as a global leader in resilience, innovation, and sustainability while enhancing cohesion and prosperity within its borders.

The EU's fiscal framework, while innovative in its shared governance model, has long been shaped by limitations that hinder its responsiveness and efficiency. Historical reliance on Member State contributions and political negotiations has often prioritized fairness over impact, leading to suboptimal allocations.

The **NextGenerationEU (NGEU)** initiative, introduced as a temporary recovery instrument post-COVID-19, marked a departure from these constraints. By leveraging joint borrowing and emphasizing performance-based funding, NGEU demonstrated how innovative fiscal tools can address cross-border challenges effectively. However, its temporary nature underscores the need for institutionalizing such mechanisms to ensure long-term impact.

National fiscal policies across the EU further reveal disparities in prioritizing productive expenditures. Many Member States continue to exhibit a "present bias," favoring consumption-oriented spending like pensions and subsidies over investments in education, R&D, and infrastructure. These practices exacerbate economic disparities and limit the EU's collective growth potential.

The analysis throughout this publication has identified several critical reforms essential to reshaping the EU budget into a future-ready fiscal framework.

The EU budget, capped at approximately 1% of GNI, is insufficient to address the Union's transnational challenges. Expanding the budget to 2–4% of GNI would allow for more significant investments in European public goods, such as climate resilience, digital transformation, and defense.[14] A larger fiscal capacity would also enable the EU to respond proactively to crises, ensuring resilience and stability.

The success of NGEU highlights the potential of debt-financed investments to achieve transformative goals. Embedding permanent borrowing mechanisms within the EU fiscal framework would provide flexibility and scalability, enabling the Union to finance long-term priorities without disproportionately burdening Member States. It is insufficient though, to debate permanent borrowing mechanismus without any reforms of EU own resources, as debt service costs can easily overburden the budget.

The Future Share, as a metric for assessing the share of future-oriented spending, can serve as a benchmark for aligning budgets with strategic objectives. Applying this metric at both EU and national levels would enhance transparency, prioritize high-impact investments, and ensure accountability.

14 Felbermayr, G. (2024). *Europa muss sich rechnen.* Christian Brandstätter Verlag.

Reducing reliance on Member State contributions is essential for enhancing the EU budget's autonomy and sustainability. Innovative revenue mechanisms, such as a Carbon Border Adjustment Mechanism (CBAM), digital services tax and ressources from the Emission Trading Scheme 2 can supplement traditional sources while aligning with EU priorities like environmental sustainability and technological competitiveness.

Effective fiscal reform requires stronger alignment between EU and national policies. Tools like the European Semester and performance-based funding models can help ensure consistency in fiscal priorities. Additionally, robust governance mechanisms, such as independent fiscal councils, can safeguard against inefficiencies and political interference.

While the proposed reforms offer a pathway to a more effective EU budget, their implementation will encounter significant challenges. Member States may resist reforms perceived as reducing their fiscal autonomy or redistributing resources away from politically sensitive areas like agricultural subsidies. Building consensus will require demonstrating the collective benefits of a stronger EU budget framework.

Expanding the EU budget and introducing new mechanisms will demand substantial administrative capacity and coordination. Reforms must include investments in institutional infrastructure to manage these complexities effectively.

The EU budget must balance the need for equitable distribution of resources with the goal of maximizing efficiency. Ensuring that less developed regions benefit from future-oriented investments while avoiding inefficiencies will require nuanced policy design and monitoring.

Reform efforts must address public skepticism regarding EU spending by enhancing transparency and demonstrating tangible benefits. Metrics like the Future Share can play a critical role in fostering trust by showcasing how budgets align with citizens' long-term interests.

The upcoming Multiannual Financial Framework (MFF) for 2028–2034 represents a decisive opportunity to implement these reforms and establish a resilient and forward-looking fiscal strategy. Allocating significant resources to initiatives like the European Green Deal and Digital Decade will enhance the EU's global competitiveness and sustainability. Institutionalizing tools like the Future Share within the MFF can ensure that a substantial portion of expenditures is dedicated to long-term growth and resilience. Investments in trans-European networks and shared defense capabilities can address challenges that transcend national boundaries, demonstrating the added value of EU-level interventions.

The EU has the resources, expertise, and collective ambition to lead the world in sustainable growth, technological innovation, and geopolitical stability. However, achieving this potential requires bold action to reform its fiscal policies and frameworks. By expanding its budgetary capacity, institutionalizing borrowing mechanisms, adopting the Future Share, and diversifying revenue sources, the EU can create a more cohesive, efficient, and future-oriented fiscal system.

The reforms proposed in this publication provide a roadmap for aligning the EU budget with 21st-century challenges. Overcoming political and institutional barriers will require collective commitment and strategic vision. Yet, the rewards—a resilient, prosperous, and united Europe—make this endeavor not only necessary but imperative. As the EU embarks on the next MFF, it has the opportunity to secure a legacy of innovation, inclusivity, and sustainability for generations to come.

Key Conclusions

- **Addressing Global and Domestic Challenges:** The EU budget must evolve to address pressing issues such as climate change, technological disruption, geopolitical tensions, and social inequalities.
- **Expanding Budgetary Capacity:** Increasing the EU budget from its current cap of approximately 1% of GNI to 2–4% would enable more significant investments in European public goods, enhancing resilience and stability. However, this should not come as a additional tax burden, given that overall tax revenues are already high both in historical and international comparisons.
- **Reform Borrowing Mechanisms:** Building on NextGenerationEU, it is important to adjust common borrowing mechanismus in order not to overburden upcoming European budgets with debt service costs.
- **Embedding the Future Share:** Utilizing the Future Share as a metric can align EU and national budgets with long-term growth and sustainability goals, enhancing transparency and prioritization of high-impact investments.
- **Innovating Revenue Sources:** Diversifying income through mechanisms like a Carbon Border Adjustment Mechanism (CBAM), digital services tax, and Emission Trading Schemes can reduce reliance on Member State contributions and enhance fiscal autonomy.
- **Strengthening Governance:** Improved coordination between EU and national fiscal policies, supported by tools like the European Semester and independent fiscal councils, can ensure alignment and efficiency.
- **Overcoming Challenges:** Political resistance, administrative complexity, and regional disparities must be addressed through consensus-building, institutional reforms, and transparent metrics.
- **Strategic Priorities for 2028–2034:** Allocating significant resources to initiatives like the European Green Deal, Digital Decade, and trans-European networks can bolster the EU's competitiveness and sustainability. The budget needs to be planned more strategicly in order to avoid the same problems as in the 2021-2027 MFF.
- **Future-Oriented Legacy:** By adopting bold reforms, the EU has the opportunity to establish a fiscal framework that ensures innovation, inclusivity, and sustainability for future generations.

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