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European Union Committee

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EU Financial Framework from 2014

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The European Union Committee

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References in footnotes to the Report are as follows:

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EUFF 1 refers to written evidence as listed in Appendix 2

SUMMARY

This report considers the Commission Communication *The EU Budget Review* and looks ahead to the negotiations on a new EU Multiannual Financial Framework (MFF) from 2014 which are about to begin. The MFF is a vital piece of policy, which will affect much of what the EU does for years to come. The Government have already taken a position on the MFF, that EU spending must not increase in real terms.

The Commission expects EU spending to offer "European added value" (EAV), compared with spending by individual Member States. We conclude that EAV is a subjective and in the end political quantity. It is the obverse of the subsidiarity principle, whereby action must be taken at the lowest level of government consistent with a good outcome. In our view EAV is not in fact the overriding consideration in large areas of EU spending; the Government should aim to make it more so for the next MFF.

The Commission reviews the Budget against the themes of the EU's "Europe 2020 Strategy": smart, sustainable and inclusive growth. This report follows that structure. Under the heading "Smart growth" we consider the Commission's proposals for research, education and cross-border infrastructure. We believe the EU adds value in this area, which can support the EU's economic recovery after the financial crisis. Therefore we recommend that the share of the budget allocated to EU R&D should be increased. We endorse the Commission's proposed improvements to the management of large-scale projects, such as Galileo and ITER, as well as initiatives designed to secure a greater contribution from the private sector to the funding of cross-border transport, energy and telecommunications infrastructure projects, which are important for European growth.

The sustainable development of a low carbon economy ("Sustainable growth") will be key to the EU's future economic growth. We therefore agree with the Commission that energy and climate policies should be taken into account throughout the EU funding instruments. The most pertinent of those is the Common Agricultural Policy, which should be orientated towards meeting the new challenges of global food security, biodiversity protection and climate change. Its share of the budget ought to be reduced and transferred, at least in part, towards agricultural research spending. In order to make best use of that research, sustainable innovation must in turn become an essential component of the CAP. Funds for rural development, including innovation, should be increased as a proportion of the CAP budget.

Our examination of cohesion policy, under the heading of "Inclusive growth", was carried out against the Commission's plans to reform it, outlined in its 5th Report on economic, social and territorial cohesion, and in light of the current economic circumstances. Witnesses emphasised the value of cohesion policy as the greatest expression of EU solidarity. The inquiry explored the divides over two different visions of cohesion policy: a pan-European development programme, and a redistributive tool. Key to our considerations has been the distinction between the roles of the different structural funds, with the European Social Fund emerging as an important resource for all Member States. We found that the economic crisis has triggered the need for a wider reflection on the role of cohesion instruments as a counterbalance to the effects of austerity measures.

The Budget Review promotes cohesion policy as a means to achieving Europe 2020 objectives. The inquiry highlighted the danger of turning cohesion policy into an all-purpose instrument for delivering Europe 2020. In aligning cohesion policy with Europe 2020, the distinct identity of cohesion policy must be safeguarded.

The inquiry sought to reflect on the use of the EU budget as a tool to support economic governance. The Budget Review lacks a strategic vision on the issue. We found that, so long as the budget is of a limited size and is obliged to balance, its impact in macroeconomic policy can only be limited. We therefore focused our attention on two specific distinct uses of the budget as a tool of economic governance: first as a budget guarantee for an EU rescue mechanism and second as an instrument for macroeconomic conditionality. The report also considers other spending lines not aligned to the Europe 2020 strategy: Citizenship, Freedom, Security and Justice; external affairs, including aid; and administration.

Our report concludes that achieving the Europe 2020 strategy should be among the objectives of the next MFF; but this should be balanced with the need to fund other EU priorities so as to respond clearly and collectively to the principal challenges facing the EU today.

Turning to the Commission's proposals to increase the impact of the EU Budget, we conclude that an increased use of private sector financing in partnership with EU funds is acceptable. We note, however, that the structure of the current budget is heavily predicated to favour stability over flexibility. A more widespread use of leveraging would have implications for the predictability of the budget and would require a greater degree of flexibility than is available in the current MFF. In addition, if the Commission increasingly leverages private financing, it is essential that the private sector bears a fair share of the risk. This strategy should not result in the EU having to provide projects with additional funds beyond its intended contribution.

We conclude that the current MFF has proven too inflexible. It has been difficult for the EU to adapt its policies and spending to meet the rapidly changing economic circumstances of the past few years. The next MFF should incorporate greater flexibility. For the same reasons, we recommend that the next MFF should run for only five years, to ensure that it does not become out-dated by events.

On the overall size of the EU Budget over the next MFF, we agree with the Government: it should not increase in real terms. We recommend an increase in spending on the following:

- R&D, with funds transferred from the CAP, and in particular research relevant to agriculture, climate change and internal security
- A fund for climate change projects without a territorial dimension
- Pillar II of the CAP, with funds transferred from Pillar I
- The Area of Freedom, Security and Justice
- Overseas aid
- Court of Justice

We balance these recommendations with a recommendation that the CAP's share of the budget should fall.

And we call for continued provision for the following:

- Lifelong Learning
- Advice to farmers
- Culture, MEDIA and the prospective future Sports programme
- Communicating to citizens
- Civilian CSDP missions

We agree with the Government that the Commission's proposals for new sources of EU revenue are a distraction, and so we do not comment on its individual proposals. And we agree with the Government that the UK abatement is justified and will stay, until the CAP is reformed and the rebate fades away.

CHAPTER 10: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

European Added Value

237. EAV is a subjective and in the end political quantity; but this does not make it meaningless. It is the obverse of subsidiarity; where it is present, EU spending definitely achieves more than spending by Member States (paragraph 30).

238. Treaty obligations to spend, together with national interest in maintaining established funding streams and the honouring of deals made in the decision-making process, mean that EAV is not the overriding consideration in large areas of EU-level spending. The MFF negotiation provides an opportunity to move EU spending closer to EAV, and this should be the Government's objective (paragraph 31).

239. In our view the CAP as currently designed offers poor EAV, partly for these reasons (paragraph 32).

Research, development and innovation funding

240. EU R&D funding represents strong EAV and will support the EU's economic recovery after the financial crisis. We recommend an increase in the budget of the successor programme to FP7 relative to the current programme and the rest of the EU Budget (paragraph 41).

241. The structure of the framework programme should be reviewed. We welcome the Commission's Green Paper on the future of EU research and innovation funding, including the proposals to simplify the application process, address fragmentation, and maintain flexibility to respond to emerging policy needs. Proposals for simplification are especially welcome, since the current tendering, reporting and auditing procedures are unduly bureaucratic. We look forward to considering the detail of this proposal in due course (paragraph 42).

242. With regard to priority funding areas for the next programme, we support its alignment with the Europe 2020 Strategy. We would specifically recommend a larger share of funding for agricultural research (with funds transferred from the CAP—see Chapter 4), climate change and internal security research (paragraph 43).

243. The total share of the R&D budget currently allocated to the European Research Council should be increased as its bottom-up approach ensures that researchers identify the direction of funding, with the criterion being scientific excellence, rather than allocations being made on the basis of the expectations of the Member States. This approach should also ensure that funding can be targeted at research areas with the greatest potential for generating economic growth (paragraph 44).

244. We see particular benefit in the Lifelong Learning Programme, which supports mobility; this can enhance growth through the sharing of ideas and access to new or alternative opportunities. It should be provided for in the new MFF (paragraph 45).

The management of large-scale projects

245. We strongly regret the delays, cost overruns and management difficulties which have beset large-scale projects such as Galileo and ITER since their inception. It is crucial for these types of projects to be costed in a robust manner at the outset and then managed effectively throughout their lifetime, with a thorough *ex post* evaluation of the economic and social benefits which result. Therefore we endorse the Commission's proposed improvements in this area. In the meantime we will continue to monitor the progress of the Galileo and ITER projects closely (paragraph 49).

246. We are concerned by suggestions that shortfalls in the funding of projects such as ITER could be made up from allocations to other existing research projects within the 1a Research budget heading, rather than being transferred from another EU budget heading. Outside these large and poorly-managed projects, it is generally believed that R&D spending can provide significant returns; therefore this type of reallocation could undermine growth (paragraph 50).

Energy, transport and telecommunications infrastructure funding

247. We agree that the EU should provide funding for cross-border transport, energy and telecommunications infrastructure projects which are important to European growth (paragraph 56).

248. Funding for such projects should be focussed where there is a demonstrable cross-border element or other European added value. The development of the TEN-E and TEN-T projects would seem to be good examples. But the EU should consider other options to facilitate such projects. For instance, by ensuring interoperability, and a predictable regulatory framework, the EU might be able to encourage more investment from the private sector and Member States (paragraph 57).

249. Greater use of EIB financing and higher contributions from the private sector are desirable, as such initiatives may mitigate the need for budget increases to these areas (paragraph 58).

250. There will be some areas where public intervention, in the form of EU funding, will nevertheless be necessary, particularly where the opportunity to attract private capital is limited. Before funding is allocated to projects of this nature the risks should be properly assessed as they are likely to be substantially higher and adequate returns are less likely to be guaranteed (paragraph 59).

Sustainable growth: mainstreaming

251. We agree with the Commission that energy and climate policies should be taken into account throughout EU funding instruments. As reflected in Europe 2020, the sustainable development of a low-carbon economy is likely to be key to the EU's future economic growth. It is therefore important that all the funding instruments support that goal. For example, the European Social Fund can be used to promote sustainable practice in existing professions and to develop new skills in "greener technologies and greener services". Such a focus throughout the funding instruments should also assist with their strategic alignment (paragraph 69).

252. The Commission suggests an accompanying obligation to identify action in pursuit of sustainability across funding streams. We see merit in such a strategic overview, without which it is difficult to identify what proportion of the budget is directed at these objectives, and would recommend that the Climate Action Commissioner take overall responsibility for the success of this policy (paragraph 70).

253. While we would place greatest emphasis on mainstreaming, there are certain climate-change and energy related projects of cross-border interest, such as Carbon Capture and Storage (CCS) demonstration plants, to which the various Funds disbursed through regions and Member States do not easily apply. The CCS and innovative renewable energy demonstration plants to be part financed from the EU's Emissions Trading System will, ultimately, be chosen by the European Commission as part of an EU-wide demonstration programme. We therefore recommend that in addition the introduction of a fund devoted to climate change projects of EU interest, within the agreed MFF total, be considered (paragraph 71).

254. We recommend that the Commission and Member States explore how the EU's Copenhagen contribution, to assist developing countries financially with efforts to mitigate and adapt to climate change, can be more effectively coordinated, and whether an increased contribution from the EU budget after 2013 would be feasible (paragraph 72).

255. The EU has agreed to halt the loss of biodiversity by 2020. We recommend that this important commitment be reflected in the MFF, and that biodiversity protection be mainstreamed through relevant funding instruments, above all the CAP (paragraph 73).

The Common Agricultural Policy

256. The CAP requires reform, and evolutionary change is more likely to succeed than any radical approach. Trade-distorting subsidies must be phased out, and the CAP aligned with the outcome of discussions on agriculture at the World Trade Organisation, conclusion of which must be a political priority for the EU and its Member States. The CAP's share of the budget ought to be reduced and transferred, at least in part, towards R&D spending, particularly since the proportion of the R&D framework programme devoted to agriculture has shrunk while new challenges relating to agriculture have become apparent: global food security, biodiversity protection and climate change (paragraph 85).

257. The remaining CAP budget ought to support a CAP that is re-orientated towards meeting these new challenges. If EU agriculture is to contribute to global food security and to decrease its reliance on public support, it needs to become more efficient. Therefore sustainable innovation should be an essential component running through the CAP (paragraph 86).

258. We welcome the idea of "greening" Pillar I, i.e. making direct payments available for the delivery of environmental public goods such as biodiversity protection and climate change mitigation and adaptation. Over time, Pillar I payments ought to become conditional on making those contributions, as long as the conditions encourage sustainable innovation and do not render EU agriculture uncompetitive. Such a change requires the availability to farmers of high quality advice on meeting the conditions and explanation of their benefits (paragraph 87).

259. The Rural Development Fund (Pillar II) continues to be a vital method of helping farmers to innovate and supporting the diversification of rural economies. Pillar II should also expand its current role in relation to mitigating climate change, adapting to it, and tackling other key resource challenges such as water and soil management. It can do this through financing infrastructure and advisory services. We would therefore support a strengthening of Pillar II, moving funds there from Pillar I (paragraph 88).

260. The application of co-financing to Pillar I, with the level of Member State contribution depending on their level of prosperity, should be explored in negotiations on the MFF. We note, however, that it is not a panacea. Its overall financial impact must be assessed, as must risks to competition within the Single Market, and compatibility with restrictions on state aid (paragraph 89).

Inclusive growth: a policy for development or redistribution?

261. Under the new MFF, the ERDF should be concentrated on the least prosperous regions. It is for consideration whether EU regional spending in the wealthier Member States should require a higher proportion of national contribution than hitherto (paragraph 100).

262. The ESF, however, can add value throughout the EU, regardless of the wealth of the region, especially in the current economic climate. It offers long-term additional funding, its objectives are not geographically restricted, and unemployment and poverty do not respect national or regional boundaries. It should therefore continue to be made available throughout the EU during the course of the next MFF (paragraph 101).

263. The European Agricultural Fund for Rural Development should also remain available throughout the EU (paragraph 102).

Cohesion policy in difficult economic times

264. We recommend that further reflection is undertaken soon, in preparation for the new MFF, on whether cohesion instruments can be better used to benefit poor regions across the EU as a counterbalance to the effects of austerity measures (paragraph 106).

Common Strategic Framework

265. We support a Common Strategic Framework for structural funds, so long as it allows flexibility for identification of priorities at the local level. A strategic approach is an important way to draw maximum value from expenditure under each fund in the current climate, and a better way than merging the funds. Alignment between Funds would be facilitated by approximating the administrative requirements, timetable and scheduling, and operational liaison for each Fund (paragraph 108).

Cohesion Policy and Europe 2020

266. Europe 2020 provides a useful strategic orientation for cohesion policy in the next MFF. However, Europe 2020 is a broad, time-limited and political strategy; cohesion is enshrined in the Treaty as a permanent core objective of the Union to support less favoured regions. In aligning cohesion policy with

Europe 2020, the distinct identity and the fundamental objective of cohesion must be safeguarded (paragraph 114).

267. In principle we support the concept of a performance reserve. The resistance from Member States illustrates our earlier conclusion that one block to EAV is national interest in maintaining established funding streams. In particular, it should be the aim of all beneficiaries of the Cohesion Fund to reduce their dependency on it, and indeed in the longer term to become ineligible for funding; a performance reserve would encourage this (paragraph 115).

268. However more consideration should be given to the practical implications of a performance reserve. In particular it should take a country's financial absorption capacity into consideration (paragraph 116).

The Budget as guarantee for an EU rescue mechanism

269. So long as the budget is so small as a proportion of overall public expenditure in the EU (and is obliged to balance), it can only have a marginal impact in macroeconomic policy. But the forthcoming negotiation on the next MFF should prompt reflection on the long-term contribution that the EU budget could make to add value to efforts by Member States to improve economic governance and stabilise the Eurozone and the whole EU (paragraph 126).

The Budget as an instrument for macroeconomic conditionality

270. While not dismissing the use of the budget as a tool of economic governance, we would not favour arrangements which allowed EU funds to be withdrawn to enforce the Stability and Growth Pact, since the impact would fall on organisations that are not responsible for the fiscal conduct of Member States (paragraph 128).

Citizenship, Freedom, Security and Justice

271. We consider that the level of activity in the Area of Freedom, Security and Justice in the period of the next MFF should be broadly consistent with the level at the end of the current MFF period, and we recommend that the next MFF should provide for spending in real terms at the level for 2013, with savings found elsewhere in the MFF (paragraph 134).

272. Some small but important EU funding programmes sit under this heading, notably Culture, MEDIA, and the prospective future Sport funding programme. The Culture programme adds value by promoting trans-national cultural awareness and co-operation among artists, MEDIA by helping European cinema to flourish. In our current inquiry into the EU and Grassroots Sports, we have noted that limited EU funding under a sport programme could add most value by bringing grassroots organisations of a similar nature together, to share experiences of how to boost participation in sport and how it can help to bind communities together. These should be provided for in the new MFF (paragraph 135).

273. The importance of communicating the work of the EU to citizens, which also sits under this heading, must be recognised in the MFF (paragraph 136).

274. Finally we back the call of the UK delegation to the Committee of the Regions for a new focus on gender equality across expenditure lines, to make

training, business start-up assistance and business finance more accessible to women (paragraph 137).

External Affairs

275. We support the role of the EU in addressing global challenges, including poverty, disasters and conflict-affected states. The EU aid budget should rise, with clearer priorities and improvements in effectiveness and outcomes (paragraph 152).

276. We considered the question of bringing the EDF within the EU budget in 2004. We concluded, "If it were not for the extra cost to the United Kingdom, the advantages of budgetisation in our view would clearly outweigh any disadvantages". We stand by that view. The extra cost to the UK makes this unattractive at present, but we recommend it for the future (paragraph 153).

277. As we concluded in 2004, the benefits of EU aid outweigh the possible advantages of repatriating it to national aid budgets. Indeed we agree with the Commission that more national aid should be channelled through the EU budget, since the EU is good at managing aid and likely to get better, and a single source of funding is easier for recipients. Member States would remain free to give bilaterally, and to agree a lead donor, particularly where there are historic ties (paragraph 154).

278. There should be greater flexibility within the next MFF to respond to changing priorities and unforeseen international crises. The Common Foreign and Security Policy budget should reflect the need for the EU to provide adequate resources for future civilian Common Security and Defence Policy missions, and for evaluation of such missions (paragraph 155).

Administration

279. Like any administration, the Commission should be subject to regular review. We commend Commissioner Lewandowski's recent initiative to challenge his colleagues to make savings (paragraph 159).

280. The findings of our inquiry into the working of the Court of Justice indicate that expenditure on the EU courts should rise during the next MFF period in order to enable the courts to handle an increasing workload (paragraph 160).

281. Abolition of Strasbourg sittings of the European Parliament is desirable. However such a step would require Treaty change, so we do not regard it as a practical issue for the MFF negotiation (paragraph 161).

The Europe 2020 Strategy

282. Achieving the Europe 2020 strategy should be among the objectives of the next MFF. But this should be balanced with the need to fund other EU priorities (including development aid, protection of the environment and biodiversity, and the area of Freedom, Security and Justice) so as to respond clearly and collectively to the principal challenges facing the EU today (paragraph 170).

283. EU budgetary action in support of Europe 2020 should aim to complement that of the Member States in preparing their national reform programmes. In negotiating the MFF, the Government and the EU should consider where

EU spending is the most appropriate means to achieve the Europe 2020 goals. Alternative EU policy instruments, such as voluntary guidelines, the coordination of national policies, and legislation, may be more appropriate tools, depending on the goal in question (paragraph 171).

Leveraging within the structure of the current MFF

284. We do not believe that an increasing use of leveraging can be accommodated successfully within an MFF of similar structure to the present one. It would require a far greater degree of flexibility within the MFF to ensure that large quantities of funding do not simply remain unused whilst viable programmes remain unfunded (paragraph 178).

Innovative financial instruments

285. The European Investment Bank has built up significant expertise in funding large-scale projects. We recommend that it should be involved in all large-scale projects in which the Commission intends to leverage private investment (paragraph 183).

286. The use of private finance in conjunction with EU funds is acceptable as long as the private sector bears a fair share of the risk. The use of innovative financial instruments and other means of leveraging private investment should be explored with caution, particularly in Member States with limited administrative capacity. It should not be allowed to lead to the EU having to provide additional funds beyond its intended contribution (paragraph 184).

Flexibility

287. The current MFF has proven too inflexible, making it difficult for the EU to adapt its policies and spending as the economic climate in Europe has changed over the past two years. The reaction in a national context if the national budget had not changed following the recent financial crisis can be imagined. We recommend that the next MFF make it easier for funds to be re-prioritised and reallocated between and within headings to allow for a more effective adaptation to changing circumstances. This will become more important if the Commission's proposals to increase leveraging private investment are agreed, since they will require the Commission to be able to reallocate committed funds from one programme to another as projects succeed, or fail, to attract sufficient private investment (paragraph 190).

The length of the MFF

288. We recommend that the new MFF should run for five years. This would match the Parliament and Commission terms, making Parliament elections more meaningful. Seven years is too long; to lock in austerity for seven or ten years would be unwise and would not be accepted by the European Parliament. The less the flexibility within the MFF, the shorter it must be to be able to respond to changing circumstances. The economic situation in Europe may be very different in a few years; and the current effects of events in North Africa illustrate the need for flexibility (paragraph 193).

Size of budget

289. In the straitened economic circumstances being experienced by many Member States at present, we agree with the Government that there should

be no increase in the absolute quantum of the EU Budget in real terms over the next MFF. This will encourage efficiency and prioritisation at EU level. It should be clearly understood that the Framework sets a maximum budget which may not be exceeded, not a target to be aimed at or a forecast which might turn out to be wrong (paragraph 212).

290. Ideally, in negotiating a new MFF on the basis of the Commission's proposal, Member States should come to an agreement on what they wish to fund at an EU level, taking into account the principles of added value and subsidiarity; prioritise these activities; and then determine whether they are affordable and how they might be funded. In short, an MFF should be negotiated and prepared in the same way as a business plan (paragraph 217).

New own resources

291. Whether referred to as an "EU tax" or not, we agree with the Government that new own resources are an "unfortunate distraction". The question was explored by the Discussion Circle on Own Resources of the Convention on the Future of Europe in 2003. This made no headway, and we expect the same result in the MFF negotiation (paragraph 225).

292. We share the Government's concern that losing the VAT-based resource should not compromise the UK abatement (paragraph 226).

Corrections

293. At national level, the net impact of taxes and public spending on different sectors of society is a frequent and normal subject of debate. At EU level, such discussion is too often cut short by accusations of a *juste retour* approach (paragraph 234).

294. A constant focus on precise *juste retour* could indeed result in skewed funding priorities. Member States should not expect that the contribution they make should be in proportion to the funds they receive. However the CAP involves irrational and indefensible transfers to the benefit of some of the EU's wealthiest States. We last reported on Funding the EU in 2007. In that report, and in the Commission Consultation of 2008, we took the position that the problems with the budget were on the expenditure side. If these were dealt with, particularly in relation to income support for farmers, income-side corrections could be reduced. This remains our view. The UK abatement is justified and will stay, until the CAP is reformed and the rebate, as a residual, fades away (paragraph 235).