House of Commons

European Scrutiny Committee

# The EU's Financial Perspective for 2007–13 and Reform of the Structural and Cohesion Funds

## Fifteenth Report of Session 2003–04

HC 42-xv

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## Fifteenth Report of Session 2003–04

*Report, together with formal minutes*

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## The European Scrutiny Committee

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Standing Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

The expression 'European Union document' covers —

i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee's powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House's Standing Orders, which are available at www.parliament.uk.

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# Summary

This Report examines two EU documents: the Commission's proposals for a new Financial Perspective for the EU and its proposals for reform of regional and cohesion funding.

The new Financial Perspective will determine the overall revenue and expenditure of the EU and the expenditure on each category of EU activity for the seven years from 2007 to 2013. It will also largely determine the net contribution to the EU of each Member State, and the future of the UK's budget rebate. As well as determining the shape of the EU's finances it will set the Commission's policy agenda. It is therefore one of the most crucial forthcoming EU decisions.

The Report examines in turn the Commission's priorities for the enlarged EU, the proposed overall level of expenditure, how the Commission plans to ensure the objectives are met, the new structure of the Financial Perspective and new ways of providing flexibility within the overall framework, and proposals for revenue raising and for a system of budget rebates.

The central aspect of the Financial Perspective is the overall level of expenditure. Widely differing figures have already been floated, from the 1% of gross national income proposed by the UK and certain other Member States to the 1.24% proposed by the Commission.

The two largest areas of expenditure are the Common Agricultural Policy, on which spending up to 2013 has largely been determined already, and regional and cohesion policy. However, the Commission's proposals include many proposals for increased spending and for significant new policies or changes in policies. The Committee requests the Government's views on some of these, such as the proposed European Border Guard Corps and increased spending on security-related research.

The Commission will present proposals later on revenue, but has set out options for "a relatively major and visible tax resource payable by EU citizens and/or economic operators" to replace the existing system. It also proposes a system of budget rebates which would replace the UK rebate and be available to any Member State making an excessive budgetary contribution, but (unlike the UK rebate) this would be subject to a threshold and all Member States would have to contribute to it. The UK Government firmly opposes this proposal.

The overall level of funding and the funding of regional and cohesion policies will be closely linked. The second document examined here presents the Commission's proposals for regional and cohesion funding for 2007 to 2013, together with an assessment of the impact of such funding hitherto.

For the future the Commission proposes three priorities: assistance for regions with per capita GDP of less than 75% of the EU average, together with transitional funding for regions which qualified in that respect before enlargement but will no longer do so after enlargement (together accounting for 78% of the funding); promotion of regional competitiveness and employment, through help for urban areas in decline and disadvantaged rural areas and through national programmes to assist labour market reform and strengthen social inclusion (together accounting for 18% of the budget); and support for inter-regional, cross-border and transnational co-operation to promote joint solutions to common problems (accounting for 4% of the funding). Total spending would be €336.3 billion in the seven years, compared with €257 in the preceding seven years. In the UK only Cornwall and the Isles of Scilly would be likely to qualify in the first priority area, but some other regions would receive transitional funding.

The UK Government argues that the priority should be the poorer Member States, particularly the new ones, whereas under the Commission's proposals about 50% of the funding would go to the existing Member States. It adds that the proposals do not focus sufficiently on the need to add value at EU level.

The Committee notes that the two key questions are the overall amount of regional and cohesion funding for 2007-2013 and what proportion should be available to the more prosperous Member States (and, following from that, whether it should be left to those Member States to finance and deliver their own regional policies). It has asked the Government for an assessment of the likely impact of the Commission's proposals on the resources available for UK domestic assistance to the regions and of how the impact of the Commission's proposals would compare with that of the Government's preferred approach.

The Committee recommends that the two documents be debated together on the Floor of the House, but plans to gather further evidence before such a debate takes place.

# Introduction

1. The new Financial Perspective for the EU will determine the overall revenue and expenditure of the EU and the expenditure on each category of EU activity for the seven years from 2007 to 2013. It will also largely determine the net contribution to the EU of each Member State, and the future of the UK's budget rebate. It will in practice be binding on the parties to it for those seven years. It is therefore one of the most crucial forthcoming EU decisions, with important consequences for enlargement and the draft constitutional treaty.

2. The process of agreeing the new Financial Perspective began with the document currently before the Committee — the Commission Communication of 10 February 2004 — and the Commission hopes that agreement can be reached in the first half of 2005, though, given the difficulty of the negotiations, that must be uncertain.

3. The overall level of revenue and expenditure under the Financial Perspective is central, and widely differing figures have already been floated, from the 1% of Gross National Income (GNI) proposed by the UK and certain other Member States to the 1.24% proposed by the Commission. Within the overall figure, the two main areas of spending are the Common Agricultural Policy, on which a major part of the anticipated expenditure up to 2013 has already been determined by the decision taken at the Brussels European Council in October 2002, and regional and cohesion policy. Since the latter will in practice be the main determinant of the overall figure, we examine the Commission's recent proposals for it as part of this Report.

4. Other increases in spending are scattered through the Commission Communication, not always with much attempt to justify them, together with some major new policy commitments. We have sought to concentrate here on what is new in the Commission's proposals and what will give rise to increased expenditure. We deal with each element of the new Financial Perspective in turn, and then examine the proposals for regional and cohesion policy.

**This Report examines the following two documents:**

| | |
|---|---|
| (25367)<br>6232/04<br>COM(04) 101 | Commission Communication: *Building our common future: Policy challenges and Budgetary means of the Enlarged Union 2007-2013* |

| | |
|---|---|
| *Legal base* | — |
| *Document originated* | 10 February 2004 |
| *Deposited in Parliament* | 16 February 2004 |
| *Department* | HM Treasury |
| *Basis of consideration* | EM of 27 February 2004 |
| *Previous Committee Report* | None |
| *To be discussed in Council* | March-June 2004 |
| *Committee's assessment* | Politically important |
| *Committee's decision* | For debate on the Floor of the House, together with the Communication on economic and social cohesion |

| | |
|---|---|
| (25423)<br>—<br>COM(04) 107 | Commission Communication: Third report on economic and social cohesion |

| | |
|---|---|
| *Legal base* | Article 159 EC |
| *Document originated* | 18 February 2004 |
| *Deposited in Parliament* | 3 March 2004 |
| *Department* | Trade and Industry |
| *Basis of consideration* | EM of 23 March 2004 |
| *Previous Committee Report* | None |
| *To be discussed in Council* | No date set |
| *Committee's assessment* | Politically important |
| *Committee's decision* | For debate on the Floor of the House, together with the Communication on a new Financial Perspective for 2007-13 |

Note: Of the three document numbers in each case, the first is the Committee's, the second the Council's and the third the Commission's. 'EM' means the Government's Explanatory Memorandum.

# The Financial Perspective 2007–13

## The Communication

5. The Commission introduces its Communication with a polemical exposition of its view of the future of the Union. It says enlargement presents new opportunities for the Union. It argues for a European constitution, continued integration and the need to "avoid the trap of unwieldy inter-governmentalism". It sets out what it sees as the economic challenge for the Union. It says:

> "The choices to be made on the next financial perspectives are not just about money. It is a question of political direction, to be made on the basis of a clear vision of what we want to do. These choices will determine whether the European Union and its Member States are able to achieve in practice what European people expect.
>
> "This means a new phase for the Union's budget. It is not about redistributing resources between Member States. It is about how to maximise the impact of our common policies so that we further enhance the added value of every euro spent at European level."

6. In the body of the document the Commission sets out its proposals for the priorities of the enlarged Union, the overall level of spending (or "matching resources to needs"), ensuring objectives are met, the structure of the new financial framework for 2007-13, and revenue.

## Priorities for the enlarged European Union

7. The Commission identifies three priorities for the next Financial Perspective:

- completion of the internal market to help in achieving the broader objective of sustainable development;
- completion of an area of freedom, justice, security and access to basic goods in order to promote "the political concept of European citizenship"; and
- projection of a coherent role for "the EU as a global partner".

The Commission then sets out its proposals for budgetary expenditure to contribute to meeting these priorities, often in very general terms but incorporating significant new policies and commitments.

### *Sustainable development*

8. The Commission envisages transforming the EU into a dynamic knowledge-based economy geared towards sustainable growth; pursuing greater cohesion in an enlarged Union; and reinforcing the competitiveness of agriculture, strengthening rural development and ensuring sustainable exploitation of fish resources and the quality of the environment. It proposes budgetary support, with significant increases in some areas, to promote:

- competitiveness for growth and employment (noting the need to implement the Lisbon Strategy), by promoting the competitiveness of enterprises in a fully integrated single market; strengthening European research and technological development; connecting Europe through Trans-European Networks; improving the quality of education and training; and helping society, through a social policy agenda, to anticipate and manage change;

- greater cohesion, with the three priorities discussed later in our Report; and

- sustainable management and protection of natural resources, focussing rural development policy after 2006 on three main objectives — increasing the competitiveness of agriculture through support for restructuring, enhancing the environment and countryside, improving quality of life and promoting diversification of economic activities in rural areas; focussing fisheries policy more on sustainable exploitation; and implementation of the EC Climate Change Programme, of the Environmental Technology Action Plan, of the biodiversity action plan and of policies addressing specific issues such as soil, pesticides and waste recycling.

### *European citizenship*

9. In support of this priority the Commission envisages promoting:

- "a true area of Freedom, Security and Justice", necessitated by integration of the Charter of Fundamental Rights into a constitutional treaty (including a legal obligation actively to promote Charter rights) and by the challenges of immigration, asylum and the fight against crime and terrorism, through: management of the EU's external borders by a new European Border Agency (paving the way for a European Border Guard Corps); a common asylum policy; a common policy on immigration to address labour market needs; ensuring security through developing Europol and the European Police College and focussing more strongly on crime prevention; and providing legal certainty across borders and strengthening Eurojust;

- "access to basic goods and services", by reinforcing safety, security and environmental standards, developing a disaster response capacity, helping national authorities to empower individuals to improve their health and facilitate cross-border access for patients, and possible common frameworks for access to an adequate level of such basic services of general interest[1] as health, education or telecommunications; and

- European culture and diversity, by supporting cultural cooperation, overcoming the obstacles to cross-border exchanges (including in the audiovisual industry) and

1 Services of general interest, including services of general economic interest (SGEI), are services provided by the public or private sector and subject to public service obligations. SGEI can range from network industries such as energy supply or telecommunications to services as diverse as waste collection, port services and carcase rendering. Non-economic services of general interest can include services such as education or health provision. But the boundary between SGEI and non-economic services of general interest is imprecise and shifting. A common justification for the imposition of public service obligations is the promotion of territorial and social cohesion. Typically public service obligations include universal provision at a standard price.

fostering youth exchanges, voluntary service and informal learning and language training.

### *The EU as a global partner*

10. The Commission argues that there is a gap between the Union's economic weight and its political weight and that a more coherent external relations strategy would enhance the Union's influence beyond the level that Member States could achieve individually. It envisages budgetary support to promote:

- a policy for the EU's near neighbourhood (countries immediately bordering the Union) as a stepping-stone to world sustainability and stability. It proposes "stabilising" the near neighbourhood and supporting its development through cooperation and integration in trade, regulatory matters, transport, energy, education, training, and immigration; tackling environmental and nuclear safety, energy security, illegal immigration, organised crime, trafficking, terrorism and communicable diseases; moves to consolidate democracy and the rule of law and to encourage economic reforms and integration; and measures, including "as a last resort by using force under a UN mandate", aimed at guaranteeing stability, preventing conflicts and managing crises;

- the EU as a sustainable development partner, through work aimed at eradicating global poverty, including the Union's contribution towards the Millennium Development Goals, a single external representation on trade, finance and "norms-setting", promoting common Member State positions (agreed by qualified majority) in multilateral negotiations and a unified presence in the World Bank, IMF and UN economic agencies;

- the EU as a global player, supporting effective multilateralism and contributing to strategic and civil security both within and beyond its borders. In this context "a need for increased security-related research" to strengthen military capabilities is estimated later in the document as needing "an order of magnitude of €3 billion" (£2.05 billion); and

- improved coherence in bilateral relations and international institutions and effective complementary actions between the Union and Member States.

## The overall level of expenditure

11. The Commission notes that "sound financial planning means matching resources to needs" and that financial decisions are essentially about choices and priorities. It argues that, whilst the demand that the Union applies rigour and restraint to its finances is fully justified, it is an illusion to believe that restricting spending guarantees value for money. It says "To saddle the Union with a set of goals and then deny it the resources required would be to condemn it to the justified criticism of citizens denied their legitimate expectations".

12. The Commission then discusses what it calls "the legacy of existing commitments". It notes that in 2006 the commitment appropriations ceiling of the current Financial Perspective for the EU of 25 is 1.11% of Union gross national income (GNI), with

commitment appropriations under the Ninth European Development Fund adding on average another 0.03% of Union GNI, and asserts that the evolution of expenditure for the period 2007-13 is already partly determined by:

- the October 2002 Brussels European Council agreement on market-related and direct payments in the agricultural sector until 2013;
- the need to support cohesion policies in the ten new Member States;
- accommodating Bulgaria and Romania; and
- resource consequences of policies which flow directly from the treaties and legislation.

The Commission says that integrating the European Development Fund into the General Budget ("budgetising" the fund), at current levels of expenditure, would add 0.03% of GNI to the total figure.

13. The Commission also asserts that a budget limited to 1% of Union GNI (as favoured by six net contributors — the UK, France, Germany, Austria, Sweden and the Netherlands) would prejudice fulfilment of these commitments and would mean the EU having to:

> "reduce its efforts in terms of external aid, reduce support for rural development, one of the key objectives of CAP reform, renege on international commitments and pledges, drastically decrease cohesion support in the current Member States in the face of major problems of lagging development, unemployment and social exclusion, retreat from commitments it has already made, its new neighbourhood policy or justice and security tasks, and jeopardise further enlargement.
>
> "Alternatively, cuts would be needed across the board, and existing agreements would have to be re-opened, including the amounts decided at the Brussels European Council of October 2002, and in particular the re-orientation of the CAP towards rural development."

14. The Commission argues that the challenges it identifies would require a substantial increase in funding, but says that a credible plan to meet the Union's needs within the priorities set out above can be drawn up with limited increases in the budget, within a ceiling of 1.24% of Union GNI. It says that, within that ceiling, rebalancing the budget would allow room for the new priorities. A significant proportion of EU resources would be focused on objectives such as competitiveness for growth and employment (16%) and Europe as a global partner (7%). Its framework financial proposals are set out here in Table A, together with an HM Treasury version in sterling (Table B).[2]

2 Using the exchange rate at 30 January 2004 of €1.00 = £0.6846.

**TABLE A — OVERVIEW OF THE NEW FINANCIAL FRAMEWORK 2007–2013**

Million € at 2004 prices

| COMMITMENT APPROPRIATIONS | **2006** (a) | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **Cumulated 2007-13** | |
|---|---|---|---|---|---|---|---|---|---|---|
| **1. Sustainable growth** | **47,582** | **59,675** | **62,795** | **65,800** | **68,235** | **70,660** | **73,715** | **76,785** | **477,665** | |
| **1a. Competitiveness for growth and employment** | 8,791 | 12,105 | 14,390 | 16,680 | 18,965 | 21,250 | 23,540 | 25,825 | 132,755 | |
| **1b. Cohesion for growth and employment** (b) | 38,791 | 47,570 | 48,405 | 49,120 | 49,270 | 49,410 | 50,175 | 50,960 | 344,910 | |
| **2. Preservation and management of natural resources** | **56,015** | **57,180** | **57,900** | **58,115** | **57,980** | **57,850** | **57,825** | **57,805** | **404,655** | |
| of which: **Agriculture** — Market related expenditure and direct payments | 43,735 | 43,500 | 43,673 | 43,354 | 43,034 | 42,714 | 42,506 | 42,293 | 301,074 | |
| **3. Citizenship, freedom, security and justice** | **1,381** | **1,630** | **2,015** | **2,330** | **2,645** | **2,970** | **3,295** | **3,620** | **18,505** | |
| **4. The EU as a global partner** (c) | **11,232** | **11,400** | **12,175** | **12,945** | **13,720** | **14,495** | **15,115** | **15,740** | **95,590** | |
| **5. Administration** (d) | **3,436** | **3,675** | **3,815** | **3,950** | **4,090** | **4,225** | **4,365** | **4,500** | **28,620** | |
| Compensations | 1,041 | | | | | | | | | |
| **Total appropriations for commitments** | **120,688** | **133,560** | **138,700** | **143,140** | **146,670** | **150,200** | **154,315** | **158,450** | **1,025,035** | |
| **Total appropriations for payments** (b) (c) | **114,740** | **124,600** | **136,500** | **127,700** | **126,000** | **132,400** | **138,400** | **143,100** | **928,700** | **Average** |
| Appropriations for payments as a percentage of GNI | 1.09% | 1.15% | 1.23% | 1.12% | 1.08% | 1.11% | 1.14% | 1.15% | 1.14% | 1.14% |
| Margin available | 0.15% | 0.09% | 0.01% | 0.12% | 0.16% | 0.13% | 0.10% | 0.09% | 0.10% | 0.10% |
| Own resources ceiling as a percentage of GNI | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% |

(a) 2006 expenditure under the current financial perspective has been broken down according to the proposed new nomenclature for reference and to facilitate comparisons.

(b) Includes expenditure for the Solidarity Fund (€1 billion in 2004 at current prices) as from 2006. However, corresponding payments are calculated only as from 2007.

(c) The integration of EDF in the EU budget is assumed to take effect in 2008. Commitments for 2006 and 2007 are included only for comparison purposes. Payments on commitments before 2008 are not taken into account in the payment figures.

(d) Includes administrative expenditure for institutions other than the Commission, pensions and European schools. Commission administrative expenditure is integrated in the first four expenditure headings.

**TABLE B — OVERVIEW OF THE NEW FINANCIAL FRAMEWORK 2007–2013**

Million £ at 2004 prices

| COMMITMENT APPROPRIATIONS | **2006** (a) | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **Cumulated 2007-13** | |
|---|---|---|---|---|---|---|---|---|---|---|
| **1. Sustainable growth** | **32,575** | **40,854** | **42,989** | **45,047** | **46,714** | **48,374** | **50,465** | **52,567** | **327,009** | |
| **1a. Competitiveness for growth and employment** | 6,018 | 8,287 | 9,851 | 11,419 | 12,983 | 14,548 | 16,115 | 17,680 | 90,884 | |
| **1b. Cohesion for growth and employment** (b) | 26,556 | 32,566 | 33,138 | 33,628 | 33,730 | 33,826 | 34,350 | 34,887 | 236,125 | |
| **2. Preservation and management of natural resources** | **38,348** | **39,145** | **39,638** | **39,786** | **39,693** | **39,604** | **39,587** | **39,573** | **277,027** | |
| of which: **Agriculture** — Market-related expenditure and direct payments | 29,941 | 29,780 | 29,899 | 29,680 | 29,461 | 29,242 | 29,100 | 28,954 | 206,115 | |
| **3. Citizenship, freedom, security and justice** | **945** | **1,116** | **1,379** | **1,595** | **1,811** | **2,033** | **2,256** | **2,478** | **12,669** | |
| **4. The EU as a global partner** (c) | **7,689** | **7,804** | **8,335** | **8,862** | **9,393** | **9,923** | **10,348** | **10,776** | **65,441** | |
| **5. Administration** (d) | **2,352** | **2,516** | **2,612** | **2,704** | **2,800** | **2,892** | **2,988** | **3,081** | **19,593** | |
| Compensations | 713 | | | | | | | | | |
| **Total appropriations for commitments** | **82,623** | **91,435** | **94,954** | **97,994** | **100,410** | **102,827** | **105,644** | **108,475** | **701,739** | |
| **Total appropriations for payments** (b) (c) | **78,551** | **85,301** | **93,448** | **87,423** | **86,260** | **90,641** | **94,749** | **97,966** | **635,788** | **Average** |
| Appropriations for payments as a percentage of GNI | 1.09% | 1.15% | 1.23% | 1.12% | 1.08% | 1.11% | 1.14% | 1.15% | 1.14% | 1.14% |
| Margin available | 0.15% | 0.09% | 0.01% | 0.12% | 0.16% | 0.13% | 0.10% | 0.09% | 0.10% | 0.10% |
| Own resources ceiling as a percentage of GNI | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% | 1.24% |

(a) 2006 expenditure under the current financial perspective has been broken down according to the proposed new nomenclature for reference and to facilitate comparisons.

(b) Includes expenditure for the Solidarity Fund (€1 billion in 2004 at current prices) as from 2006. However, corresponding payments are calculated only as from 2007.

(c) The integration of EDF in the EU budget is assumed to take effect in 2008. Commitments for 2006 and 2007 are included only for comparison purposes. Payments on commitments before 2008 are not taken into account in the payment figures.

(d) Includes administrative expenditure for institutions other than the Commission, pensions and European schools. Commission administrative expenditure is integrated in the first four expenditure headings.

15. On the general thrust of the Commission's proposals and its financial framework the Financial Secretary to the Treasury (Ruth Kelly) says:

> "The Government believes the next Financial Perspective represents a unique opportunity to increase both the effectiveness and transparency of expenditure and to consider how allocations within a limited EU budget can best be refocused in support of the Union's Lisbon strategy. In particular, the Government believes that the future EU Budget should
>
> - *be objectives-focussed, with the emphasis on outcomes not inputs*, meaning that there should be no automatic assumption that a certain level of spending is needed to meet the Union's objectives. The Government's view is that the Financial Perspectives should be set with reference to explicit high-level, evidence-based objectives thereby meeting the strategic direction established by the European Council;
> - *be evidence-based, with evaluation of the impact of budgetary policy*. Strategic EU budget planning should be based on clear evidence of what works, and what doesn't, and poorly performing programmes should be displaced or redirected;
> - *examine, for existing as well as new areas of spending, whether the Union budget is the best instrument for adding value*, or whether action would be better addressed at Member State level or through other, non-spending, policy measures. Even where a case for spending to meet objectives has been made, that does not mean that spending should be carried out at the EU level;
> - ensure sound financial management and budget discipline; and
> - ensure an equitable distribution of spending across the EU, consistent with value-added principles and objectives.
>
> "The Government believes that the Commission's Communication has failed to respond adequately to these challenges, and that its proposals are neither realistic nor acceptable. The Government will continue to analyse the details and implications of the Communication, including seeking clarifications and additional information from the Commission.
>
> "On the overall size of the budget being proposed by the Commission, the Government believes that the needs of an enlarged Union can be adequately met by a budget of 1% EU GNI as set out in the Prime Minister's joint letter (with the Heads of Austria, France, Germany, Sweden, and the Netherlands) to Commission President Romano Prodi on 15 December 2003."

## Ensuring the objectives are met

16. In this section the Commission says the success of policies relies on efficiency of delivery and, more broadly, on an appropriate system of governance. It suggests three guiding principles:

- concentrating Community resources on a few major initiatives, thereby giving better financial transparency, scope for improved quality and effectiveness of expenditure and possibly the ability better to assess value added;
- consistency between different strategic goals, targets and instruments; and
- partnership with all involved, especially between the Union and Member States.

17. The Commission proposes to back this up with a rationalisation of implementing instruments. It suggests:

- "a roadmap" to bring together goals, objectives, instruments and indicators, as well as a stringent timetable to assess whether agreed benchmarks have been reached; and
- whilst noting that the instruments available to the Union include regulation, coordination and budgetary support, there should be several underlying principles in proposing expenditure programmes — one instrument per policy area, one fund per programme and Commission consideration of alternatives to in-house direct management, including delegation to outside offices and agencies or partnership with Member States or regions (but apparently not with the private sector).

The Commission intends to make detailed proposals for simplification shortly.

18. On this section the Minister comments:

> "The Government supports in principle the aim of simplifying the financial instruments to ensure a more transparent, coherent and effective approach. The Government is looking at the Commission's proposals in this regard and will aim to ensure that any proposals improve the effectiveness of EC Budget spending, do not disrupt the inter-institutional balance, nor lead to any dilution of proper financial management and control."

## The structure of the Financial Perspective

19. The Commission proposes changing the structure of the Financial Perspective from its present one with eight headings (agriculture, structural operations, internal policies, external action, administration, reserves, pre-accession strategy and post-enlargement compensations) and 11 subheadings. It acknowledges the legitimate objective of budgetary discipline but says ring-fencing of resources under so many headings creates rigidity and prevents proper adjustment and more effective use of resources.

20. Instead the Commission proposes five main expenditure headings for 2007-13:

- sustainable growth, split between measures to promote competitiveness for growth and employment and to promote cohesion for growth and employment (including a solidarity fund);
- sustainable management and protection of natural resources;
- citizenship, freedom, security and justice;

- the European Union as a global partner, including the emergency aid and loan guarantee reserves; and
- a residual administration category to include expenditure for institutions other than the Commission, pensions and European schools. (The Commission's own administrative expenditure would be included with other expenditure linked to a particular policy objective, following the logic of activity-based budget management.)

21. In relation to the budgetary categories the Minister tells us:

> "On classification of expenditure, the Government notes that currently the link between objectives and Financial Perspective headings and annual budget allocations is often unclear, making it difficult to judge whether expenditure is actually delivering desired policy outcomes. There is insufficient information in the Communication to determine whether the proposed budget structure would deliver a clearer link between spending and outcomes."

22. In order to avoid inflexibility under the Financial Perspective the Commission proposes three procedures for adjusting the expenditure ceilings. First, it suggests the existing procedure to adjust ceilings should remain the main instrument to allow adjustments, when substantial and lasting changes in political priorities occur. But it asserts that this procedure has not worked well and proposes additionally an annual assessment of needs, possibly through a discussion between the European Parliament, the Council and the Commission ahead of each presentation of the Preliminary Draft Budget.

23. The Commission proposes secondly a new reallocation facility so as to provide short-term flexibility within the agreed financial framework. This would allow the Budgetary Authority (the European Parliament and the Council) to reallocate appropriations within certain limits between expenditure headings, with the exception of cohesion and rural development appropriations for multi-annual programmes.

24. Thirdly, the Commission proposes a new growth adjustment fund, within the sustainable growth budgetary heading, "to optimise the delivery of the growth and cohesion objectives" and to provide flexibility to take account of uneven progress towards these objectives and to cope with unforeseen events impacting on growth and employment.

25. On flexibility the Minister comments:

> "The Government is examining the Commission's proposals on flexibility. It will aim to ensure that proposals on flexibility do not come at the expense of budget discipline and will look at this closely in relation to the overall structure of the Financial Perspective."

26. For subsequent financial frameworks after 2013, the Commission proposes moving to a five-year cycle, in line with its own and the European Parliament's five-year terms. The Minister says that the Government "in principle, sees no problem in moving to a five-year period", though this should form part of negotiations on the subsequent Financial Perspectives.

## Revenue raising and rebates

27. The Commission will present specific proposals on own resources (the Union's revenue sources) in the Own Resources Report which it intends to submit to the Council by summer 2004. The Commission says the current own resources system has performed relatively well from a financial point of view, but has been criticised on grounds of insufficient transparency for EU citizens, limited financial autonomy, and complexity and opacity.

28. The Commission says that it does not intend to propose a new own resource in the near future.[3] But it says that, subject to the conclusions in the Own Resources Report, it might launch a process to create a new own resource to replace an important part of national contributions in the medium term. The Commission sets out options for "a relatively major and visible tax resource payable by EU citizens and/or economic operators" that could partly replace gross national income (GNI) contributions. It presents what it sees as three main candidates:

- a tax on corporate income;
- a genuine VAT resource; and
- an energy tax.

29. The Commission also discusses budgetary imbalances in this section. Whilst stating that "There will always be net beneficiaries of and net contributors to the EU budget, although the policy benefits accrue to the Union as a whole", it acknowledges that imbalances in Member States' contributions may give rise to concerns, and that limited corrections of excessive imbalances may therefore appear necessary. It notes that a correction mechanism should both correct excessive net contributions and give fair treatment to Member States with similar capacities to contribute. The Commission recalls that, since the mid-1980s, a formal correction mechanism has existed for the UK only, financed by all other Member States, and that since 2002 financing of that correction by four Member States (Germany, the Netherlands, Austria and Sweden) has been reduced to 25% of their normal share.

30. The Commission proposes to introduce a generalised correction mechanism which would correct a budgetary burden which is excessive in relation to Member States' relative prosperity. However, the Commission intends to prevent the total cost of the mechanism from becoming excessive. The Commission does not specify the form of such a mechanism, although it notes that it "would be aimed at correcting net contributions in excess of a certain pre-defined threshold of 'financial solidarity'", based on a percentage of GNI. It says that the effect of a generalised mechanism should be limited to avoiding excessive and unjustified fiscal burdens and that all Member States should contribute to the mechanism.

31. The Commission says that it will table detailed proposals in the context of the overall financial package, which will address both revenue and expenditure issues.

3 The current own resources are customs and other duties levied on trade with third countries, contributions based notionally on value added taxation and contributions based on the gross national income of Member States.

32. The Minister's comments on revenue raising and the UK rebate are unsurprising:

> "The Government is firmly against any proposals for an EU tax to finance the Community Budget and believes that taxation is a matter for member states to determine on a national basis. The Government believes that the current UK abatement remains justified and necessary to correct for the UK's disproportionate budgetary imbalance."

## Timescale

33. It is expected that the European Council will consider the Commission's proposals in June 2004. The new European Parliament will also consider it at an early stage. The Commission expects to table formal proposals arising from the Communication before August 2004 and hopes agreement will be reached on them in the first half of 2005. Proper preparation of the next multi-annual financial frameworks for such programmes as European research and technological development and the Trans-European Networks and of the General Budget for 2007 depend on a timely agreement on the next Financial Perspective.

## Conclusion

34. **This document is important. It is not just concerned with the future finances of the Union — an important enough subject in its own right — but also sets out the Commission's policy agenda for the next decade and beyond. The Communication is at a fairly high level of generality. But it outlines a full and detailed agenda, within which are suggestions about or allusions to significant changes or expansions of policy and to significant new ones.**

35. **We are certain that the House will wish to debate this Communication, the related proposals on regional and cohesion policy (on which we report below) and perhaps other documents yet to come, such as the promised Own Resources Report, and we therefore recommend that the Communication be debated on the Floor. This debate will need to take place early enough to have some influence on the next Financial Perspective and the policy agenda on which it will be based, and before the June 2004 European Council. However, we plan to gather further information before the debate we now recommend takes place.**

36. **Meanwhile, we note the Government's**

- **intention "to analyse the details and implications of the Communication, including seeking clarifications and additional information from the Commission";**
- **aim of focussing the Union budget on supporting the Lisbon Strategy (which the Commission does address in part in the document);**
- **continued insistence on budgetary restraint;**
- **defence of the UK rebate; and**

- **reiteration of its firm opposition to an EU tax.**

37. **But we should also like to hear from the Government as soon as possible about its view of:**

- **the Commission's presumption about the content of the proposed constitutional treaty, particularly in relation to the active promotion of rights under the Charter of Fundamental Rights;**

- **the presumption that there will be a European Border Guard Corps;**

- **the Commission's intention to promote "the political concept of European citizenship";**

- **the Commission developing a disaster response capacity;**

- **the relationship of a near neighbourhood policy to the policy of focussing development assistance more on poverty eradication in the world's most disadvantaged countries;**

- **the proposal for a single external representation on trade, finance and "norms setting" and a unified presence in the World Bank, IMF and UN economic agencies;**

- **"budgetisation" of the European Regional Development Funds, which the Secretary of State for International Development (Mr Hilary Benn) told us in November 2004 that the Government firmly opposed,[4] though there is no mention of this in the Government's Explanatory Memorandum;**

- **the Commission's identification of "a need for increased security-related research" to strengthen military capabilities;**

- **the Commission's apparent omission of the private sector as regards alternatives to in-house direct management of programmes.**

4 (24951) 13465/03: see HC 63-xxxvii (2002-03), para 13 (12 November 2003).

# Regional and cohesion policy

## Background

38. Article 2 of the EC Treaty lists among the Community's tasks the promotion of "economic and social cohesion and solidarity among Member States". Article 3, which lists EC activities for the purpose of its tasks, expressly includes the strengthening of economic and social cohesion and mentions other relevant activities such as common policies for agriculture and fisheries, transport and the environment, the promotion of research and technological development and a contribution to education and training.

39. Article 158 EC provides that "the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas". Article 159 EC says that the Community is to support the achievement of these objectives through, among other things, the Structural Funds.

40. The EU's current budget for the promotion of economic and social cohesion equates to about 1% of the Gross Domestic Product (GDP) of the present 15 Member States.[5] The total budget for this expenditure between 2000 and 2006 is €257 billion.[6]

41. Article 159 EC requires the Commission to report every three years on progress towards achieving economic and social cohesion and how EU policies have contributed to it.[7] In response, the Commission's recent report (its third) reviews the current and foreseeable economic and social conditions of the existing Member States and the accession countries, and sets out the Commission's proposals for reform of the Structural and Cohesion Funds for the period 2007-13.

42. The Structural Funds comprise:

- the European Regional Development Fund (ERDF), established by Article 160 EC "to redress the main regional imbalances in the Community through participation in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions";
- the European Social Fund (ESF), established by Article 146 EC "to improve employment opportunities for workers in the internal market and to contribute thereby to raising the standard of living";
- the guidance section of the European Agricultural Guidance and Guarantee Fund (EAGGF); and
- the Financial Instrument for Fisheries Guidance (FIFG).

5 This figure excludes Member States' own expenditure on economic and social cohesion projects; the EU usually meets no more than half the cost of projects.

6 Including €22 billion for the accession states before their accession and another €22 billion for structural assistance to them in 2004-06.

7 We considered the Commission's second report in January 2002: see HC 152-xi (2001-02), para12 (9 January 2002).

43. For the period 2000-06, the distribution of the Structural Funds is primarily related to three aims:

- Objective 1— to promote the development and structural adjustment of regions whose per capita GDP is less than 75% of the Community average and remote regions (such as the Azores and the most northern areas of Finland and Sweden);
- Objective 2 —to assist regions seriously affected by industrial decline; and
- Objective 3 — to combat long-term unemployment and facilitate the integration into working life of young people and people excluded from the labour market outside Objective 1 regions.

44. The Cohesion Fund, established under Article 162 EC, provides financial contributions to environmental projects and trans-European transport infrastructure networks. Financial assistance from the Cohesion Fund is available to Member States with a GDP of less than 90% of the EU average (currently Greece, Ireland, Portugal and Spain).

45. Access to the Funds is dependent on the Member State providing matching funding.

46. The Commission is expected to publish its detailed draft Structural and Cohesion Funds Regulations for 2007-13 in July 2004. What is eventually agreed will depend to a large extent on the outcome of the negotiations on the next Financial Perspective.

## The document

47. The report contains an extensive Executive Summary (pages 3-19) and the Commission's proposals for the reform of cohesion policy for the period from 2007 to 2013 (pages 20-38). The rest of the Report gives the Commission's assessment of:

- the current economic and social situation in the existing and accession states (Part 1— pages 39-85);
- the impact of Member States' policies on cohesion (Part 2 — pages 86-100);
- the impact of Community policies on competitiveness, employment and cohesion (Part 3 — pages 101-120); and
- the impact and added value of structural policies (Part 4 — pages 121-164).

The Commission's report generally uses the term "cohesion policy" to cover both cohesion and regional policy, but does not do so consistently.

## The Commission's assessment

48. The Commission notes that the EU's economic growth has slowed over the last three years and that unemployment has risen in many parts of the Community. Wide disparities in output, productivity and competitiveness persist between countries and between regions within countries.

49. Between 1994 and 2001, the annual growth of per capita GDP in the Objective 1 regions of the EU 15 (that is, regions with per capita GDP of less than 75% of the EU

average) averaged almost 3% in real terms. But some of the regions grew by considerably less. For example, in the Italian Mezzogiorno, annual growth was less than 2% and in 2002 only 42% of the working-age population was in employment, well below anywhere else in the EU.

50. Disparities in income and employment will widen much more when the accession states join the EU. Average GDP in the accession states is less than half the average in the existing 15 Member States (the EU 15). The GDP of the enlarged EU (the EU 25) after May will be 5% more than the combined GDP of the EU 15, but the population will be 20% greater. The average per capita GDP of the EU 25 will be over 12% less than that of the EU 15. Over 90% of the people of the accession states live in regions with a per capita GDP of less than 75% of the average for the EU 25; more than two-thirds live in regions with less than half the EU 25 average.

51. The Commission notes that public expenditure by the Member States is many times larger than the EU's expenditure on cohesion policy. Member States' public expenditure averages 47% of GDP whereas the budget allocated for cohesion policy is less than 0.4% of EU GDP. But two-thirds of Member States' expenditure is on education, health and social protection (such as pensions and benefits). The Commission says that, by contrast, EU structural spending is focussed on reducing structural disparities which directly affect the economic competitiveness of the regions and the employability of people.

52. The Commission goes on to assess the impact of Community policies relevant to cohesion, including those to promote a knowledge-based economy, to strengthen education and training, to encourage more and better jobs and to protect the environment.

53. On the impact of interventions through the Structural Funds, the Commission says that the growth of GDP, employment and productivity in Objective 1 regions has exceeded the rate of growth in the rest of the EU since the mid-1990s. Assistance from the Cohesion Fund, too, has boosted growth. In Spain, GDP in 1999 is estimated to have been 1.5% higher than it would have been without intervention; the comparable figure for Greece is over 2%, for Ireland almost 3% and for Portugal over 4.5%. On average, a quarter of structural expenditure returns to the rest of the EU in the form of increased trade, especially of machinery and equipment.

54. The Commission says that the Structural Funds are of key importance to helping the accession states improve their competitiveness. They will be eligible to receive almost €22 billion of assistance over the three years ending on 31 December 2006.

## The Commission's proposals

55. The report says that, when adopting its proposal for the Financial Perspective for 2007-13, the Commission decided that an ambitious cohesion policy was an essential element of the package. Cohesion policy will be all the more necessary because:

- enlargement presents an unprecedented challenge to the competitiveness and internal cohesion of the EU;
- the EU faces challenges arising from globalisation, technological development and changes in demography; and

- economic growth has slowed and unemployment increased.

56. Moreover, the Commission says, cohesion policy must be seen as an integral part of the Lisbon strategy to make the EU the world's most dynamic and competitive knowledge-based economy by 2010.

57. Accordingly, the Commission proposes that, from 2007, there should be three priorities for the ERDF, the ESF and the Cohesion Fund:

- convergence;
- regional competitiveness and employment; and
- territorial cooperation.

58. *Convergence*: the key objective of cohesion policy would be the promotion of economic growth and job creation in the least favoured regions. Those with a per capita GDP of less than 75% of the average of the EU 25 would be eligible for assistance from the ERDF and the ESF. In the UK, the only region which might qualify is Cornwall and the Isles of Scilly. Member States with a per capita GDP of less than 90% of the average would be eligible for assistance from the Cohesion Fund. The Commission proposes the allocation of 78% of the combined resources of the ERDF, ESF and Cohesion Fund to convergence projects.

59. Some of the regions of the existing Member States will have per capita GDP of less than 75% of the average of the EU 15 but more than 75% of the average of the EU 25. The Commission comments that the objective circumstances of these regions will not have changed. The Commission proposes, therefore, that these regions should receive transitional funding, on a declining scale, between 2007 and 2013. In the UK, Merseyside, the Highlands and Islands and West Wales and the Valleys might qualify.

60. *Regional competitiveness and employment*: there would be two main strands under this heading. The regional programme strand would help eligible regions deal with the difficulties caused by industries or urban areas in decline and rural areas with a highly dispersed or ageing population. Regions not covered by the convergence programmes would be eligible for financial assistance. Current Objective 1 regions which do not meet the criteria for the convergence programmes would be eligible for transitional funding (in the UK, South Yorkshire might qualify for this). Funding for the regional programmes would come from the ERDF.

61. The other strand — national programmes — would assist labour market reforms and strengthen social inclusion by, for example, putting money into skills training, attracting more people into employment and increasing the employability of migrants and people from ethnic minorities or with disabilities. Funding would come from the ESF.

62. Spending on the regional and national programmes would account for about 18% of the total cohesion policy budget.

63. *European territorial cooperation*: this would be a new programme to support inter-regional, cross-border and transnational cooperation to promote joint solutions to common problems. The programme would be financed from the ERDF and would be allocated about 4% of the total cohesion budget. The Commission intends to propose the

creation of a new agency, the cross-border regional authority, to help national, regional and local authorities manage cross-border projects.

64. *Total expenditure on cohesion projects 2007-13*: the Commission proposes that spending on these projects in the next Financial Perspective should be €336.3 billion, in 2004 prices. This amount excludes expenditure on matters currently funded from the Agricultural Guidance and Guarantee Fund and the Financial Instrument for Fisheries Guidance, both of which would cease to be part of the Structural Funds. The proposed expenditure on cohesion projects would be equivalent to 0.41% of the gross national income (GNI) of the EU 25 plus Romania and Bulgaria (or 0.46% including spending under the agriculture and fisheries instruments). The Structural Funds' budget for 2000-06 is €257 billion.

## The Government's view

65. The Minister of State for Industry and the Regions and Deputy Minister for Women at the Department of Trade and Industry (Jacqui Smith) tells us that the Commission's budget proposals for spending on cohesion policy between 2007-13 are inconsistent with the Government's objective of an EU budget of no more than 1% of EU GNI.

66. The Minister says:

> "If the Commission's proposals were implemented, the UK's gross and net contributions to the EC budget would rise significantly. This would impact on the resources available for domestic programmes, including the three quarters of regional development funding that is already directly funded by UK central government.
>
> "The Government believes that the priority for SCF [Structural and Cohesion Funds] assistance should be the poorest Member States in the enlarged Union, principally the new Member States. The Commission's proposals do not meet this objective, as they imply that approximately 50% of the SCF budget would continue to be spent in the current Member States. A continuation of SCFs in the EU 15 would mean prolonging the inefficient recycling of funds amongst the richer Member States.
>
> "Additionally, the report does not focus sufficiently on the need to add value at the EU level. Following a UK-wide consultation on the future of the Funds last year the UK put forward its own proposed approach, the EU Framework for Devolved Regional Policy.[8] Our proposals are based on concentrating the EC budget on the areas where it would most add value, whilst respecting budget discipline. Under the Framework, EU Member States would agree common principles, but delivery of regional policy would be substantially devolved and decentralised, and offer greater flexibility to Member States and regions. Richer Member States would in future finance and deliver regional policy themselves and EU support, both financial and institutional, would be refocused on those poorest Member States that would benefit most from direct EU involvement."

8 The UK Government's consultation paper of March 2003. See also the written statement by the Secretary of State for Trade and Industry, Official Report, columns 54-56 WS, 17 September 2003.

## Conclusion

67. **The two key questions arising from the Commission's report are:**

- **the size of the cohesion budget for 2007-13; and**
- **what proportion, if any, of that budget should be available for the support of the more prosperous Member States (and, following from that, whether it should be left to those States to finance and deliver their own regional policies).**

68. **The Secretary of State for Trade and Industry will give us oral evidence in May. We shall ask her to enlarge on the Government's views on these questions. In preparation for her appearance before us, we should be grateful for a supplementary Explanatory Memorandum on:**

- **the likely impact on the resources available for UK "domestic programmes"[9] if the Commission's proposals for cohesion expenditure were adopted; and**
- **the likely impact on the regions of the UK if the Government's preferred approach were adopted compared with the likely impact of the Commission's proposals.**

69. **We recommend that the Commission's report be debated on the Floor of the House together with its report on the new Financial Perspective. We would expect that debate to take place after we have taken evidence from the Secretary of State.**

9 See para 66 above.

# Formal minutes

## Wednesday 24 March 2004

Members present:

| | |
|---|---|
| Mr Michael Connarty | John Robertson |
| Mr Jimmy Hood | Mr Anthony Steen |
| Angus Robertson | Mr Bill Tynan |

In the absence of the Chairman, Mr Michael Connarty was called to the Chair.

The Committee deliberated.

* * *

Draft Report, proposed by the Chairman, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 34 read and agreed to.

Paragraph 35 read, amended and agreed to.

Paragraphs 36 to 68 read and agreed to.

Paragraph 69 read, amended and agreed to.

Summary read, amended and agreed to.

*Resolved*, That the Report be the Fifteenth Report of the Committee of the House

*Ordered*, That the Chairman do make the Report to the House.

* * *

[Adjourned till Wednesday 31 March at Two o'clock