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SELECT COMMITTEE ON
THE EUROPEAN UNION

THE 2004 EC BUDGET

WITH EVIDENCE

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NOTE: Pages of the report are numbered in bold type; pages of evidence are numbered in ordinary type. References in the text of the report are as follows:

- (Q) refers to a question in oral evidence
- (p) refers to a page of written evidence.

A short glossary of the key terms can be found in Annex 2 of the Explanatory Memorandum by HM Treasury (pp 13-14)

THIRTY-THIRD REPORT

14 JULY 2003

By the Select Committee appointed to consider European Union documents and other matters relating to the European Union.

ORDERED TO REPORT

THE 2004 EC BUDGET

Preliminary Draft General Budget of the European Communities for the financial year 2004

PART 1: EXECUTIVE SUMMARY

The aim of this report is to inform the House of issues pertaining to the EC Budget generally and the 2004 Budget in particular. 2004 is a significant year for the EC Budget for three reasons:

- it is the first EC Budget in which spending is linked to objectives, outcomes and performance indicators, through the use of Activity-Based Budgeting;
- the 2004 EC Budget is the first to cover an enlarged Union of 25 members; and
- the draft European constitutional Treaty proposes changes to the budgetary process which aim to make it simpler and more transparent.

In this report, we examine the Commission's Preliminary Draft Budget for 2004, which represents the first stage in the annual budgetary procedure, and we analyse the Government's priorities for the subsequent negotiations on the budget. The Committee has decided that it can best fulfil its responsibility of parliamentary scrutiny by examining the Government's position before it enters into negotiations on the 2004 Budget in the Council of Ministers, which will start this year on 16 July.

The Government has outlined two priorities for the 2004 EC Budget:

- spending on external action should have a greater poverty focus; and
- strict conditions of value for money must be applied to the substantial increases for administration expenditure related to enlargement.

We broadly agree with the Government's position, whilst insisting that focusing funding on regions affected by poverty should not deflect from the EU's other objective of working towards stability in regions such as the Middle East and the Balkans.

In relation to the changes proposed by the Convention, we welcome the proposal that the European Parliament should have a greater say over spending on agriculture. However, we concur with the Government's view that the changes to the system of Own Resources proposed in the draft Constitutional Treaty are unacceptable, and we support the Government in its efforts to retain the status quo for decision-making in this area.

PART 2: BACKGROUND

Introduction: what is the purpose of this report?

1. The aim of this report is to inform the House of issues pertaining to the EC Budget generally and the 2004 Budget in particular.¹ We also scrutinise the Government's position before it enters into negotiations on the 2004 Budget in the Council of Ministers.

2. This report is the first in a series of reforms that we are implementing (in conjunction with the Government) to develop the way in which we scrutinise the annual EC Budget and its implementation. This short report, which focuses on the Commission's Preliminary Draft Budget for 2004, introduces an element of parliamentary scrutiny where little effective scrutiny previously existed in this House.²

3. For a long time there was dissatisfaction with the arrangements for parliamentary scrutiny of the annual EC Budget. Despite several reviews over the years,³ and various improvements in how scrutiny of the Budget is handled, frustration remained. The annual budgetary process is complicated and involves many different stages (see below, paragraphs 17-20). Yet, although the overall procedure is lengthy, the short amounts of time between the different stages mean that the process does not lend itself to in-depth scrutiny at all junctures by a national parliament.

4. At the start of this session, we carried out a thorough review of how we scrutinise European legislation.⁴ One of our conclusions was that Sub-Committee A (Economic and Financial Affairs) should take oral evidence from the Government on an annual basis before the first reading of the Budget in the Council, and thereafter we should publish a short report for the House. Publication of a report at this juncture in the Budget-making process aims to inform the House of negotiations at an early stage and to ensure greater accountability, openness and transparency. We hope that this focused approach to the annual budgetary process will be constructive for all concerned. If this is indeed the case, we will make it an annual procedure. For the moment, we make this report to the House for information.

Why examine the Preliminary Draft Budget?

5. The Commission's Preliminary Draft Budget (PDB) represents the first stage in the annual budgetary procedure, which results in the formal adoption of the following year's Budget at the end of each calendar year. In between these two stages, the Budget is negotiated between the Budget Council (the Member States in the Council of Ministers) and the European Parliament. The Committee has decided that scrutinising the PDB before the first reading in the Budget Council (which will take place this year on 16 July) is the best way that we can discharge our parliamentary responsibilities given the restrictions of the Budget timetable. It is before the first reading of the PDB at the Budget Council that we can best hold the Government to account and inform the House of the key issues pertaining to the EC Budget.

2004 is a significant year for the EC Budget

6. 2004 is of particular significance for the EC Budget for three reasons. First, this year's Budget is the first to be presented in an Activity-Based Budgeting (ABB) format, which means that for the first time spending is linked to objectives, outcomes and performance indicators. Secondly, the

¹ The Budget is established and authorised under the Community pillar of the Union and its legal order; it is thus a Budget not of the Union but of the Communities.

² From 1994 to 1996, Sub-Committee A took oral evidence from the Government on the Preliminary Draft Budget at the beginning of July, before the Budget Council, and we published short reports following each of these evidence sessions: *Preliminary Draft General Budget for 1995* (Session 1993-94, 18th Report, HL 94); *Preliminary Draft General Budget for 1996* (Session 1994-95, 20th Report, HL 100); *Preliminary Draft Budget for 1997* (Session 1995-96, 14th Report, HL 104). However, the short inquiries for these reports were hindered by the limited amount of information available or the delay in the availability of the necessary information. Consequently, in two out of these three years the reports were not published until after the summer recess. It is our intention now to ensure that we always publish our report before the Council conducts its first reading on the annual Budget (the importance of scrutiny at this stage of the annual process is explained in paragraphs 4-5). The Government is proving helpful in coordinating with us to this end, but we urge it to continue to do more (see paragraph 21).

³ Over the years there have been several internal reviews in Parliament and numerous meetings between the officials of the two Houses and HM Treasury. These have led to several sets of correspondence and two published reports: one by the House of Commons Select Committee on European Legislation entitled *Scrutiny of the EC Budget* (Session 1997-98, 20th Report, HC 155-xx) and one by the House of Commons European Scrutiny Committee *European Scrutiny in the Commons* (Session 2001-02, 30th Report, HC 152-xxx).

⁴ *Review of Scrutiny of European Legislation* (Session 2002-03, 1st Report, HL 15).

2004 EC Budget is also the first to cover an enlarged Union of 25 members. The third reason why 2004 is significant is that the Convention on the Future of Europe has proposed a number of changes to the budgetary process, and these have been incorporated in the draft EU constitutional Treaty. The draft Treaty, which was presented to the European Council in Thessaloniki on 20 June by the Chairman of the Convention Valéry Giscard d'Estaing, proposes a budgetary process which aims to be simpler and more transparent.⁵ However, the draft Treaty also includes a prospective change to the decision-making procedure that determines the level of individual Member States' contributions to the Union's resources. If adopted, this would have substantial implications. We examine the key proposals from the Convention in a separate section below (paragraphs 39-45).

Putting the annual Budget in context

7. The annual EC Budget is one element in how European spending levels are determined. Expenditure in the annual Budget is tightly constrained by certain key items of legislation, and many important budgetary decisions are taken outside the annual budgetary process. Broadly speaking, decisions on European spending involve three levels of legislation, which can be considered to be in a hierarchy of importance.

THE OVER-ARCHING LEGAL FRAMEWORK

8. The annual Budget is not negotiated in a vacuum but is set within an over-arching legal framework, which contains three key elements: the Financial Perspective, the Own Resources Decision and the Financial Regulation.

The Financial Perspective

9. The most important decision for the EC Budget is a multi-annual financial programme, known as the Financial Perspective, which lays down the revenue and expenditure parameters for annual Budgets. This financial framework is agreed by the Heads of State and Government in the European Council; it contains the Communities' medium-term expenditure plans and places clear limits on the annual Budget. The Financial Perspective sets out annual ceilings for the seven major categories of EC expenditure and is thus decisive in shaping the annual Budgets. Once agreed by the European Council, the Financial Perspective forms part of an Inter-Institutional Agreement between the Commission, the Council and the European Parliament, all of which are bound to respect its principles and ceilings when the annual Budget is set year by year.⁶

10. The current Financial Perspective was set at the March 1999 Berlin Council and covers the period 2000-2006. It was revised at the Copenhagen European Council in December 2002, when new expenditure ceilings for an enlarged Union of 25 Member States were agreed.

The Own Resources Decision

11. Another key element of the legal framework surrounding the annual Budget is the Own Resources Decision, which sets out the arrangements for financing the Budget. This Decision determines Member States' contributions to the Budget and limits the amount of money that the Community can raise from the Member States. It is fixed in terms of a percentage of overall Community Gross National Income (GNI) that the Budget may absorb in any one year. For 2003, this figure is equivalent to 1.02% of Community GNI.⁷ The Financial Perspective and the Own Resources Decision constitute the major financial decisions for the EC, as they set the boundaries within which the annual EC Budget is negotiated.

The Financial Regulation

12. A third significant element of the over-arching framework is the Financial Regulation applicable to the EC Budget, which lays down the basic rules governing all budgetary matters that are referred to in the Treaties. The original 1977 Financial Regulation was revised in 2001, in an attempt to clarify and simplify the budgetary rules. The new Financial Regulation introduced Activity-Based Budgeting to the EC Budget, in an attempt to link proposed expenditure to clear objectives and outputs. The 2004 EC Budget is the first to be set on such a basis. The revision of

⁵ CONV 820/1/03, Title VII.

⁶ One of the proposals in the draft Treaty is to change the legal basis of the Financial Perspective. We discuss this proposal below (paragraphs 42 and 45).

⁷ *European Community Finances: Statement on the 2003 EC Budget and measures to counter fraud and financial mismanagement*, HM Treasury, Cm 5800.

the Financial Regulation also redefined the financial actors, clearly separating the roles of authorising and accounting officer.

INDIVIDUAL SPENDING PROGRAMMES

13. Spending in the annual Budget is normally divided into seven categories:

- 1) agriculture,
- 2) structural operations,
- 3) internal policies,
- 4) external action,
- 5) administration,
- 6) reserves, and
- 7) pre-accession aid.

14. Whilst the ceilings for spending in each category are set in the Financial Perspective, the driver for how and where money is spent within each category in the annual Budget comes not from each year's Budget, but from decisions to adopt particular spending programmes. For example, a decision to enter billions into a particular year's Budget on a multi-annual research programme automatically follows from the decision to approve the research programme. The initial policy decision approving the spending programme therefore sets the dynamics for future annual Budgets. In this sense, the annual Budget process simply records budgetary provisions for previously considered and scrutinised spending and revenue decisions. This is the case for the two areas that together take up nearly 80% of the total EC Budget: spending on the Common Agricultural Policy and Structural Operations.

15. Exceptionally, the 2004 Budget includes an eighth category of expenditure: 'compensation', which will be allocated to the new Member States to ensure that they are net recipients of the EC Budget in the period before they become fully part of all EU programmes.

THE ANNUAL BUDGETARY PROCESS

16. After the first two levels of legislation, and in many ways consequent upon them, are the negotiations on the annual Budget.

A brief overview of the process

17. The present budgetary procedure is set out in Article 272 of the EC Treaty, which stipulates the sequence of stages and the time-limits which must be respected by the two arms of the 'budgetary authority': the Council of Ministers (acting by qualified majority) and the European Parliament, who together establish the annual Budget. The Council has the final say on "compulsory" expenditure, that is, spending that is a direct result of treaty application or acts adopted on the basis of the treaties. In practice this means spending on agriculture. The European Parliament has the final say on all other categories, defined as "non-compulsory" expenditure. Non-compulsory expenditure includes spending on regional policy, research policy and energy policy.

18. The annual budgetary procedure, as defined in the Treaty, extends from 1 September to 31 December of the year preceding the Budget year in question. In practice, however, a 'pragmatic' timetable has been applied by the three EU institutions since 1977. The different stages of the Budget procedure are as follows:

- The Commission draws up a Preliminary Draft Budget (PDB) in May.
- The Council conducts its first reading of the PDB in July and establishes a Draft Budget (DB), which is then passed to the European Parliament for a first reading.
- The European Parliament conducts its first reading in October on the basis of the Council's Draft Budget.
- In November, the Council conducts a second reading on the Draft Budget to consider any amendments or proposed modifications from the European Parliament.
- In December, the European Parliament reviews the Council's proposals and the Budget is then adopted.

The Council's second reading

19. The Council conducts its second reading during the third week of November, after a conciliation meeting with a delegation from the European Parliament. The Draft Budget is amended in the light of the European Parliament's amendments (non-compulsory expenditure) or proposed modifications (compulsory expenditure). As a general rule, the Council's decisions on second reading relating to compulsory expenditure determine the final amount. Unless the entire Budget is subsequently rejected by the European Parliament, the Council has the 'last word' on this category of expenditure. The Draft Budget as amended is then returned to the European Parliament.

The European Parliament's second reading and the adoption of the Budget

20. In December, the European Parliament reviews non-compulsory expenditure, for which it can accept or refuse the Council's proposals. The President of the European Parliament then declares the Budget adopted and it can be implemented.

The position of the Committee

21. **Although the Financial Perspective sets the overall budgetary spending limits for the annual Budget, and individual spending programmes determine much spending in advance, scrutiny of the annual EC Budget remains important. We appreciate the efforts the Government has already made to coordinate with us over scrutiny of the annual Budget—these have helped our scrutiny of the 2004 Budget—and we ask the Government in the future to bring forward as far as possible production of its Explanatory Memorandum on the PDB to facilitate further the scrutiny process.**

22. **The 2004 EC Budget is the first to be presented in the new Activity-Based Budgeting (ABB) format. By focusing spending on outputs rather than inputs, ABB will allow more effective scrutiny in future of value for money. We therefore welcome the introduction of ABB. Over time, ABB will enhance transparency by linking expenditure to clear objectives that can be evaluated through performance indicators. We are encouraged to hear there is wide-spread support for the system both from other Member States and the Commission. We accept that it will take time for the full benefits of ABB to be felt, but we urge the Government to press the EU institutions to make as much use as possible of this new system in evaluating and, where necessary, improving value for money for EC spending.**

PART 3: THE 2004 EC BUDGET

Introduction

23. The 2004 Preliminary Draft Budget is the first to cover an enlarged European Union of twenty five Member States. Accession of the ten new Member States is planned for 1 May 2004. The Budget therefore includes two sets of figures: the first for the EU-15, the second for the EU-25. Presuming a successful conclusion of the accession process, the EU-25 budget will be formally adopted as a Supplementary and Amending Budget (SAB) in May 2004. Unless otherwise stated, the figures in this report refer to the enlarged Union of 25 Member States and therefore set out the real level of expenditure after enlargement.

24. The Budget is split into two types of expenditure. The first covers legal obligations which the Commission has entered into during the current financial year for activities which will lead to payment in current and future years and is called “commitment appropriations”. The second type of expenditure is called “payment appropriations” and covers actual transfers of cash from the Community Budget to creditors. As Table 1 shows, the Preliminary Draft Budget envisages a total of commitment appropriations of € 112.2 billion, which amounts to a 12.6% increase from the 2003 Budget.⁸ All but 0.7% of this increase is due to Enlargement. The total for commitment appropriations in 2004 is € 3.2 billion below the revised Financial Perspective ceiling agreed at the Copenhagen European Council in 2002. The figures for the EU-15 have seen a modest increase by 0.7% to € 100.4 billion, which is € 3.3 billion below the Financial Perspective ceiling set at the Berlin European Council in 1999.

Table 1: Budget 2003 and PDB 2004 (EU-25)
Appropriations for commitments (in € million)

Appropriations for Commitments	Adopted 2003 Budget	PDB 2004 (EU-25)	% Change
1. Agriculture	44,780	47,874	6.9%
2. Structural Operations	33,980	41,035	20.8%
3. Internal Policies	6,796	8,640	27.3%
4. External Action	4,949	4,996	3.9%
5. Administration	5,360	6,112	14.0%
6. Reserves	434	442	1.8%
7. Pre-Accession Aid	3,386	1,732	-51%
8. Compensation		1,410	
Total	99,686	112,240	12.6%

25. As Table 2 below illustrates, payment appropriations increase by 3.3% in the 2004 PDB to € 100.7 billion, which is € 10.9 billion below the Copenhagen Financial Perspective ceiling.⁹ The payment appropriations for the EU-15 in 2004 show a 2% decrease in comparison with 2003 to € 95.6 billion, which is € 6.7 billion below the Berlin Financial Perspective ceiling. Total payment appropriations represent 0.99% of Community Gross National Income (GNI), which is a reduction from 1.04% GNI in 2003.

26. We note with approval that the proposed 2004 PDB expenditure levels are within the ceilings set by both the 1999 Berlin European Council and the 2002 Copenhagen European Council.

⁸ For a more detailed break-down of figures, see the Government's tables in Annex 1 to its Explanatory Memorandum (pp.5-12).

⁹ For a more detailed break-down of figures, see the Government's tables in Annex 1 to its Explanatory Memorandum (pp.5-12).

**Table 2: Budget 2003 and PDB 2004 (EU-25)
Appropriations for Payments (€ million)**

Appropriations for Payments	Adopted 2003 Budget	PDB 2004 (EU-25)	% Change
1. Agriculture	44,780	46,786	4.5%
2. Structural Operations	33,173	30,682	-7.5%
3. Internal Policies	6,198	7,496	20.9%
4. External Action	4,695	4,792	2.1%
5. Administration	5,360	6,112	14.0%
6. Reserves	434	442	1.8%
7. Pre-Accession Aid	2,863	2,956	3.3%
8. Compensation		1,410	
Total	97,503	100,676	3.3%
Margin	5,435	10,878	
Compulsory Exp	41,581	44,304	6.5%
Non-Compulsory Exp	55,922	56,372	0.8%

The Government's priorities for the 2004 Budget

27. The Government has identified its main priorities for negotiations on the 2004 Budget as external action and administration (spending categories 4 and 5 respectively). The Government considers improvements in the overall effectiveness of EC spending on external relations a main priority. Its second priority concerns administration costs. The figure in this category has increased by 14% over last year. The Government wishes to pursue value for money issues in this area.

EXTERNAL ACTIONS (CATEGORY 4)

28. Commitment appropriations for external action (spending category 4) for 2004 are € 4.9 billion, which amounts to an increase of 0.9% compared with the 2003 Budget. This figure is the same for EU-15 as EU-25, as external policies are unaffected by enlargement. € 174 million extra will be available in this category following the accession of Cyprus and Malta and because financial assistance to Turkey now comes under the different category of pre-accession aid. This means that there is a 4.5% increase in available spending on external actions. The Western-Balkans and the Middle East have been provisionally identified by the Commission as the main beneficiaries of this increase. Substantial increases of € 50 million each for both humanitarian aid and assistance to Asia, mainly to cover commitments to Afghanistan, have also been programmed. The other main beneficiaries of this increase are Eastern Europe and Central Asia where a € 30 million increase in spending on assistance has been programmed by the Commission. These figures leave a margin of € 86 million for unforeseen expenditure.

29. The Government's priority is to assure an increase in this margin. This is because a larger margin will provide more flexibility to deal with foreseeable but as yet uncostered requirements in Iraq and the Middle East (Q 39). The Government also wishes to see a shift away from EC spending on middle-income countries such as the Western Balkans in favour of a "greater poverty focus" (Q 2). These concerns are part of a broader drive which the Chancellor has initiated through a UK action plan for reform of the whole category of external actions (Q 39) which he presented to the ECOFIN on 13 March 2003. The plan is divided into three sections:

- reforms that can be achieved before 2006 (i.e., within the current Financial Perspective) through proper use of ABB;
- changes in management and skills in the Commission and its EC delegations; and
- priorities for the new financial perspective which will be agreed in 2004.

30. **The Committee agrees with the Government that spending on external action should be a priority for the 2004 Budget. We are encouraged to hear that the Government is proposing a larger margin to deal with foreseeable, but as yet uncostered, spending in Iraq and the Middle East. We urge the Government to do everything in its power to ensure best use of EC spending on external action. The Committee supports the Government's initiative to develop a greater poverty focus for EC external action spending over the next few years, but this focus should not deflect from the EU's other objective of working towards stability in regions such as the Middle East and the Balkans. We would welcome greater clarity on how far the Government considers that the EU can take on ambitious plans for greater external action involvement without substantial increases in spending under category 4 of the EC Budget.**

ADMINISTRATION (CATEGORY 5)

31. The Government's second priority is expenditure on administration (category 5). This category has been programmed for the EU-25 for the full calendar year to cover the additional administrative burdens in the run-up to formal accession between January and May 2004. The amount in this category is € 6.1 billion, which amounts to an increase of 14%. With a view to enlargement, each EU institution has bid for substantial increases in funding for staff and buildings, which amount to a total of € 725 million. The greatest increase is for the Commission, which is bidding for an extra € 104 million, of which € 9.5 million is to be spent on buildings and the rest is to cover recruitment of an additional 780 staff. Increases for the Council and the European Court of Justice amount to € 73 million each (Q 20).

32. **While emphasising its support for sufficient resources to deal with enlargement, the Government says that it is keen to see strict conditions for value for money applied to these institutional increases. The Committee fully supports the Government in this approach. We also wish to see efficient use being made of these increases in administrative costs through the application of modern management practices and techniques.**

33. **On a related institutional matter, we would urge the Government, in the forthcoming Inter-Governmental Conference, to continue with attempts to reform the European Court of Auditors. We produced a report on the European Court of Auditors in April 2001,¹⁰ and our view on the subject remains unchanged. In particular, we consider that the European Court of Auditors would be most effective in an enlarged Union if it had a highly-qualified chief executive who was appointed impartially. The chief executive would be supported by a large team of audit staff who would report to a part-time, non-executive board of representatives from each of the Members States. We will return to this issue as part of our work on the forthcoming Inter-Governmental Conference.**

Other Spending Categories

AGRICULTURE (CATEGORY 1)

34. The Common Agricultural Policy (CAP) is historically the most resource-consuming of the Community policies. The EC provides a large proportion of the funding for European agriculture: for 2004, agriculture is set to consume almost 43% of EC expenditure.

35. The total budget for agriculture (spending category 1) in 2004 amounts to € 47.8 billion. This is an increase of 6.9% compared with 2003, of which 4.7% is due to enlargement. € 41.3 billion of spending in this category is expenditure on the CAP, which amounts to an increase of 3.1%. The Commission included in the PDB the first tranche of savings that would result from its CAP reform proposals on the assumption that they would be agreed as proposed (Q 25). The Council has agreed to reform the CAP, but the reductions included in the 2004 PDB are small, as changes to the system of direct payments will not come into effect until the 2005 Budget. **We ask the Government to explain exactly how the recently-agreed changes to the CAP will affect the final 2004 EC Budget. We call on the Government to use the recent agreement on reform of the CAP to make progress in the Doha round of world trade talks. Furthermore, we continue to urge the Government to push for further reform of the CAP.¹¹**

¹⁰ *The European Court of Auditors: The Case for Reform* (Session 2000-2001, 12th Report, HL 63).

¹¹ cf. our report *Mid-Term Review of the Common Agricultural Policy: External Implications* (Session 2002-2003, 27th Report, HL 114).

36. Category 1 of the Budget includes a further € 6.5 billion for Rural Development spending, which is an increase of 39.1% up to the revised spending ceiling set by the Financial Perspective agreed at Copenhagen. The large increase in this figure reflects the fact that direct payments to farmers in the new Member States will not commence until 2005. In 2004, expenditure on agriculture in the new Member States is made up of market support measures and rural development measures (Q 16). The rural development programme consists of the following five areas:

- early retirement schemes for farmers,
- support for less favoured areas,
- agri–environment programmes,
- afforestation of agricultural land, and
- transitional support for semi–subsistence farms to develop into commercially viable businesses (Q 28).

STRUCTURAL OPERATIONS (CATEGORY 2)

37. The second largest spending category in the EC Budget covers the structural funds, which account for 37% of the total 2004 PDB and amount to € 41 billion. Structural operations aim to reduce inequalities in wealth distribution across the regions so that all European citizens can benefit equally from the large Community market. The 2004 PDB commitment appropriations in this category rise by 20.8%, of which € 6.7 billion is the result of the participation of the new Member States in the structural and cohesion funds. This figure reflects the level of expenditure in this area agreed at the Copenhagen European Council. The payment appropriations (actual cash payments in 2004) for Structural Operations have decreased by 7.5% due to the closure of programmes launched between 1993 and 1999. The Committee notes that the increase in this category is within the expenditure ceiling agreed at the Copenhagen European Council. We fully accept that the new Member States should benefit on an equal basis from structural funds. However, we were concerned to hear that when the 2002 Budget was closed, it emerged that € 4.8 billion less than forecast had been spent on structural funds. The Government told us that this did not constitute an underspend but was due to structural fund money being held back until the audits of the concluded projects were completed in 2003. A new system has since been introduced which is expected to solve this problem (Q 18). Nevertheless **we urge the Government to make full use of the new Activity–Based Budgeting rules to ensure that structural fund money in all Member States is properly forecast and effectively spent in order to achieve clear outcomes.**

PRE–ACCESSION STRATEGY (CATEGORY 6)

38. Expenditure in category 6 (pre–accession aid) of the 2004 PDB is 50% lower than in the 2003 Budget and amounts to € 1.7 billion. This is because the pre–accession programmes for the ten accession countries will close on their joining the EU in May 2004. The remaining money is programmed for the other recipients of pre–accession aid: Romania, Bulgaria and Turkey. Payment appropriations amount to € 2.9 billion, a 3% increase over 2003. This reflects payment resulting from previous commitments to the PHARE,¹² ISPA¹³ and SEPARD¹⁴ programmes. As with the structural funds, there appear to have been complications in the absorption capabilities of pre–accession countries. The closing of the 2002 Budget also revealed that € 800 million less than forecast was absorbed by the pre–accession countries. **We note with approval that there was a marked improvement during 2002 in the absorption capacity for funds such as the PHARE programme.**

¹² Pre–accession aid for institution–building.

¹³ Pre–accession aid for transport and environment infrastructure.

¹⁴ Pre–accession aid for agriculture and rural development.

PART 4: PROPOSALS FOR REFORM OF THE BUDGET PROCESS

39. The Convention on the Future of Europe considered the EC Budget in some detail. Working Group IX on Simplification was mandated to consider the EU budgetary process and recommended a simplification of the current procedures. Two discussion circles on the Budget and Own Resources looked in more detail at ways of reforming the EC Budget and their conclusions informed the relevant articles in the draft constitutional Treaty. The Government has been active in influencing the Convention outcomes in general and on the Budget in particular, as has Lord Tomlinson, one of the House of Lords representatives on the Convention.

40. The draft constitutional Treaty introduces a number of changes to the EC Budget that would affect the process by which it is agreed and both the revenues and expenditure side of the Budget. For revenues, the draft Treaty maintains current arrangements whereby the ceiling of own resources and the introduction of new own resources is decided by unanimity in the Council with national ratification and after consultation of the European Parliament.¹⁵ As the Minister said, this means “there can be no increase in the overall ceilings for the EU Budgets without the agreement of this Parliament and there is no question of European tax being imposed on the UK” (Q 41).

41. However, the draft Treaty proposes a change to the decision-making procedure for determining the level of individual Member State contributions to the Union’s resources which would allow decisions to be reached by qualified majority vote without national parliamentary ratification and subject to the consent of the European Parliament.¹⁶ At present, such decisions must be reached by unanimity, with national parliamentary ratification and after consultation with the European Parliament. The Minister said that this proposal “would mean that changes to the Own Resources decisions directly affecting the level of UK contributions [to the EU] could be taken out of the hands of the UK Government and Parliament” (Q 41). **We concur with the Government’s view that the changes to the system of Own Resources proposed in the draft Constitutional Treaty are “unacceptable” (Q 41). We support the Government in its efforts to retain the status quo for decision-making in this area.**

Proposed Changes to Budget Expenditure

42. The draft constitutional Treaty introduces three main changes to the expenditure side of the Budget. The first is to give legally-binding status to the Financial Perspectives under the new title of Multi-Annual Financial Framework.¹⁷ Like the Financial Perspectives, the Multi-Annual Financial Framework would set binding expenditure ceilings for the categories of spending for a period of at least five years. At present, Financial Perspectives are agreed inter-institutionally between the Council, the European Parliament and the Commission (see above, paragraph 9). As a result, decision-making in this system can be opaque. By giving a Treaty base to the Financial Framework, transparency of the budgetary process should be enhanced.

43. The draft Constitutional Treaty also proposes simplifying the complicated annual budget procedure. The draft Treaty proposes a streamlined procedure with a single reading in the Council and the European Parliament, and with both institutions having a say on all expenditure. This would replace the present system in which the European Parliament has the last word on non-compulsory expenditure and the Council has the last word on compulsory expenditure (Q 41). **We welcome the proposal that the European Parliament should have a greater say over spending on agriculture.**

44. The third key change on Budget expenditure proposed in the draft Treaty concerns a further drive for value for money. If adopted by the IGC, the Commission will be required to produce a performance report to accompany the financial accounts each year.¹⁸ It is hoped that this performance report will provide an opportunity for an output-focused analysis of the use to which EC spending has been put.

¹⁵ CONV 820/1/03 Art. I-53.3

¹⁶ CONV 820/1/03 Art. I-53.4

¹⁷ CONV 820/1/03 Art. I-54.

¹⁸ CONV 568/03; CONV 634/03 and CONV 635/03.

45. **The proposals for a Treaty base for the Financial Perspectives, the simplification of the annual budgetary process and the requirement for the Commission to produce an annual performance report, if adopted, would greatly aid our future scrutiny of EC spending. We welcome these reforms as facilitating greater accountability for EC spending and urge the Government to continue to support these reforms in the Inter-Governmental Conference, which will decide on the final version of the Treaty. We support the Government in its efforts to retain unanimity and the need for national parliamentary ratification for decisions about the level of individual Member State contributions to the Union's resources.**

PART 5: SUMMARY OF CONCLUSIONS

Scrutiny of the annual EC Budget

46. Although the Financial Perspective sets the overall budgetary spending limits for the annual Budget, and individual spending programmes determine much spending in advance, scrutiny of the annual EC Budget remains important. We appreciate the efforts the Government has already made to coordinate with us over scrutiny of the annual Budget—these have helped our scrutiny of the 2004 Budget—and we ask the Government in the future to bring forward as far as possible production of its Explanatory Memorandum on the PDB to facilitate further the scrutiny process (paragraph 21).

Activity-Based Budgeting

47. The 2004 EC Budget is the first to be presented in the new Activity-Based Budgeting (ABB) format. By focusing spending on outputs rather than inputs, ABB will allow more effective scrutiny in future of value for money. We therefore welcome the introduction of ABB. Over time, ABB will enhance transparency by linking expenditure to clear objectives that can be evaluated through performance indicators. We are encouraged to hear there is wide-spread support for the system both from other Member States and the Commission. We accept that it will take time for the full benefits of ABB to be felt, but we urge the Government to press the EU institutions to make as much use as possible of this new system in evaluating and, where necessary, improving value for money in the way in which EC moneys are spent (paragraph 22).

The 2004 Budget

48. We note with approval that the proposed 2004 PDB expenditure levels are within the ceilings set by both the 1999 Berlin European Council and the 2002 Copenhagen European Council (paragraph 26).

The Government's priorities for the 2004 Budget

EXTERNAL ACTION (CATEGORY 4)

49. The Committee agrees with the Government that spending on external action should be a priority for the 2004 Budget. We are encouraged to hear that the Government is proposing a larger margin to deal with foreseeable, but as yet uncoded, spending in Iraq and the Middle East. We urge the Government to do everything in its power to ensure best use of EC spending on external action. The Committee supports the Government's initiative to develop a greater poverty focus for EC external action spending over the next few years, but this focus should not deflect from the EU's other objective of working towards stability in regions such as the Middle East and the Balkans. We would welcome greater clarity on how far the Government considers that the EU can take on ambitious plans for greater external action involvement without substantial increases in spending under category 4 of the EC Budget (paragraph 30).

ADMINISTRATION (CATEGORY 5)

50. While emphasising its support for sufficient resources to deal with enlargement, the Government says that it is keen to see strict conditions for value for money applied to these institutional increases. The Committee fully supports the Government in this approach. We also wish to see efficient use being made of these increases in administrative costs through the application of modern management practices and techniques (paragraph 32).

51. On a related institutional matter, we would urge the Government, in the forthcoming Inter-Governmental Conference, to continue with attempts to reform the European Court of Auditors. We produced a report on the European Court of Auditors in April 2001, and our view on the subject remains unchanged. In particular, we consider that the European Court of Auditors would be most effective in an enlarged Union if it had a highly-qualified chief executive who was appointed impartially. The chief executive would be supported by a large team of audit staff who would report to a part-time, non-executive board of representatives from each of the Members States. We will return to this issue as part of our work on the forthcoming Inter-Governmental Conference (paragraph 33).

Other categories of expenditure**AGRICULTURE (CATEGORY 1)**

52. We ask the Government to explain exactly how the recently-agreed changes to the CAP will affect the final 2004 EC Budget. We call on the Government to use the recent agreement on reform of the CAP to make progress in the Doha round of world trade talks. Furthermore, we continue to urge the Government to push for further reform of the CAP (paragraph 35).

STRUCTURAL OPERATIONS (CATEGORY 2)

53. We urge the Government to make full use of the new Activity-Based Budgeting rules to ensure that structural fund money in all Member States is properly forecast and effectively spent in order to achieve clear outcomes (paragraph 37).

PRE-ACCESSION STRATEGY (CATEGORY 6)

54. We note with approval that there was a marked improvement during 2002 in the absorption capacity for funds such as the PHARE programme (paragraph 38).

Proposals for reform of the Budget process

55. We concur with the Government's view that the changes to the system of Own Resources proposed in the draft Constitutional Treaty are "unacceptable" (Q 41). We support the Government in its efforts to retain the status quo for decision-making in this area (paragraph 41).

56. We welcome the proposal that the European Parliament should have a greater say over spending on agriculture (paragraph 43).

57. The proposals for a Treaty base for the Financial Perspectives, the simplification of the annual budgetary process and the requirement for the Commission to produce an annual performance report, if adopted, would greatly aid our future scrutiny of EC spending. We welcome these reforms as facilitating greater accountability for EC spending and urge the Government to continue to support these reforms in the Inter-Governmental Conference, which will decide on the final version of the Treaty. We support the Government in its efforts to retain unanimity and the need for national parliamentary ratification for decisions about the level of individual Member State contributions to the Union's resources (paragraph 45).

RECOMMENDATION

58. The Committee considers that the 2004 EC Budget raises important questions to which the attention of the House should be drawn and makes this Report to the House for information.

APPENDIX 1

List of Membership*Sub-Committee A (Economic and Financial Affairs, Trade and External Relations)
Members of the Sub-Committee*

Lord Armstrong of Ilminster
Lord Geddes (Chairman)
Lord Hannay of Chiswick
The Rt Hon the Lord Jones
The Rt Hon the Lord Lamont of Lerwick
Lord Lea of Crondall
Lord Marlesford
The Rt Hon the Lord Radice
Lord Sharman
The Rt Hon the Lord Sheldon
Lord St John of Bletso
Lord Taverne

*Members of the Sub-Committee declared the following interests:***Lord Geddes**

Non-Executive Chairman:
Pacific Chartered Capital Management Limited
Pacific Chartered (Europe) Limited
Photo Corporation (UK) Limited
Trinity College London
Chrome Castle Limited

Non-Executive Director:

Portman Settled Estates Limited
Trinity College of Music

Lord Armstrong of Ilminster

Chairman, Forensic Investigative Associates plc
Chairman, Board of Governors, Royal Northern College of Music
Chancellor, University of Hull
Chairman, Leeds Castle Foundation
Chairman, Hestercombe Gardens Trust
Trustee, RVW Trust

Lord Hannay of Chiswick

British Government Special Representative for Cyprus
Tanggung Independent Advisory Panel (for BP)
Member, Council of Britain in Europe
Non-Executive Director, Aegis Group
Non-Executive Director, Chime Communications
Pro-Chancellor, University of Birmingham
Director Salzburg Seminar
Member, International Advisory Board of EDHEC (French Business and Management Schools)
Member, Advisory board, Centre for European Reform
Member, Advisory board, European Foreign Affairs Review
Member, Advisory board, Prospect Magazine

Lord Lamont of Lerwick:

Chairman, East European Food Fund
Director, Balli plc
Director, Banca Commerciale Robank SA
Director, Compagnie Internationale de Participations Bancaires et Financieres
Director, European Growth and Income Trust (managed by Aberdeen Asset Management)
Director, Jupiter Finance and Income Trust (Investment Trust)
Consultant, Fintrade
Consultant, Rotch Group
Vice-President, Bruges Group
Member, Business for Sterling

Chairman, Le Cercle
Director, British Iranian Chamber of Commerce
Director, British Romanian Chamber of Commerce
Vice Chairman, International Nuclear Safety Commission
Chairman of the Oil Club

Lord Lea of Crondall

Treasurer, Parliamentary Group on Macedonia
Treasurer, Parliamentary Group on the Federal Republic of Yugoslavia
Member, Central Arbitration Committee

Lord Marlesford

Adviser, Board of John Swire and Sons
Adviser, Mitsubishi Corporation (UK) plc

Adviser, Sit Investment Associates (Minneapolis)
Adviser, World View Incorporated (New York)
Non-Executive Director, Baring New Russia Fund Ltd
Independent National Director, Times Newspaper Holdings Ltd
Chairman Marlesford Parish Council
President, Suffolk ACRE (Action for Communities in Rural England)
President, Suffolk Preservation Society

Lord Radice

Board Member, Britain in Europe
Board Member, European Movement
Chairman, British Association for Central and Eastern Europe

Lord Sharman

Chairman and Shareholder, Aegis plc
Board Member, Britain in Europe
Director and Shareholder, B G International plc
Director, AEA Technology plc
Director, Reed Elsevier plc
Director, Youngs Brewery plc
Director and Shareholder, Phocis plc
Adviser (paid) KPMG

Lord Taverne

Director, Industrial Finance Group Ltd
Chairman, Monitoring Board, Axa Sun Life plc
Chairman, Advisory Board, Oxford Centre for Environment, Ethics and Society (OCEES)
Chairman of Trustees, Alcohol and Drug Addiction Prevention and Treatment (ADAPT) Ltd
Chairman of Trustees, Iran Aid Foundation
Trustee, The Health and Science Communication Trust