HOUSE OF LORDS

European Union Committee

33rd Report of Session 2006–07

The 2008 EC Budget

Report with Evidence

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(p) refers to a page of written evidence

FOREWORD—What this report is about

This report informs the House about the Commission's proposals for the 2008 General Budget of the European Communities. The report summarises the significant proposed changes to funding under each of the budget headings. We have been aided in this by oral evidence from the Economic Secretary to HM Treasury (Kitty Ussher MP) and a written Explanatory Memorandum from HM Treasury.

We consider the following to be important principles for budgetary examination:

- Negotiations on European expenditure must emphasise budget discipline;
- All European expenditure must demonstrate efficiency, effectiveness and value for money;
- Expenditure proposals should be based on a realistic assessment of what can be implemented properly and effectively; and
- Increases proposed for administration must be scrutinised to ensure they are based on genuine need and reflect economies of scale.

As a further general principle we consider that the Council should be more aware of the budgetary and administrative effects of the commitments it makes and that it should be prepared to accept the payment implications of these in budgetary negotiations.

While looking specifically at the 2008 Preliminary Draft Budget, we have also looked forward to the review of the budget which the Commission will undertake in 2008/9. We have also closely examined the funding mechanisms for the Galileo global satellite navigation system and the European Institute of Technology, as there appears to be a lack of clarity about how these items will be funded. We note the Government's commitment not to reopen the financial perspective ceilings to fund these programmes. We share the Government's concerns regarding the controls that are in place to monitor spending and administration within the EU's agencies.

The 2008 EC Budget

CHAPTER 1: THE 2008 EC BUDGET IN CONTEXT

1. This is the fifth consecutive year that the Committee has undertaken a first scrutiny of the EC Budget on the basis of oral evidence from the Government before the First Reading of the Budget in the Council. The Committee decided in the last Parliament that taking evidence from the Government at such an early stage in the budgetary process was the most effective way in which we could fulfil our parliamentary obligation to scrutinise proposed EU legislation and ensure greater accountability and transparency[1].

2. This year we received an Explanatory Memorandum on the Provisional Draft Budget from HM Treasury on 6 June; on the basis of this document we took formal oral evidence from the Economic Secretary to the Treasury, Kitty Ussher MP, on 5 July. Both the Explanatory Memorandum and the transcript of oral evidence are printed with this report.

3. The aim of the Committee's reports on the EC Budget is to inform the House of issues relating to the Budget and to scrutinise the Government's position before the Commission's Preliminary Draft Budget is considered at the Budget Council. The Government reshuffle this summer delayed the scrutiny process and as a result this Report is published following the Budget Council meeting on 13 July. We were, however, able to state our concerns to the Minister in a letter dated 10 July, which is annexed to this report.

4. We make this report to the House for information.

Budgetary Procedure

5. The 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, which together establish the annual budget.

The two arms of the budgetary authority

6. Under the present budgetary procedure, the Council has the final say on compulsory expenditure. This is spending that is a direct result of Treaty application or of acts adopted on the basis of the Treaties. In practice this mainly means spending on agriculture.

7. The European Parliament has the final say on all other categories of spending which are defined as non-compulsory expenditure. Non-compulsory expenditure includes spending on regional policy, research policy and energy policy.

The stages of the annual budget

8. The stages in the negotiations over the annual budget are as follows:

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

(1) The Commission draws up a Preliminary Draft Budget (PDB) in May;

(2) The Council conducts its first reading of the PDB in July and establishes a Draft Budget;

(3) The European Parliament conducts its first reading in October on the basis of the Council's Draft Budget;

(4) In November, the Council conducts a second reading on the Draft Budget to consider any amendments or proposed modifications by the European Parliament; and

(5) In December the European Parliament reviews the Council's proposals and adopts the Budget.

9. This report deals with the Preliminary Draft version of the Budget as issued by the Commission on 2 May 2007. This version of the Budget represents the first stage of the procedure and provides the basis for subsequent negotiations between the Council and the European Parliament who act as the two arms of the budgetary authority. Following the establishment of the Draft Budget at the 13 July Council meeting the negotiations continue along the following lines.

The Council's Second Reading

10. The Council conducts its second reading in early 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 (for non-compulsory expenditure) or proposed modifications (for compulsory expenditure). As a general rule, the Council's decisions on second reading determine the final amount of compulsory expenditure. 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

11. 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.

Individual Spending Programmes and the Financial Perspective

12. Spending in the annual EC Budget is divided into eight categories:

(a) Competitiveness for Growth and Employment;

(b) Cohesion for Growth and Employment;

(c) Preservation and Management of Natural Resources;

(d) Freedom, Security and Justice;

(e) Citizenship;

(f) The EU as a Global Partner;

(g) Administration; and

(h) Compensation.

13. These categories are pre-determined by the multi-annual Financial Perspective agreement between the European Council, the Commission and the European Parliament. This agreement sets both a ceiling for total EC expenditure, defined in terms of a percentage of EU Gross National Income (GNI), as well as annual ceilings for each of the seven expenditure categories. This agreement provides the financial framework for the EC over a period of seven years. The 2008 Budget is the second to be proposed under the current Financial Perspective, which governs Budgets from 2007 to 2013.

14. The European Council of December 2005 agreed that the Commission "should carry out a comprehensive reassessment of the financial framework, covering both revenue and expenditure, to sustain modernisation and to enhance it, on an ongoing basis". The Commission was asked to conduct a "full, wide ranging review covering all aspects of EU spending, including the CAP, and of resources, including the UK rebate, to report in 2008/9"[2].

15. The Minister outlined the Government's preparations for the forthcoming review, noting that "the Government will argue that this is hardly a budget designed to meet the challenges that the EU faces in the 21st century … some fundamental aspects of the EU budget do not represent value for money. We have had that view for some time on the Common Agricultural Policy, where we want fundamental reform, and we also believe it is not good value for money for such a high proportion of the structural and cohesion funds to be going to rich Member States. We do not think that is the point of that type of programme." (QQ 1–2)

16. The Minister explained that the Government has established three general principles which will form the basis of its negotiating position. These are:

   (1) "that the EU should only act where there are clear additional benefits from collective efforts, compared with action solely by individual Member States";

   (2) "that where EU-level action is appropriate, it should be proportionate, flexible and use the most appropriate policy lever, which may or may not be spending"; and

   (3) that there should be the highest levels of financial management and administration (Q 3).

17. The Minister explained that, with these principles in mind, work on the Review has already commenced. We were told that HM Treasury has "started a process within the UK of analysing the kind of 'fit for purposeness' of all EU spending. It may well be that that will lead to a conclusion that will have some very significant implications for our negotiating stance in the fundamental review but we do not at this stage have a view on the outcome in terms of absolute levels … we are developing a UK vision for expenditure and future financing. That is a process of ongoing work and it is involving a cross-Whitehall effort. We have already begun some informal conversations with our EU partners, Member States and the Commission, obviously, but the Commission itself has not yet published its draft proposal so we are in that sense at an early stage in all this" (Q 3). **We support HM Treasury's three principles and welcome the news that work on the 2008/9 review has already commenced in Government. We request that HM**

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2 EM 15915/05

Treasury provide in due course details of the items of expenditure that it finds not to be 'fit for purpose'. We particularly welcome the Government's commitment to sound financial management and the need to pressure all Member States to manage expenditure with greater care—in line with the recommendations in our 2006 report.[3] (QQ 11, 14)

Resources for the EC Budget

18. The money for the annual EC Budget has four main sources, collectively known as 'Own Resources'; these are:

(1) Customs duties;

(2) Agricultural levies, including sugar levies;

(3) A contribution based on a harmonised base for VAT income in Member States; and

(4) Contributions from Member States based on a proportion of their GNI.

19. Under Article 269 of the EC Treaty, the Council, acting unanimously, lays down the provisions governing the EC's Own Resources. A maximum level for Own Resources of 1.27% EU Gross National Product (GNP) was set in 1988. This has subsequently been changed to 1.24% of EU GNI. This change merely reflects the preference for using GNI as a statistical tool, and does not represent a change in the level of the ceiling.

20. Over time, the proportions of income from each resource have adjusted to the current position whereby the GNI-based contribution is the primary source of income for the EC Budget. In our recent report, we supported this development; other means of funding the Budget are likely to be proposed during the 2008/9 Review, but we found that no new form of taxation put to us provided the same level of clarity and certainty as the GNI-based resource.[4]

The role of scrutiny

21. Although for the most part the annual EC Budget is determined by policies previously agreed as part of the Financial Perspective, scrutiny of the annual EC Budget remains an important means of making the process more transparent. We appreciate the Government's effort to assist us in our scrutiny of the annual Budget.

22. This report is the European Union Select Committee's main contribution to the scrutiny of the EC Budget. However, as part of our regular scrutiny role, we will continue to consider the Budget before it is adopted. We will also consider any Preliminary Draft Amending Budget presented by the Commission.

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3 *Financial Management And Fraud In The European Union* (50th Report, Session 2005–6, HL 270)

4 *Funding The European Union* (12th Report, Session 2006–7, HL 64)

CHAPTER 2: THE 2008 PRELIMINARY DRAFT BUDGET

23. As the European Commission has noted[5], the 2008 Budget marks the first time that commitment appropriations for growth and employment policies represent the highest share of the budget, ahead of agriculture and natural resources (i.e. the Common Agricultural Policy). While the payment appropriations have not yet reached this point, it is a tangible demonstration of the increased focus on growth and jobs under the current Financial Perspective. Furthermore, agricultural spending in the 2008 Budget will be lower in real terms than is the case in 2007.

The Budget

24. As in every year, the 2008 Preliminary Draft Budget makes a distinction between appropriations for commitments and appropriations for payments.

BOX 1

Commitment and Payment appropriations

Commitment appropriations are the total cost of legal obligations which can be entered into during the current year, for activities which will lead to payments in the current and future years.

Payment appropriations are actual transfers of cash from the Community Budget to creditors during the current year, resulting from commitments made in the current or previous years.

Total commitment appropriations

25. As the table on page 14 shows, the Commission's Preliminary Draft Budget envisages a total of €129.17 billion for commitment appropriations. This represents an increase of €2,591 million or 2.0% over the 2007 Budget, but is €3,137 million below the ceiling permitted by the Financial Perspective.

Total payment appropriations

26. The table also indicates a proposed total of €121.58 billion for payment appropriations. This represents an increase of €6,084 million, or 5.3% over the 2007 Budget. However, the level of payment appropriations is still €7,448 million below the Financial Perspective ceiling.

27. The proposed level of payments is equivalent to 0.97% of EU Gross National Income. This is slightly higher than in 2007, when it was 0.96% of EU GNI, and is €8,216 million below the Own Resources Decision Ceiling of 1.24% of EU GNI.

28. In her evidence, the Minister outlined the Government's priorities for the negotiation of the 2008 budget. At Q 25, she noted the following targets:

(1) reduce the budget levels for cohesion funding;

(2) reduce the generous funding allocated to the "woolly" citizenship programmes under heading 3b;

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5 European Commission press release IP/07/597

(3) maintain sufficient funding for the Global Partner (heading 4) projects, including Afghanistan and development spending in Iraq and Asia;

(4) maintain sufficient development spending allocated to the ACP countries transitioning out of sugar dependency;

(5) maintain downward pressure on the administration budget line; and

(6) ensure that there is sufficient margin between the overall financial perspective ceiling and the commitments in the annual budget to pay for any additional items without renegotiating the Financial Perspective.

Extraordinary budget items

29. Paragraph 28(6) refers to the possibility that the Council may wish to pursue "important priorities" (Q 25) outside of the budget. This is a reference to the European Institute of Technology and the Galileo Project.

Galileo Project

30. On 8 June, the EU Transport Council voted to end talks to establish a Public-Private Partnership (PPP) to develop the Galileo global satellite navigation system and use public funds instead. The UK has not supported this position and the Commission will report to the October Transport Council with funding proposals. While there is a budget line for Galileo, it was included in the Financial Perspective under the assumption that the PPP would go ahead, and the amounts allocated to this budget line reflect administrative and management costs rather than delivery and deployment of the thirty satellite system.

31. The Minister noted that the Government is "very supportive" of the Galileo Project but also stated that raising the ceiling under the Financial Perspective is "completely unacceptable" (QQ 19, 21) and that they would instead maintain pressure on other budget lines under the Competitiveness for Growth and Employment heading to find funds. **This Committee will continue to scrutinise closely the form and transparency of the funding of the Galileo Project. We support the Government's stance in refusing to raise the Financial Perspective ceilings to fund the Project.**

European Institute of Technology

32. A second item which has been closely examined, and criticised in its proposed form, by this Committee is the European Institute of Technology (EIT).[6] The budget envelope for this project is €308.7 million, and this has remained the case despite the fact that we were recently told that the EIT will have a gradual launch with only two or three Knowledge and Innovation Communities (KICs) in the first period to 2013, rather than the original proposal of up to six KICs.[7] This project also has a budget line but has been allocated €2.9 million in the Preliminary Draft Budget; a realistic amount to fund the gradual launch might be closer to €100 million.[8]

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6 *Proposal to establish the European Institute of Technology* (25th Report, Session 2006–7, HL 130)

7 ibid at page 20

8 ibid at Q 9

33. Our principal concern in this area is that an amount that the Minister agreed was "rather nominal" is allocated to the EIT, and that the Commission has suggested that the rest of the budget be found using the contingency fund of Budget heading 1a. The Minister shared our unease, noting that the Budget-setting authorities will have to work together to "juggle things around and … work out what our priorities really are, because we cannot have a situation where, just because there is a project which may have had initially good merits, that somehow the budget needs to increase—precisely the type of thing that should be avoided in terms of budgetary laxness—although the project may turn out to be worthwhile." (Q 28)

34. **We recommend that EU funding for the EIT should be reduced to a level commensurate with the gradual phased approach which is now envisaged for its implementation; and that the year by year profile of the total budget should properly reflect that phased approach. We recommend, further, that the practice of funding such a major project as the EIT from a reserve budgetary source should not be regarded as acceptable. Contingency funds should be reserved for genuinely unforeseen contingencies regardless of size.**

Agencies

35. A number of specialised and decentralised EU agencies have been established to support the Member States and citizens. Each focuses on tasks of a legal, technical and/or scientific nature, and examples include the European Maritime Safety Agency (EMSA), European Defence Agency (EDA), European Police Office (EUROPOL), and Community Fisheries Control Agency (CFCA).[9] The increases in funding for the agencies are allocated under Headings 1a, 3a and 3b, and amount to 24%, 9.5%, and 23% respectively.

36. We have concerns about the controls that are in place for monitoring spending and administration within these agencies, and we were pleased to note that the Government shares these concerns (Q 13). **We support the Government's view that the budgets for the external agencies should be closely examined to ensure they are producing value for money**. The oversight and management of the agencies is a subject we may return to in a future report.

[9] More information is available on the Europa website at http://europa.eu/agencies/index_en.htm

TABLE 1

Summary of 2008 PDB Proposals—EUR million and GBP million

Heading		2007 Budget				2008 PDB				Change 2007 to 2008					
		Commitments		Payments		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	€	£	€	£	%	€	£	%
1	Sustainable growth	54,854	37,306	44,837	30,494	57,148	38,866	50,161	34,115	2,294	1,560	4.2	5,324	3,621	11.9
1a	Competitiveness for growth and employment	9,368	6,371	7,047	4,793	10,270	6,985	9,539	6,487	903	614	9.6	2,492	1,695	35.4
1b	Cohesion for growth and employment	45,487	30,936	37,790	25,701	46,878	31,882	40,623	27,628	1,391	946	3.1	2,832	1,926	7.5
2	Preservation and management of natural resources (CAP)	56,250	38,256	54,719	37,214	56,276	38,273	54,770	37,249	26	18	0.0	52	35	0.1
	Of which market related expenditure and direct payments	42,712	29,048	42,436	28,861	42,499	28,904	42,447	28,868	-213	-145	-0.5	11	7	0.0
3	Citizenship, Freedom, Security and Justice	1,271	864	1,202	817	1,288	876	1,190	809	17	12	1.3	-12	-8	-1.0
3a	Freedom, security and justice	624	424	474	322	691	470	496	337	67	46	10.8	23	15	4.8
3b	Citizenship	648	441	728	495	597	406	693	471	-50	-34	-7.8	-35	-24	-4.8
4	EU as a global partner	6,812	4,633	7,353	5,001	6,911	4,700	7,917	5,384	99	67	1.5	564	384	7.7
5	Administration	6,942	4,721	6,942	4,721	7,336	4,989	7,336	4,989	393	267	5.7	394	268	5.7
6	Compensation	445	303	445	301	207	141	207	140	-238	-161	-53.5	-238	-162	-53.5
Total		126,575	86,084	115,497	78,550	129,166	87,846	121,581	82,687	2,591	1,762	2.0	6,084	4,138	5.3
Margin						3,137	2,133								
Compulsory expenditure		44,597	30,330	44,487	30,256	44,053	29,960	44,057	29,963	-544	-370	-1.2	-430	-292	-1.0
Non-compulsory expenditure		81,979	55,754	71,010	48,294	85,113	57,885	77,524	52,724	3,135	2,132	3.8	6,514	4,430	9.2
As a percentage of GNI				0.96%				0.97%							

Notes: Due to rounding, the sum of the lines may not equal the total. Conversion rate as of 31 May 2007, £1 = €1.4705, €1 = £0.6801

Detail by expenditure heading

TABLE 2

Heading 1: Sustainable Growth

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
1	**Sustainable growth**	**57,148**	**38,866**	**50,161**	**34,115**	**2,294**	**1,560**	**4.2**	**5,324**	**3.621**	**11.9**
1a	Competitiveness for growth and employment	10,270	6.985	9,539	6,487	903	641	9.6	2,492	1,695	35.4
1b	Cohesion for growth and management	46,878	31,882	40,623	27,628	1,391	946	3.1	2,832	1,926	7.5

37. Overall expenditure in this category for commitments is €87.6 million under the Financial Perspective ceiling.

38. In Heading 1a (Competitiveness for Growth and Employment), the increases in commitment appropriations are largely accounted for by programmes that the Commission considers crucial to the implementation of the Lisbon Strategy. These include the following:

- 7th Research Framework Programme (increase of €589 million or 11%);
- Trans-European Networks (increase of €129 million or 17.7%);
- Lifelong Learning (increase of €81 million or 9%);
- Galileo (increase of €51 million or 51%).

39. The increases in Heading 1b (Cohesion for Growth and Employment) result largely from proposed expenditure devoted to the Cohesion Fund, which rises by €1029 million or 14.4%. The Structural Funds continue to be the dominant item under this heading, with commitment appropriations of €38,723 million (a rise of 0.9% or €363 million compared to 2007). The Minister noted (Q 27) that 60% of the Structural Funds go to rich Member States, and thought the need for long-term reform remained. As we have stated before, **we support the principle of increasing the Structural Fund receipts accruing to the poorest Member States as this is where European money can add the most value.**

TABLE 3

Heading 2: Preservation and management of natural resources

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
2	**Preservation and management of natural resources (CAP)**	**56,276**	**38,273**	**54,770**	**37,249**	**26**	**18**	**0.0**	**52**	**35**	**0.1**
	Of which market related expenditure and direct payments	42,499	28,904	42,447	28,868	-213	-145	-0.5	11	7	0.0

40. Commitment appropriations in this category rise by 0.05% or €25.6 million, to €56,276 million. This leaves a margin of €2,524 million under the ceiling agreed in the Financial Perspective. The Government's Explanatory Memorandum notes that market related expenditure and direct payments to farmers decrease by €212.6 million from 2007 (p 2). The Commission notes that 83% of direct aid to farmers is now decoupled from production. It further notes that in 2008 it will undertake a "CAP health check", to assess whether the reformed CAP is functioning satisfactorily.

41. Increases in commitment appropriations under this Heading include

- A rise of €199.2 million or 1.6% for Rural Development programmes
- A rise of €26.3 million or 10.9% for Life+, an environmental protection programme.

TABLE 4

Heading 3: Freedom, Security, Justice and Citizenship

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
3	**Citizenship, Freedom, Security and Justice**	**1,288**	**876**	**1,190**	**809**	**17**	**12**	**1.3**	**-12**	**-8**	**-1.0**
3a	Freedom, security and justice	691	470	496	337	67	46	10.8	23	15	4.8
3b	Citizenship	597	406	693	471	-50	-34	-7.8	-35	-24	-4.8

42. Proposed commitments in this area leave a margin of €74 million under the Financial Perspective ceiling.

43. Under Heading 3a, there is a €76 million or 24% increase in commitments for Solidarity and Management of Migration Flows. The Minister described this as an extremely important budget line and a very good example of where European co-operation can lead to added value (Q 33). Items under this sub-heading are the External Borders Fund, the European Refugee Fund, the European Return Fund, and the European Fund for the Integration of Third-Country Nationals. We noted that the proposed budget for the External Borders Fund is unchanged on that adopted in 2007, and that the Government raised concerns about absorption capacity under Heading 3a.

44. Under Heading 3b, there are increased allowances for programmes designed to foster mutual understanding and a shared European identity. This includes a €11.5 million (27.6%) increase in payments for Culture 2007–2013, and €29.5 million for a new programme, Europe for Citizens. The overall decrease in funding under this heading is due to a decrease of €85 million (81.8%) for programmes related to enlargement (i.e. the transition facility for Romania and Bulgaria).

TABLE 5

Heading 4: The EU as a global partner

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
4	**EU as a global partner**	**6,911**	**4,700**	**7,917**	**5,384**	**99**	**67**	**1.5**	**564**	**384**	**7.7**

45. Proposed commitments in this area leave a margin of €329 million under the Financial Perspective ceiling. The Commission notes that this is larger than last year, but expects additional appropriations to be required for funding in Kosovo and in the Middle East.

46. Of note here are commitment increases of:

- €119 million or 9.4% for the Instrument for Pre-Accession;
- €40 million or 28.7% for the Instrument for Stability;
- €34 million or 58.1% for Macroeconomic assistance; and
- €41 million or 25.8% for the Common and Foreign Security Policy.

47. We are pleased to note that the Instrument for Pre-Accession funding is ring-fenced to Macedonia, Croatia, Turkey and the remaining countries of the Western Balkans. We support the Minister's view that it would be inappropriate to leave Turkey out of this programme at this stage.

48. Funding under the Instrument for Stability includes €135 million on "Crisis Response and Preparedness" and €27 million for "actions in the area of non-proliferation of weapons of mass destruction". The Minister agreed that these did not look like large sums, but also argued that "the importance of a policy cannot purely be measured in financial terms. Many of the most effective ways of helping neighbourhood countries do not involve huge amounts of budget resources—trade concessions, loans, targeted technical assistance, regular dialogue, shared diplomatic concerns and so on." (Q 43)

49. The Minister writes that the Government will also prioritise the maintenance of spending at sufficient levels for other items under this Heading, including assistance to sugar protocol countries and the CFSP. In giving evidence she added the need to support development funding in Iraq and Asia. (Q 25)

TABLE 6

Heading 5: Administration

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
5	**Administration**	**7,336**	**4,989**	**7,336**	**4,989**	**393**	**267**	**5.7**	**394**	**268**	**5.7**

50. Commitments under this heading leave a €113 million margin below the Financial Perspective ceiling.

51. Commitments under this heading include a 10.2% increase to fund the pension funds for staff of all institutions, and funding for an increase in staff by 3,960 posts over 2003–8 due to the enlargement to 25 Member States and a further 750 posts over 2006–9 due to the accession of Bulgaria and Romania. The Minister told us that that the Government "believe there can be efficiency and productivity gains in terms of staffing and we have been negotiating very hard at official level on this point in the last few weeks. National administrations are facing restrictions. It is going to be a tough spending round for us here in the UK. That is replicated across Europe. We are making efficiency cuts and we do not think it is right that we should be supporting staffing gains in the European Commission, not just because it is not fair or anything like that, but simply because we think they could do their job more effectively, so we agree 100 per cent and we are negotiating hard on this." (Q 44)

52. Other funding increases under this heading are related:

- A 9% (€6.4 million) increase to fund security at all Commission buildings and for delegations working outside of the EU.
- A 21.5% (€6.6 million) increase in social provision for staff, including a new childcare facility.
- A 180% (€1.6 million) rise in funding for measures to encourage Commission staff to adopt green travel methods while commuting. The scope of these measures and the increase in commitments is less than was requested for similar initiatives in the 2007 budget.

53. **We also note and support the Government's intention to initiate a "Gershon-type review" as part of the 2008/9 review of the budget (QQ 10, 25), and to take steps to promote productivity and value for money.**

TABLE 7

Heading 6: Compensation

		2008 PDB				Change 2007–2008					
		Commitments		Payments		Commitments			Payments		
		€	£	€	£	€	£	%	€	£	%
6	**Compensation**	**207**	**141**	**207**	**140**	**-238**	**-161**	**-53.5**	**-238**	**-162**	**-53.5**

54. For a fifth consecutive year, the 2008 Budget also includes a sixth heading for expenditure. This heading is intended to improve cash-flow in the national budgets of the newest Member States (Bulgaria and Romania) and to finance control actions at the new external borders of the Union. The amount spent under this heading is less than half of that in 2007; it will cease to exist after 2009 (p 1). Expenditure in this heading leaves a margin of €0.36 million below the Financial Perspective ceiling.

CHAPTER 3: SUMMARY OF CONCLUSIONS

55. We support HM Treasury's three principles and welcome the news that work on the 2008/9 review has already commenced in Government. We request that HM Treasury provide in due course details of the items of expenditure that it finds not to be 'fit for purpose'. We particularly welcome the Government's commitment to sound financial management and the need to pressure all Member States to manage expenditure with greater care. (paragraph 17)

56. This Committee will continue to scrutinise closely the form and transparency of the funding of the Galileo Project. We support the Government's stance in refusing to raise the Financial Perspective ceilings to fund the Project. (paragraph 31)

57. We recommend that EU funding for the EIT should be reduced to a level commensurate with the gradual phased approach which is now envisaged for its implementation; and that the year by year profile of the total budget should properly reflect that phased approach. We recommend, further, that the practice of funding such a major project as the EIT from a reserve budgetary source should not be regarded as acceptable. Contingency funds should be reserved for genuinely unforeseen contingencies regardless of size. (paragraph 34)

58. We support the Government's view that the budgets for the external agencies should be closely examined to ensure they are producing value for money. (paragraph 36)

59. We support the principle of increasing the Structural Fund receipts accruing to the poorest Member States as this is where European money can add the most value. (paragraph 39)

60. We also note and support the Government's intention to initiate a "Gershon-type review" as part of the 2008/9 review of the budget (QQ 10, 25), and to take steps to promote productivity and value for money. (paragraph 53)

APPENDIX 1: SUB-COMMITTEE A (ECONOMIC AND FINANCIAL AFFAIRS, AND INTERNATIONAL TRADE)

Sub-Committee A

The members of the Sub-Committee which conducted this inquiry were:

Lord Blackwell
Lord Cobbold
Baroness Cohen of Pimlico (Chairman)
Lord Giddens
Lord Inglewood
Lord Jordan
Lord Kerr of Kinlochard
Lord Maclennan of Rogart
Lord Steinberg
Lord Trimble
Lord Watson of Richmond

Declaration of Interests

A full list of Members' interest can be found in the Register of Lords Interests:

http://www.publications.parliament.uk/pa/ld/ldreg.htm

APPENDIX 2: LETTER FROM LORD GRENFELL TO KITTY USSHER MP, ECONOMIC SECRETARY, HM TREASURY, 11 JULY 2007

Thank you for your Ministry's Explanatory Memorandum dated 6 June and for meeting with Sub-Committee A on 5 July. The Sub-Committee have now considered the Preliminary Draft Budget and have cleared the item from scrutiny. As is usual practice, the Committee plans to publish a Report on the Budget in due course.

We broadly agree with the Government's position and endorse your priorities. We fully support the Government's efforts to ensure that the principles of affordability, efficiency and value for money underpin all proposed expenditure to the EC budget. The Sub-Committee were also pleased to hear that the Government is still minded to focus the Regional Development and Social Funds where they are most needed. In giving evidence, you discussed hoped-for improvements in the draft budget to be agreed on 13 July. We would be grateful if you would write to the Committee after 13 July to update us on progress at Budget ECOFIN.

As the Sub-Committee discussed with you at the meeting last week, the Committee has particular concerns relating to the form and transparency of the funding of the Galileo Project. We support your stance to refuse to raise the Financial Perspective ceilings to fund the Project. However, we remain concerned that other Member states will not support your position and that the Government's views may not prevail at Transport Council. The Sub-Committee would appreciate regular updates on the progress of this dossier.

The Sub-Committee also noted that there appear to be a variety of opinions on the form and purpose of the European Institute of Technology. The Sub-Committee strongly opposes the dedication of a contingency fund towards any purpose other than as a reserve for an urgent situation, and so does not support the Commission's planned use of this as a funding mechanism for the European Institute of Technology. We support your stance that funding for the European Institute of Technology should be found by transparent means within the existing Financial Perspective headings, and also urge the Government to work with all stakeholders to agree on the purpose of the Institute.

The lack of transparency surrounding the funding of the Commission's Agencies remains a concern, and is a subject which we may choose to return to in the future. We would welcome news of any steps you are able to take in Budget ECOFIN to improve monitoring of their management, budgets and output.

You agreed to write to the Committee with more information regarding the External Borders Funds, which appears to have had its budget frozen; to give more information on the purpose of the "mobility" line of the administration budget and the reason for its significant increase. The Sub-Committee also noted your aim to negotiate a lower number of additional staff for the Commission.

The Sub-Committee have asked me to emphasise the conclusions of their Report *Financial Management and Fraud in the EU*. Although this is not directly related to the matter at hand, the Committee noted that some progress has been made in this field. Given the orders of magnitude involved, the Sub-Committee urge the Government to show real determination in energising other Member States to scrutinise actively their own expenditure of EU funds.

Finally, Baroness Cohen and the Sub-Committee's Members have asked me to thank you for giving evidence so promptly after taking up your new post. We look forward to working with you both on this issue and on other dossiers in the future.

I am copying this letter to Michael Connarty MP, Chairman of the Commons Committee; Alistair Doherty, Clerk to the Commons Committee; Michael Carpenter, Legal Adviser to the Commons Committee; Les Saunders, Cabinet Office; Ian Moules, European Union Scrutiny and Infractions Branch and Eleanor Padfield, European Union Coordination and Strategy Team, HM Treasury.

APPENDIX 3: GLOSSARY

CAP	Common Agricultural Policy
CFCA	Community Fisheries Control Agency
CFSP	Common and Foreign Security Policy
EC	European Communities
EDA	European Defence Agency
EIT	European Institute of Technology
EMSA	European Maritime Safety Agency
EP	European Parliament
EU	European Union
EUROPOL	European Police Office
GDP	Gross Domestic Product
GNI	Gross National Income
HMT	HM Treasury
KIC	Knowledge and Innovation Communities
PDB	Preliminary Draft Budget
PPP	Public-Private Partnership

APPENDIX 4: REPORTS

Recent Reports from the Select Committee

Proposal to establish the European Institute of Technology (25th Report session 2006–07, HL Paper 130)

The Commission's Annual Policy Strategy for 2008 (23rd Report session 2006–07, HL Paper 123)

Current Developments in European Foreign Policy (16th Report session 2006–07, HL Paper 76)

The Commission's 2007 Legislative and Work Programme (7th Report session 2006–07, HL Paper 42)

Annual Report 2006 (46th Report session 2005–06, HL Paper 261)

Session 2006–2007 Reports prepared by Sub-Committee A

Stopping the Carousel: Missing Trader Fraud in the EU (20th Report, HL Paper 101)

Financial Management and Fraud in the European Union: Responses to the Report (19th Report, HL Paper 98)

Funding the European Union (12th Report, HL Paper 64)

Other Relevant Reports prepared by Sub-Committee A

Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals (50th Report session 2005–2006, HL Paper 270)

The 2007 EC Budget (39th Report session 2005–2006, HL Paper 218)

A European Strategy for Jobs and Growth (28th Report session 2005–2006, HL Paper 137)

Evidence from the Financial Secretary on the proposed reforms of the Stability and Growth Pact (7th Report session 2004–05, HL Paper 74)

Future Financing of the European Union (6th Report session 2004–05, HL Paper 62)

Minutes of Evidence

TAKEN BEFORE THE SELECT COMMITTEE ON THE EUROPEAN UNION (SUB-COMMITTEE A)

THURSDAY 5 JULY 2007

Present		
	Cobbold, L	Trimble, L
	Cohen of Pimlico, B (Chairman)	Watson of Richmond, L
	Inglewood, L	Marlesford, L
	Jordan, L	

Explanatory memorandum by HM Treasury SEC (2007) 500

PRELIMINARY DRAFT BUDGET (PDB) OF THE EUROPEAN COMMUNITIES 2008

Subject Matter

Commission Proposals, the Budget Structure and the Annual Procedure

The Preliminary Draft Budget (PDB) sets out the Commission's proposals for European Community expenditure in 2008. It represents the first stage in the *annual budget procedure*[1], and provides the basis for subsequent negotiations between the two arms of the Budgetary Authority (the Council and the European Parliament), which will result in the adoption of the 2008 General Budget in December.

The context for each year's PDB is determined by the multi-annual *Financial Perspective* (FP), which sets out annual ceilings for six broad expenditure categories—Heading 1 Sustainable Growth; 2 Preservation and Management of Natural Resources; 3 Citizenship, Freedom, Security and Justice; 4 The European Union as a Global Partner; 5 Administration; and 6 Compensation (which only applies to Bulgaria and Romania until 2009). The PDB for 2008 will be the second of the FP for 2007–13.

The 2008 PDB is presented in *Activity-Based Budgeting* (ABB) format whereby the Commission provides Activity Statements on its proposed spending plans. ABB seeks to tie budgetary resources to clear policy objectives, together with appropriate performance indicators and evaluation measures. Negotiations on the 2008 budget will be conducted on the basis of ABB documentation.

We expect the PDB to be published in 10 volumes, covering a General Introduction, a General Statement of Revenue, and expenditure proposals for nine separate EU institutions (European Parliament, Council, Commission, Court of Justice, Court of Auditors, Economic and Social Committee, Committee of the Regions, European Ombudsman, European Data Protection Supervisor). In addition, we expect the Commission to publish two sets of Working Documents, known as Activity Statements and Financial Statements. These present specific objectives, planned outputs, and performance measures at the level of individual budget lines as well as higher-level activity areas, in line with ABB.

PDB 2008—Overview

As European Commissioner for Financial Programming and Budget, Dr. Dalia Grybauskaite, pointed out in her presentation to the European Parliament in early May, the key message from the Commission on the 2008 PDB is that for the first time spending on growth and employment will represent the highest share of the budget, ahead of agriculture and natural resources.

For *commitment appropriations*, the PDB proposes a total of €129,166 million[2]. This represents an increase of €2,591 million, or 2%, over 2007. The margin remaining under the global FP ceiling for commitments is €3,137 million.

[1] Terms in italics are explained in the glossary (Annex 2)

[2] For Sterling equivalents of key figures quoted, please refer to the tables in Annex 1

5 July 2007

For *payment appropriations*, the PDB proposes a total of €121,581 million. This represents an increase of €6,084 million or 5.3% over 2007 levels. The margin remaining under the global FP ceiling is €8,216 million. The proposed level of payments is equivalent to 0.97% of EU Gross National Income (GNI), just higher than for the agreed 2007 Budget when it was 0.96% of EU GNI and significantly below the ceiling of 1.24% set by the *Own Resources Decision*.

Compulsory expenditure accounts for €44,053 million of total commitment appropriations and €44,057 million of total payment appropriations. For *Non-Compulsory expenditure*, commitment appropriations total €85,113 million and payment appropriations total €77,524 million. There is a global decrease in Compulsory expenditure of 1.2% for commitments and 1% for payments. There is a global increase in Non-Compulsory expenditure of 3.8% for commitments and 9.2% for payments.

Tables summarising the key figures of the 2008 PDB are provided in Annex 1 (in both Euros and Sterling).

PDB 2008—Detail of Proposed Expenditure by Heading

Overall proposed expenditure on Heading 1 (Sustainable Growth) is €57,148 million for commitment appropriations and €50,161 million for payment appropriations, leaving a margin of €87.6 million under the FP ceiling for commitments. Heading 1 is divided into two further headings.

For Heading 1a (Competitiveness for Growth and Employment). the PDB proposes €10,270 million for commitments and €9,539 million for payments. This represents an increase of €903 million, or 9.6%, for commitments and an increase of €2,492 million, or 35.4%, for payments over 2007 levels. The change in commitment appropriation levels is largely accounted for by increases for programmes the Commission considers crucial to the implementation of the Lisbon Strategy. These include:

- Seventh Research framework programme (increased by €589 million, or 11%, against 2007 levels);
- Trans-European Networks (increased by €119 million or 14%);
- Lifelong Learning (increased by £81 million or 9%); and
- Galileo (increased by £51 million or 51%).

The change in payment appropriations is largely accounted for by increases for:

- Seventh Research framework programme (increased by €2,183 million or 54.5%);
- Trans-European Networks (increased by €334 million or 88.8%);
- Lifelong Learning (increased by €165 million or 19.7%);
- Competitiveness and innovation framework programme (increased by €92 million or 25.7%); and
- Decentralised agencies (increased by €54 million or 24.9%).

For Heading lb (Cohesion for Growth and Employment), the PDB proposes commitment appropriations of €46,878 million and payment appropriations of €40,623 million. These represent increases to commitments of €1,391 million or 3.1%, and to payments of €2,832 million or 7.5% against 2007 levels. These commitment and payment increases result particularly from proposed expenditure devoted to the Cohesion Fund, which is set to rise by more than 14% in 2008.

For Heading 2 (Preservation and Management of Natural Resources), the PDB proposes commitments of €56,276 million and payments of €54,770 million. These represent increases of €25.6 million or 0.05%, and €51.9 million or 0.1% respectively compared to 2007. This leaves a margin of €2,524 million under the ceiling for commitments.

Although overall expenditure under Heading 2 is set to remain relatively stable compared to 2007, there are gradual percentage shifts within this policy area which amount to fairly large sums. With regard to commitments, market-related expenditure and direct aids to farmers decrease as a whole by €212.6 million, whilst rural development programmes are set to grow by €199.2 million (or 1.6%) to reach €12.5 billion—continuing along the lines of the 2003 CAP reform and the associated modulation of payments. Another noteworthy commitments increase is that of €26.3 million (or 10.9%) for Life + , the environmental protection programme.

With regard to payments, there is an effective shift within market-related expenditure and direct aids from agricultural markets to proposed spending on animal and plant health (health and consumer protection), which increases by €182.4 million (an increase of 516.6% on 2007). There is a proposed payment appropriations increase for rural development programmes of €485 million (4.5%) whilst payments for the European Fisheries Fund decrease by €387.4 million (a decrease of 46.2% on 2007).

Overall, the proposed expenditure on Heading 3 (Citizenship Freedom, Security and Justice) is €1,288 million for commitments and €1,190 million for payments. This represents an increase in commitments of €17 million, or 1.3%, and a decrease in payments of €12 million or 1%, against 2007 levels. This leaves a margin of €74 million under the FP ceiling for commitments. Heading 3 is divided into two further headings.

For Heading 3a (Freedom, Security and Justice), the PDB proposes commitment appropriations of €691 million and payment appropriations of €496 million. These represent an increase to commitments of €67 million or 10.8%, and a decrease to payments of €22.5 million or 4.8% against 2007 levels. This leaves a margin below the FP ceiling of €56 million.

The largest increase in commitments on 2007 concerns Solidarity and Management of Migration Flows (€76 million or 24%), which is set to reach €392.5 million in commitment appropriations. With regard to payments, questions will once again remain on absorption capacity in this area and also for programmes under Fundamental rights and justice (where an increase of €13.8 million or 28.3% is foreseen) and Decentralised agencies (with an increase of €8.2 million or 9.5%).

For Heading 3b (Citizenship), the PDB proposes, commitments of €597 million and payments of €693 million. These represent overall decreases of €50 million or 7.8% for commitments, and of €35 million or 4.8% for payments, against 2007 levels. This leaves a margin below the ceiling for commitments of €17.7 million. The decrease in commitments is largely due to a decrease in funding of €85 million (or 81.8%) for Other actions and programmes relating to enlargement (the transition facility for Romania and Bulgaria)—while commitments for Public health and consumer protection and Media 2007 programmes within the sub-heading receive increases of €9 million and €18 million respectively. Similarly, in respect of payments, the large decrease for enlargement associated programmes of €37 million (or 24%) is offset by increases for Culture 2007–13 of €11.5 million (or 27.6%) and for Decentralised agencies of €19 million (or 22.9%).

For Heading 4 (The EU as a Global Partner), the PDB proposes commitments of €6,911 million and payments of €7,917 million. These represent an increase in commitments of €99 million or 1.5% and an increase in payments of €564 million or 7.7%, against 2007 levels. This leaves a margin of €329 million below the Financial Perspective ceiling.

Some noteworthy increases to commitments include:

— Instrument for Pre-Accession (€119 million or 9.4%);
— Development Cooperation Instrument (€41 million or 1.9%);
— Instrument for Stability (€40 million or 28.7%);
— Macroeconomic assistance (€34 million or 58.1%); and
— Common and Foreign Security Policy (€41 million or 25.8%).

Development Cooperation continues to represent the largest budgetary item at €2.2 billion.

Some noteworthy changes to payments include:

— Instrument for Pre-Accession (increase of €368 million or 14.3% largely for regional policy and agriculture and rural development);
— European Neighbourhood and Partnership Instrument (increase of €43 million or 4%);
— Development Cooperation Instrument (decrease of €30 million or 1.5%);
— Instrument for Stability (increase of €38 million or 51.3%); and
— Common and Foreign Security Policy (increase of €35 million or 29.5%).

For Heading 5 (Administration), the PDB proposes commitments of €7,335.7 million and payments of €7,336 million. These represent increases of €393 million and €394 million or 5.7%, against 2007 levels. This leaves a margin for commitments of €121 million below the ceiling. The increase in resources is intended to provide for an extra 860 posts in the EU institutions and bodies, for which enlargement remains the main reason given, and for pensions provision for all institutions which is set to increase by 10.2%.

For Heading 6 (Compensation), which now only applies to Bulgaria and Romania, the PDB proposes commitments and payments of €206 million. These represent decreases of €238 million or 53.5%, against 2007 levels, leaving a margin for commitments of €0.36 million below the ceiling. The heading covers temporary measures foreseen in accession treaties such as the Cash-Flow and Schengen Facilities agreed in those accession negotiations.

Ministerial Responsibility

Treasury Ministers are responsible for the Government's policy on the budget of the European Communities. Other Ministers have interests in those parts of the budget that are of relevance to their departments.

Legal and Procedural Issues

Legal basis: The PDB is presented under Article 272 of the EC Treaty.

European Parliament procedure: The European Parliament (EP) participates fully in the budgetary process and formally adopts the budget. The EP votes by a majority of its members, or a three-fifths majority of the votes cast, depending on the circumstances, and has the final say in setting non-compulsory expenditure.

Voting procedure: The Council votes by qualified majority and has the final say in setting the level of compulsory expenditure.

Impact on United Kingdom Law: None.

Application to Gibraltar: Not applicable.

Application to the European Economic Area

Not applicable.

Subsidiarity

The EC Budget is a matter of exclusive Community competence and the Commission's presentation of the PDB is required by the Treaty.

Policy Implications

The Community budget has significant financial and policy implications. Since the UK is a net contributor to the EC budget, it is in the UK's interest to control growth in the budget, while working to achieve a more efficient use of resources. The Government will work with like-minded Member States to maintain budget discipline and subject all areas of EC spending to rigorous scrutiny. However, it must be borne in mind that most EC spending (including agriculture, structural funds and multi-annual programmes) is largely pre-determined by previous decisions on the Financial Perspective, and that in the annual budget process, the final decision on much of the expenditure is taken by the European Parliament.

The Government's primary aim will be to respect agreed and established budgetary principles. In particular, to ensure that: spending delivers genuine value for money; global appropriations for payments are based on realistic implementation forecasts (to prevent the emergence of a large budget surplus); Financial Perspective ceilings are respected, with full accordance being given to the rules governing use of the *Flexibility Instrument*, and; *Activity-Based Budgeting* is fully factored into the budgeting process.

Key spending areas in the 2008 budget, which the Government intends to examine in detail, include Heading 1a (Competitiveness for growth and employment) where a high payments increase of 35.4% has been proposed. Although the Commission has presented these large increases as a reflection and acknowledgement of new challenges in this spending area, the issue remains as to whether such absorption capacity exists for such large increases to be spent, and the Government will be seeking full justifications. for this extra expenditure. On Heading 1b (Structural and Cohesion Funds), where an increase of 7.5% is put forward for payments and where there have been significant levels of under-spend in previous years, the Government will also seek to achieve realistic levels of payments that take into account genuine implementation capacity.

Within Heading 4 (The European Union as a Global Partner) it will be a Government priority to ensure that key spending on development co-operation and external relations in certain areas (including Afghanistan, assistance to sugar protocol countries and the CFSP) is maintained at sufficient levels. Finally, Heading 5 (Administration), as last year, will be an area that the Government will scrutinise particularly closely, once again questioning what efforts have been made to find efficiency gains and economies of scale. Working with other like-minded Member States, the Government will also examine the level of vacancies, the redeployment of staff and the reprioritisation of work in the administrations of the EU institutions, agencies and bodies.

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Regulatory Impact Assessment

Not applicable.

Financial Implications

The UK financing share of the 2008 PDB is estimated as 17.1% before the *abatement*, or 12.3% after abatement. The actual net financial cost to the UK of the 2008 EC Budget will depend not only on the size of the budget that is finally adopted, but also on the balance between different spending programmes within the budget. This determines the level of UK receipts and subsequently affects the size of the UK's abatement in the following year.

Consultation

Not applicable.

Timetable

Discussion of the PDB began in Council's budget committee on 3 May. On 13 July the Council will establish the Draft Budget on the basis of these discussions, which will then be forwarded to the European Parliament (EP). It is expected that the Draft Budget will be debated by the EP in a plenary session in October. The EP's amendments and modifications will be considered at the Council's second reading in November. A revised Draft Budget will then be submitted to the EP for its second reading, and formal adoption of the budget is expected by mid-December.

Ed Balls
Economic Secretary
HM Treasury

6 June 2007

Annex 1

Table 1

SUMMARY OF 2008 PDB PROPOSALS—EUR MILLION

Heading	*2007 Budget*		*2008 PDB*		*Change 2008–07*		*Change 2008–07 %*	
	CA (2)	PA (3)	CA (2)	PA (3)	CA (2)	PA (3)	CA (2)	PA (3)
1. Sustainable Growth	**54,854**	**44,837**	**57,148**	**50,161**	**2,294**	**5,324**	**4.2%**	**11.9%**
1a. Competitiveness for Growth and Employment	9,368	7,047	10,270	9,539	903	2,492	9.6%	35.4%
1b. Cohesion for Growth and Employment	45,487	37,790	46,878	40,623	1,391	2,832	3.1%	7.5%
2. Preservation and Management of Natural Resources	**56,250**	**54,719**	**56,276**	**54,770**	**26**	**52**	**0.0%**	**0.1%**
Of which: Market related expenditure and direct payments	42,712	42,436	42,499	42,447	–213	11	–0.5%	0.0%
3. Citizenship, Freedom, Security and Justice	**1,271**	**1,202**	**1,288**	**1,190**	**17**	**–12**	**1.3%**	**–1.0%**
3a. Freedom, Security and Justice	624	474	691	496	67	23	10.8%	4.8%
3b. Citizenship	648	728	597	693	–50	–35	–7.8%	–4.8%
4. European Union as a Global Partner	**6,812**	**7,353**	**6,911**	**7,917**	**99**	**564**	**1.5%**	**7.7%**
5. Administration	**6,942**	**6,942**	**7,336**	**7,336**	**393**	**394**	**5.7%**	**5.7%**
6. Compensation	**445**	**445**	**207**	**207**	**–238**	**–238**	**–53.5%**	**–53.5%**
TOTAL (4)	**126,575**	**115,497**	**129,166**	**121,581**	**2,591**	**6,084**	**2.0%**	**5.3%**
Margin			*3,137*					
Compulsory expenditure	*44,597*	*44,487*	*44,053*	*44,057*	*–544*	*–430*	*–1.2%*	*–1.0%*
Non-compulsory expenditure	*81,979*	*71,010*	*85,113*	*77,524*	*3,135*	*6,514*	*3.8%*	*9.2%*
Appropriations for payment as % of GNI		**0.96%**		**0.97%**				

Notes

(2) CA = commitment appropriations

(3) PA = payment appropriations

(4) Due to rounding, the sum of the lines may not equal the total.

5 July 2007

Table 2

SUMMARY OF 2008 PDB PROPOSALS—GBP MILLION

Heading	*2007 Budget*		*2008 PDB*		*Change 2008–07*		*Change 2008–07 %*	
	CA (2)	*PA (3)*	*CA (2)*	*PA (3)*	*CA (2)*	*PA (3)*	*CA (2)*	*PA (3)*
1. Sustainable Growth	**37,306**	**30,494**	**38,866**	**34,115**	**1,560**	**3,621**	**4.2%**	**11.9%**
1a. Competitiveness for Growth and Employment	6,371	4,793	6,985	6,487	614	1,695	9.6%	35.4%
1b. Cohesion for Growth and Management	30,936	25,701	31,882	27,628	946	1926	3.1%	7.5%
2. Preservation and Management of Natural Resources	**38,256**	**37,214**	**38,273**	**37,249**	**18**	**35**	**0.0%**	**0.1%**
Of which: Market related expenditure and direct payments	29,048	28,861	28,904	28,868	− 145	7	− 0.5%	0.0%
3. Citizenship, Freedom, Security and Justice	**864**	**817**	**876**	**809**	**12**	**− 8**	**1.3%**	**− 1.0%**
3a. Freedom, Security and Justice	424	322	470	337	46	15	10.8% .	4.8%
3b. Citizenship	441	495	406	471	− 34	− 24	− 7.8%	− 4.8%
4. European Union as a Global Partner	**4,633**	**5,001**	**4,700**	**5,384**	**67**	**384**	**1.5%**	**7.7%**
5. Administration	**4,721**	**4,721**	**4,989**	**4,989**	**267**	**268**	**5.7%**	**5.7%**
6. Compensation	**303**	**301**	**141**	**140**	**− 161**	**− 162**	**− 53.5%**	**− 53.5%**
TOTAL (4)	**86,084**	**78,550**	**87,846**	**82,687**	**1,762**	**4,138**	**2.0%**	**5.3%**
Margin			2,133					
Compulsory expenditure	30,330	30,256	29,960	29,963	− 370	–292	− 1.2%	− 1.0%
Non-compulsory expenditure	55,754	48,294	57,885	52,724	2,132	4,430	3.8%	9.2%
Appropriations for payment as % of GNI		**0.96%**		**0.97%**				

Notes

(2) CA = commitment appropriations

(3) PA = payment appropriations

(4) Due to rounding, the sum of the lines may not equal the total.

Sterling figures converted at the exchange rate on 31 May 2007

£1 = €1.4705

€1 = £0.6801

Annex 2

GLOSSARY

Abatement

The UK's VAT-based contributions are abated according to a formula set out in the Own Resources Decision. Broadly this is equivalent to 66% of the difference between what the UK contributes to the EC Budget and the receipts which it gets, subject to the following points:

- the abatement applies only in respect of spending within the EU. Expenditure outside the EU (mainly aid) is excluded;
- the UK's contribution is calculated as if the budget were entirely financed by VAT;
- the abatement is deducted from the UK's VAT contribution a year in arrears.

Activity-Based Budgeting (ABB)

ABB was introduced in 2002 to improve decision-making by ensuring budget allocations more closely reflect pre-defined political priorities and objectives. Similar to Public Service Agreements in the UK, ABB requires the EC Budget to be based on a clear justification for intervention and an evaluation of past performance. It also requires SMART (Specific, Measurable, Achievable, Realistic and Time-bound) objectives and future performance targets that focus on delivering value for money for the EU taxpayer.

5 July 2007

The Annual Budget Procedure

The Community's financial year runs from 1 January to 31 December. The rules governing decisions on the EC Budget are set out in Article 272 of the EC Treaty and in the *Inter-Institutional Agreement*. The timetable is s follows:

- establishment of the preliminary draft Budget by the Commission, normally in May;
- establishment of the draft Budget by the Council in late July;
- first reading by the Parliament in late October;
- second reading by the Council in mid-November; and
- second reading by the Parliament and adoption of the Budget in mid-December.

Commitment and Payment Appropriations

The budget distinguishes between appropriations for commitments and appropriations for payments. Commitment appropriations are the total cost of legal obligations that can be entered into during the current financial year, for activities that, in turn, will lead to payments in the current and future years. Payment appropriations are the amounts of money that are available to be spent during the year arising from commitments in the budget for the current or preceding years. Unused payment appropriations may, in exceptional circumstances, be carried forward into the following year.

Compulsory and Non-Compulsory Expenditure

EC expenditure is regarded as either "compulsory" or "non-compulsory". Compulsory expenditure is expenditure necessarily resulting from the Treaty or from acts adopted in accordance with the Treaty. It mainly includes agricultural guarantee expenditure, including stock depreciation. The Council has the final say in fixing its total.

The European Parliament has the final say in determining the amount and pattern of non-compulsory expenditure. The growth of this expenditure is governed by the "maximum rate of increase". Article 272(9) of the EC Treaty provides a formula for determining this rate, unless the budgetary authority agrees an alternative figure. Under the *Inter-Institutional Agreement* the Council and Parliament agree to accept maximum rates implied by the *Financial Perspective ceilings*.

Financial Perspective

The Financial Perspective (FP) forms the framework for Community expenditure over a period of several years. The FP for 2007–13 sets expenditure ceilings for six distinct expenditure headings (Sustainable Growth, Preservation and Management of Natural Resources, Citizenship, Freedom, Security and Justice, The European Union as a Global Partner, Administration, and Compensation), as well as global ceilings for commitments and payments. The Budgetary Authority (Council and European Parliament) is bound by these ceilings in the annual budget negotiations.

Flexibility Instrument

The Flexibility Instrument was established under paragraph 24 of the 1999 Inter-Institutional Agreement, which allows for expenditure in any given budget year of up to €200 million above the FP ceilings established for one or more budget headings. Any portion of the Flexibility Instrument unused at the end of one year may be carried over for up to two subsequent years, but the Flexibility Instrument should not as a rule be used to cover the same needs two years running. The Flexibility Instrument is intended for extraordinary expenditure and may only be used after all possibilities for reallocating existing appropriations have been exhausted. Both arms of the Budgetary Authority must agree to a mobilisation of the Flexibility Instrument following a proposal from the Commission.

5 July 2007

Inter-Institutional Agreement

The Inter-Institutional Agreement (IIA) is a politically and legally binding agreement that clarifies the EC's budgetary procedure. Under the Treaty, the Council and the European Parliament have joint responsibility for deciding the EC Budget on the basis of proposals from the Comission. The IIA sets out the way in which the three institutions will exercise their responsibilities in accordance with the Treaty, and their respect for the revenue ceilings laid down in the *Own Resources Decision*.

Own Resources Decision

The existing arrangements for financing the EC Budget are set out in the Communities' Own Resources Decision (ORD). The current ORD was agreed in September 2000, entered into UK law in 2001 and took effect in 2002. It sets an own resources ceiling on the amount the Communities can raise from Member States in any one year. The ceiling is currently fixed at 1.24% of EU GNI for payments and 1.31% for commitments. As the Communities are not allowed to save, or borrow, revenue must equal expenditure. Budget payments are therefore limited by the amount of Own Resources that can be called up from Member States.

The ORD lays down four sources of Community revenue, or "own resources":

- Customs duties including those on agricultural products;
- Sugar levies;
- Contributions based on VAT; and
- GNI-based contributions.

Examination of Witnesses

Witnesses: Kitty Ussher, a Member of the House of Commons, Economic Secretary, HM Treasury; Mr Jean-Christophe Gray, HM Treasury, Mr Duncan Sparkes, HM Treasury, and Mr Nicholas Joicey, HM Treasury, examined.

Q1 ***Chairman:*** Minister, we take it particularly kindly that you have come to see us, with all of three days in the job, and for bringing such a lot of friends. Can I say for the record that this session is broadcast and appears on the website but we do give you a transcript of whatever was said afterwards. We sent you a list of questions which indicate broad areas which we would like to discuss. We wondered how you would like to do this: is there a general statement that you would like to make as an opening bid or would you rather we just started?

Kitty Ussher: It might be helpful if I just set out some general points and then I am looking forward to the more detailed questions and answers. Thank you very much, Baroness Cohen. It is a great privilege for me to appear in front of your esteemed Committee, a rather daunting prospect, I must say, so early in my ministerial career because your Committee has such a high reputation for its scrutiny and analysis of European budgets. I am sure it is only a good thing for the Government that European budgets should become my top priority on taking over this post at the Treasury. I just want to say at the start that I know there were some difficulties in scheduling this evidence session, for which we can only apologise but, now that we are here, after the reshuffle, there is some sense in the fact that you are scrutinising me, as I will be the one negotiating on behalf of the Government. I am delighted that we are able to be here today and thank you for your flexibility in scheduling this session in a way that works for us as well. I will be going to the ECOFIN Budget Council at the end of next week so this is extremely timely. I am accompanied today by some extremely able Treasury officials. On my right is Jean-Christophe Gray, who is the team leader for the Treasury EU Finances team; on my left is Duncan Sparkes, who is the Policy Adviser with responsibility for EU financial management and the annual budget; and on my far left is Nick Joicey, who is the Director with overall responsibility for Europe. I will try not to bring them in but where I have to, I hope you will permit me. I would like to place the Commission's proposals for the 2008 EC budget in a slightly wider context which includes the preparations we are making for the mid-term review of the EC budget and the way that it is financed and our efforts to improve the way in which the EC budget is managed overall, because I know that will be of interest to the Committee. Our overall objective for the EC budget is to ensure that expenditure at EU level provides value for money, is affordable, well-managed and that the budget is fairly financed by the Member States. The Committee will be aware that the annual negotiations on the EC budget are conducted in the context of the agreement reached by the European Council at the end of our presidency in December 2005 on the financial perspectives for 2007-2013, which set ceilings for expenditure under six headings. The annual budget negotiations, which is what is in front of us today, are essentially about how to divide up between the various expenditure programmes the resources agreed under those financial perspective ceilings. The negotiations are not the occasion for discussing major reform of the EC budget although I would be delighted to take questions on that as well this morning. Unlike the financial perspective negotiations, which are concluded by the Council, the European Parliament has at least as much influence on the annual budget as the Council. The basis for the annual negotiations is the Commission's preliminary draft budget. The Government's priorities for this year's annual budget negotiations are broadly to ensure that the total payment appropriations are based on realistic forecasts of capacity for absorption and implementation in order to prevent the emergence of a large budget surplus with no question as to how that should be spent; to ensure that the financial perspective ceilings are respected, with adequate margins for foreseeable and unforeseeable expenditure; and to bear down on areas of expenditure which the Government regards as particularly questionable value for money—and I am sure that we will return to that subject—but notably agriculture and administration; and to protect certain areas of external expenditure such as development cooperation and the CFSP. Since the preliminary draft budget was published, the UK has been working closely with like-minded Member States, and I have to say that at this point I am cautiously optimistic that the draft budget to be adopted by the Council that I shall be attending on 13 July will represent an improvement, although we never know in the final eventuality, as far as our own priorities are concerned, on what was initially published by the Commission. But, of course, the whole process then goes to the European Parliament and it remains to be seen whether they will be as amenable to our arguments when it comes back to us later on in the year. Just a couple of words on the wider context, because I am sure members of this Committee will want to discuss that as well. When the European Council reached agreement in December 2005 on the financial perspectives for the next period, 2007–13, it also invited the Commission to undertake a comprehensive review of the EC budget, both of expenditure, including the CAP, and of resources, including the UK's abatement, and to report in 2008–09. The Commission has indicated that it will begin a review later this year by launching a consultation with all interested stakeholders. You will be well aware of the position of the UK Government on this, with 40% of the total EC budget still being spent on the CAP, and more than 60% of structural and cohesion funding expenditure still being directed to rich Member States. The Government will argue that this is hardly a budget designed to meet the challenges that the EU faces in the 21st century. We have set out three principles which will guide our approach to the budget review and we may well want to return to this in the discussion that we have. The third of these principles is that relating to sound financial management and administration. I just wanted to say in conclusion that I know this Committee published an important and highly regarded report on this subject at the end of last year and I am grateful for that. As your report made clear, a particular priority is to improve the management of the 80% of the EC budget for which the Commission and Member States share responsibility, notably agriculture and structural funds. That is why the Government announced last November that the UK could take a lead in showing how Member States could improve their own management of EC spending at a national level. Our initiative, supported by your proposals, has been widely welcomed and similar initiatives are now being developed in a number of other Member States, and I will continue to make the case for such reform when I meet for the first time my ECOFIN colleagues at the end of next week. I am grateful to you for allowing me to put some initial remarks of context and I look forward to our discussions.

Q2 ***Lord Inglewood:*** Thank you very much for that helpful overview. If I might I shall start by asking a number of separate but connected questions to do with the general approach that you are adopting towards the review of the European Union's budget that is coming up next year. You have indicated some priorities but you did not really indicate a great deal about level. Are you approaching it on the basis that the appropriate thing is for the amount of the EU budget to be up against the limit, or are you in fact of the view that it would be better and in Europe's and Britain's best interests for us to have a budget that is below the maximum that is permitted? Secondly—you touched on it—how in general terms are you going to deploy your resources and forces in advance of these negotiations to try and drive forward the things we think are important? Clearly, others will have a different view. Finally, if I can declare an interest as a farmer myself, in thinking about the future of the CAP, and in particular the European component of the expenditure involved in it, how do you feel about the new Sarkozy regime in France? Is that going to make it easier for you or do you perhaps think it might make it a little bit trickier?

Kitty Ussher: On the first point, on what we are trying to achieve from the comprehensive review and whether we want to keep the same ceilings, it is probably worth saying that this really is a very comprehensive review and consultations on it have only just begun. The informal presumption is that it will inform the discussions for the next financial perspective, ie, beginning after 2013, so in a sense, the ceilings of the current one are irrelevant because that is always negotiated from first principles but, of course, it goes without saying that we believe some fundamental aspects of the EC budget do not represent value for money. We have had that view for some time on the Common Agricultural Policy, where we want fundamental reform, and we also believe it is not good value for money for such a high proportion of the structural and cohesion funds to be going to rich Member States. We do not think that is the point of that type of programme. It therefore goes without saying that we would want to argue for a bottom-up approach. Does that answer your question?

Q3 ***Lord Inglewood:*** Can I just ask for an elaboration on that? If you take it, as you do, that there is no value for money in much of the CAP expenditure and quite a lot of the structural fund expenditure is being deployed probably in the wrong places, you can either proceed by saying that money should in future be spent in the European budget in different ways or you can say it is much better not to have this money spent in the European budget at all. Do you have a position on that alternative?
Kitty Ussher: We do not have a position in terms of what the overall ceiling of the budget should be for the next financial perspective, which I am sure will be informed by this review that we are currently undertaking. What we have done is set out some principles, and we have started a process within the UK of analysing the kind of "fit for purposeness" of all EU spending. It may well be that that will lead to a conclusion that will have some very significant implications for our negotiating stance in the fundamental review but we do not at this stage have a view on the outcome in terms of absolute levels. Would it help if I set out the general principles that we have established? It probably comes to answering your second question, which is what are we going to do in moving for that. My predecessor, at the end of last year, November 2006, set out our principles, which is that the EU should only act where there are clear additional benefits from collective efforts, compared with action solely by individual Member States, and this has informed our view on the CAP, where we are perfectly happy for payments to be made to agricultural farmers but that does not necessarily mean that they have to be paid through the EC budget, which may partly answer your question. The second point is that where EU-level action is appropriate, it should be proportionate, flexible and use the most appropriate policy lever, which may or may not be spending. Thirdly, of course, we must have sound financial management. On the basis of these principles, we are developing a UK vision for expenditure and future financing. That is a process of ongoing work and it is involving a cross-Whitehall effort. We have already begun some informal conversations with our EU partners, Member States and the Commission, obviously, but the Commission itself has not yet published its draft proposal so we are in that sense at an early stage in all this. There was a third point?

Q4 ***Lord Inglewood:*** The way in which the election of President Sarkozy will make it easier for you to reform the CAP.
Kitty Ussher: I think we are at rather early days. The French position has been clearly stated in many different ways. However, the fundamental point is that I am a member of the British Government, representing British interests, and we feel it is always worth a try. Perhaps there are some pressures out there that will work to our advantage but I do not think I would be doing my job if I thought "Oh, the French are adopting their usual negotiating stance and therefore I'm not going to try and represent the best for our people".

Q5 ***Lord Inglewood:*** Are you confident that you can be successful, at least in part?
Kitty Ussher: I think it is probably too early to say but I am ever optimistic.

Q6 ***Lord Marlesford:*** Minister, could I ask you a supplementary on this question of structural funds, because it is so important? You may remember, although you were not in the Treasury at the time, but in the days of the Prodi Commission there was a jolly good report produced by Professor Sapir, and that report came to the broad conclusion that there should be a major switch of resources in the structural funds from rich countries to the new entrants. It was very sensible but it was sat on by the Commission, and it never saw the light of day, effectively. Do you think there is some merit and indeed some chance of reviving the Sapir report and getting the present Commission, perhaps via ECOFIN, to reconsider its conclusions?
Kitty Ussher: I am not an expert in the individual specifics of that report but from what you have just said it seems to fit rather closely to the UK position. You will recall, of course, the domestic document the British Government produced, I think round about 2003, when we were entering discussions on the current financial perspective, which argued very much that structural and cohesion funds should be prioritised extensively on the new countries and there were quite difficult political discussions that took

place within the UK about what that meant for the regions of Britain that were currently receiving EU structural and cohesion funding and a debate about how we should finance that through the regional development agencies and so on. We fought hard, and we made some progress, but we lost that debate in Europe, but it remains our view. So I guess the answer is yes, subject to the detail of that report, that is exactly the type of argument that we will be pushing when the proper debate on the fundamental review takes place.

Q7 ***Lord Watson of Richmond:*** I was very interested in what you said in your opening remarks about the importance of realistic forecasts and not actually arriving at situations of unforeseen surpluses. Of course, there are a number of reasons for that and it is an admirable intention. As we know from companies and local government and everything else, there is a tendency that, if you have unforeseen surpluses, you urgently wish to spend them before the deadline expires and you rush them into other projects. We have questions for you later on about Galileo and about the European Institute of Technology, for example, both of which would be candidates for unforeseen surpluses, I suspect. My question really is, at this stage—and I know it is early in the procedure—do you have a feeling about the degree to which the forecasts that you have been looking at are actually realistic?
Kitty Ussher: We feel that some of them are over-generous based on the experience that we have seen in recent years of the ability for the Commission and Member States to spend, so we are anxious that they should be borne down on for precisely the reasons you state.

Q8 ***Lord Watson of Richmond:*** Can you indicate which are the main ones?
Kitty Ussher: Yes. Aspects of structural and cohesion funding, definitely. We are also concerned about agriculture, as we always are, and elements in the administration lines we think are inflated unnecessarily as well. Specifically on the points that you mention, we are concerned that there will be pressure for spending on projects that were unforeseen at the time that the financial perspective was agreed in heading 1a, around pressure to spend on Galileo and the European Institute of Technology, and therefore it would be prudent to perhaps bear down on—

Q9 ***Lord Watson of Richmond:*** Which may be very worthy but that is not the point. The point is that it should have been foreseen.
Kitty Ussher: Indeed. So "yes", I think, is the answer to your question, Lord Watson.

Q10 ***Lord Jordan:*** Minister, from the remarks you have already made, it is clear that the Government is keen to improve the management of the budget expenditure. We know that many of the biggest anti-European propaganda pieces are about waste and fraud. This Committee in particular has reason to know that they are generally over-stated but they do exist and there is the potential for them to exist. What steps is the Government taking to ensure that the Commission obtains value for money on both the projects it funds and on its own internal administration? Further, are you content with the controls in place for monitoring spending and administration within the external agencies? Finally, what response has the Government received to your predecessor's announcement last November regarding Member States producing a statement of assurance, which, again, this Committee thought was a step in the right direction?
Kitty Ussher: I have been extremely interested to read the work that this Committee has done on fraud. That has been a very useful contribution to the debate. But it is no secret that our view is that there are some quite serious questions remaining about the extent to which the EC budget represents value for money, both in terms of the programme spend but also in terms of simply the way that the budget is managed and the adequacy of mechanisms to ensure spending achieves the desired results. We do think some progress has been made, often at our instigation—we are near the forefront of this—to improve the way the budget is programmed but we think much more needs to be done. There are several separate ways of dealing with this. In terms of project outcomes, obviously we do not think that there is sufficient value for money on the big areas that I have already mentioned in terms of the Common Agricultural Policy, and the structural and cohesion funds. That is a value for money question. We think that such projects, in so far as they should happen at all, should be financed differently. Those are questions that we address through the fundamental reform of the EC budget, not in the annual budget process. We also think—this probably answers your final point—that the countries' administration, the national governments' administration of EU financial flows is not as good as it could be, which is why we have led the way here by asking countries to go through a mechanism that provides a statement of assurance as to how they do. I know that a number of other Member States have followed our example in this area—Netherlands, Denmark, Sweden—so I am proud that we are able to be leading the way in this area, which will lead to better efficiency in terms of financial management. There is the issue of fraud, which I will come back to in a minute, but there is also a general point, I think, about the efficiency of

spending on public finances by the EU Commission. We all know that within the UK we have gone through some quite difficult budget rounds, we have had the Gershon efficiency review and that type of thing, and we are bearing down on core expenditure in order to get higher productivity, more bangs for each buck, and what we are not convinced of is that the European Commission is, to a sufficient extent, adopting the same process. What we are seeing is staffing levels rising without a corresponding rise in output, which we think leads to lower productivity and therefore is less efficient and less value for money. We think that, just as private sector companies should continually strive to raise productivity and achieve greater output for input, so the public sector should as well, and that we are not convinced the European Commission is doing that. That is another rationale, to answer Lord Watson's point, for why we need to keep bearing down in negotiations on individual budget lines. On fraud specifically, we have consistently championed improving the management of the EC budget, not least because we are one of the major contributors to it. This is not just a general point about how to run an organisation; it is because this is British taxpayers' money that is being spent. We think it is unacceptable that the European Court of Auditors is unable to give a positive statement of assurance on the EC budget year after year. Our taxpayers deserve better. That is what led to the initiative that we discussed last year. Other steps are being taken to improve EU financial management. For example, the Commission has introduced accruals accounting and activity-based budgeting where it is much easier to see the relationship between the budget line and the actual output that taxpayers expect from that in terms of actual outputs on the ground. It leads to a more targeted approach, similar to PSA targets that were introduced a few years ago here, where individual government departments are given financial allocations and are expected to deliver a certain thing. What we are trying to do is to do that in the EU around activity-based budgeting as well. There is an action plan to establish a better internal control framework but we think that far more needs to be done and we will be arguing that in the annual process and we will be arguing it in the fundamental review as well.

Q11 ***Lord Inglewood:*** Could I just follow that point up? The countries you refer to are the countries that, in very general terms, from a traditional British perspective, one might have most confidence in their accounts and their accounting arrangements. They are not the problem. The problem is a number of other Member States where there is much less confidence. How do you deal with the difficulties of scrutinising expenditure in some of the countries that are less willing themselves to present material? We end up in the difficulty that, before you know where you are, we will be advocating proposals which will really involve European scrutiny of Member States' accounts, which will clearly have significant political and sovereignty implications, because it does seem there is a problem here.
Kitty Ussher: I think the point about sovereignty is the crucial point. All Member States are sovereign national governments and we cannot tell them, instruct them or direct them what to do, even if we are concerned about the way that they manage their internal finances and the way they manage EU programmes. The benefit, in my mind, of the EU is that it provides some mechanism to put pressure on, so we have the opportunity to name and shame, to build coalitions, to force people into a corner, and that is what we try and do. It is not a legislative approach; it is a peer pressure approach, and I think Britain is doing exactly the right thing. It is finding a way itself to organise its own method of implementing the EC budget effectively, building coalitions with, yes, like-minded, "usual suspect" people, but that will shift the balance of the debate, working through the Commission, so that eventually other countries will feel that there are pressures on them to do the same, which must be much better than not doing anything at all.

Q12 ***Lord Inglewood:*** As long as it works.
Kitty Ussher: We want it to work. If you can think of a better way, I would be delighted to hear it.

Q13 ***Chairman:*** Minister, can I ask a supplementary about the agencies? Are you content with the controls in place for monitoring spending and administration within the external agencies? This is an issue much discussed last Thursday, when I went as the head of a budget scrutiny committee to talk to my equivalent from other Member States and to MEPs at a meeting chaired, of course, by the European Parliament. This was something that everybody was worrying about.
Kitty Ussher: That is an extremely good question. I am sorry, Lord Jordan; you mentioned it as well but it slipped my mind. No, we are not content, basically. We are not content with the increases laid out in the preliminary draft budget under headings 1a, 3a and 3b, which show huge increases—24%, 9.5%, and 23% respectively. We do not think that it is justified, for all the reasons I have just laid out in terms of value for money and the efficient spending of taxpayers' money. That is not to say we do not agree with what these agencies are trying to do; we just want them to do it in the most effective way. The rationale behind the agencies is that they should be able to implement Community programmes more effectively and more

efficiently, their staff should become more expert, and we need to be raising the productivity of the work that is being done there without, to be blunt, just chucking money at it. This has been a priority of our initial negotiations over the last few weeks. The result ought to be efficiency savings and economies of scale but we have not seen any evidence of this in the preliminary draft budget in headings 1 and 3. We think the budgets are growing at a worrying rate without clear justification, and so we oppose it. It is very interesting to hear the feedback—

Chairman: I think you might have some support, we might have some support for that in Europe.

Q14 ***Lord Watson of Richmond:*** If I may, I want to just follow up very quickly something that Lord Inglewood asked, because he raised this absolutely essential issue and, let us face it, difficulty, that the sovereignty principle means that Member States are free, in effect, to administer the funds themselves and you said we have a name and shame regime. Actually, we have to some extent a name, shame and pain regime because the Greek government, for example, has been fined on several occasions. I am just interested in your basic approach to this, because clearly, you face the same dilemma. You wish to protect and preserve the sovereignty principle; on the other hand, it is absolutely against the interests of the British taxpayer that Community funding should be misused within individual Member States. How do you reconcile those two things?

Kitty Ussher: It is a crucial point. Obviously, fraud faces legal sanctions as well. You mentioned the financial sanctions we can use. It also has to be said—and I am not in any way suggesting that there are not serious problems but I do think that there is some tendency perhaps in some quarters of this country to imply that every single euro is somehow ending up fraudulently in someone's back pocket. Members of this Committee know that not to be true because of the report that you did last year. That is not to say there are not serious concerns about the effectiveness of spending in terms of the efficiency and productivity issues that I mentioned.

Q15 ***Lord Watson of Richmond:*** And accuracy, with respect. It follows that the fine was initiated by the Commission. The question is whether more can be done via the Council of Ministers and at Council and intergovernmental level because, at the end of the day, particularly with the enlargement of the Community, it is in everybody's interests that Member States administer these funds accurately and as pre-agreed.

Kitty Ussher: There are procedures in place. The European Court of Auditors has to sign off the report, therefore we at least have a mechanism for knowing that things are not as good as they could be because they are unable to. It is our job as members of the European Council to continue to make the point that that is completely unacceptable.

Q16 ***Lord Watson of Richmond:*** And to energise that mechanism.

Kitty Ussher: Absolutely. I am personally very concerned about the fact that this seems to be happening year after year. Often within Whitehall, if accounts are qualified or not signed off, there tends to be a crisis and the problem is fixed, whereas in Europe we have not seen the movement, although there may be individual improvements, and that is unacceptable.

Q17 ***Lord Watson of Richmond:*** I am encouraged to hear that.

Kitty Ussher: There is the European Anti Fraud Office, which is able to quantify the extent to which this is real fraud or just slight timing irregularities. I think that you have perhaps answered the question yourself in terms of energising it, and that is certainly a point we have to push.

Chairman: I am rather unsportingly going to take the questions out of order. We need to ask the key, general questions about the budget and then proceed rapidly to scrutiny and I hope, given the amount of time you have allowed for this meeting, we will then be able to sweep up the ones of general but not absolutely critical interest.

Q18 ***Lord Cobbold:*** You mentioned the Galileo project briefly. We would very much like to know what the Government's attitude towards this project is, what the difficulties are and whether you are going to do public-private partnership and what you feel about the whole project.

Kitty Ussher: We are very supportive of the Galileo project, which I think has very useful benefits for the EU and is the type of thing that we should be co-operating on. We supported the PPP approach in principle. That support remains. It is a fact that the Commission's negotiations with the various private sector potential providers have broken down. A decision will be taken by qualified majority voting and it is clear that many Member States support the Commission's proposal to abandon the original PPP negotiations, which do appear to have reached a dead end, and to deliver the project by classic direct public procurement. Our immediate concern—and I understand that the Chancellor will be discussing this at the routine ECOFIN on Tuesday—is that there should be no implications for the already agreed financial perspective ceilings as a result of the breakdown of the negotiations in the PPP financing.

Q19 ***Lord Cobbold:*** Why did the negotiations break down, do you think?
Kitty Ussher: I have not been involved directly, obviously.
Mr Sparkes: I think there were several reasons why the PPP negotiations broke down. One of the key ones is that the companies that the Commission was negotiating with formed a single cartel and it was very difficult in those circumstances to get competitive offers. There was a great deal of involvement by Member States at a political level to try and secure benefits for their own particular countries, and the way the PPP was structured was simply not optimal. So I think the reason the PPP has broken down is not so much a criticism of PPP as a concept, which we regard as a good one for major infrastructure projects of this sort, but of the way in which it was managed.

Q20 ***Lord Cobbold:*** Do you think it will die as a result of that?
Kitty Ussher: I think my personal view is that there is a strong political support for Galileo. The question is how it should be financed given that the PPP negotiations seem to have reached an impasse.

Q21 ***Lord Cobbold:*** If it involves a question of raising the financial perspective, that would be very difficult.
Kitty Ussher: It must not, and that is why we must be absolutely vigilant in the other budget lines that come under heading 1a in order to ensure that, should the Council decide, there are other options that are available that do not involve abandoning the whole project or raising the ceiling, because raising the ceiling is completely unacceptable as far as we are concerned.

Q22 ***Chairman:*** Minister, I am familiar with the Galileo project from another incarnation. My understanding is that the United Kingdom never considered it a terribly good idea and used the PPP mechanism to some extent to test commercially whether this could be funded commercially. The answer is clearly no, for all the reasons which Mr Sparkes has kindly given us, but, as you say, it has very strong political support. Is it going to be enough to have the United Kingdom saying the funding ceiling must not be raised? The alternative, given the failure of the PPP, must surely be that the project is abandoned. This seems to me a real cuckoo in the nest of the budget and a real difficulty, so you will forgive me if I press you a little on what we are going to do about it.
Kitty Ussher: I think Galileo can have some huge benefits. Obviously, you cannot fund good ideas without any indication of the cost. Everything the Government does at home or abroad should represent value for money. I think my colleague, Stephen Ladyman, at the June Transport Council made the point that we should not proceed with the project unless the costs were reasonable—in other words, not throwing money down a black hole—and the German Presidency recognized this. But we do think it has real potential benefits. I think this is potentially quite an exciting project for EU Member States to cooperate on but, of course, there needs to be strong governance, commercial disciplines, open competition, risk management and all the rest of it, which is why we favoured a PPP solution, but we must not compromise on our absolute fixed conviction that the budget ceilings should remain as they are.

Q23 ***Chairman:*** If I may press further, one of the things that caused the Galileo project not to be one of our top favourites, as it were, was that the benefit to the United Kingdom was remarkably thin. If I may, I will just complete the question. Being as that is my understanding, what plans do you have to ensure parliamentary scrutiny of this important decision, which is likely to be taken while both Houses are in recess?
Kitty Ussher: To answer the second point first, to a certain extent, this is it, and I am listening very carefully to the points that you raise, and obviously, we are going to the Commons next week as well. I am presenting you with all the facts as they are currently available and you are, quite rightly, scrutinising me on that and expressing concerns where you have concerns, which will be taken on board. You are in a sense giving me and the Chancellor our democratic mandate for the pursuit of the budget negotiations that start at the end of next week. What is traditional is that, should those facts change substantially, we will of course let you know and it is traditional for that to take place by correspondence. I understand it is unusual but, of course, you are totally within your rights to respond to that if you think there are additional points that we should be taking account of, and certainly, for my own part, that is a dialogue I would welcome. In terms of benefits to the UK, as I have said before, I think it is an exciting project. What it all comes down to, I think, is priorities. We have agreed the budget limit and it is up to members of the European Council, working with the European Parliament, in order to decide what are the most important projects within that, and what seems to be clear is that there are a number of different projects being added to the potential list and ultimately it comes down to priorities but overall, we do think it is a worthwhile project, otherwise we would be opposing it.

Chairman: Perhaps this is a gypsy's warning, but I think the United Kingdom will face very considerable pressure somehow to go on funding this project.

Q24 ***Lord Watson of Richmond:*** Very briefly, if I may, on the subject of Galileo, as it happens, I share your enthusiasm for the Galileo project. However, I think the case for the benefits to the UK has not been adequately made and I would strongly suggest that the Government turns its mind to that. Secondly, clearly, this is a possible candidate for unforeseen surpluses and I think we have to be very careful about this because there has often been in the past the feeling that major projects get through in the European Union not through the proper route but in a slightly fudged away, because not all the money has been allocated and so on and so forth. Were all that to happen during the parliamentary recess, I think that would store up unnecessary trouble. I hope you would agree that, one, the case must be properly made; two, the method of funding must be absolutely clear; and three, there really must be genuine Council agreement on this. This is a huge strategic project and it should not go through on a fudge.
Kitty Ussher: Yes, I could not agree with you more. Each budget needs to be considered on its merits and that applies to both the outcomes and in terms of how much it costs, and what the value for money is on that. So even if the final decision is made when the House is not sitting, I feel very clearly that you have made your representations to me and I understand what you say. I am told, by the way, on parliamentary scrutiny, that on Monday the Minister of State for Transport had a debate on the floor of the House of Commons on this issue, so there has been that scrutiny already.

Q25 ***Lord Cobbold:*** You have made value for money a very big issue, and rightly so. Do you consider that overall the proposals represent value for money? You have additionally said that, when looking at the whole, it comes down to priorities. What specifically are the Government's priorities?
Kitty Ussher: Our top priority is value for money, obviously. We think that on the parts of the budget that focus on research and development, fighting international crime and terrorism, and managing migration flows, there is a clear case for working at EU level and we think the proposals that have been put forward in general represent sufficient value for money. We are okay with those. We think that there are many areas where value for money is less clear or non-existent, and these fall into two categories: the ones that have been a longstanding negotiated position, where we think we can probably best achieve our aims through the fundamental review of the EU budget, CAP spending, and the fact that 60% of structural funds go to wealthier Member States, which we think is morally wrong and an ineffective use of money. The second category where we think there is not value for money are more micro issues, where we feel we can have and have been having—as I said, I am cautiously optimistic—some influence over, and these are dealt with in the current budget, i.e., the one that I am going to start negotiating at the end of next week. Our priority is there to reduce spending on programmes that have a poor implementation record because, for precisely the reasons that Lord Watson said, we do not want to make a decision to give a certain amount of money and then have it not spent and we have this money swilling around that all sorts of things could happen to. We think, in terms of cohesion funding, it is incorrectly allocated, to start with, but even within that we think the levels are too high. We also want to reduce spending on programmes that have weak or inappropriate performance targets. In the jargon, heading 3b is an example of that, for example, the programmes on citizenship, which we think are a bit woolly. We want budgets in those areas that are set at levels that can realistically be absorbed and reflect our priorities. I do not know if this is too much detail. In our negotiations we want to ensure that under heading 4, which is the EU as a global partner, we continue to provide sufficient funding to areas where it is desperately required, and we would certainly put Afghanistan right at the top of that, but also development spending in Iraq and Asia. We do not want to see any reduction there. We also want to defend development spending allocated to the ACP countries, transitioning out of sugar dependency. It is very important to say that we agree with the reforms to the sugar regime but we want to make sure the transition in the countries we are closest to is done in an adequate way. On heading 5, the administration budget, both on the central institutions that we have talked about and the decentralised agencies that Baroness Cohen mentioned, we think that efficiency gains can be realised and therefore the implication is that the overall budget line at the moment is too generous. We have been making investment in buildings and IT and we think the financial benefits of that should be flowing through to a greater extent, and we think they can make greater economies of scale and we want a Gershon-type review. In passing on that, I understand that Lord Kinnock five years ago did introduce a quite effective review of the way that efficiency gains throughout the whole administration were realised but we think it is time for another one, Kinnock Plus. The final priority in terms of our negotiations is to make sure—this comes back to your earlier point about Galileo—that there is a sufficient margin between the overall financial

perspective ceiling that has already been agreed and the commitments that we are discussing now, so that gives some room, if there are important priorities that we decide when it comes to Council that we want to pursue, we do need to have a discussion about raising the ceiling, because that is unacceptable.

Q26 ***Lord Jordan:*** Just on the main priorities, you feel you have a body of support?
Kitty Ussher: As I said, we are cautiously optimistic about the revised budget that will be put to Ministers at the end of next week, so we feel, certainly at the Council level, that we are hopefully making some progress but it is too early to really say any more than that. Then of course it goes to the European Parliament, which may have different pressures, and it comes back to us in November. So whilst we are cautiously optimistic at stage one, I cannot yet give you an indication of the end of the process.

Q27 ***Chairman:*** I would like to pick down the headings and give the other members of the Committee a chance to ask about each of them. If I may start, the Commission has publicised that commitment appropriations under heading 1, which includes of course structural funds, exceeds heading 2 for the first time. You have touched on your concerns regarding the absorption capacity in some of these spending areas. Would you like to talk a little more about that?
Kitty Ussher: Yes. I saw the Commission press release. They are quite proud of the fact obviously that appropriations under heading 1, which is the main economic heading, exceed heading 2. It is quite interesting that they are keen to show that economics is taken more seriously than CAP, one presumes, because of the way they are doing that. It shows at least that their press office is in the right place. But we can see through this, because it is quite clear that the spending on preservation of natural resources, i.e. heading 2, has only fallen because the rest of the budget has been growing around it. It does increase in absolute terms. I think the precise figures are a €25.6 million increase in 2008 in the initial preliminary draft budget proposed by the Commission, and of course, spending on structural and cohesion funds still makes up 82% of the spending under heading one, and, as I have said a couple of times, 60% of this goes to rich Member States, which we think is wrong. We note their press release but we think the need for long-term reform remains. We have talked a little bit about absorption capacity in some of these areas and certainly with spending on accession countries we think that is extremely important, but we have to be realistic about the capacity to spend. We cannot be over-generous because that would be bad for British taxpayers, so our approach has always been twin-track, to very much champion enlargement and make the point that the whole cohesion line of the budget should go to the accession countries and at the same time provide direct financial support—the UK is a very generous contributor to programmes of capacity building, civil service expansion and training and so on—in order that we can allocate a more generous settlement and they can spend it effectively but if they cannot spend it effectively, we should not be allocating them a generous settlement.
Lord Marlesford: I would like to take another particular project, which has had a lot of publicity, and in Britain's Parliament a lot of negative publicity: the European Institute of Technology. You will have noticed that the House of Lords had a debate on it and a lot of very well qualified people spoke, of which I was obviously not one. They gave it a total thumbs down. One of our sub-committees has recently been looking at it. The extraordinary thing is that here is a project which is of doubtful merit and which we understand the British Government is not mad keen on, and apparently, it does not even have its own budget. It appears to be going to be financed out of a contingency fund. Is that not a rather extraordinary way of trying to finance something and, of course, the total budget for the thing is very small in relation to the sort of thing that it is meant to be doing. The easy simile is that they want to create another MIT.
Lord Watson of Richmond: We have Cambridge.

Q28 ***Lord Marlesford:*** Another Cambridge, exactly. The risks being seen are, first of all, that the money allocated is inadequate, and secondly, that the source of finance is extraordinary, and thirdly, the danger is that some small countries—and there is no criticism of that—would like to have it. The only possible solution would be to attach it, if it is going to happen, to somewhere like Cambridge or some great centre of learning which already exists, to get a bit of synergy going. Would you like to comment, particularly from the Treasury point of view?
Kitty Ussher: From the Treasury point of view, we absolutely share your concerns. The project as a whole could theoretically have some advantages, and we supported it to start with as a means of facilitating the conversion of research findings into commercial opportunities, which is exactly what we have been doing in Britain and what Europe should be doing more of. We played a pivotal role in redefining the concept during the initial negotiations, so in many ways this was a UK-led project—UK-supported certainly. However, for precisely the reasons that you say, we ended up opposing it at the Competitiveness Council on the basis that the budget was totally unjustified. It had been re-scoped and led to quite serious concerns about whether this is the way

taxpayers' money should be spent, when no source for the budget had been identified. We were in a minority, so it remains on the table. I think a budget envelope of €308.7 million has been agreed. If I can just correct you slightly, your general point is completely right, but the EIT does have a budget line in the preliminary draft budget. It seems to be a rather nominal amount compared to the budget that is actually attached to the project, and this is one of the things that will have to be urgently sorted out and, in a sense, it falls into the same category as Galileo, which is that they are going to have to juggle things around and we collectively, as the EU, are going to have to work out what our priorities really are, because we cannot have a situation where, just because there is a project which may have had initially good merits, that somehow the budget needs to increase—precisely the type of thing that should be avoided in terms of budgetary laxness—although the project may turn out to be worthwhile.
Chairman: That is the second cuckoo in the nest, of course, of this year's budget.

Q29 ***Lord Inglewood:*** This is actually a point that occurred to me in the context of your remarks to Lord Watson about Galileo, which is a simple but quite difficult one. You have explained both the context of the European Institute of Technology and the fact that in the Galileo project we have serious reservations in the UK Government about this. If I am doing my scrutinising properly, I have to say—and I do not expect you to give me a detailed answer—do we, the UK, have a line in the sand beyond which we are not going to go, where we are going to say, frankly, this ought to be pulled?
Kitty Ussher: We will not reopen the financial perspective ceilings.

Q30 ***Lord Watson of Richmond:*** You have just drawn a line in the sand. Would you not agree that there is from your perspective, the Government's perspective, rather a fundamental difference between the EIT proposal and the Galileo proposal? You have expressed substantial and conceptual doubts about the EIT, and you have expressed your enthusiasm for Galileo. So these are actually rather different things. If I may, through you, Chairman, declaring an interest as the Chairman of the Cambridge Foundation, I was told by the Vice Chancellor of a conversation she had with the present President of the Commission, who explained that the EIT was basically to create an MIT in Europe, to which the Vice Chancellor said, "You already have one in Cambridge now." That is part of that remark. What it does illustrate is the extreme looseness of the thinking around this EIT project.
Kitty Ussher: I should probably clarify what I am saying. If you asked me personally whether I am in favour of collaborative space research that could have significant commercial spin-offs, my answer is completely, yes. I think Galileo is an interesting project but it is of a completely different order of magnitude to EIT. Both of them could potentially be exactly the type of thing Europe could do; both of them could potentially be enormous white elephants. Cambridge is wonderful.

Q31 ***Lord Inglewood:*** This is really about the business about absorption capacity, implementation capacity. How can we get this all a bit more realistic, in your view? You say it is important that those who receive money ought to be in a position to use it properly, and there is clear evidence that in a number of countries this has really not been happening. Do you think from the European point of view there is anything we should be taking forward to try and ensure that, where money is allocated, it can then actually be spent properly, in a timely and genuinely transparent manner?
Kitty Ussher: That is exactly what the European Commission should be doing, and I hope that by the European Council expressing their very strong priority in this area, with others at the forefront of doing so, that that is exactly what they will do, and I want them to realise that they cannot produce draft budgets that are over-generous when they cannot at the same time guarantee that the money will be spent effectively. In a sense, this is the European institutions working in the way that they should. The apparatchiks, very good that they are, are putting forward a proposal, and we are saying, "Hang on, do this properly. Send it back. Try again."

Q32 ***Lord Inglewood:*** Is there any specific systems that you would recommend based on UK experience that they should adopt that they do not have now. It may be too detailed and unfair a question.
Kitty Ussher: No, I cannot give you a specific system, though we are happy to reflect and come back to you on that. In terms of does what we are doing now work, I think to a certain extent it does. Notwithstanding our general points about reforming the entire way the EC budget works, the stance we are taking at the moment has in previous years led to budget lines coming down. Therefore, we think it is the right way to approach this annual budget this year. As I said, I am cautiously optimistic about what will come out at the end of next week.
Chairman: Moving smoothly over heading 2, which has been discussed, Lord Trimble has a question about 3a.

Q33 ***Lord Trimble:*** Yes, 3a is spending on managing migration flows and there is a significant increase in the heading, so I wonder if you could give us some detail as to how this money is being spent.
Kitty Ussher: Yes, it is an extremely important budget line as far as we are concerned. It is important for us and also for the EU as a whole. It mainly provides for the external borders fund, which supports Member States who have a heavy burden in the area of external borders and visa policy. It supports the European Refugee Fund, now in its third incarnation, for which €82 million is proposed in this preliminary draft budget. It supports the new European Return Fund, intended to support Member States with the integrated management of returning people, for which €56 million is proposed, and the European Fund for the Integration of Third-Country Nationals, for which €78 million is proposed. There is a high degree of co-operation between Member States in this policy area and we think it is a very good example of where European co-operation can lead to added value.

Q34 ***Lord Trimble:*** You mentioned a number of headings and figures under those headings, but where are the increases? Are they all increasing at the same rate or are some increasing and others not?
Kitty Ussher: I know there is an overall increase for this budget line, which is large; it is 24% or €78 million. In terms of how each one is increasing, I am delighted to hand over to Mr Sparkes.
Mr Sparkes: Thank you. I am afraid I do not have the information to hand about the individual programmes.

Q35 ***Lord Trimble:*** Can you supply some information though?
Kitty Ussher: It is publicly available. We shall get it to you.

Q36 ***Lord Trimble:*** There are increases on some of them but the External Borders Fund, it says here, is the same amount as adopted by the budget authority for 2007. This surprised me because earlier in the same passage it said, "Following the start-up period in 2007, the year 2008 will be the first full 12-month period of the implementation for the new specific actions which are grouped in these programmes". Unless I am mistaken, if this is the first full 12-month period and there was less than a 12-month in 2007 and if the money is the same for the two years, that is going to translate into an effective cut for the External Borders Fund, which surprises me.
Kitty Ussher: You have gone a level beyond my initial understanding, so I hear exactly what you are saying and—-

Q37 ***Lord Trimble:*** I would have thought that of all the things there it is the External Borders Fund which is the most important one.
Kitty Ussher: We agree; it is extremely important, and the proposed amount for 2008 is €170 million. I am hearing what you are saying about the phasing effects of this and what we will do is to go and have a look.

Q38 ***Lord Trimble:*** I am just reading from the Commission's Expenditure Analysis by multi-annual financial framework headings. I know nothing beyond what is on that page and I am just puzzled by it.
Kitty Ussher: I understand the point you are making and we will go and see if we share your concerns and we will provide you with a note on that. Thank you for raising it.

Q39 ***Chairman:*** Thank you. If we could have that further information for Lord Trimble in writing, that would be great.
Kitty Ussher: We will do that.

Q40 ***Lord Watson of Richmond:*** I want to move on to Heading 4, which is somewhat related to what we have been talking about. Under Heading 4 there is a 9.4% increase in pre-accession funding. We are obviously interested to know what that really is going to be spent on. Does it in fact relate to the EU's rather ambitious proposals in terms of a zone of stability around the Union, touching on the last question? 9.4% is not an insubstantial increase but what is it going to be spent on?
Kitty Ussher: The short answer to your question is that it is going to assistance to Turkey and parts of the Balkans. It is an increase in the instrument for pre-accession which will bring the commitment appropriations there to €1.4 billion. The overall financing for this was largely agreed in the negotiations for the financial framework. We strongly support pre-accession countries' efforts in preparing to manage and implement Community programmes. From my own personal memory I know that we have provided some help to eastern European countries at a similar stage.

Q41 ***Lord Watson of Richmond:*** And that has been very effective, but you said Turkey, and, of course, the status of Turkey with regard to accession is absolutely not clear. One of the ways in which the European Union—correct me if I am wrong—has attempted to create a zone of stability is by making the ultimate offer of membership, and that is the use

of soft power by the European Union and it has been extremely effective. Heading money towards Turkey is something rather different. I am interested if that is now becoming a significant budget feature here.
Kitty Ussher: I must say this is different from the general zone of stability which I am sure comes under neighbourhood policy. In terms of Turkey, they are eligible as a pre-accession country. The view that we take is that they should not be unfairly treated as they attempt to work out whether they are eligible or not or whether they can be. It would be wrong, I think, to say, "You cannot try. We are not going to support you to try in the way that we have supported other countries to try".

Q42 ***Lord Watson of Richmond:*** Were you saying that the larger part of this increase is going to go towards Turkey?
Mr Sparkes: Yes, indeed. The pre-accession instrument which replaces the previous separate PHARE, SAPARD, ISPA and CARDS programmes is now devoted to the candidate countries—Macedonia, Croatia and Turkey—and the remaining countries of the Western Balkans. It is ring-fenced to those countries. Turkey, being the country with by far the largest population and by some measures the poorest, is inevitably going to be eligible, if it can spend, commission and programme it, for the lion's share of that funding.

Q43 ***Chairman:*** Can I ask a supplementary question about the EU's ambitious plans to create a zone of stability around the Union? Is there enough money for that? It seemed to us to look a bit short if the zone of stability is going to include places like Iraq and Afghanistan.
Kitty Ussher: We think there is enough money for that, although you make an extremely important point. It is also worth saying that the importance of a policy cannot purely be measured in financial terms. Many of the most effective ways of helping neighbourhood countries do not involve huge amounts of budget resources—trade concessions, loans, targeted technical assistance, regular dialogue, shared diplomatic concerns and so on. We do not think that budget line is too small.

Q44 ***Lord Cobbold:*** Under Heading 5 we note with approval your desire to examine the Commission's proposal for increased staffing. There seem to be some pretty enormous and varying figures. On page 41 of the Commission's Expenditure Analysis document it talks about it requiring "the recruitment of 3,960 additional staff members financed under heading 5 over a transitional period from 2003 to 2008 . . . ", and then there is a figure, which one would understand, relating to the necessity for more staff in connection with the adoption of Bulgaria and Romania, looking for 750 posts over the period 2006-2009. These all seem slightly vague and rather high numbers. What is your view on that?
Kitty Ussher: I completely agree with you 100%. This is a prime example of the more general point we were making earlier, that we believe there can be efficiency and productivity gains in terms of staffing and we have been negotiating very hard at official level on this point in the last few weeks. National administrations are facing restrictions. It is going to be a tough spending round for us here in the UK. That is replicated across Europe. We are making efficiency cuts and we do not think it is right that we should be supporting staffing gains in the European Commission, not just because it is not fair or anything like that, but simply because we think they could do their job more effectively, so we agree 100% and we are negotiating hard on this.

Q45 ***Lord Watson of Richmond:*** So you will be taking a tough stance on that?
Kitty Ussher: Absolutely; we are already and will continue to do so.
Lord Watson of Richmond: Just one point of detail. On page 43 of this document under "General administrative expenditure" there is an item called "Mobility", which is moving from €900,000 up to two and a half million euros, a 180% increase. Do we know what mobility is?

Q46 ***Chairman:*** Can it be air fares?
Kitty Ussher: Presumably. It is something to do with moving around, I would guess. The clue is in the name.

Q47 ***Lord Watson of Richmond:*** It is not a very large amount but it is a very large increase.
Kitty Ussher: I am waiting for my rent-a-crowd to provide the answer. Apologies. We will find out.

Q48 ***Chairman:*** You can always write us a letter.
Kitty Ussher: We are writing on two points.

Q49 ***Chairman:*** That is fine. Having managed to go down the headings I now have the luxury of inviting Lord Trimble to ask a more general question.

Q50 ***Lord Trimble:*** It is a question more about the Commission's annual policy strategy, which I understand is drawn up without any costing or figures. It looks as though it is drawn up without thinking about the cost of these strategies, and surely in terms of determining their annual policy strategy there ought to be some consideration given to costings.

Kitty Ussher: I understand there is some consideration but the two documents are not really parallel parts of the same process. The Commission can set out its activities for the year, as it is doing. It presents its political priorities and key initiatives and so on, but the annual budget process is the breaking down of the priorities that were agreed in 2005 when we agreed the financial perspectives. Obviously, there is some overlap and you can easily cross-reference between one and the other but one is not the political narrative for the other in any sense whatsoever. The timings are different for a start.

Q51 ***Chairman:*** If I may have another go at this, the EU Select Committee has done a critique of the policy strategy which suggests that it is meaningless unless it is related more closely to and within the same timescale as the budget. Would you agree?
Kitty Ussher: We can look into it but, to be honest, our focus has been on making sure that the budget lines are more clearly associated with targets and that is why we have been pushing activity-based budgeting, simply because there are timing problems with comparing the two documents. The composition of the annual budget is inevitably dominated by ongoing multi-annual expenditure programmes which may not correlate to the policy initiatives that people are thinking about in the European Commission at any one time and are covered in their programme.

Q52 ***Lord Trimble:*** But those policy initiatives will eventually come through with budgetary consequences and surely in determining a policy you should have regard to what the budgetary consequences are going to be?
Kitty Ussher: Of course, though I think what I am saying is that that document in the Annual Policy Strategy is not directly comparable to discussions that take place around the annual budget, but I agree with your general point, which is that we need to be able to hold the Commission to account and make sure that we completely understand what is happening as a result of each budget line. We will certainly reflect on what you say, but our instinctive answer and my view, having looked at both documents, is that they are talking about things happening in different time periods and being looked at in different ways. I am not sure it is the most effective way of scrutinising the budget.

Q53 ***Lord Trimble:*** It is not a question of time periods and it is not a question of thinking whether these things are comparable. It is just that in deciding what your policies are you need to think about what they are going to cost rather than have the policies there and then later work out what the financial implications of them are.
Kitty Ussher: Sure, but I think we feel we have an effective policy process through the negotiations on the financial perspective and the big European Council set-pieces rather than through a document that the Commission is effectively producing, saying, "This is what our managers are thinking about this year". I do agree with your general points. It is just that I think we are having a debate about the mechanism to do it. There is absolutely no doubt, I agree with you, that we should be scrutinising exactly what happens as a result of each budget line. At the moment we feel that focusing on the policy statement is not the way to make progress, but I am hearing what you are saying.

Q54 ***Chairman:*** We have about five minutes left. I am therefore going to allow myself the luxury of asking you about the first report which was done under my watch, which was on funding the EU. We arrived at the conclusion that really it worked quite well as it was, that a share of GNI turned out to be the right way to do it. This view, I have to say, last Thursday went down with elements of lead balloon in the meeting of Budget Committee MEPs and national Parliamentarians and there is clearly pressure to change the basis on which the own resources are calculated. Are you expecting this pressure? Are you ready for it?
Kitty Ussher: It is not something that we think will come up in the annual budget.

Q55 ***Chairman:*** No, indeed.
Kitty Ussher: However, I am sure it will be discussed in the budget review, the process of which is just beginning to start. I think I have already made clear that we were very keen to get the commitment to the budget review in the negotiations that culminated in Council at the end of 2005, and we think it should be root and branch; it should look at the fit-for-purposeness of the whole aspect of the EC budget. I am sure that there will be conversations about how that budget is financed as part of it. We are absolutely ready but it has not quite started yet, so we can come back to it next year.

Q56 ***Lord Watson of Richmond:*** Just before I come to the last question, connected with it you are saying that there should be a root and branch review.
Kitty Ussher: Yes.

Q57 ***Lord Watson of Richmond:*** Is the basic motor behind such a root and branch approach that we are after all now looking at a European Union of 27 countries, that it is an entirely different animal from what it was when the original budget procedures were

evolved? Is that the basic reason for this different kind of European Union and we therefore should take a different sort of look at the budget?
Kitty Ussher: That is one of the reasons but the main reason from a UK point of view is that we think the budget has always not represented value for money for UK taxpayers. We can discuss the various reasons for that but that is why we want a review.

Q58 ***Lord Watson of Richmond:*** In that specific context then, why are we no longer insisting, as we were previously, that the UK rebate should be calculated first? We appear now to be saying that we are happy to wait until the rebate negotiations complete with Germany, Sweden and the Netherlands. Why have we moved our place in the queue?
Kitty Ussher: If I may, and this is a slightly different point, there was press speculation when the own resources decision was being negotiated, I think following the 2005 agreement on the financial perspective, because you complete the budget line and you work out how to finance it, that the UK had somehow retreated on its negotiating stance.

Q59 ***Lord Watson of Richmond:*** You are saying that is not true?
Kitty Ussher: I am saying that we are extremely happy with the outcome. With regard to negotiations in European fora, there is some realpolitik in there and you would expect, and it is right, that the British Government should take an extremely aggressive negotiating stance, but we always knew the backstop beyond which we would not go, and we did not go beyond it, and we are extremely happy about that.

Q60 ***Lord Watson of Richmond:*** Does it matter that we are willing to stand further back in the queue or not?
Kitty Ussher: We do not think in terms of the outcome that that created a problem at all for us, no. In relation to the 2005 agreement, there is an enormous amount of detail chucked into the melting pot when we are doing the negotiations, and I think that the press story was rather misleading in that sense because there was an enormous amount going on and we wanted a fair outcome, and we are absolutely happy that we got one. The outcome will be, as we told Parliament, that the Prime Minister as was made a statement following the European Summit in December 2005 about how it would be financed, and that is how it is being financed.

Q61 ***Lord Watson of Richmond:*** We are still in the queue for our second bowl of porridge?
Kitty Ussher: We think it is a fair outcome.

Q62 ***Chairman:*** Minister, it remains for me to thank you very much for coming and for giving us a generous amount of time, during which we have just about been able to ask all our questions. I particularly thank you for coming three days into the job, which is quite demanding, and we look forward to seeing you again. We are grateful for your assurances that should things turn out very different we will be consulted again and we will, of course, be writing to you.
Kitty Ussher: It has been a huge pleasure to be here and I just wanted to say that you have fulfilled your role in the constitution to a stupendous extent because what it has meant is that I am more prepared than I could otherwise ever have been for ECOFIN by the end of next week, thereby doing my job as well as I possibly can, so thank you very much for making me prepare well and I hope I will do you justice.

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