EUROPEAN COMMISSION

Brussels, 19.10.2010
COM(2010) 700 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE NATIONAL PARLIAMENTS

The EU Budget Review

{SEC(2010) 7000 final}

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The EU Budget Review

The decision to undertake a full, wide-ranging review of EU spending and resources was agreed in 2006[1]. The economic climate has radically changed since the mandate was given; and the global economic crisis has put public spending at the heart of the political debate in European countries. Throughout the European Union, difficult choices are being made. Public spending priorities are being challenged in a way not seen for decades.

At the same time, public spending has played a key role in the process of recovery. The stimulus agreed at the end of 2008 prevented the worst of the crisis. Intelligent targeting meant that stimulus was directed at areas which could pay off for the future: at growth-enhancing policies, at strategic infrastructure, at preventing key skills and key assets from being wiped out by the shock.

This review therefore comes forward at a time when prioritisation, added value and a high quality of spending are uppermost in the minds of citizens. It follows a long process of consultation and reflection[2] which allowed promising ideas to be floated about how the budget can best be targeted to secure the EU's objectives, be policy-driven and promote the Europe 2020 strategy; about how the budget can deliver in the most effective way possible; and about how to take a fresh look at the best way of providing the resources necessary to fund EU policies.

Public spending is a means to an end and growth for jobs is our overarching priority, concentrating on getting more people in jobs, boosting our companies' competitiveness and building an open and modern single market.

The Commission must present its proposals for the next multiannual financial framework before 1 July 2011. This review sets out some of the issues facing the EU budget for the next framework and beyond. How the EU must take account of both the impact of the economic and fiscal crisis and long-term challenges like demographic change, the need to address climate change and pressure on natural resources. How the issue is not first and foremost about spending more or less, but about finding ways to spend *more intelligently*. How we need to present a holistic vision of budget reform, covering both the expenditure and the revenue side of the budget.

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1 OJ C 139, 14.6.2006, p. 15 (Declaration No 3).

2 Consultation website: http://ec.europa.eu/budget/reform/library/issue_paper/summary_consulation_doc_final_en.pdf

Agreeing the way forward will be a major challenge for the European Union, but also a major prize. It would represent a powerful signal that the European Union is equal to the task of harnessing the tools at its disposal to make a real difference for its citizens.

1. WHAT LESSONS FROM THE BUDGET TODAY?

The Lisbon Treaty has introduced a new legal setting for the multiannual financial framework. It confirmed the need to provide a medium-term approach to EU spending, as well as the principle that the EU is financed by Own Resources. This means that the review process – while looking ahead – has also drawn heavily on the experience of the current financing period.

So far, the EU budget has proved itself as an effective tool to realise the EU's aspirations and implement its policies. The EU budget has made a real difference to the task of delivering more growth and jobs, boosting research, competitiveness and skills and ensuring that the Union offers particular support to those most in need of solidarity. It has given particular support to priority projects, including contributing to the stimulus needed in the wake of the economic crisis. It has reinforced the Union's security. It has brought help to hundreds of millions of the world's poorest, accelerated the development of Europe's neighbours and promoted EU policies worldwide.

The goal must be to use the budget as effectively as possible to achieving the EU's objectives. Some of the key lessons to be learnt to further this objective include:

- Since their introduction in 1988, the EU's multiannual financial frameworks have ensured strict budgetary discipline and medium-term predictability of EU expenditure. This predictability has come at the price of limited flexibility. The past years have shown that the financial framework and its programmes have not always been able to respond to political imperatives and changing circumstances. EU decisions to bring extra help to developing countries when food prices soared in 2008, to respond to changing demands in major European projects such as Galileo and ITER due to their long lead times and evolving costs, to contribute to economic stimulus in 2008-2009, or indeed to react to global crises such as the tsunami have come up against the excessive inflexibility of he current system. They have only been accommodated with extreme difficulty, relying on unexpected margins in other parts of the budget. Even within programmes, the obstacles to re-prioritisation have made it harder to give the right priority to new issues like public health emergencies, to refocus training needs in the wake of the crisis or to reflect the Union's changing relationship with emerging economies. So the budget's inability to "expect the unexpected" brings both an operational and a reputational cost to the EU.

- Another of the unforeseen events of recent years has been the economic crisis and its effects on the debate on economic governance. This underlined the interdependence of the EU's economies and the need to strengthen common rules. In the first place, the use of the budget as collateral to support the European stabilisation mechanism showed an innovative use of the budget to support an urgent policy need, however tightly constrained by the ceiling of own resources. In addition, it was suggested that the receipt of EU funds could be used to reinforce both preventative and corrective measures to support the Stability and Growth Pact.

- The nature of the debate leading up to agreement on the last financial framework also had consequences for the ability of the budget to deliver. The concentration on the issue of "net balances" meant that programmes were skewed to maximise the ability to put a "national flag" on spending in advance. This was given priority over measures designed to improve performance, such as macro policy dialogue and holding back reserves to reward effectiveness. It also meant that the European dimension – where the EU can bring the highest added value – was not always the primary consideration. The "juste retour" debate therefore had a negative impact on the quality of delivery and reduced the EU added value.

- Putting new programmes in place takes time – particularly when they are based on a partnership approach to factor in local needs and priorities. The time available between agreement on the legal texts and the start of a financing period is crucial to make this work well. In the run-up to 2007, the late agreement on the financing package squeezed this critical period. The result was that the real start of programmes was delayed, and in some cases this has had a knock-on throughout the period.

- The delays in launching the programmes, enshrined complexities in the process, a very decentralised approach and the impact of the financial crisis on national public budgets led to a slow uptake of cohesion spending. A better design, faster decision making, streamlined and harmonised procedures, a clearer definition of priorities at all levels and more flexible approach to co-financing have all been identified as potential remedies.

- The impact of EU spending can be hampered by the rules governing the programmes concerned. Whilst controls have helped to ensure a steady improvement in sound financial management, inconsistencies between programmes and high administrative burdens have both proved obstacles to effectiveness. Controls have also had a tendency to assess programmes on the basis of inputs rather than performance, reducing the incentives for effective results.

- The existing financial framework has taken the first steps in pioneering a new approach to the impact the EU budget can have. If the EU budget can leverage investment from other public and private sources, the same funding can achieve the EU's policy goals more effectively. This approach has been successful in cases like the Risk Sharing Finance Facility, which has kick-started business investment in higher-risk research. So the domination of the grants approach may have limited the budget's potential impact.

2. PRINCIPLES FOR THE EU BUDGET

The EU budget must be grounded in a series of core principles. These are the tests against which options should be assessed. Through these principles, European citizens should be able to have a better view of what the EU budget is for, and how the key choices have been made.

2.1. Delivering key policy priorities

The EU budget is a key instrument for shaping and delivering EU policies for citizens and economic and social actors. It is not the only tool at the EU's disposal: many of the EU's objectives can be reached through law or policy coordination. But it is an essential part of the EU's toolbox.

Amongst the policies that require significant public spending, the weight of spending should mirror the EU's core policy priorities. It should also reflect the new policy directions of the

Treaty of Lisbon, the importance given to particular areas, for example energy and climate, the external projection of the EU and justice and home affairs.

Above all, it should be designed as one of the most important instruments to help deliver the Europe 2020 strategy for smart, sustainable and inclusive growth. The economic and financial crisis has left a legacy of weaker growth. Dealing effectively with the legacy of the crisis and increasing potential growth in times of budgetary consolidation cannot be achieved at the national level alone, but will also require a common response at the EU level. The EU budget needs to help the process of restoring the capacity for growth by directing resources where the rewards can come more quickly, more broadly and more strongly.

2.2. EU added value

Whilst added value of a political project cannot be reduced to a balance sheet, it is another key test to justify spending at the EU level: whether spending at EU level means a better deal for citizens than spending at national level. The European dimension can maximise the efficiency of Member States' finances and help to reduce total expenditure, by pooling common services and resources to benefit from economies of scale. As a consequence, the EU budget should be used to finance EU public goods, actions that Member States and regions cannot finance themselves, or where it can secure better results.

EU spending for 2010 amounted to € 122.9bn. This is relatively small in comparison to national budgets – some 1% of EU GDP, compared to overall public spending averaging between 45 and 50% across the EU. Large areas of spending – such as providing services such as health, education, and social security – are rightly the domain of national budgets, delivering services which reflect societal choices.

But in other areas, delivery through the EU budget is the rational choice and the best way to achieve the EU's objectives. The EU has 500 million citizens, and is the largest economy in the world. This offers real opportunities to exploit added value. It can offer economies of scale and allow the effective targeting of policy priorities and avoid unnecessary overlaps. Its continental scale can allow core policies to work well, such as the identification of excellence in research through competition, where the critical mass required often does not exist at national level alone. It can plug gaps left by the dynamics of national policy-making, most obviously addressing cross-border challenges in areas like infrastructure, mobility, territorial cohesion or EU research cooperation – gaps which would otherwise damage the interests of the EU as a whole. It can open the door to leveraging a much wider range of public and private resources than available at the national level alone.

In times of severe and long-term budgetary constraints, coordination between the EU and national budgets should be seen as crucial for the sake of improving economic governance, transparency and efficiency of public spending.

2.3. A results-driven budget

Identifying those areas where the EU dimension can offer more is not in itself sufficient. Spending on the right policies is only worthwhile if it secures the desired results. Spending programmes must have a real impact, with the investment feeding through into action – action which is measured in terms of real impact, rather than in terms of the inputs involved. The right balance has to be found between predictability and the important goals of flexibility, conditionality, and payment on the basis of results, as well as between simplification and the controls required for sound financial management. But incentives and checks must be in place to ensure that spending fulfils its real purpose.

2.4. Mutual benefits through solidarity

Solidarity is one of the foundation stones of the European Union, a core principle and source of strength. The EU budget is not the only way for the EU to express solidarity, but it is an indispensible part of the EU approach. Enlargement has increased the economic diversity of the Union, and the Union has a political, social and economic interest in helping the less developed parts of the Union to contribute to its overall goals: the benefits of stability accrue to all. In addition, as the European Union seeks to realise a comprehensive economic strategy for future growth, solidarity requires that special attention is paid to the most vulnerable and to those on whom reform places a particular burden. But the benefits of this solidarity are enjoyed by all, through the growth potential of the single market, through the transnational effects of EU spending at national or regional level and through the virtuous circle of individuals and businesses taking the opportunities opened up by the EU as a whole. GDP in the EU25 as a whole is estimated to have been 0.7% higher in 2009 as a result of cohesion policy over the 2000/2006 period – meaning a good return for spending accounting for less than 0.5 % of EU GDP over the same period[3].

The EU's collective objectives often require geographically concentrated interventions. Protecting the external borders of the Union against illegal immigration falls naturally on Member States with external borders. Infrastructure located in particular Member States can still have major benefits for the Union. Action to promote environment protection or tackle climate change can be very local, but the benefits are spread much more widely. In such cases, the investment available at the national level often falls short of what is needed to trigger action, but failure to act can come at a real loss to Europe as a whole. The EU budget should make a contribution to such costs to further its collective goals.

2.5. A reformed financing of the budget

The issue of "own resources" is an important part of the budget review. From the beginning of the1970s, the EU collected own resources deriving from common policies like the common customs tariff duties. The autonomy of these own resources has been gradually undermined and the current system of EU financing has evolved piecemeal into a confusing and opaque mix of contributions from national budgets, corrections and rebates. The connection between the original own resources and common EU policies has been lost, making the system less transparent and increasing doubts about fairness. A fresh look is essential, to re-align EU financing with principles of autonomy, transparency and fairness.

3. A BUDGET FOR THE FUTURE

The EU is now committed to a fundamental programme of economic reform, to unlock the potential of the EU economy to find new sources of growth and create new jobs – the Europe 2020 strategy.

Europe 2020 pursues smart, sustainable and inclusive growth, exemplified by the following five targets:

[3] This includes both EU budget and national co-financing.

– Increase the employment rate of the population aged 20-64 to at least 75%;

– Invest 3% of GDP in R&D;

– Reduce greenhouse gas emissions by at least 20% compared to 1990 levels, 30% if the conditions are right; increase the share of renewable energy sources in final energy consumption to 20%; and increase by 20% its energy efficiency;

– Reduce the early-school leavers rate to 10% and increase the share of the population aged 30-34 having completed tertiary education to at least 40% in 2020;

– Lift at least 20 million people out of poverty.

Taken together, the Commission estimates that when these targets are achieved, the result could be an extra 4% on EU GDP and 5.6 million new jobs by 2020[4].

This task touches on a wide range of policy areas. It requires a partnership between the EU, national and regional levels; and it also requires careful targeting to ensure that efforts are concentrated where they can be most effective. There should also be special attention paid to where action can have an early impact on growth. The EU budget can and must play a key part in delivering this strategy, and it should be the touchstone for a new generation of spending programmes.

Part of the driving force of Europe 2020 is the need to have a global vision for the EU economy and society, where objectives reinforce each other and where actions can serve different goals at once. This does not require a single fund – it does require a high degree of coordination. Europe 2020 needs integrated solutions, so the instruments to deliver it should be integrated as well. The actions set out below should therefore be seen as a package of measures, closely linked and working together to secure smart, sustainable and inclusive growth.

3.1. Smart growth

At the core of the 2020 strategy is the need to support the transformation of the European economy towards an economy based on knowledge and innovation. Much of the work needed to drive future competitiveness and create tomorrow's jobs centres on national efforts to boost research and innovation, upgrade education and remove barriers to entrepreneurship. But Europe has a huge asset in its scale, and this asset must be used to the full: by exploiting the potential of the single market, and by using funds from the EU budget to bring added value to how the public sector galvanises the drivers of growth.

Research, innovation and education

Research and innovation are the most sustainable engines of economic and productivity growth. The current EU programmes for research and innovation offer a high societal pay-off and clear European added value, bringing critical mass in areas like basic research. EU expenditure on research and innovation has doubled over the last multiannual financial

[4] Commission services' estimate based on the following analyses: "Quantifying the potential macroeconomic effects of the Europe 2020 strategy: stylised scenarios" (European Commission Economic Papers n°424. September 2010) and "Macroeconomic effects of Europe 2020: stylised scenarios" (ECFIN Economic Briefs 2010 n°11).

framework and by 2013 it will amount to around 7% of the Union's budget[5]. With the European Research Council and the European Institute for Technology, the EU has put in place a fresh new approach to promoting excellence on a European scale and forging the links between education, research and business so critical to seeing creativity carry through into growth. Future research and innovation spending must have an even stronger impact in terms of growth and job creation and in terms of significant social and environmental return.

To achieve Europe 2020's goals in this area, the Commission has proposed an Innovation Union. In times of fiscal constraints, the EU and Member States need to continue to invest in R&D, and innovation. They also need to ensure that remaining barriers for entrepreneurs to bring "ideas to market" must be removed: better access to finance, affordable IPR, faster setting of interoperable standards, and strategic use of our procurement budgets. This should go hand in hand with reforms to get more value for money, tackle fragmentation and maximise leverage effects.

– **Focussing on innovation**. Future research and innovation funding must contribute directly to the achievement of Europe 2020, in particular the Innovation Union[6]. It should build on the work of the Competitiveness and Innovation Programme and support innovative projects, notably involving SMEs, with clear economic potential, to help consolidate and enlarge Europe's industrial base. The success of the Risk-sharing Finance Facility (RSFF) has demonstrated that novel approaches to providing support can be successful in leveraging private investment. This facility has used an EU budget of € 1 billion to bring an additional € 16.2 billion to support R&D across the EU. The European Technology Platforms have been instrumental in helping to define industry relevant priorities for the Framework Programme. Public-private partnerships have been created to get industry actively involved and co-invest in industry-driven research programmes such as Joint Technology Initiatives, which have shown how imaginative collaboration can use a relatively small EU budgetary contribution to galvanise major European industrial efforts. The full range of instruments should work together, in a common strategic framework, to this end.

– **Tackling major societal challenges**. Europe is faced with an unprecedented range of societal challenges, which can only be tackled with major scientific and technological breakthroughs. Priority should be given to the EU's core objectives, and in particular Europe 2020. For example, the EU should contribute to remedy decades of shortfall in energy research, which has left Europe lagging behind in terms of developing domestic energy supplies and tackling the challenge of reduced emissions. European Innovation Partnerships will be launched to accelerate research, development and market deployment of innovations to pool expertise and resources and boost the competitiveness of EU industry.

– **Delivering the European Research Area**. It is more vital than ever to maximise the efficiency of the European research and innovation system by creating a genuinely unified European Research Area, in which all actors, both public and private, can operate freely, forge alliances and gather critical mass in order to compete and cooperate on a global scale. Better coordination at regional, national and EU level can do more to prevent

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5 The current Framework Programme has been estimated to bring 900,000 jobs and to add 1% to the EU's GDP.

6 Innovation Union - COM(2010) 565, 6.10.2010. Other key 2020 flagships in this area include the Digital Agenda and industrial policy.

overlaps and encourage best practice and reinforced joint programming could ensure synergies and complementarity of the different funding levels. This implies that the barriers to the mobility of researchers need to be addressed.

– **Spreading the base of EU research**. Whilst EU support needs to drive excellence, it should also contribute to broaden the base of research and innovation by helping to raise the quality of research infrastructure across the EU. The Structural Funds should be fully exploited to develop the next generation of research infrastructures, based on regional specialisation.

– **Increasing the efficiency of delivery through simplification**. The scientific and business community has complained about excessive administrative burden and has called upon the Commission to find a better balance between trust and control and between risk taking and risk avoidance. Despite progress made towards simplification under the existing programmes more needs to be done. Measures with a far reaching potential for simplification are the general acceptance of the accounting practices of participants including average costs, a unique set of rules for all participants covering all intervention measures and a reduction of the number of different reimbursement rates and methods for calculating indirect costs.

– **Modernising education systems at all levels**. Excellence must even more become the guiding principle for education. We need more world-class universities, raise skill levels and attract top talent from abroad. A coordinated review of existing education and training programmes should be launched to develop an integrated approach in the context of the "Youth on the move" flagship. Most of the competences for education and employment policy lie with Member States, but the Union has a special responsibility to promote mobility and eliminate barriers across Europe. Existing mobility schemes in education have not only improved the skills, knowledge and education of the beneficiaries, they also stimulate competition between universities and educational systems. Demand currently goes well beyond the current supply – with Erasmus, at university level, limited to around 5% of students. Such programmes could be extended and the allocation of resources linked more clearly to the extent to which the opportunities of mobility are used in practice.

Infrastructures of the future

Cross-border infrastructure is one of the best examples of where the EU can plug gaps and deliver better value results. Transport, communication and energy networks bring enormous benefits to society at large. But market failures can mean that projects with high EU added value can fail to attract the investment needed from private companies. The result is a cost for the EU in terms of competitiveness, solidarity, and the effective functioning of the single market. Targeted financial support on EU level can help to kick-start such important projects, which often hold great commercial potential in the long term.

Countries like the United States and China are now launching huge, ambitious infrastructure investment drives. Maintaining competitiveness means that Europe has a particularly strong strategic interest in effective infrastructure, to lay the foundations for long-term economic growth. The EU needs to offer the right policy mix to stimulate the modernisation required, as well as maintaining the standards of existing infrastructure. This means a credible long-term policy framework which will convince investors to release the huge long-term capital finance required. It needs a supportive regulatory framework and carefully directed financial support through appropriate finance vehicles to help get projects off the ground. The result would be a

European core transport network shifting freight and passenger flows towards more sustainable transport modes; high-speed broadband available in every part of the EU; and an energy network capable of delivering on the promise of the internal market, accessing new energy sources and exploiting new smart technologies.

Such support needs to be targeted on key priorities – removing bottlenecks on strategic trans-European axes, encouraging their extension and building cross-border and inter-modal connections. Strict criteria are also needed to select the best projects: those that can demonstrate that they have the management capacity required and can be launched in a reasonable timeframe, and that they meet sustainability benchmarks. Whilst for some infrastructure, like rail transport or bringing networks to sparsely-populated communities, public investment will always be needed, for other areas the ability of projects to attract private financing could also be an important criterion. A common approach would be needed between the EU and national budgets, the European Investment Bank and private funding sources to determine the priorities for investment and to provide the right catalyst for action. This requires the right regulatory framework at EU level, to pool resources from private and public sources. Consideration should also be given to how support could include projects stretching beyond the borders of the EU, to the mutual benefit of our neighbours and ourselves.

3.2. Sustainable growth

Mainstreaming energy and climate policies in a resource-efficient economy

Tackling the challenge of resource efficiency, climate change, and of delivering energy security and efficiency, is one of the core objectives of the Europe 2020 strategy. This not only means gearing up the economy to deliver the agreed goals, but also kick-starting investment in the greener technologies and greener services recognised as having some of the greatest potential for future exports and future jobs as an industry which already employs 3.5 million Europeans[7]. To secure this ambitious goal, all the instruments at the EU's disposal, including innovative financial instruments and sources, need to be harnessed effectively.

One option would be to reshape the EU budget to create large-scale, dedicated funds devoted to the delivery of investment in such areas. The European Economic Recovery Plan showed how it was possible to identify and support key strategic energy projects, and address the risk that the credit crunch brought such projects to a standstill. It helped to give credibility to the EU's long-range policies on energy, as well as increasing the willingness of investors to release capital for projects with long lead-times. This approach could be taken forward as an option based on distinct programmes. Nevertheless, mainstreaming these priorities into different programmes may be a more effective approach, recognising that the same action can and should pursue different objectives at once. The primacy of policy goals like climate change and energy would already point to a re-prioritisation inside policies like research, cohesion, agriculture and rural development – with a clear political earmarking balanced by the need to avoid new rigidities. This could be accompanied with a clear cross-cutting obligation to identify where programmes had promoted such policies. The result should mean that the EU would be able to set out clearly what resources were contributing to policies like tackling climate change or supporting energy security, irrespective of the instruments through which these policies are delivered.

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[7] Commission report for the high level conference on industrial competitiveness (April 2010):

The Common Agriculture Policy

A sustainable EU economy needs a thriving agricultural sector making its contribution to a wide variety of EU objectives – including cohesion, climate change, environmental protection and biodiversity, health and competitiveness, as well as food security. A series of reforms to the Common Agricultural Policy has seen support to farmers increasingly linked to delivering these goals and the share of the CAP in the overall budget falling steadily in recent years. Continuing the trend would still leave agriculture representing a major public investment – one falling on the EU's shoulders, rather than on national budgets.

Successive reforms have brought EU agriculture closer to the market and helped to deliver food security, a better management of natural resources and stable rural communities. Over one third of farm income relies on payments from the EU budget. EU farming continues to be a major supplier of high quality food at a time when the needs of a rapidly growing world population continue to grow. The agro-industry is an important source of dynamism in the EU economy.

However, there are also clear issues to address. The allocation of direct payments is based on reference values now over a decade old, and the levels of direct payments to farmers vary considerably from one Member State to another. Whilst some variation can be justified, there is a strong case for progressively bringing payments levels closer together. Moving away from historical references would also avoid a culture of dependency which may hold back the use of incentives to ensure that results are delivered. This would also raise issues with regard to pressure on farmers' income and on production costs, as well as the question of targeting and prioritisation of both pillars of the CAP.

The European Council underlined in June how a sustainable, productive and competitive agricultural sector could make an important contribution to the Europe 2020 strategy, considering the growth and employment potential of rural areas while ensuring fair competition.

Continuing along the path of reform could be pursued in different ways:

– Further targeting the CAP on the EU's broader policy priorities with the greening of direct aids to support more demanding environmental practices and positive improvements to boost innovation and competitiveness in the countryside, in addition to the cross-compliance concept;

– Rural development should aim at fostering a competitive agricultural sector and innovation in areas like production processes and technological progress; economic diversification in rural areas; preserving the environment and natural resources; addressing climate change, both mitigation and adaptation; helping water management and resource efficiency; and offering specific support to the most disadvantaged in the rural economy – including those facing issues such as desertification;

– Reliance on the market, coupled with the development of forms of insurance compatible with the WTO "green box", and other tools for the management of risks linked to sudden shifts in incomes, combined with better competitive conditions in the food supply chain;

– Better synergy between rural development and other EU policies, to help deliver policies in areas such as research, employment and network infrastructure, including integration with a common strategic framework and the National Reform Programmes under Europe 2020.

Reform of the CAP could therefore be pursued with different degrees of intensity. It could restrict itself to ironing out some current discrepancies, such as more equity in the distribution of direct payments between Member States and farmers. It could make major overhauls of the policy in order to ensure that it becomes more sustainable, and reshapes the balance between different policy objectives, farmers and Member States, in particular by introducing a more targeted approach to priorities. A more radical reform would go further, moving away from income support and most market measures, and giving priority to environmental and climate change objectives rather than the economic and social dimensions of the CAP.

3.3. Inclusive growth

Cohesion policy and Europe 2020

Cohesion has proved one of the most successful ways for the Union to demonstrate its commitment to solidarity, while spreading growth and prosperity across the EU. The policy has positive effects for all: investing in the economies of the EU benefits all Member States. It provides investment for modernisation, galvanises growth in the least prosperous parts of the EU and acts as a catalyst for change in all Europe's regions. It increases markets and creates new business opportunities for the EU as a whole. When coupled with structural reform and macroeconomic stability, it can make a real contribution to growth. However, to ensure these benefits, cohesion funding must be accurately targeted so that its added value is maximised. This points to a disciplined concentration on the objectives of Europe 2020, and a rigorous concentration on results.

The earmarking of cohesion spending in 2007-2013 to the objectives of the Lisbon strategy has shown the benefits of using a variety of financial instruments to pursue overarching policy objectives. For the next period the Europe 2020 strategy provides both a clear set of common priorities, and a clear framework for identification of funding priorities. Europe 2020 allows a much greater concentration than in the past. Clear priorities could be fixed to deliver smart, sustainable and inclusive growth, with work on: support for new businesses; innovation; reducing emissions; improving the quality of our environment; modernising universities; energy saving; the development of energy, transport and telecommunication networks with a common EU interest; investment in research infrastructure; human capital development; and active inclusion to help the fight against poverty.

The explicit linkage of cohesion policy and Europe 2020 provides a real opportunity to both continue to help the poorer regions of the EU to catch up, and to develop further cohesion policy into an important enabler of growth for the whole of the EU. The National Reform Programmes offer the right vehicle to ensure that EU cohesion spending and national reform and spending priorities are working effectively in tandem.

Cohesion policy should become a standard bearer for the objectives of smart, inclusive and sustainable growth of the Europe 2020 strategy in all regions. This can be a powerful driver for the policy, reinforcing the Treaty obligations of strengthening the Union's economic, social and territorial cohesion, so as to accelerate the process of reducing disparities between the levels of development of the different regions. As today, Community resources should be focused on the poorest regions and Member States in line with the Union's commitment to solidarity. Cohesion policy support is also important for the rest of the Union – to tackle issues like social exclusion or environmental degradation (for example in urban areas), to support economic restructuring and the shift to a more innovative and knowledge based economy, and to create jobs and improve skills. Particular attention needs to be paid to those regions which have not yet completed their process of catching up. A simple and fair system of transitional support would avoid an economic shock due a sudden drop of funding.

A number of adjustments to the current strategic programming are needed to increase the EU added value of strategic programming, through closer coordination between Europe 2020 and Cohesion Policy. This coordination requires clearer guidance at the European level, a more strategic negotiation process between partners at local and regional level, the Member State and the European Commission, and a proper follow-up of progress made. The result should be a common sense that Europe 2020 is driving policy at all levels, that all have ownership of actions to be undertaken in partnership by EU, national and regional levels.

Greater concentration and coherence

To maximize the impact of cohesion spending in the future, it will be necessary to ensure that Member States and regions concentrate EU and national resources on agreed EU priorities. This can be achieved by identifying a limited number of priorities of European importance, linked through the Europe 2020 Strategy to sectoral policy objectives. Such a "menu" of thematic priorities directly linked to the Integrated Guidelines and flagship projects of Europe 2020 would be presented in the legal instruments for cohesion, reflecting also the ability of cohesion policy to address different needs (such as from large infrastructure in some regions to small community led projects in deprived urban areas). Crosscutting priorities, such as innovation, would be obligatory. More developed regions could be required to allocate the entirety of the financial allocation available to two or three priorities, while less developed regions could devote their larger resources to a slightly wider range of priorities.

Increased coherence and coordination with other EU instruments delivering EU policies in areas including transport, communications, energy, agriculture, environment, and innovation would be essential. Beneficiaries of EU support should be offered a consistent set of programmes complementing each other and allowing for "smart specialisation", rather than being confronted with a multitude of partially overlapping schemes and different rules. A greater harmonization of eligibility and implementation rules would be an important step towards a more integrated delivery of EU policies on the ground.

A common strategic framework

In order to strengthen the integration of EU policies for the delivery of the Europe 2020 strategy and in accordance with the Integrated Guidelines, the Commission could adopt a common Strategic Framework, outlining a comprehensive investment strategy translating the targets and objectives of Europe 2020 into investment priorities. It would identify, in particular, investment needs in relation to headline targets and flagship projects. It would also highlight the reforms needed to maximise the impact of investment supported by cohesion policy.

Such a framework would replace the current approach of separate sets of strategic guidelines for policies and would ensure greater coordination between them. It would encompass the actions covered today by the Cohesion Fund, the European Regional Development Fund, the European Social Fund, the European Fisheries Fund and the European Agricultural Fund for Rural Development. The framework would also identify linkages and coordination mechanisms with other EU instruments such as programmes for research, innovation, lifelong learning, and networks.

A Development and Investment Partnership Contract to focus on the results expected from EU support

Based on the Strategic Framework, Member States would present their development strategy in their National Reform Programmes, in order to ensure strong ownership of EU priorities and national and regional level. This strategy would identify how the Member State and its regions seek to address the priorities and targets established in Europe 2020, the Flagship projects and thematic and country-specific recommendations. It would also define the positive changes they aim to achieve with EU support. The result of the discussion with the Commission would be a Development and Investment Partnership Contract between the Commission and the Member State reflecting the commitments of partners at national and regional level.

The Contract would set out the objectives to be achieved, how progress towards the achievement of these objectives will be quantified and measured and the allocation of national and EU resources among priority areas and programmes. The Contract would also establish a limited number of conditionalities, linked to the reforms needed to ensure effective delivery. Where relevant, it would identify strategic projects to be included (e.g. key transport and energy interconnectors). It would also describe the coordination between EU funds to be applied at national level.

The result of such an approach would be to link the initial potential allocation of resources between Member States and regions – a political choice about how to express solidarity – with an effective mechanism ensuring that the level of support is matched by the achievement of targets and objectives.

Improving the quality of expenditure

The institutional capacity of the public sector at national, regional and local level is key for successful development, implementation and monitoring of the policies needed to reach Europe 2020 objectives. The smooth absorption of Community resources also critically depends on the technical and administrative capacity of the participating public authorities and beneficiaries. Strengthening institutional and administrative capacity can underpin structural adjustments and foster growth and jobs – and in turn significantly improve the quality of public expenditure. The allocation of financial resources should therefore take into account the capacity of Member States and regions to effectively utilise these resources and the need to respect the principles of co-financing and additionality, as well as recognising the pressure on the national budgets.

Cohesion policy can play an important role in this respect by financing institutional capacity measures, promoting administrative reform, and fostering a culture geared to performance and results. This could be deepened through focused technical assistance facilities to support Member States and regions in preparing, implementing and monitoring large investment programmes in areas such as network infrastructure or environment.

Another technique to increase the quality of spending would be to introduce some form of qualitative competition among programmes for cohesion funding. This could mean setting aside a limited share of cohesion funding in a performance reserve open to all eligible Member States and regions. It would be allocated on the basis on progress made by national and regional programmes towards Europe 2020 objectives.

The right skills for tomorrow's workforce

A workforce with more and better skills is central to a European economy built on knowledge. More and more jobs will rely on higher skills. EU action should therefore be focused on securing the 2020 objectives, training for the needs of tomorrow's economy. Targeted investment can offer significant added value in encouraging adaptability and lifelong learning, in particular by assisting national strategies for reforming education and training systems and for improving institutional capacity.

The European Social Fund already supports training for some 9 million Europeans each year. It reflects a balance in EU economic policies – a practical demonstration of how the EU actively promotes inclusion alongside growth. It uses cross-border experience to bring support to social groups or policy areas that would otherwise receive little or no support, as well as a special focus on innovative approaches to employment, training and social inclusion.

The European Social Fund could be refocused on securing the 2020 objectives. A comprehensive European Employment initiative could improve skills, mobility, adaptability and participation in society through joint initiatives in the area of education, employment and integration. Another strand of direct importance to the EU is the integration of minorities such as the Roma and migrants, where action to ensure social inclusion and legal rights for migrants is closely linked to the EU approach to migration as a whole. At the same time, the importance of jobs and skills to the EU's vision for the economy points to the need for both greater visibility and predictable funding volumes within the common strategic cohesion framework described above.

Supporting sectors put under pressure

The scale and diverse profile of the EU economy means that inevitably, there are times when the benefits enjoyed by the many come at the cost of the few. An example might be a trade agreement that opens up significant new markets for EU exports, but which means a significant change in the competitive climate for particular sectors. The European Globalisation Adjustment Fund has already provided a good example of how such localised negative effects can be tackled, and an extended fund could be put on a permanent footing to help cushion the impact of certain major disruptions on the workforce in a Member State. The functioning of this Fund needs also to be simplified to become more reactive to changes of economic circumstances.

3.4. Citizenship

Many different EU spending programmes contribute in different ways to the consolidation of EU citizenship. Every time a citizen sees the concrete effects of EU action – from mobility grants to the results of research to local cohesion projects – it helps to illustrate the vocation of the Union to serve its citizens. Programmes which support cultural diversity help to show how European integration can touch citizens in a huge variety of ways.

EU action in this area also covers the "rights" dimension, such promoting fundamental rights and EU values. Action could include developing the EU as an area of justice to eliminate obstacles for the good functioning of cross-border civil proceedings and business-to-consumer relations, promoting mutual recognition and mutual trust in criminal proceedings, and fostering access to justice throughout the EU.

More specific cultural and citizenship programmes also help preparing Europeans to overcome cultural barriers and use the opportunities of the European space to the full. Different programmes aiming at promoting cultural cooperation and Europe's cultural heritage, citizens' interaction and the involvement of young people in European society might be integrated into one visible programme promoting European unity in diversity and could benefit from joint management.

The responsibilities of the EU towards its citizens are also shown in the European Union Solidarity Fund. This has allowed the EU to demonstrate its collective commitment to help respond to situations of crisis. Since 2002, the EU has been able to grant more than € 2.1 billion to support Member States and regions hit by major natural disasters. However, experience points to some important limitations and weaknesses in the operation of the Fund. The speed with which aid from the Fund is made available, the transparency of the criteria for mobilising the Fund and its limitation to disasters of natural origin are all issues to address. For example, the Fund is not funded on a permanent footing and cannot help follow all kinds of major disasters. An EU budget contribution could also help to plug gaps in the system which prevent Member States' civil protection teams from being deployed quickly where they are needed, and help the development of an effective civil protection network – an example of EU cooperation that can make a real difference to those in need both inside and outside the EU.

Another important area of direct relevance to citizens is spending on policies central to the delivery of freedom, security and justice. These are policies where there is a clear common interest in successful delivery. Support to effective border management, to the exchange of information and expertise to apply justice effectively, or to implement policies on asylum and migration, benefits the Union as a whole. The emphasis in the next financing period will have to be on management of external borders (including SIS II/VIS and the future entry/exit system), return policy, asylum and integration of legal immigrants. On these issues, burden sharing among Member States, support to the work of national administrations and pooling of resources with the EU budget are priorities in order to find cost-effective ways of ensuring the effective delivery of these policies.

3.5. Pre-accession support

Financial support for closer integration through the enlargement process helps the EU to achieve its objectives in a number of areas which are key to economic recovery and sustainable growth, including energy, network infrastructures, the protection of the environment and efforts to address climate change. It also helps to ensure that candidate countries and potential candidates are fully prepared for eventual accession, including through encouraging countries to consolidate EU priorities linked to Europe 2020 objectives into their national priorities. It should therefore continue to be one of the tools to promote successful enlargement.

3.6 Global Europe

Europeans expect the EU to promote its interests and exert its influence on the international stage. Issues such as poverty alleviation, migration, competitiveness, climate change, energy, terrorism and organised crime can only be tackled in an international context. In the age of globalisation, it is essential that the internal agenda of securing sustainable growth and jobs in Europe is complemented with an external agenda. In addition, of course, solidarity has an external dimension: the EU is rightly proud to be the world's largest development and humanitarian donor – with the EU and its Member States providing around 55% of the total worldwide – a champion of the fight against poverty, and is acutely conscious of the importance of the Millennium Development Goals to the stability, security and well-being of large areas of the globe.

The same rules apply to the effective use of EU resources internationally as inside the Union: an intelligent look at where collective action can deliver better value than a collection of national actions; coherence between spending programmes and key policies; and a fresh look at the delivery mechanisms and instruments being used.

Applying this approach will be facilitated by the new structures for external relations under the Lisbon Treaty, with the opportunity to use the different tools of EU external policy creatively, and to work within a long-term strategic framework.

Projecting the EU's values and interests globally

The establishment of the EEAS gives the EU the tools it needs to improve the ability of the EU's to project its interests across the world, in line with its economic and political importance. The ability of the EU to target its instruments effectively needs a clear strategic overview, the right relationship with third country partners, and well-designed instruments. Instruments need to be sufficiently responsive to changing priorities and adapted to different circumstances. Some of the key global issues faced by the Union today need particular attention. For example, the EU and its Member States will need to be able to deliver on climate finance commitments. This deserves a separate reflection which will be influenced by the progress of negotiations and will need to ensure the coherence and visibility of the EU contribution to international efforts; effectiveness; and permit economies of scale in the management of disbursements. It should also include whether the role of the EU budget should be complemented by a separate instrument to bring together a stable and visible collective EU contribution. Another example is migration, which faces the need to calibrate effectively action inside the EU and beyond its borders.

Responding to crisis situations

It is particularly important to improve the Union's ability to respond to large-scale conflicts or disasters. The EU's essential contribution to the broader security dimension of external relations points to a need to build on current tools like the Instrument for Stability, CFSP actions and Election Observation Missions. Speed of deployment, flexibility and the ability to modulate action in line with changing political circumstances are all essential components.

The EU's humanitarian aid is one of the most high-profile and effective suppliers of emergency assistance. However, the phase of emergency aid should be more quickly and substantially followed by development actions to rebuild from crisis situations and to develop more resilience for the future. This is held back by the inflexibilities in the budget. The humanitarian aid budget has had to access the Emergency Aid Reserve every year of the present financing period, pointing to the heavy calls being made in this area of the budget.

Poverty Alleviation

As a Europe built on values, combating global poverty is one of the EU's core goals**.** Assistance to least developed countries makes a real impact on challenges like access to food, health, education and clean water, as well as adapting to the consequences of climate change. The EU is at the forefront of efforts to achieve the Millennium Development Goals by 2015. Its collective commitment to dedicate 0.7% of GNI by 2015 to official development aid recognises the important role external financial action plays in reaching our objectives. It implies a substantial increase of the overall volume of development assistance.

Since there is clear evidence that development policy at EU level can offer high value added, the EU level should play its part in this increase. EU development policy already offers a global reach – compared to Member States' concentration on a limited number of partners – and for many partner countries, it is the only significant development presence to be seen. Through its action, the EU is able to implement a consistent and coherent set of objectives across the world. So in terms of presence, scale and focus of operations and political weight EU intervention offers significant benefits over national action. It offers a big potential for a better division of labour between donors, promoting important economies of scale and a single contact point for beneficiaries. It also carries the weight and legitimacy associated with 27 Member States acting together.

Experience shows that effective, high quality delivery needs a particular effort in terms of donor coordination and governance arrangements. The EU's role as the primary global donor gives it a voice on issues such as governance, regional cooperation, economic development and infrastructure not possible for Member States acting alone. Following the adoption of the European Consensus on Development in 2006[8], progress has been made in pooling resources from all European aid donors to prevent overlaps and bring concentration where necessary. But fragmentation of aid remains, causing inefficiencies with both financial and political consequences. Tackling these weaknesses would bring both substantial efficiency gains for Member States – estimated at up to € 6 billion a year[9] – facilitate the work of partner country administrations, and help the EU to use its influence to the full. Other key priorities include the right balance between predictability in aid levels for partner countries and the need for an appropriate degree of flexibility, to adapt to changing situations such as major changes in food prices and the need to deliver effective post-disaster reconstruction programmes.

EU trust funds such as the EU-Africa Infrastructure Trust Fund have been created, which channel grant resources from the Commission and Member States in such a way that they can be blended with the lending capacity of the EIB and Member State development banks – bringing an important multiplier effect. These can be explored further.

Additional priorities are to ensure that EU development policy makes a strong and direct contribution to significantly improving governance in partner countries and continuing to improve the real impact of aid. This includes an increased focus on projects showing strong Community added value, and partnership agreements that are clear, focused and result-orientated. The experience with respect to the different financial regimes that apply to the European Development Fund and the Development and Cooperation Instrument today has raised important issues in terms of efficiency, flexibility and democratic procedure, which require further examination.

In addition, the EU needs to consider how a more sophisticated approach to the changing nature of partners can be developed, such as middle-income countries and emerging economies, where cooperation issues in areas including economic, environmental and social partnership are becoming increasingly important, alongside development ones.

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8 'The European Consensus" (OJ C 46, 24.2.2006, p. 1).

9 "Aid Effectiveness Agenda: Benefits of a European Approach" (HTSPE on behalf of the European Commission, October 2009).

Close and effective relations with the EU's closest neighbours

The EU's neighbourhood, with some 300 million people, represents an important opportunity for the EU. To secure long-term prosperity and stability and to prove its ability to assume its responsibilities as a global player, the EU needs to effectively promote its values and support economic development close to its borders. Financial support can be an important lever to deliver an effective neighbourhood policy. Here the emphasis should be on providing credible reform and cooperation incentives to the EU's neighbours, whether or not they have any long-term perspective of EU accession. Specific support should in particular be provided in the context of deep and comprehensive free trade agreements and the alignment with the single market acquis. Areas close to the acquis and to the EU's own strategic priorities – such as energy, migration and border controls, and environmental protection – should be prioritised, with a particular focus on capacity- and institution- building.

The neighbourhood has already been one of the strongest examples where the EU budget and European Finance Institutions have worked together to leverage the maximum investment to social and economic development. A € 117 million commitment from the EU budget to blending mechanisms has been followed by a € 7 billion investment from European Financial Institutions. This approach could be developed still further

3.6. Administrative expenditure

In the current financial framework 5.7% of the budget is used for administrative expenditure. This covers not only staff costs, IT and buildings for all the Institutions but also the costs of working in 23 languages. Now that the different Institutions have largely completed recruitment from the newer Member States, staff numbers should level off. Indeed, since 2007, the Commission has been operating a policy of zero growth, dealing with new priorities through redeployment of existing staff and asking for no extra staff beyond the consequences of enlargement. The Council, the Parliament and other institutions have requested some additional posts linked to the Lisbon Treaty. The launch of the EEAS will initially require additional posts to support the recruitment of Member State diplomats although over time the whole process should seek to be neutral from a budgetary point of view.

Part of the work to define the next financial framework package must be a rigorous search for increased efficiency and performance in administrative resources. This implies examining how rationalisation and common use of procedures, tools and resources could limit the costs of action by the institutions and the agencies of the EU. For example, the Commission has just launched an important analysis of its use of IT, designed to enhance performance and produce economies. This could lead to common savings by developing common or shared IT systems for all the institutions. Similar inter-institutional cooperation could bring benefits in areas like translation or document management. Another area is the design of spending programmes themselves, where administrative burden for both the Commission and for partners should be an important consideration. At the same time, the Commission will continue to redeploy staff to focus on priorities, reduce overheads and increase those working on front line policy. The Commission will review its administrative expenditure – and that of the agencies – as part of its preparation for the next financial framework to identify ways of meeting new challenges from within existing resources, including finding the right balance between delivering programmes effectively and holding down administrative costs.

Overall, a strict discipline will have to be pursued by all EU institutions to ensure that administrative expenditure is contained in the future.

4. A BUDGET DELIVERING RESULTS

Well targeted spending is indispensable, but not enough. Spending also needs to be delivered in a way which is designed to bring results. If the public's investment in the EU budget is to pay off, the next generation of financial programmes needs to be reworked to put effectiveness at the top of the agenda.

4.1. Using the budget to leverage investment

The impact of the EU budget can be magnified the more it can be used to leverage both funding and financing to support strategic investments with the highest European added value. Innovative financial instruments could provide an important new financing stream for strategic investments. The norm for projects with long-term commercial potential should be that EU funds are used in partnership with the private and banking sectors, particularly via the European Investment Bank (EIB), but also with other partners including development banks in Member States and the European Bank for Reconstruction and Development (EBRD). This requires close upstream coordination between the technical expertise of both the Commission and the banks: the logic of such an approach is that projects are supported on the basis of competitive application by the project promoters, with a focus on EU added value.

The EIB has made a major contribution to the European response to the economic crisis. Now it will play a key role in reforming Europe's economy in areas like green technology, infrastructure and energy security. This may point to a need to optimize use of EIB capital, including an increased use of risk sharing mechanisms to permit a higher leverage of the Bank's resources and enhance the Bank's reach. The Commission and the EIB have already successfully developed a number of common financial instruments. Blending between grants from the EU budget and loans from the EIB and other financial institutions has made it possible to treble the financial impact of EU external spending by attracting huge multiples of investment from financial institutions. This should be extended to become the norm in areas of long-term commercial potential, with new rules to govern blended instruments.

In general, spending programmes need to be both sensitive to the needs of private finance – such as in terms of lead time and burdensome procedures – precise as to what they want to achieve, and hard-headed about when the EU should step out of projects reaching commercial viability. The EU could be more open to looking at revenue streams collected from users of infrastructure such as tolls as a means to limit the long-term costs to taxpayers. Similarly, the more that external costs can be internalised, the more revenues can be generated to contribute to the investments needed to achieve strategic goals like accelerating the decarbonisation of the economy. Financial instruments should be focused on addressing identifiable market failures taking into account the state of national financial markets, the legal and regulatory environment and the needs of final beneficiaries.

The new financial instruments for budget delivery must be smart, integrated and flexible. They can address many different policy needs, but using consistent instruments. The laws of financing are essentially the same, regardless of the sector involved: companies and projects in different stages of development need equity, or debt, or a combination of both. The “tool-kit” of EU budget financial instruments required is essentially twofold, and could be delivered through two general mechanisms to be used by the different spending programmes, an EU Equity Platform Mechanism and an EU Risk Sharing Platform Mechanism (including guarantees).When looking at the option of loan guarantees as one of the options for innovative financial instruments, the implications of leveraging the EU budget need to be carefully analysed in order to respect the own resources ceiling, notably in the light of existing guarantee schemes. A more general use of the EU budget as an instrument to guarantee loans and bonds would need to take proper account of the capacity to underwrite such guarantees.

4.2. EU project bonds

The potential of innovative financing instruments and the particular circumstances of the European economy today come together in the idea of EU project bonds. The EU economy is heavily dependent on infrastructure, in areas like energy, transport and ICT. The Europe 2020 objectives for modernisation of the European economy will require huge investment[10]. The EU can already help such projects by providing a consistent strategic direction for investors taking decisions for many decades to come, and by providing the right regulatory framework. But in the wake of the financial crisis, investors remain reluctant. Projects of key strategic interest for the EU are finding it impossible to secure the investment required. National budgets are not in a position to take over funding of such projects, and indeed are looking for alternative solutions to shoulder a greater responsibility for infrastructure. Delaying projects could deprive the EU of the economic and other benefits from the infrastructure, and risk higher-cost solutions in the future.

EU project bonds would be designed to plug this gap, to give sufficient confidence to allow major investment projects to attract the support they need. The European Investment Bank and other major financial institutions already make a major contribution by their direct lending, and the EIB in particular has responded to the crisis with a major increase in the scale of lending. But the size of the infrastructure challenge is such that the EU needs to help to unlock private finance.

This could be achieved by using appropriations from the EU budget to support projects to the extent required to enhance their credit rating, and thereby attract financing by the EIB, other financial institutions, and private capital market investors like pension funds and insurance companies. The EU and/or EIB guarantees would be issued in favour of special vehicles set up by the private sector to attract capital market financing for the project. The projects benefitting from such a facility would need to demonstrate an EU strategic interest, as well as meeting certain criteria for viability. As such the support could not be pre-allocated across Member States or sectors but would flow to those projects that manage to attract appropriate private sector financing. The timescale for repayment would depend on an assessment of the length of time required for the project to reach viability.

4.3. Large scale projects

A particular issue arises for large scale projects requiring multi billion Euro contributions over long periods. The EU is gaining considerable experience of projects like Galileo, ITER, and GMES. These projects are acknowledged to have major strategic importance, and could have long-term commercial potential. They need transnational collaboration to work. However, they are also subject to significant cost overruns and their governance is not well-suited to the direct management of the EU institutions. The budgetary uncertainties are hardly compatible

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10 As examples: until 2020, €500bn is estimated to be needed for the implementation of the TEN-T programme and between €38-58bn and €181-268bn to achieve the Commission's broadband targets. In the energy sector, €400bn is estimated as the need for distribution networks and smart grids, another €200bn on transmission networks and storage, and €500bn to upgrade existing and build new generation capacity, particularly in renewable energy, between now and 2020.

with the way in which the EU budget is planned. An alternative approach would be for the project promoters to set up a support structure as a separate entity, with the active interest of the EU to ensure effective governance, and to which the EU budget would make a stable contribution in the form of a fixed annual contribution with no assumption that the EU should make up any shortfalls.

4.4. Incentivising the use of resources

The EU budget can be a powerful agent for reform – as recognised in the current debate about using financial sanctions and incentives to ensure respect for the Stability and Growth Pact. So there is every reason to use this influence within programmes to ensure effective delivery. The ideas set out above in respect of cohesion policy could be applied in other contexts and spread to all areas of spending, defining a specific set of targets on which disbursement of the funds would depend. Other approaches include setting aside an EU-wide reserve in most programmes, or modulating co-financing rates to performance. In all these cases, it would be essential to assure fair treatment of all Member States, transparency and automaticity.

This requires a different approach and different tools. Programmes should provide for the definition of specific, measurable, achievable, relevant and timed objectives as well as for appropriate performance indicators. Clear evaluation criteria are needed before an incentive system can work fairly, as well as systematic and enhanced evaluation. Applied systematically and in good time, evaluations can play a pivotal role in the overall effort aimed at maximising the added value of EU spending.

4.5. A structure to reflect priorities

The structure of the budget is itself an important tool for communicating and delivering on the purpose of the spending and the objectives to be reached. There is an obvious benefit in a budget which in structure, as well as balance, reflects the EU's political priorities. The current structure made some progress in that direction, but a further step would be to either reduce the number of headings to the minimum or organise the budget around the Europe 2020 strategy. The first alternative could consist of 3 headings: Internal expenditure, External expenditure and Administrative expenditure. The second alternative would point to three sub-headings replacing the current Headings I – III and covering policies where the centre of gravity falls under the three strands of smart, sustainable and inclusive growth, in addition to a fourth "internal" sub-heading on citizenship policies. This would be complemented by two final headings, one covering external policies (current Heading IV) and another covering administration.

4.6. The duration of the MFF

A multiannual financial framework allows long-term consistency and predictability. It also guarantees budgetary discipline and the smooth functioning of the budgetary cycle. However, each framework is the fruit of political decisions which need to reflect changing political preferences.

The last three financial frameworks were concluded for a period of seven years. The European Parliament[11] as well as some of the participants to the public consultation have taken the view

[11] Resolution of 25 March 2009 on the mid-term review of the 2007-2013 financial framework [INI/2008/2055 – P6_TA(2009)0174].

that this duration should be brought down to five years. A major reason was to align the duration with the term of the European Parliament and Commission's mandate. A five year period would allow each Commission to propose and each Parliament to negotiate a framework, even if they would not see the framework implemented. A five year period would also bring some advantages in terms of an ability to reflect new needs, and some disadvantages in terms of planning lead-times: longer periods not only allow programmes to make deeper changes, they may also fit in better with the investment patterns of the private sector. Another option targeted on the specific dates in question would be a seven year period with a major review after five years, to allow a final reallocation targeted specifically on Europe 2020. This would explicitly avoid prejudging the future.

However, the most attractive solution may be a ten year period, but with a substantial mid-term review ("5+5"). Under this approach, there would be an opportunity for a major re-prioritisation. Overall ceilings and the core legal instruments could be fixed for ten years. But the distribution of resources within headings, and the prioritisation within programmes and instruments, could be left open for re-assessment. One approach would be to facilitate this through the retention of substantial reserves and margins in all parts of the budget.

4.7. Responding to changing circumstances

One of the most difficult balances to strike in the budget is the balance between predictability and flexibility. But it is clear that the current budget has proved too inflexible to meet the pressure of events. Pressing needs for the EU to respond to external events from the tsunami and the Middle East, followed by the compelling need to react to the economic crisis, showed the shortcomings of the current approach. With proper targeting so crucial to effective spending, and changing circumstances imposing changing priorities, the rigidity of the budget clearly damages the quality of spending. It is right for the European Parliament and the Council to exercise proper scrutiny of changes in the direction of spending. But the extent of the changes possible, and the procedures by which this scrutiny are exercised, both need reform. Experience suggests that the obvious solution of increased margins has not proved possible in the face of pressures to pre-allocate spending. Therefore a fixed percentage – such as 5%, could be agreed as an obligatory figure. Such a figure could also be set at a lower level for the first 5 years of the financial period and at a higher percentage for the remaining years of the financial period, or be set to increase year on year. This would give the possibility to take new priorities better into account at the occasion of the mid-term review. Other means to increase flexibility include:

– A reallocation flexibility to transfer between headings in a given year, within a specific limit*;*

– A possibility to transfer unused margins from one year to another – again, within agreed limits;

– Freedom to front or backload spending within a heading's multi-annual envelope, to allow for countercyclical action and a meaningful response to major crises;

– Increasing the size, or widening the scope, of the existing Flexibility Instrument and Emergency Aid Reserve, and possibly merging them.

The current 0.03% flexibility arrangement agreed by qualified majority should also be maintained as an important safety valve allowing limited deviations from the foreseen ceilings.

All these changes should accompany a different mindset. The emphasis should shift from permanent and pre-determined financial allocations to using the scarce EU resources for strategic investments of limited duration, and expecting that the receipt of funds is dependent on delivery.

4.8. Simplifying and minimising unnecessary administrative burdens

The public consultation has conveyed a clear message that implementation procedures and control requirements are too complicated and can be a real disincentive to participation in EU programmes. The EU has a responsibility to ensure that funds are well spent, but it could also take a series of measures to reduce the administrative burden for recipients of funds, and to cut EU administrative costs – allowing more of the resources to be directed at the end purpose:

– The EU has common financial rules in its Financial Regulation. But implementing rules and procedures may vary considerably from one policy instrument to another. A clear set of common principles should be agreed to reduce differences to the absolutely necessary. Linking different instruments together in a common implementation framework is a good way to help the interface of citizens, businesses, especially SMEs, and governments with the EU budget.

– The recent Commission proposal to revise the Financial Regulation contains bold measures to put in place simplified financial rules. This should be looked at further to allow for lighter procedures for smaller grants (thresholds could be set at a higher level for such small projects), and more use of lump sum payments, as well as performance-based schemes.

4.9. Ensuring sound financial management

Public spending requires effective, efficient and proportionate control. It must provide the necessary assurances for citizens and their representatives in the European Parliament and the Council that the EU budget is being well spent. But there is a point when the burden of controls negates the effectiveness of the programme. A more modulated approach to the controls required in different Member States, and a common understanding of the tolerable risk of error for different policy areas, would both help to secure the right balance.

In recent years, the Commission has devoted much attention to increasing the effectiveness of management and control systems, with an objective of achieving an unqualified Statement of Assurance by the European Court of Auditors. The results are positive but more can be done, in particular by working with the Member States who implement an important part of the budget in shared management with the Commission. The system of basing payments on a declaration of payments by Member States, rather than on expenditure by beneficiaries – as used today for CAP expenditure – would make the process of controls more local and allow more alignment with existing national procedures. This would be a more straightforward and regular procedure than centralising controls at EU level. It could be linked to reliable national statements of assurance to underline the accountability of public authorities handling EU resources.

Increasing the amount of funds channelled through financial instruments will mean profound changes in the way the Commission manages its budget expenditure. The Commission will increasingly delegate budget implementation tasks and cooperate with key financial institutions such as the European Investment Bank (EIB)[12]. This creates a need to align core aspects of the design and management of financial instruments, to secure the right balance between a common approach in the Commission's dealings with its financing partners, safeguarding the EU's financial interests, and leaving the flexibility required at implementation level to ensure that policies are delivered effectively. This would also secure higher political visibility, administrative efficiency through simplification, streamlined reporting and monitoring, and finally easier evaluation across instruments.

5. THE EU BUDGET AS A TOOL TO SUPPORT ECONOMIC GOVERNANCE

The drive for growth and jobs in the European Union requires a complete approach. That is at the heart of the Europe 2020 strategy. Macroeconomic stability and structural reforms are not alternatives, but dual imperatives which also reinforce each other. It is therefore natural to make a connection between the EU budget and the reinforcement of economic governance.

The Commission has set out a variety of measures to reform economic governance and make it more effective[13]. It will take these issues forward in the context of the debate on economic governance following the October European Council.

6. TAKING ACCOUNT OF ENLARGEMENT

Future enlargements will inevitably have an impact on the EU budget, in terms of both potential increases in revenue and in spending commitments. While new Member States will increase the cumulated GDP and create new opportunities for economic expansion, they will also become eligible for structural and other funds. The timing of accessions is dependent on the speed with which candidates can meet the necessary criteria. In this context, the December 2006 European Council committed to refrain from setting any target dates for accession until negotiations are close to completion. Consequently, the new financial framework should not pre-empt any political decision on future enlargements which will be based on a country's readiness for membership. Once accessions are agreed and dates confirmed, the financial framework should be adjusted to take account of the expenditure requirements resulting from the outcome of accession negotiations.

7. REFORM OF EU FINANCING

Just like the expenditure side of the budget, the structure of the financing side has evolved considerably over time. The GNI-based contribution has taken on a growing importance and now represents three-quarters of the budget. A large number of corrections and special arrangements have been introduced over time, both on the revenue and expenditure side of the budget (some of these mechanisms end automatically in 2013). Budget negotiations have recently been heavily influenced by Member States' focus on the notion of net positions with the consequence of favoring instruments with geographically pre-allocated financial envelopes, rather than those with the greatest EU added value.

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[12] Financial instruments will not be implemented exclusively through the EIB, but the EIB will play a key catalytic role in attracting other public and private sources of finance.

[13] Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance - COM(2010) 367.

The consultation on the budget review has shown that stakeholders are very critical about the current system of financing the EU budget. The current system is perceived as opaque and too complex, lacking fairness – notably with regard to corrections – and relying excessively on resources which are perceived as expenditures to be minimized by the Member States. With the exception of customs duties stemming from the customs union, existing resources display no clear link to EU policies.

It should be underlined that this is not an argument about the size of the budget – it is a debate about the right mix of resources. The progressive introduction of a new resource would open the door for other resources to be reduced, phased out or dropped.

Proposals for a reform of the financing side have been made by academics, governments, non-governmental organisations and the European Parliament. The Parliament adopted a report in 2007 analysing the current system of own resources and suggesting a whole range of possible new own resources[14].

The introduction of a new phase in the evolution of EU financing could include three closely linked dimensions – the simplification of Member States' contributions, the introduction of one or several new own resources and the progressive phasing-out of all correction mechanisms. As changes were phased in, essential elements of the EU financing system should be retained: a stable and sufficient financing of the EU budget, respect for budgetary discipline and a mechanism to ensure a balanced budget.

Simplifying the contributions from Member States

Compared to the GNI-based own resource, the current VAT-based own resource has little added value. To re-create a comparable tax base, it results from a mathematical calculation rather than passing directly from the citizen to the EU. As such it contributes to the complexity and the opacity of the contributions. Ending the VAT-based resource in its current form would simplify the system of contributions in parallel with the introduction of a new own resource.

Progressively introducing one or several policy-driven own resources:

New own resources could fully replace the existing VAT-based own resource as well as reducing the scale of the GNI-based resource, taken directly from national treasuries. The introduction of new own resources would mirror the progressive shift of the budget structure towards policies closer to EU citizens and aiming at delivering European public goods and a higher EU added value. It could support – and be closely linked to – the achievement of important EU or international policy objectives, for instance in relation to development, climate change or the financial markets.

The following criteria seem pertinent when looking at possible new own resources:

– They should be more closely linked to the *acquis and the objectives of the EU* to increase the coherence and effectiveness of the entire budget in the achievement of EU policy priorities. In this respect it is important to keep in mind Article 2.2 of the Own Resources

[14] European Parliament, Report on the future of the European Union's own resources (2006/2205(INI) Rapporteur A. Lamassoure).

Decision[15] which states that "*revenue deriving from any new charges introduced within the framework of a common policy shall also constitute own resources entered in the general budget of the European Union*."

– They should be cross-border in nature, based on a system covering the whole internal market.

– They should have a harmonised base to ensure an equal application of the resource throughout the Union.

– If feasible, the proceeds of a new resource should be collected directly by the EU outside national budgets.

– They should be applied in an equitable and fair way, and not exacerbate the question of corrections.

– The cumulative impact on particular sectors should be taken into account.

– They should seek to avoid a heavy new administrative responsibility for the EU in terms of collection.

The Commission considers that the following non-exclusive list of financing means could be possible candidates for own resources to gradually displace national contributions, leaving a lesser burden on national treasuries:

– EU taxation of the financial sector

– EU revenues from auctioning under the greenhouse gas Emissions Trading System

– EU charge related to air transport

– EU VAT

– EU energy tax

– EU corporate income tax.

Each of these financing means has its particular characteristics and presents advantages and disadvantages[16]. In the light of the comments received, the Commission will submit proposals as part of its overall proposals on the next Multiannual Financial Framework.

Tackling the correction mechanisms

The 1984 Fontainebleau European Council set out the core principles behind the system: that "*expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances*", and that "*any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time*." Reinforced spending for growth and jobs, energy, climate change and the external projection of Europe's interest would reduce the need to maintain correction mechanisms. The

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[15] Council decision 2007/436/EC, Euratom (7 June 2007).

[16] See Staff Working Document.

composition of expenditure of the next Multiannual Financial Framework and other reforms of the own resources system will determine whether correction mechanisms are justified in the future.

8. Conclusions and Next Steps

This Budget Review sets out the Commission's ideas on the architecture and purpose of the EU budget. It sets out a vision of a reformed budget committed to making a real difference: this will be the Commission's ambition for the proposals it will make for the new financial framework next year. These ideas are based on the conviction that by 2020 the EU must have taken decisive steps help the EU become a smart, sustainable and inclusive society. To do this, we need to put the European economy on the right track, to take the big decisions to reshape our infrastructure, to give us the skills we need for the future, to assert our global leadership, and to prevent increasing divergences in our societies from undermining its long-term stability. The budget of the Union must be seen as one of the common tools we have at the service of common objectives. At a time of intense pressure on public finances, EU and national budgets cannot be seen as in competition, but as pursuing the same objectives at the levels which can deliver to best effect.

Tomorrow's budgets must therefore be focused on making a real impact on realising our goals. They must recognise the need to adapt to a rapidly-changing world. They must be disciplined in their concentration on results. They must reflect the need for solidarity in pursuing our common agenda. And they must be resourced in ways which our citizens can understand and recognise as rational and fair.

The way in which the EU budget is delivered can be simplified and made more effective. There is a need for greater flexibility so that the budget can respond to changing circumstances, while at the same time supporting long term investments. At a time of fiscal constraint more innovative financial instruments can be used to make the budget go further, and to increase the impact and range of high priority EU projects that can be realised.

The modernisation of the EU budget must therefore be about targeting, about maximising the benefits from every euro spent, and about setting the budget firmly in the context of the other ways in which the European Union, its institutions and its Member States, can put Europe on the path to growth and jobs for the future.

In the coming months the Commission will translate the ideas and options set out in this Budget Review into concrete proposals. The Commission looks forward to a dialogue with the other Institutions and with stakeholders on the ideas and options outlined in this Review. These discussions will feed into proposals in June 2011 for a new Multiannual Financial Framework covering the period after 2013. This will include a proposal for a regulation laying down the Multiannual Financial Framework and a draft decision on own resources. In the second half of 2011, the Commission will make the legislative proposals required to implement the policies and programmes needed to drive forward the European Union's ambitions for the years ahead.