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Ukraine and the EU Budget – A Tale of Two Narratives: The Manageable Versus The Alarmist

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Executive Summary

The imminence of decision by the EU over the opening of accession negotiations with Ukraine highlights the question of its likely cost to the EU budget. A detailed study by the present author suggests that under a deliberately simplified hypothesis that Ukraine were already a full member state now, with nothing else changed, Ukraine would receive net benefits of around €18.9 billion, or a little over 10% of the present budget[1]. Another unpublished study by the EU Council's secretariat surprisingly headlines a huge alternative estimate of €186 billion. But this is a 7-year aggregate, which reduces to an annual €26 billion. The remaining difference seems attributable to maximalist assumptions in the Council study of key parameters concerning Ukraine's effective land area and population, whereas our study is more cautious, closer to the status quo. Even more important is to take into account what may well happen between now and when Ukraine actually might accede, followed by up to a further 10 years of transitional measures, leading into the 2040s. This must consider the possible continuation of the EU's remarkable unsung success story of its enlargements since 2004, with the acceding states' upward convergence towards the EU's high average income levels. Continuation of these trends, which is ignored by the Council study, would mean that the EU's fiscal absorptive capacity would be increasing to accommodate new and lower income states.

1 '*The Potential Impact of Ukrainian Accession on the EU's Budget – and the Importance of Control Valves*', Policy Paper, International Centre for Defence Studies (ICDS), September 2023. https://icds.ee/en/the-impact-on-the-eu-budget-of-ukraine-as-a-member-state/

The likely cost of Ukraine's accession to the EU is now a topic of highest importance, as the EU heads towards its 14-15 December summit meeting, which will have to deliberate over the Commission's proposed €50 billion Ukraine Facility for 2024 to 2027. Looking further ahead to actual membership some years later there are now two estimates in circulation.

The fullest assessment is that of the present author, published in September 2023. However the EU Council's secretariat has also been studying the question, with a confidential internal document dated July 2023 distributed to EU member states, but which entered the public domain through the leak of its main arguments to the Financial Times, published on 4 October 2023.

The two studies have a starting point in common. Both seek to estimate the consequences for the EU budget under the formal hypothesis that Ukraine were today a full member state, with nothing else changed in the policies or budget of the EU – a 'static' exercise. Both had judged that this was the best way to begin to get a quantitative handle on the question.

The headline numbers under this hypothesis for Ukraine's accession alone, i.e., leaving aside the other accession candidates, are:

- our study, €18.9 billion per annum
- the Council study, €186 billion over seven years (making €26 billion per annum, but the study surprisingly only cites 7-year aggregates).

The Council's presentational choice invites a first comment. Most policy debate about the macroeconomy and budgets are conducted around annual numbers. The huge 7-year aggregate has predictably been highlighted by the media with comments about how it is impossibly expensive. The authors of the Council study may have been following the precedent of the Recovery and Resilience Facility (RRF), with its much cited €738 billion financial envelope for a multi-year period, after which it ends. However, Ukraine's future participation in the budget has no such time limit, making annual numbers the more appropriate indicator. The choice of 7-year aggregates risks feeding the arguments of enlargement-sceptic interests.

There is also the difference between the €18.9 and €26 billions to be explained. This is difficult because the Council study is much less detailed and transparent in its methodology than our study. However, the Council study does give a number for agricultural spending: €96.5 billion, again for 7 years, or €13.8 billion annually, compared to our €10.4 billion. Agriculture is thus accounting for about half of the difference. Digging a bit deeper, these amounts are mainly dependent on direct payments to farmers per hectare, which leads into the question of the agricultural land area assumed. The Council study seems to assume the land area of pre-2014 Ukraine, whereas our study assumes a map close the status quo. No-one can yet know where the war will end. But for present purposes it is to be noted that the Council study chose the maximum, while our study was more cautious.

A similar issue arises for cohesion spending, which is heavily dependent on population numbers. The Council study does not say what it assumes, while our study quotes relevant Ukrainian sources, where the population of government-controlled territory has declined from 43.8 million in 2019 to around 31 million now. The Council study may well have chosen, as for agriculture, a number preceding the war. If so, it would roughly complete the explanation of the difference between the two studies.

To conclude on the 'static' estimates, the Council study maximises its estimates in two respects:

- First, in presenting only huge 7-year aggregates, without the fair perspective of the EU's GNI for 7 years (€110,654 billion);
- Second, it also appears to adopt maximalist assumptions in its specific workings, although these are not entirely transparent.

Even more important issues arise under the heading of 'dynamics', which would take into account what might plausibly happen to the EU and Ukrainian economies over the time horizon before the full cost of Ukraine to the EU budget would be felt. As for the possible date of accession, there is some discussion around the 2030 date, but most observers would speculate on somewhat later, such as 2034, on top of which one has to add transitional arrangements. The most important of these for the EU budget concerns the build up of direct payments to farmers, which in recent enlargements have spanned 10 years. In this case that the full burden on the budget would not happen until way into the 2040s.

This leads into the major issue how far the most recently acceding member states, 13 in all since 2004, might converge on the EU's average gross national income (GNI) per capita over this time horizon. This leads further into the question how far this might enhance the EU's fiscal capacity and diminish the need for cohesion spending for various existing member states. On this there is important data to take into account. Over the last decade the economies of all 13 latest acceding states grew significantly faster that the EU average. The average of these states grew 1.7% points faster than the EU average. Poland and Romania, as Ukraine's biggest neighbours did even better, with 2% points better performance. These trends seem to be solidly entrenched, and have in fact been seen over the two decades since the 2004 enlargement. This is a major while largely unsung achievement by the EU. If something like these trends are continued into the 2040s, even on a lesser scale, the convergence within the EU on high GNI per capita levels would mean a huge and positive transformation of economic structures. The EU would indeed see an enhanced fiscal capacity to support new and poorer member states. The absorptive capacity of the EU is one of the official criteria conditioning enlargement. While looking ahead there remain all manner of other risks and uncertainties, the prospects of budgetary absorptive capacity becoming adequate for the next enlargements is looking plausible. This is indeed a most positive prospect, which the Council study ignores.

There are a few more precise points warranting attention. There is the obvious political need for the costs of the enlargement process to be kept under control, rather than risk escalating like a run-away train. For this there are established control mechanisms, open for negotiated adaptation for the next enlargements. For agricultural direct payments there is an existing mechanism for capping payment to large or very large farms. This would be necessary in the case of Ukraine's mega-farms. The existing capping mechanism is not entirely satisfactory, but the Commission is fully aware of the need to reform it as and when Ukraine's accession advances. In the case of cohesion spending there is also a capping mechanism limiting grants as a share of GNI, whose specifics would also need to be revised for Ukraine. As regards contributions to the budget, the 'static' estimates above are based on Ukraine's currently very reduced GNI, from which one may expect a substantial rise up to the 2040s. This is one instance where even the initial 'static' estimate is only a reference, exceeding a plausible maximum.

Conclusions

Our study suggests that the budgetary implications of Ukraine's accession, while clearly important, should prove manageable and within the EU's absorptive capacity over the relevant time horizon.

On the other hand, the Council study is maximalist if not exaggerated in its assessments, and could be considered alarmist.

It is of the highest importance that a sound narrative is established in public debate.

Recommendations

The European Commission should undertake a thorough study of the budgetary implications of Ukraine's accession, as for the other candidate states. This study should be published with full account of its methodology.

The study should not only cover the simplified hypothesis that Ukraine were already today a full member state. It should go on to explore the positive implications for the EU's fiscal capacity to accommodate new member states of a plausible continuation of the remarkable upward convergence on the EU average income levels of the member states acceding since 2004.

The EU should further ease the budgetary burden of Ukraine's accession by using Russia's frozen financial assets as *de facto* reparations for the huge damages it is continuing to cause.

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