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TECHNICAL ANNEXES

Accompanying document to the

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

The EU Budget Review

{COM(2010) 700 final}

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1. ORIGINS OF THE BUDGET REVIEW

The December 2005 European Council and the Inter-Institutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management of May 2006 mandated the Commission "*to undertake a full, wide ranging review covering all aspects of EU spending, including the Common Agricultural Policy, and of resources, including the United Kingdom rebate, and to report in 2008/ 2009*"[1].

The Commission's general approach to the reform was set out in its consultation paper of September 2007[2]. A series of external studies have been commissioned and academic experts have provided a sound analytical basis for assessing EU finances, notably in the framework of an academic conference organised by the Commission in April 2009 and followed by a series of workshops[3]. A broad consultation with interested parties at local, regional and national levels, backed up by a number of hearings, seminars, workshops and information events, has stimulated a Europe-wide debate on EU political priorities and the role of EU finances to promote these priorities.

The European Parliament made significant contributions to the preparatory work leading up to the establishment of the review. It engaged in a dialogue with national parliaments on the reform of the own resources system.

The Commission received close to 300 contributions in the public consultation[4], reflecting a broad range of opinions and approaches. They included contributions from all Member States as well as from national parliaments, regional and local authorities, social partners, non-governmental organisations, universities and academic experts, private sector interest groups and individual citizens. Contributions were also received from the European Court of Auditors, the Committee of the Regions, the European Economic and Social Committee, the European Parliament's Committee on Budgetary Control and some individual Members of the European Parliament. A major conference organised in November 2008 allowed contributors and other stakeholders to express their views and provided a further opportunity for dialogue with the European Parliament[5].

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

2 SEC(2007) 1188, 12.9.2007.

3 The conference's proceedings and papers are available on: http://ec.europa.eu/dgs/policy_advisers/public_finance_conference_en.htm.

4 The contributions have been published: http://ec.europa.eu/budget/reform/issues/read_en.htm. A short, non-exhaustive summary of contributions can be found in SEC(2008) 2739 of 3.11.2008 (http://ec.europa.eu/budget/reform/library/issue_paper/summary_consulation_doc_final_en.pdf).

5 Resolution on the Mid-term Review of the 2007-2013 Financial Framework, A6-0110/2009

2. MAIN RESULTS OF THE PUBLIC CONSULTATION ON THE BUDGET REVIEW

The key conclusions of the public consultation can be summarised as follows:

– Only a minority of respondents were fully satisfied with the current budget structure. Many contributors saw the budget as being determined by political trade-offs rather than a well grounded allocation decision to advance European objectives;

– The majority of contributions stated that the guiding principle should be "European added value". EU spending should offer clear and visible benefits for the Union and its citizens that could not be attained by spending at national/regional/local levels;

– Maintaining and improving Europe's global competitiveness and the fight against climate change were seen as being among the most demanding future challenges that should be reflected in the EU budget;

– Other frequently mentioned challenges were: greater global responsibility to deal with increasing external pressures, ensuring energy supply, promoting Europe's transformation into a knowledge and service economy, adapting to demographic trends, managing migration, reducing inequalities and disparities, and addressing security threats;

– There was widespread support for reorienting spending priorities, with many contributions advocating, in particular, reductions in spending on agriculture and increased spending on research, energy, technological development and innovation;

– There was strong support for strengthening the Union's profile in the areas of migration and security. A significant number of contributions highlighted the increasing dependence of the well-being of Europeans on developments outside the EU's borders. Special emphasis was therefore placed on the particular importance of external policies, including the external dimension of energy security, climate change and migration, with enlargement, the European neighbourhood policy, development action and the common foreign and security policy frequently being mentioned in that context;

– The Common Agricultural Policy (CAP) was the policy area most frequently commented on in the consultation, with a relatively broad consensus about the need for further reforms to align the policy with current priorities. To many, agriculture remains a strategic sector, but most respondents advocated modernising the CAP, making European agriculture more competitive at the global level, more responsive in terms of climate change and food safety and quality requirements and better targeted on the objectives it is supposed to achieve;

– Cohesion policy received strong support, with, however, opinions considerably diverging on how it should be reformed. The reduction of regional disparities remains a key concern in the enlarged Union. A clear majority of contributions argued in favour of concentrating funds more strongly on less developed Member States and regions;

– The inflexibility within financial frameworks and the perceived inability to adapt quickly to changing priorities were seen as problems. The idea of continuing to work with multi-annual financial frameworks received general support. However, only a minority of contributors stated that the existing framework provides an adequate balance between the need for stability and the need for flexibility. A considerable number of respondents argued that sufficient margins should be foreseen to increase effectiveness and efficiency;

- A considerable number of contributors criticised the net-balance approach, which places the emphasis on net cash flows to and from Member States;
- The most frequently mentioned guiding principles for the own resources system were fairness, effectiveness, simplicity, transparency, equity, sufficiency of means, sustainability and stability;
- Two own resources received considerable support: moving towards a system exclusively based on Traditional Own Resources (TOR) and the resource based on Gross National Income (GNI);
- A large number of respondents indicated that eliminating the resource based on a statistical value added tax (VAT) could contribute to a more transparent and simple financing system, without greatly affecting its current functioning;
- Many respondents supported the idea of financing a larger part of the EU budget from new own resources. Resources related to the environment and, in particular, climate change were among the most prominent candidates. More specifically, contributors referred to the allocation of all or part of the revenues from emission allowance trading; CO_2 or carbon taxation; energy, petrol, fuel or kerosene taxation; flight duties, maritime transport taxation and vehicles taxation.
- There was very heavy opposition from all categories of contributors to any kind of corrections, exceptions or compensations. The clear majority view was that abolishing existing exceptions and correction mechanisms is an indispensable step in making the EU budget more equitable and transparent;
- The responses to the consultation also conveyed a clear message in favour of simplification and proportionality. Administrative burdens and control requirements are often considered excessive in the light of the modesty of resources involved for certain actions;
- Most respondents agreed that budget delivery should become more result- and performance-oriented, with increased coordination to achieve synergies and ensure coherence;
- Some contributors took the view that a better balance should be found between the cost of controls and the efficiency and benefit of such controls. Since aiming at zero risk is extremely expensive and not realistic, a clear understanding about the "tolerable risk of error" could help to improve the economy of the system.

3. ANALYSIS OF THE EVOLUTION OF THE EU BUDGET

3.1. Evolution of expenditure ceilings

The total amount of own resources allocated to the EU budget to cover annual payment appropriations is ultimately constrained by the ceilings laid down in the own resources decision (ORD)[6], which is adopted by the Council by unanimity and after ratification by all Member States.

First introduced in 1988 at 1.15% of EU GNP, the own resources ceiling was gradually increased, first to 1.20% in 1992 and afterwards to 1.27 % in 1999. Since then, the ceiling has remained stable and has been only subject to technical adaptations that have maintained the absolute amount of the ceiling unchanged[7]. The own resources ceiling is fixed currently at 1.23% of EU GNI. The ceiling for commitment appropriations developed accordingly and is now established at 1.29% of EU GNI.

The expenditure level of the EU budget is further restricted by the ceilings laid down in the Multiannual financial framework (MFF), also first introduced in 1988. Until the entry into force of the Lisbon Treaty, the MFF was an integral part of an inter-institutional agreement between the European Parliament, the Council and the Commission. EU spending was limited to levels which have in general remained well below the ceilings laid down in the ORD. The Lisbon Treaty has enshrined the MFF in EU primary law and introduced the requirement to lay it down in a Council regulation, to be adopted by unanimity after obtaining the consent of the European Parliament.

During the period 1993-1999, the payment ceiling in the MFF was on average equivalent to 1.18% of EU GNP. For the period 2000-2006, increasing pressure to limit the size of the EU budget resulted in an average payment ceiling of 1.06% of EU GNI. The political pressure to constrain the growth of the EU budget was even higher when the current financial framework for 2007-2013 was negotiated, resulting in an agreement to restrict the average payment ceiling to 1.00 % of EU GNI. However, due to the impact of the economic crisis in recent years and the consequent drop in the absolute level of EU GNI, the average payment ceiling for 2007-2013 corresponds currently to 1.07% GNI.

The actual annual budget execution in payments has remained significantly below the MFF ceiling, thus leaving quite significant margins available. The average execution was 1.06% of EU GNI in the period 1993-1999 (with a significant decreasing trend) and 0.94% in 2000-2006 (stable over the period), leaving in both cases an average margin of 0.12% below the MFF payment ceilings.

The evolution of the own resources ceiling, the MFF payment ceiling and the budget execution is illustrated below:

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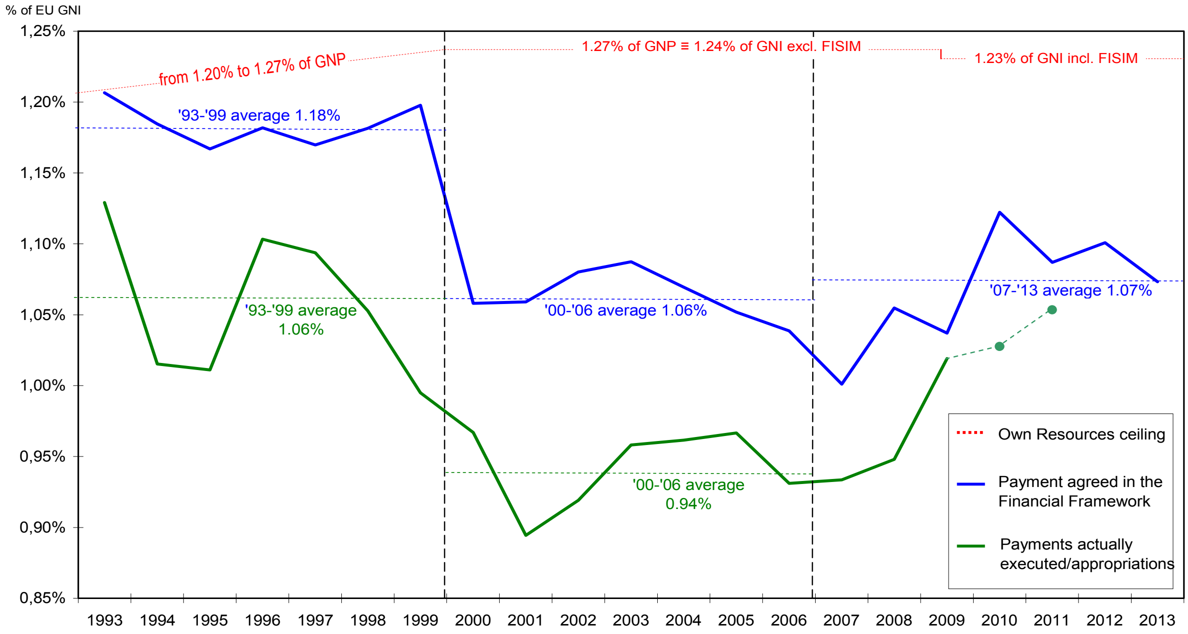
[6] Council Decision No 436 of 7 June 2007 on the system of Communities' own resources

[7] In 2001, the own resources ceiling established as 1.27 % of EU GNP was recalculated to 1.24% of EU GNI. The GNI aggregate replaced the GNP but the ceiling was adapted in order to maintain unchanged the amount of financial resources put at the disposal of the Union. The same procedure was applied in 2010, when it was decided to apply financial intermediary services (FISIM) for GNI for own resources purposes



3.2. Expenditure of the EU budget

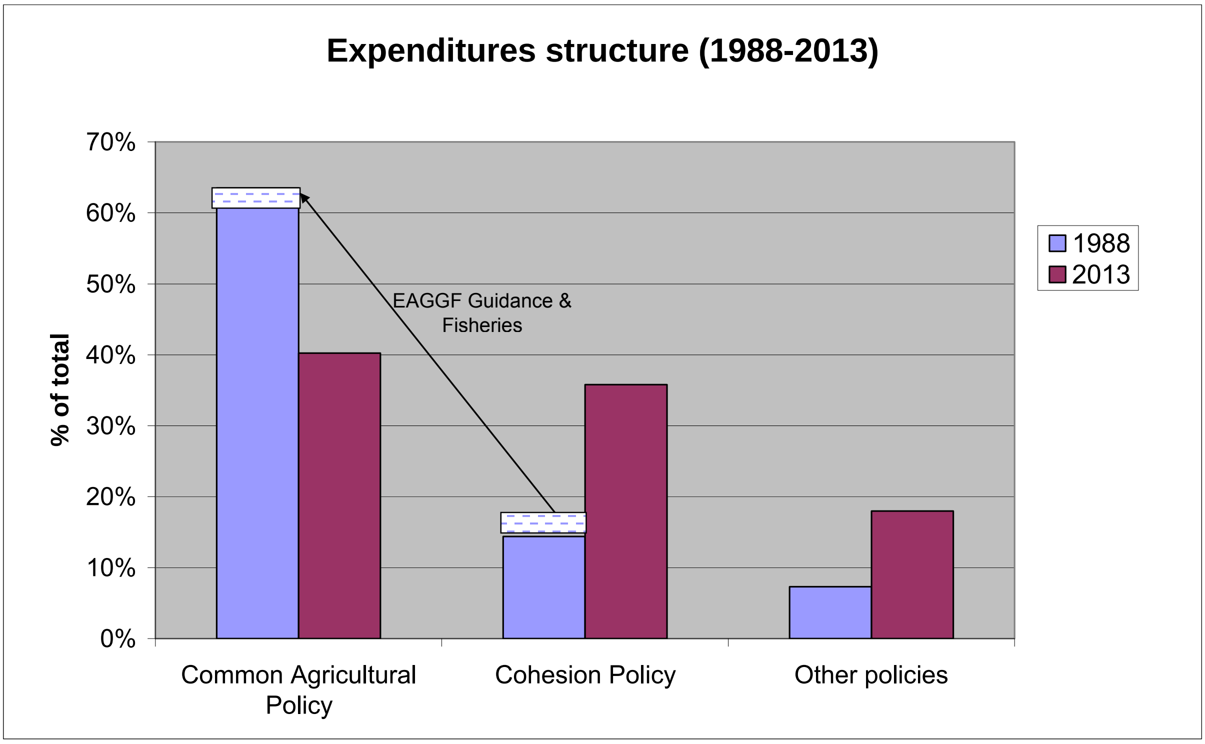
The profile of EU spending has changed considerably over time. Historically, the vast bulk of the EU budget has been concentrated in a relatively small number of policy areas. But both within and beyond these areas, the focus of spending, the policy objectives pursued and consequently the structure of the budget have evolved:

– CAP expenditure represented 64% of the budget in 1988, including 3% for the EAGGF Guidance section and the Fisheries fund that were structural funds at that time. By 2013, the share of CAP spending will have decreased to 40 %%, following a decrease of first pillar expenditure in real terms in the current financing period.

– The amounts earmarked for structural actions corresponded to around 17% of the budget in 1988 (14% if the EAGGF Guidance section and Fisheries fund are excluded), and will represent 36% of the EU budget in 2013, with at least two-thirds earmarked for competitiveness, growth and jobs. The significant increase in cohesion spending was linked to the enlargement of the EU since 2004.

– Funding for other policies (mainly related to competitiveness and external actions) was originally very limited. In the first financial framework, only 7% of the budget was reserved for these areas. But the new emphasis on economic development and competitiveness will see the share of the budget for such policies rise to 18% in 2013, of which 10% for competitiveness and 6% for external actions.

– The spending policies for the period 2007-2013 put a new emphasis on the goals of growth and employment and on new policy directions such as freedom, security and justice.



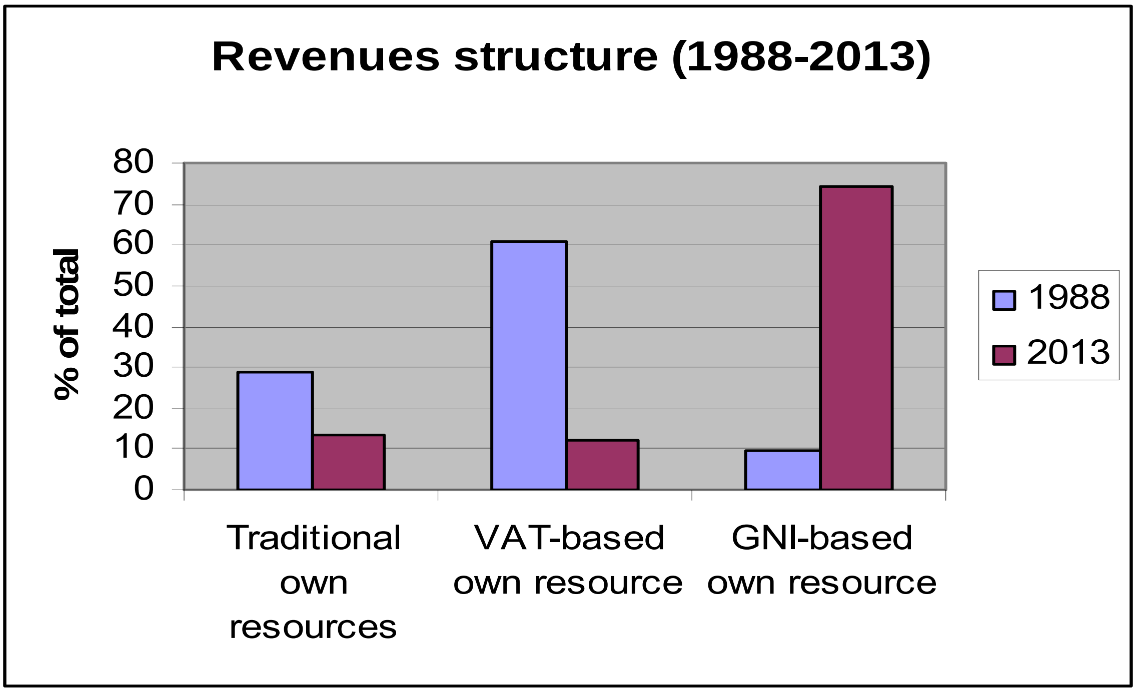
3.3. Financing of the EU budget

Evolution of the own resources

The system of own resources for the general budget was introduced in 1971 progressively to replace financial contributions from Member States. Own resources originally consisted of traditional own resources (customs and agricultural duties and sugar levies) and a VAT based resource. A new own resource based on Member States' GNP was introduced in 1988 as a 'balancing item', automatically providing the additional financing necessary to balance the Community budget.

The traditional own resources have stagnated over time due to the effects of trade liberalisation. As a result, their share in the financing has gone down. The share of VAT based resources decreased significantly as the maximum rate applicable to the uniform VAT base was reduced progressively from 1.4 to 1 % over the period 1995–99, and further to 0.75 % in 2002 and 0.50 % in 2004. Since 2007, the rate of call has been fixed at 0.3%. The balancing GNI based resource, which was originally envisaged as a marginal item, has in parallel developed into the most important source of financing (currently representing about 75% of the total).

The shift in the composition of the different types of own resources between 1988 and 2013 is illustrated below:



Evolution of the correction mechanisms

The issue of budgetary imbalances first emerged with the accession of the United Kingdom to the Communities in 1973 and became progressively the leitmotiv of all financial framework negotiations, often overshadowing the discussions on the content of the EU policies. Even though the roots of the problem are generally considered to be on the expenditure side of the budget, correcting measures have been applied mainly[8] on the revenue side.

The UK correction was agreed by the 1984 Fontainebleau European Council and has remained in place since then. Although the mechanism has been modified with every successive Own Resources Decision, its basic principle has remained unchanged, namely to reimburse to the UK 66% of the difference between what the UK pays to and what the UK receives as allocated expenditures from the EU budget.

From the very beginning of the UK correction, Germany received a 1/3 reduction of its share in the financing of the UK correction. This "rebate on the rebate" was widened to three other Member States (Austria, Sweden and the Netherlands) in 2000 and the reduction in their financing share increased to 75%.

The increase in collection costs of Traditional Own Resources from 10% to 25%, which has been in force since 2000, is also generally considered to represent a correction mechanism.

Two new corrections were introduced in the 2007 Own Resources Decision for the period 2007-2013 only. Germany, Austria, Sweden and the Netherlands benefit from a reduced rate of call on the VAT based resource[9]. Moreover, the Netherlands and Sweden were granted a gross reduction in their GNI resource payments (EUR 605 million for the Netherlands and EUR 150 million (in 2004 prices) for Sweden), to be financed by all Member States.

[8] Also the expenditure side of the EU budget contains more and more "compensating" payments to Member States (especially from the cohesion and structural funds and rural development fund).

[9] The rate of call is fixed at 0.225% for Austria, 0.15% for Germany and 0.1% for Sweden and the Netherlands.

4. FLEXIBILITY IN THE MULTI-ANNUAL FINANCIAL FRAMEWORK 2007-2013

4.1. Sources of flexibility 2007-2010

Since their introduction in 1988, the EU's multiannual financial frameworks have ensured strict budgetary discipline and medium-term predictability of EU expenditure. However, this predictability came at the price of limited flexibility.

The most important sources of flexibility within the MFF are currently:

– The revision of the MFF, by qualified majority in Council if restricted to 0.03% of the EU GNI;

– The unallocated margins under the various headings;

– Redeployment of funds within the headings concerned;

– The 4 instruments outside the MFF, in particular the Flexibility Instrument.

Over the first 4 years of the current MFF these sources of flexibility have been extensively used (and almost fully exhausted) to permit the EU budget to cope with unexpected circumstances. An additional EUR 8.4 billion was required for Galileo, the Food Facility and the European Economic Recovery Plan. The financing for these budgetary needs, which were provided through a mix of all the existing sources of flexibility (see table below), was in the end only possible because of the high margins available in Heading 2, which provided in excess of EUR 6 billion. These exceptionally high margins are however unlikely to persist in future.

FINANCING OF EERP + GALILEO + HIGH FOOD PRICES FACILITY

Commitment appropriations (EUR million)	**TOTAL**
Revision of heading 1A (fully compensated)	5.376
Compensation mechanism	*-5.376*
Compensation heading 1B	*-7*
Compensation heading 2	*-5.064*
Compensation heading 3A	*-5*
Compensation heading 5	*-300*
Financed from the unallocated margin within H1A	84
Financed through redeployment and reprioritisation under H1A	600
Financed from the unallocated margin under heading H2	1.020
Financed through redeployment within H4	240
Use of flexibility instrument	740
Use of emergency aid reserve	340
Grand total	**8.400**

In recent months an additional financing need of EUR 1.4 billion has been expressed for ITER.

4.2. Sources of flexibility 2010-2013

For the second half of the MFF, these sources of flexibility (in particular the margins) have to a large extent dried up, which poses legitimate questions about flexibility for the period 2011-2013.

The possibility to revise the MFF has been restricted by the fact that Council only accepted the principle of a revision to the extent that it does not increase the overall amount of the MFF over the period. Since any increase in a ceiling therefore has to be compensated by a corresponding decrease of another ceiling, this limits the scope for revisions in 2011-2013 to the emergence of unallocated margins under the various headings. This severely restricts the flexibility allowed for by the IIA.

As illustrated in the table below, margins for the remainder of the current MFF have been reduced to the bare minimum. For the period 2011-2013, the only margin of any significance is the 2011 margin under heading 2.

Margins currently remaining under the multiannual financial framework ceilings 2010-2013 (in EUR million)

	2010	**2011**	**2012**	**2013**
Heading 1A	0	50.1	34	47
Heading 1B	1.4	16.9	1.4	0.4
Heading 2	456.2	851.8	126.2	131.4
Heading 3A	18.5	70.7	26.5	52.9
Heading 3B	0	15.2	18.1	22.8
Heading 4	0	70.3	132.3	134.6
Heading 5	43.5	160.6	122.7	151.3

5. THE LINKS BETWEEN THE EU BUDGET AND ECONOMIC REFORM

The European Union has learned many lessons from the recent financial and economic crisis. In a highly integrated Union, and even more so in a monetary union, economies and their respective successes and weaknesses are linked. Although the EU has a number of instruments for the co-ordination of economic policy, the crisis has shown that they have not been used to the full and that there are gaps in the current governance system. There is broad political agreement that this has to change and that the EU needs to be equipped with a broader and more effective set of policy instruments to ensure its future prosperity and standards of living.

The EU has taken comprehensive and consistent measures to overcome the crisis and draw lessons for the future. The launch of the European Economic Recovery Programme in 2008 helped cushion the shock of the downturn on our economies. Coordinated support was provided to EU Member States that needed it as well as to safeguard the stability of the Economic and Monetary Union. A set of measures to strengthen the supervision and regulation of the financial system is under negotiation, in the EU and beyond. Now that the framework of the Europe 2020 Strategy is in place, a series of initiatives will follow, designed to unlock the EU's potential to boost growth and create jobs. It is logical to assume that the EU budget should be mobilised in support of the objectives that have been agreed between the EU institutions under the Europe 2020 strategy, and that the programmes and instruments to be proposed under the next multiannual financial framework should be designed to facilitate the delivery of the Europe 2020 strategy in all Member States.

At the same time, it is recognised that an essential part of the Europe 2020 strategy is the introduction of reforms with a medium- to long-term horizon that focus on promoting the sustainability of public finances and enhancing potential growth[10], particularly following a period during which the economic downturn has had a clear impact on revenues raised by Member States[11]. The extent of the benefits of such reforms depends on their depth and breadth and sustained political commitment on the part of the European institutions and the governments of the Member States.

The European Commission has put forward a number of suggestions aiming at enhancing European- wide economic policy coordination for stability, growth and jobs[12]:

– Develop the proposals for greater economic policy co-ordination and surveillance by (i) addressing imbalances through stronger macroeconomic surveillance, including alert and sanction mechanisms; (ii) strengthening national fiscal frameworks by specifying minimum requirements for domestic fiscal frameworks, and notably moving from annual to multi-annual budgetary planning; (iii) strengthening the Stability and Growth Pact, in particular by focusing on the issue of debt dynamic as well as deficits;

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[10] European Commission, DG Economic and Financial Affairs, Economic Papers 424, September 2010, Quantifying the potential macroeconomic effects of the Europe 2020 strategy: stylised scenarios.

[11] European Commission, DG Taxation and Customs Union / Eurostat, Taxation trends in the European Union, 2010; European Commission, Directorate General for Economic and Financial Affairs, Public Finances in EMU 2010, European Economy 4/2010.

[12] COM(2010) 367.

- Set out effective enforcement mechanisms to ensure that Member States will act in compliance with the EU framework to which they have agreed. Where developments in Member State economies pose a risk to the overall development of the Union, a series of preventive and corrective measures are proposed, including a range of sanctions that could be applied where breaches occur;

- Establish a European semester for policy co-ordination and explain the process and timing that will provide a European input to national policy decisions, leading to more effective ex-ante policy co-ordination. This also applies to the structural reforms and the growth enhancing elements of the Europe 2020 strategy.

With regard to the strengthening of the stability and growth pact, the European Commission recently proposed a comprehensive package of reforms[13] through an increased focus on public debt and fiscal sustainability, the extension of surveillance to macroeconomic imbalances, and more effective enforcement through the use of sanctions and incentives. The intention is that the "European semester" will integrate all revised and new surveillance processes into a comprehensive and effective economic policy framework. The monitoring of public finances will be based on the new concept of prudent fiscal policy-making that should ensure convergence, while debt developments will be followed more closely and put on an equal footing with deficit developments as regards decisions linked to the excessive deficit procedure.

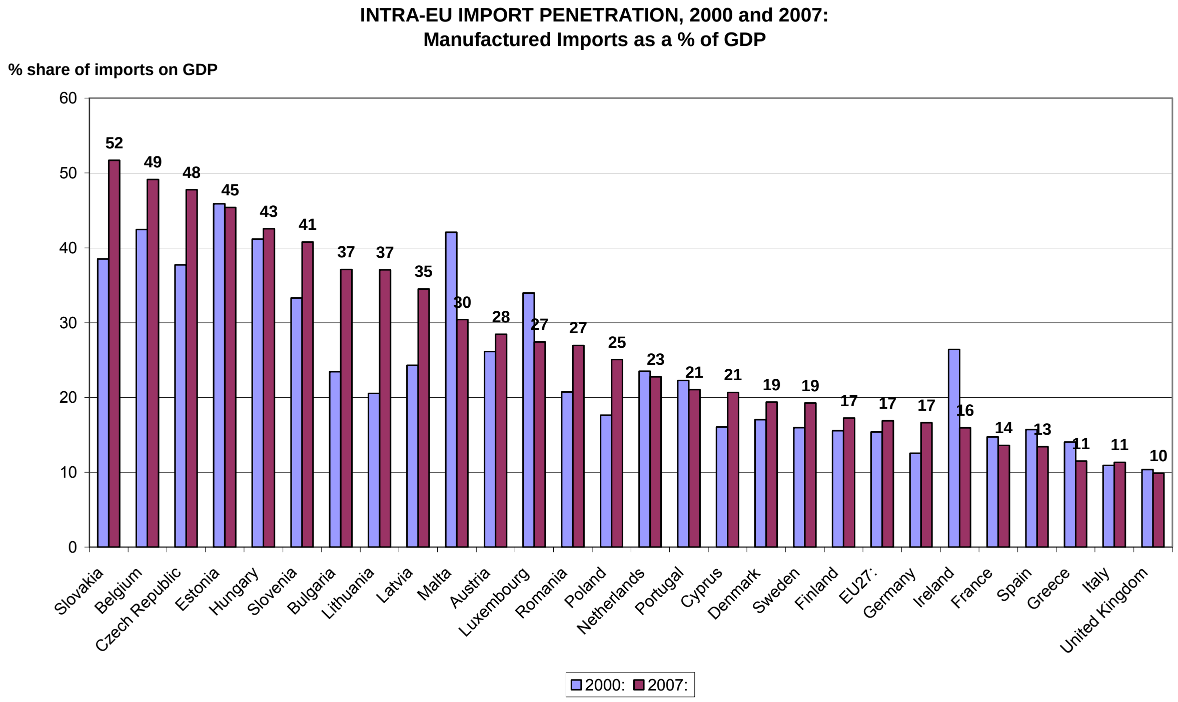
Changes in both the preventive and corrective part of the SGP are backed up by a new set of gradual financial sanctions for euro-area Member States. The changes are devised so that they should facilitate the eventual move to a system of enforcement linked to the EU budget. The newly proposed Excessive Imbalance Procedure (EIP) will comprise a regular assessment of the risks of imbalances based on a scoreboard composed of economic indicators.

[13] COM(2010) 522; COM(2010) 523; COM(2010) 524; COM(2010) 525; COM(2010) 526; COM(2010) 527.

6. INTRA-EU TRADE IN GOODS AND SERVICES

Markets are integrated when “economic frontiers” between them are eliminated. An economic frontier is any demarcation over which goods, services, capital, technology, labour and communication flows are low or absent. The removal of barriers to intra-EU products, services and factor flows *inter alia*, increases intra-EU trade and facilitates firm entry in the various national markets.

6.1. Intra-EU trade in goods



This chart shows the openness of EU countries to imports coming from other Member States in 2000 as compared to 2007. The degree of a country's openness is heavily determined by its size. Smaller countries such as Belgium are usually more open than big countries like France, as they are more dependent on the outside world for getting what they need (imports) and for selling their domestically produced goods and services (exports). Therefore, to assess the degree of trade integration inside the Internal Market, the focus should not only be on the degree of openness in any given year, but also on changes over time. A significant increase indicates that a country is becoming more open and integrated inside the Internal Market and therefore it is “trade creating”.

Among the most integrated countries in terms of imports are many of the new Member States, whose intra-EU imports account for 40 to 50% of their *GDP* (whereas the average EU-27 ratio is around 17% of GDP). Most of these countries were already highly integrated in 2000, well before their official accession date, due to the intense increase in trade flows driven by the "Europe agreements" during the nineties. Therefore, no major increases in trade were commonly expected after accession.

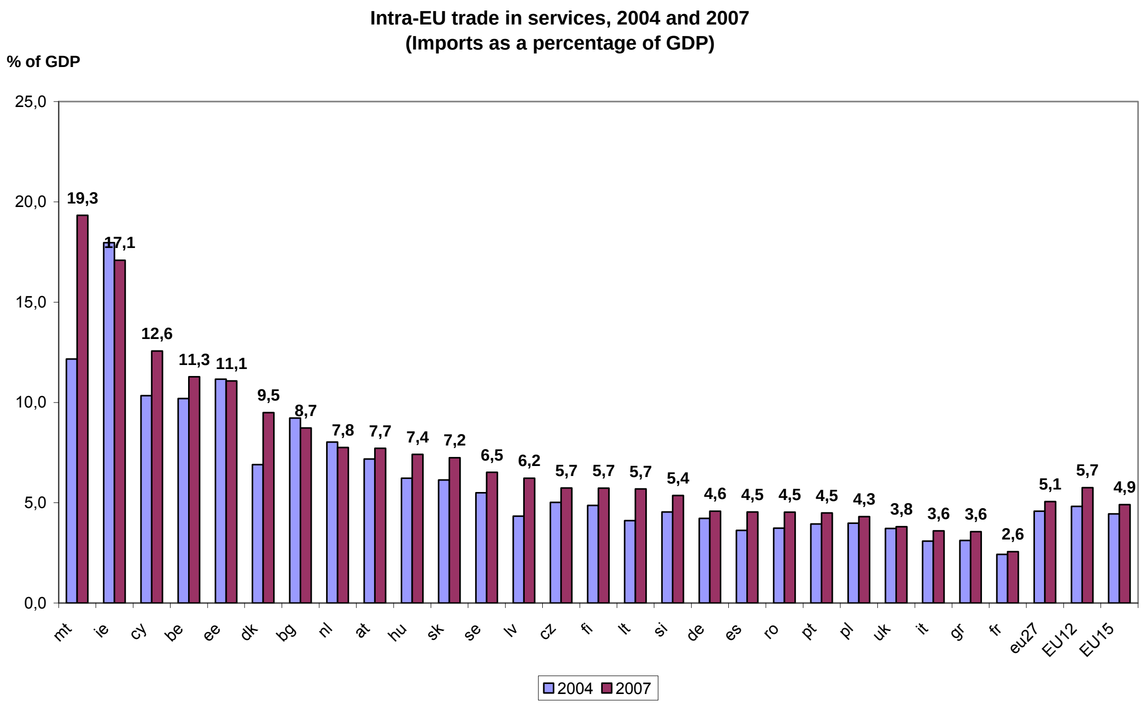
However, in many new Member States, integration has not lost momentum after accession, although significant cross-country differences can be observed: while Poland, Lithuania or

Latvia have seen further increases in imports during the current decade, countries like Estonia or Hungary stayed at their (high) 2000 levels. Overall, enlargement can be seen as the major driver for further integration within the Internal Market.

Among the "older" Member States, only some small countries exhibit high import penetration rates: Belgium (whose imports from other EU countries account for more than 49% of GDP), followed by Austria, Luxembourg, the Netherlands and Portugal. As expected, the big economies are the least open ones, with shares of intra-EU imports of GDP ranking between 9.9 % in the United Kingdom and 16.6 % in Germany. While many of these larger economies had shown growing degrees of openness during the nineties (in particular France and Spain), only Germany maintained that momentum during the current decade.

By contrast, the Nordic countries and Austria, which joined the EU in 1995, are still increasing their imports from other EU countries. Nevertheless, the highly dynamic trade performance of Belgium or Germany shows that the Internal Market still offers the potential also for more trade integration for long-time members – both with regard to small and already highly integrated economies (Belgium) and for big economies such as Germany.

6.2. Intra-EU trade in Services



This chart indicates, for each EU country, how open it is to the imports coming from other Member States. As usual, size is an important determinant of openness: All the big countries – old and new (Poland) alike – are clearly below the EU average. But not only big countries exhibit a low ratio: also Greece, Romania and Portugal are among the countries with apparently more closed markets for services.

The countries that are most open to other EU service providers are a combination of older Member States (Ireland, Denmark, Benelux[14], Austria) and newer ones, such as Malta, Cyprus, Estonia and Bulgaria. In fact, most of NMC exhibit relatively high openness: on average, EU-12 import share on GDP accounts for 5.7 of GDP against 4.9 for EU-15.

6.3. The effects of cross-border public procurement within the internal market

Cross-border procurement can take place in different ways.

Direct cross-border procurement occurs when firms operating from their home market bid and win contracts for invitations to tender launched in another Member State.

Indirect cross-border activities arise when firms bid for contracts through subsidiaries (i.e. when their foreign affiliates bid for tenders launched by authorities of a country different from the home country where the firm has its headquarters or where the parent company is located). Indirect cross-border procurement can also occur when a domestic firm imports goods in order to supply them to a contracting authority or entity. Finally, foreign bidders can submit offers in consortia with local firms.

[14] Luxembourg is a special case regarding services trade: due to its small size and the huge relevance of its financial sector, its share of services flows in GDP is very high. Its inflows from other EU countries accounted for 46% of GDP in 2004, and 53.3% in 2007.

Direct cross-border procurement

Until now, procurement indicators to measure cross-border activity have indicated limited direct cross-border procurement activity (between 1.2-1.5% of the number of awards, information collected using data from the Tenders Electronic Daily database (TED, http://ted.europa.eu/)). However, in some Member States direct cross-border procurement accounts for more than 10%.

	2009	**2008**
AT	5,61%	4,84%
BE	4,29%	4,26%
BG	1,36%	1,95%
CY	8,68%	7,31%
CZ	1,07%	2,39%
DE	1,44%	1,54%
DK	4,37%	3,18%
EE	7,10%	7,20%
ES	0,55%	0,86%
FI	1,27%	1,75%
FR	0,59%	0,72%
GR	1,87%	1,70%
HU	1,06%	1,91%
IE	13,22%	17,66%
IT	0,82%	1,35%
LT	2,26%	2,35%
LU	12,24%	15,07%
LV	1,34%	3,31%
MT	18,18%	14,17%
NL	2,73%	2,78%
PL	0,77%	0,95%
PT	1,73%	4,41%
RO	1,94%	2,27%
SE	2,27%	2,22%
SI	1,18%	1,73%
SK	4,21%	4,11%
UK	1,18%	1,55%
	1,21%	**1,49%**

Source: European Commission

EU funds in direct cross-border procurement

The proportion of contracts involving EU funds was higher in direct cross-border procurement than in all contracts:

– In 2009, 11% of direct cross-border procurement involved projects financed from EU funds, compared to 5% of all awards.

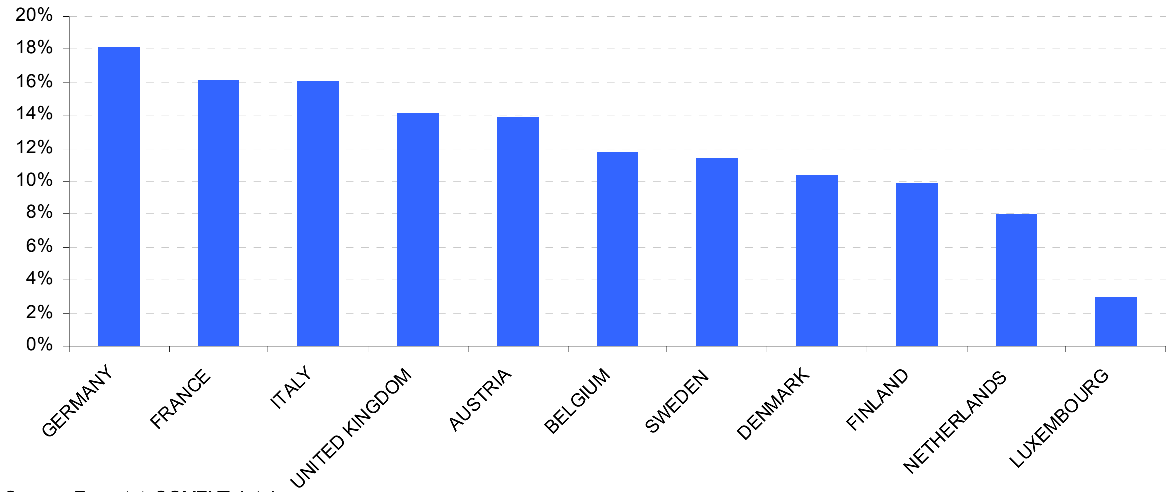
– For the EU-12 countries, the proportion of cross-border contracts involving EU funds was even higher (20% in 2009).

7. THE IMPACT OF COHESION POLICY ON THE EU ECONOMY

The impact of EU budget interventions on the economies of different Member States countries is not a scientifically well-documented subject. The documentation is limited.

The European Parliament[15] has made a study, using the HERMIN model to assess (simulate) the impact on net contributor states of the investments undertaken in the net recipient states through Cohesion Policy in the period 2000 – 2006. The table below shows the share of the total exports of the net contributor Member States going to the net recipient Member States of Cohesion Policy in the period 2000-2006.

Figure 1 - Share of the total exports of the net donor states going to the net recipient states



Source: Eurostat, COMEXT database

The net recipient Member States can in general be classified as small open economies, often with a narrow industrial basis, where many capital products or other goods that are vital for the implementation of structural interventions are not produced domestically. The main contributor Member States, on the other hand, tend to be large, diverse and advanced economies, producing many kinds of capital, goods and services that are required by recipient states as they go trough a process of fast development and growth. A consequence for a small open economy, when it implements Cohesion Policy programmes, is that the induced process of development triggers higher levels of imports of a wide range of goods and services from their main and more advanced trading partners.

The Commission also made a study on the impact of cohesion policy on the EU economy. The QUEST III endogenous R&D model of DG ECFIN has been used to assess the effect of raising taxes to pay for cohesion policy as well as of the effect of the expenditure that it finances. The modelling results indicate that, overall, the funding provided by cohesion policy for the 2000-2006 period had a positive effect on GDP growth in the EU even if account is

15 European Parliament, Directorate General for Internal Policies, Policy Department B: Structural and Cohesion Policies, Regional Development, *The Economic Return of Cohesion Expenditure for Member States,* 2009.

taken of the depressing effect in countries which were net contributors to the funding of cohesion policy.

GDP in the EU25 as a whole is estimated to have been 0.7% higher in 2009 because of cohesion policy over the 2000/2006 period. Therefore, the positive effect on countries that were net recipients of financial aid from the Structural Funds outweighed the adverse effects on the countries mainly responsible for raising the finance for the Funds (Table 1).

Moreover, the net beneficial effect on GDP tends to increase over time as the lagged effects on raising productive potential in recipient countries come through. By 2015, GDP in the EU25 is estimated to be 2.4% higher as a consequence of the support provided for the 2000-2006 period and in 2020 4% higher. The implication is, therefore, that, according to the QUEST model, the cohesion policy conducted over the 2000-2006 programming period is likely to add 0.2% a year to the EU25 average GDP growth between 2000 and 2020 (i.e. effectively increasing the average growth rate of around 2% a year by 10%).

Overall, cohesion policy over the programming period 2000-2006 is estimated to have contributed economic growth and strengthened the capacity for growth in the EU as a whole.

Concerning the 2007-2013 programming period, the most recent model-based analysis[16] has examined the potential impact of cohesion policy spending. The analysis points out those ex-ante model-based assessments cannot provide evidence on the positive output effects of fiscal transfers, but can shed light on the potential channels through which policies could have an impact. The long term growth effects depend on the precise nature of the projects that are supported. Other factors must also be taken into account, notably the increasing difficulty of Member States to provide co-funding as a result of the economic crisis, and long delays in spending due to implementation lags. The analysis found that significant effects from policies should only be expected some years after implementation.

Sources:

1) Varga, Janos and in't Veld, Jan (2009): A model-based analysis of the impact of cohesion policy expenditure 2000-2006: Simulations with the QUEST III endogenous R&D model.

http://ec.europa.eu/economy_finance/publications/publication_summary16014_en.htm

2) European Commission (2010): Ex-post evaluation of the ERDF 2000-2006, Synthesis Report

http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/synthesis_eval2000_2006.pdf

3) Varga, Janos and in't Veld, Jan (2010): The Potential Impact of EU Cohesion Policy Spending in the 2007-2013 Programming Period: A Model-Based Analysis

http://ec.europa.eu/economy_finance/publications/economic_paper/2010/ecp422_en.htm

4) European Commission: Ex-post evaluation of the ESF 2000-2006

http://ec.europa.eu/social/main.jsp?catId=701&langId=en&internal_pagesId=616&moreDocuments=yes&tableName=INTERNAL_PAGES

16 Varga, J. & in't Veld, J., The Potential Impact of EU Cohesion Policy Spending in the 2007-13 Programming Period: a Model-Based Analysis, European Commission, Directorate General for Economic and Financial Affairs, European Economy, Economic Papers 442, September 2010.

Table 1: Cumulative net effect of cohesion policy on GDP according to QUEST, 2000-2006

GDP in end year as a % of GDP in absence of cohesion policy			
	2000-09	2000-15	2000-20
DE	0,6	2,1	3,6
IE	2,0	5,2	8,1
EL	13,0	28,6	42,9
ES	9,5	20,0	29,8
IT	1,1	2,8	3,9
PT	15,7	33,7	49,7
CZ	1,4	3,9	6,0
EE	3,5	8,3	12,0
CY	0,1	0,7	1,2
LV	11,7	27,9	41,1
LT	7,7	18,7	28,8
HU	3,1	8,0	12,5
MT	0,7	2,7	4,4
PL	5,0	14,7	23,1
SI	0,8	2,3	3,4
SK	2,3	6,0	9,3
EU4 (Cohesion EU15 MS)	9,8	21,1	31,5
EU15 net donor countries	-2,2	-4,0	-5,3
EU15	0,5	1,9	3,3
EU10	3,7	10,2	15,9
EU25	0,7	2,4	4,0

Note: Aggregations are weighted averages of country estimates, using the GDP of countries expressed in EUR as weights. GDP in 2009 has been used to weight the estimates for the subsequent years.

8. THE ROLE OF FINANCIAL INSTRUMENTS

8.1. Typology of EU financial instruments

8.1.1. Introduction

In the context of the new Financial Framework 2007-2013, the European Parliament, the Council and the Commission agreed that the introduction of co-financing mechanisms would be necessary to reinforce the leverage effect of the EU budget. In particular, it was agreed that the introduction of co-financing mechanisms is necessary to reinforce the leverage effect of the limited EU funds. These mechanisms were the financial instruments under the Competitiveness and Innovation Framework Programme (in particular SME Guarantee Facility and equity instrument called GIF), the Risk Sharing Finance facility (RSFF) and the Loan Guarantee Instrument for TEN-Transport (LGTT).

Since the inception of these three instruments, a number of additional innovative financing mechanisms have been introduced by the Commission.

Innovative financial instruments can be designed in the form of loan schemes, guarantee schemes, risk-bearing instruments or equity and quasi-equity instruments. They can complement grant funding but cannot replace it. In other words, economically viable projects may need grant funding in order to become financially viable and thus 'bankable'. Therefore, the Commission has also developed a range of grant/loan blending instruments for specific policy objectives which are included in the category of financial instruments. Finally, trust funds are commonly used mechanisms in the developing countries, bringing together the resources of a number of donors into a structure which in turn may provide risk capital, loans, grants and/or technical assistance together with the IFIs.

Apart from loan facilities, the Commission has usually no direct contractual relationship with the final beneficiaries of such products, but delivers them through intermediaries. Thus, these programmes are managed with the active involvement of international financial intermediaries (IFIs) and various types of market participants, and follow to a large extent market practices. These programmes are usually also demand driven mechanisms and as such there are no legally binding obligations for a balanced portfolio by country.

Some examples of currently available instruments are presented below. They do not constitute a comprehensive list.

8.1.2. Loan schemes and blending mechanisms

Unlike grants, **loans** must be repaid by the beneficiary to the Commission or to the intermediary. Loans are funded by the Commission on the capital markets and the proceeds are on-lent to the beneficiaries on a back-to-back basis. Consequently, the loans are priced according to the market pricing including a small margin to recover costs incurred by the Commission in the context of the transaction. Examples include Euratom loan facilities to support the financing of investment projects for electricity production in the nuclear sector.

A rather new type of debt instrument are **fund structures** pulling together resources of the EU budget and other public/private institutions in order to provide a range of financial products to beneficiaries. The EU contribution is often structured as a first loss piece, leveraged by IFI contributions in the sub-ordinated shares, which together attract other private and public investors to invest in the fund in the senior shares thus achieving a higher leverage for this action. These funds often have a revolving character due to the revenue generating financial products the funds are offering to the beneficiaries. Examples include the European Fund for South-East Europe (finance to micro-enterprises) and the European Progress Microfinance Facility (guarantees, risk-sharing, equity and debt to microfinance institutions in EU-27). Typically, they are managed by independent professional management teams who are experts in the targeted sectors, countries and financial products offered.

A special type of **combined grant/loan schemes** are programmes in which loans granted by a financial intermediary are combined with technical assistance grants, investment grants or interest rate subsidies provided by the Commission. These have been used for example for capacity building purposes, i.e. banks have received technical assistance in order to set up internal guidelines, policies and processes including training of the staff. In turn, these banks have committed themselves to expand the lending volumes in specific sectors, for example energy efficiency, municipal or SMEs lending.

Finally, there are also **technical assistance schemes** supporting the development of bankable projects but for which no direct obligation of IFI co-financing exists. Examples include JASPERS (which supports managing authorities in EU-12 to develop larger scale projects for funding from the Cohesion Fund or the ERDF) and ELENA (technical assistance to support energy efficiency and renewable energy investments).

8.1.3. Guarantee schemes

Guarantees are provided to banks and guarantee institutions providing debt financing to SMEs and other beneficiaries in order to minimise risk exposure of those institutions.

In the context of the EU's expenditure programmes, extensive experience has been gained with **portfolio guarantees**. Such guarantees are typically given to intermediaries that provide lending to a large number of final beneficiaries who have difficulties to access finance (e.g. SMEs, vulnerable people, infrastructure, etc.). The portfolio approach is suited for covering a large number of loans, thus providing for diversification in terms of risk, geographical coverage and industry sectors. In order to ensure that the EU's exposure is known upfront, portfolio guarantees are typically capped, i.e. the maximum amount payable to an intermediary is limited to a pre-determined amount. Usually, this cap covers the expected loss of the portfolio potentially including a small margin. Consequently, the EU budget will normally be fully disbursed and used by the financial institution to cover the losses of its portfolio.

Portfolio guarantees do not benefit from extra leverage by IFIs as these do not provide any funding. In the EU, for example under **SME Guarantee Facility**, the leverage is achieved through the additional debt volumes the banks and guarantee institutions are requested to provide to SMEs.

The **EU Guarantee Fund for External Action** covers loans granted by the EIB to projects in third countries. It is a key instrument enabling the EIB to be involved in a wider range of countries and borrowers, both by allowing the EIB to intervene in higher risk countries and operations and by making financial conditions more attractive to borrowers. The EU guarantee is restricted to 65 % of the aggregate amount of credits disbursed and guarantees provided, less amounts reimbursed, plus all related sums.

8.1.4. Risk sharing instruments

The objective of the risk sharing is not to minimise the overall risk exposure of a programme but to optimise exposure, i.e. to take prudent risks in order to increase the leverage capacity of EU funds as much as possible. When a financial intermediary grants a loan or a guarantee to a beneficiary, the Commission shares the risk of a potential loan/guarantee loss with the intermediary, such as the EIB.

Based on experience and historic data on defaults of companies and projects, a bank assigns each loan/guarantee into a risk category. Depending on the level of the risk category, the bank has to set aside capital to cover the estimated risks. The risk of a default can be split into an expected loss, an unexpected loss and a residual loss which can be shared between the parties.

RSFF (the Risk Sharing Finance Facility) and LGTT (Loan Guarantee Facility for TEN-Transport) are examples of risk sharing instruments. For each loan and guarantee granted, the Commission pays to the EIB a portion of the risk assigned based on a financial model developed jointly by the Commission and the EIB, the remaining portion is covered by the EIB. These two instruments are not provided for free to the beneficiary but the advantage is that pricing covers only the costs of the institutions without any profit margin. An additional advantage for the beneficiary is the better pricing of the loan due to the EIB's and the Commission's AAA-rating.

These instruments have a revolving character due to the price obtained from the beneficiary to cover the risks which can be used for new projects and the high probability of non-use of the unexpected loss and residual risk.

8.1.5. Equity instruments

The Commission mainly invests through a financial intermediary in venture capital and risk capital funds, which then invest in final beneficiaries, for example innovative SMEs with high growth potential or in energy or transport infrastructure projects. These final beneficiaries are selected in an independent way, but in line with the investment policy of the fund, by the fund's management company during an investment period of several years, following the start of the fund. Examples of such instruments include Marguerite (direct equity investment in a risk capital fund aimed at investments in TEN-E, TEN-T and renewable energy infrastructure in EU-27) and the Global Energy Efficiency and Renewable Energy Fund (GEEREF) for equity investments in SMEs in third countries.

The EU's investment attracts private funding: the EU has always a minority stake of the fund's capital, and invests alongside with other investors in the fund. The majority of the fund's capital needs to be held by *market-oriented investors*, i.e., private or public investors seeking the same level of return as a private investor would have requested under the same circumstances.

8.1.6. Structural Funds financial instruments

Financial instruments under Structural Funds (shared management) offer a large variety of financial products: loans, guarantees and equity investments. The JEREMIE (Joint European Resources for Micro to medium Enterprises) and JESSICA (Joint European Support for Sustainable Investment in City Areas) initiatives enable managing authorities to invest/contribute part of their structural funds allocations into financial intermediaries and urban development funds, so that the EU contribution can be leveraged.

9. RESULTS OF EX-POST EVALUATIONS

The Commission attaches high priority to evaluations of current policies and programmes and impact assessments of future initiatives, in order to ensure as far as possible the most efficient and effective use of EU instruments. The Commission carried out more than 1400 evaluations and impact assessments in the years 2002-2009. Moreover, the "Forward Evaluation Plan for 2009 and beyond" from the Commission contains 704 evaluations that are either ongoing or planned by the services. Most of the evaluations cover the current Financial Framework for 2007-2013, while a few of them go even beyond.

As regards the previous Financial Framework 2000-2006, the Commission contracted in 2008 a comprehensive meta-study on lessons learnt from existing evaluations as an input to the review of EU spending[17]. With a view to the Budget Review, it analysed 257 evaluations of the previous programming period. The lessons learnt remain relevant for the preparation of the next generation of programmes.

9.1. Assessment per policy area

The study provides separate assessments for seventeen policies clustered into a five broad policy areas (competitiveness, cohesion, natural resources, citizenship, and global partnership).

The paragraphs below summarise these assessments for the policies that account for the most resources in budgetary terms. Overall, they cover 94% of the EU budget. The seven criteria used were <u>relevance</u> (the extent to which the objectives are (still) in line with the needs, problems and challenges which justified the launching of the intervention), <u>coherence</u> (the extent to which the intervention complements other interventions pursuing the same goals, while avoiding duplication and seeking synergies), <u>added value</u> (the extent to which the desired results/impacts are better achieved through a European intervention than what would have resulted from similar interventions at the level of Member States), <u>effectiveness</u> (the extent to which the desired results/impacts are achieved), <u>sustainability</u> (the extent to which the achieved results/impacts are likely to continue in the long-term), <u>efficiency</u> (the extent to which the desired effects are achieved at a reasonable cost) and the <u>value of unintended impacts</u> (the extent to which unintended impacts are positive or negative with respect to the needs, problems and challenges of the society).

The effectiveness of the markets support and direct aid in **agriculture** policy is assessed as satisfactory but significant shortcomings or failures are also mentioned in terms of market imbalances or increased production costs. Where efficiency is assessed, there are some very negative messages, especially with regard to over-compensation in a number of instances.

European interventions targeted at **rural development** are assessed as having generated major benefits in terms of improving product quality and marketing channels, and opening new perspectives for local governance in rural areas. Large-scale impacts are, however, limited by the fact that the policy does not reach a critical mass in the supported territories. For example, the impact on farm efficiency and young farmers was not substantial.

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17 Euréval/Rambøll Management, Meta-study on lessons from existing evaluations as an input to the review of EU spending, 2008.

Regional development programmes are assessed as relevant, although a number of evaluators mentioned concrete development needs that would deserve stronger emphasis, especially in connection with sustainable development and, to a lesser extent, the “Lisbon objectives”. Macro-economic studies predicted an impact of 1% to 3% in GDP after seven years of support, which suggests that the rapid convergence of some Member States is attributable to causes other than the cohesion policy, such as the benefits of the internal market and/or effective national economic policies.

The **Cohesion Fund** is assessed as relevant and effective. There is a clear and considerably faster improvement of infrastructure in the beneficiary Member States, owing to European assistance. Further impacts on business investments, economic activities, and employment are predicted to be positive.

The **employment** measures supported by the European Social Fund are assessed as relevant with limited exceptions, such as insufficient emphasis on social inclusion and gender pay gap in Objective 2 regions. Effectiveness is also assessed positively in terms of contribution to the development of skills and qualifications, but also in terms of system-wide effects such as reform of labour market policies.

Research and technological development policy is considered to add European value by strengthening the research system as a whole through a structural effect, although its expenditure is less than five percent of the total public RTD expenditure in the EU area. The policy has addressed a number of deficiencies in the European research landscape and significantly contributed to bridging the gap between research and innovation.

Finally, **cooperation** with third countries is subject to mixed assessments. All donors, including the Commission and the Member States, have committed themselves to better co-ordinating their activities with recipient countries and between themselves, but the assessment of coherence remained mixed during the period under study. Apart from specific successes and failures, a common pattern is repeatedly highlighted, i.e. the effectiveness of projects and programmes heavily depends on the progress of policy reforms at sector level.

9.2. Assessment per evaluation criterion

Most European policies are said to be **relevant** in that they respond to stakeholders’ needs and address key challenges. When there are reservations, the evaluators report on policy responses which are not proportionate to the problem, which build upon inappropriate impact assumptions, which do not match the expectations of the targeted groups, or which lack a proper long-term strategy.

Trans-national networks and partnerships are repeatedly assessed as **adding European value** in that they contribute to mutual learning, benchmarking, creative thinking and raising new ideas. Other ways of adding value are to address challenges that are cross-border by nature, to seek effects that arise beyond Member States’ boundaries or to tackle problems that are not politically appealing and therefore not addressed by Member States. The two last approaches may be seen as either opposing or complementing each other: (1) achieving economies of scale through European harmonisation and standardisation, and (2) promoting diversity in a context of European levelling.

With regard to **coherence**, the study differentiated between issues of coordination and complementarity. In the area of cohesion policy, the need to organise co-financing is said to have initiated new partnerships and coordination arrangements at regional level and to have removed the duplication of activity for applicants. However, the three Structural Funds (ERDF, ESF and EEAGF) have operated according to different principles and with different financial requirements, so coordination efforts are not effective enough for enabling synergy between the funds. With regard to complementarity, in several instances, conflict between objectives are addressed by creating specific measures, e.g. support to exporting enterprises in developing countries as a way to reconcile the objectives of the trade and development aid policies; agri-environmental measures as a way to reconcile the CAP and environmental objectives.

Effectiveness tends to be less positively assessed where the evaluated intervention bring direct short-term benefits to a large number of people or organisations. In contrast, the effectiveness of system changes or structural changes are often assessed more positively.

Assessments of **efficiency** are not that frequent but rather negative. Frequently-raised problems are (1) insufficient targeting and allocation of a grant, subsidy, or payment to those who do not really need it, and (2) complex procedures entailing waste of human resources and discouraging those in need of the support from applying for it.

9.3. Main lessons learned

– European interventions do not need a heavy critical mass if they are to reach their target indirectly through **inducing changes in systems and structures**. On the contrary, interventions are much more costly, and rarely reach the necessary critical mass if they attempt to reach large Europe wide targets in a direct manner. In practice, the problem raised by the lack of critical mass is to be solved through a less extreme solution, i.e. designing an adequate policy-mix involving both direct and indirect approaches.

– Instead of being used for its own merits (i.e. satisfying the end user's needs), the direct approach should be primarily understood as an incentive for inducing policy reforms or governance improvements. Expenditures should therefore be proportionate to the desired "incentivising" effects, and no longer to the needs of the targeted groups. This lesson originates from a crosscutting view on evaluation conclusions across almost all policy areas. To a certain extent, it could also be applied in the areas where the current interventions reach large targets in a direct manner, i.e. cohesion for growth and agriculture.

– **Accurate targeting of beneficiaries** is a major factor of success. It helps reaching the most in-need people or organisations and therefore optimizing the achievement of the intended results. Conversely, it minimizes deadweight. The lesson was learned in the areas of research, innovation, energy, agriculture, and rural development, more often in a negative way, i.e. from failure to target the beneficiaries in an accurate enough way. It could therefore be transferred to any policy area where implementation bodies can be given an increased autonomy in the targeting of beneficiaries. This could be the case in the future for cohesion, rural development, cooperation, enlargement, etc.

Convergent messages are delivered about the **complexity** of procedures. Dealing with a new level of government, transparent selection processes, and strict audit rules may be perceived as complex during a transitional time period. This is sometimes expressed in terms of 'entry cost' that creates a number of barriers to new entrants.

– Through decentralising management and increasing the **autonomy of implementing bodies**, it is possible to achieve flexibility, to reduce complexity, and ultimately to ensure local relevance and increased efficiency. The complexity of procedures is highlighted in evaluation reports across almost all policy areas. Explanations and remedies are however proposed in just a few reports related to SME schemes and the European Social Fund. The lesson should therefore have a large potential for being used in many policy areas. An associated risk is however that the intended results and impacts be forgotten if the implementing bodies are granted considerable autonomy. The lesson is therefore transferable if, and only if, a result-oriented management can be put in place.

– Major attempts have recently been made at developing **performance incentives** in the spirit of result-oriented management. The incentives have taken the form of additional budgetary funds allocated to the best performing interventions. The first attempt has taken place in the area of cohesion for growth and employment, but the performance incentives have not been integrated in a consistent system of result-based management and the implementing bodies have not been granted significantly larger autonomy. Complexity has not seriously declined and the assessment of the experience has been suboptimal. The second attempt has been launched in the area of cooperation, and is assessed as likely to succeed in one of the reviewed reports, but not yet on an evidence basis. There is a prospect for learning from this second experience in other policy areas, as soon as more lessons are learnt.

– Finally, there is a scope for better **leveraging private and public funds**. Leverage is said to “multiply” the budgetary expenditure in the sense that targeted people or entities are allocated a small part of the funds they need, with a view to encouraging them to provide complementary resources, either from their own funds, from public-private partnerships, or from other public or private funding institutions. The multiplier may be even larger if use is made of financial engineering where budgetary funds are converted into loans, seed capital, loan guarantee, etc. Co-financing is another way of multiplying European funds by attracting matching funds from public institutions at the level of regions, Member States, partner governments, or international institutions. In the view of impressive multipliers figures quoted in a few evaluation reports, the EU should be called to promote leverage by any available means in all policy areas.

10. IMPROVING SOUND FINANCIAL MANAGEMENT

The Commission has already taken several actions to improve Sound Financial Management, the most important being the following.

10.1. Simplifying the Implementation of the Research Framework Programmes[18]

Stakeholder consultations indicate that access to the programmes and preparation of proposals are considered too difficult, in particular for newcomers, that the administrative burden for project administration and accounting is perceived as too high and that time-to-grant and time-to-pay are viewed as being too long. The Commission has therefore outlined measures and options for simplifying EU research funding, for assuring that EU research funding promotes the highest quality research and for finding a better balance between trust and control and between risk taking and risk avoidance.

For maximum impact, research and innovation programmes at European level should be highly attractive and accessible to the best researchers worldwide, to Europe's industry and entrepreneurs, to universities and other research and innovation actors. The Commission has presented a number of simplification efforts in the following areas:

– Improvements and simplifications that the Commission will implement under the current legal and regulatory framework, which should contribute to a further reduction of average time-to-grant and time-to-pay (e.g. improved IT-tools, user support, uniform application of rules, optimising the structure and timing of calls for proposals etc.);

– Changes to the rules of the current cost-based model (e.g. general acceptance of accounting practices of participants including average personnel costs, a unique set of rules for all participants covering all intervention measures and a reduction of the number of different reimbursement rates and methods for calculating indirect costs etc.);

10.2. Strengthening the Commission's supervisory role under shared management of structural actions[19]

In 2008, following the European Court of Auditors ("Court") Annual Report of 2006, the Commission adopted an action plan with 37 actions (further measures and programmes were added during 2008 and 2009) to strengthen its supervision of Member States in relation to shared management of structural actions ("Action Plan"). The objective of the Action Plan was to reinforce actions by the Commission to address the high level of errors in reimbursements for structural actions and weaknesses in the Member States management and control systems ("systems").

The Commission has given an assessment of the results and the first impact on the implementation of the Action Plan, as well as on the implementation of additional actions by the Commission under the Joint Audit Strategy for Structural Actions ("Audit Strategy").

The 37 actions in the Action Plan were grouped under 10 headings.

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[18] COM(2010) 187.
[19] COM(2010) 52.

The Commission concluded the following:

– The Commission has produced results for all the actions and has laid the foundations for continued improvements. It, therefore, considers the Action Plan completed and the objectives achieved.

– The Commission will seek to reap the full benefits of the legislative provisions for the new programming period 2007-2013, including the simplification of cost options; it will keep up the momentum generated by the Action Plan and pursue rigorous supervisory actions in the context of its Audit Strategy and report on the situation in the Annual Activity Reports.

10.3. Reviewing the Financial Regulation

The Commission has recently submitted proposals for the triennial review of the Financial Regulation[20] aiming at more efficient delivery mechanisms and a thorough simplification of rules and procedures. A review of the financial rules is required at least every three years. This is the second such exercise: the first review took place in 2006-2007.

The new rules provide for the simplification of some unnecessarily cumbersome procedures, improve accountability and financial control and increase the transparency of EU spending. These are crucial elements in the development of a modern, efficient financial management system and to shaping the management of EU funds well into the next decade. The revised rules need to be agreed by the time the new EU-funded programmes come into play when the current multi-annual financial framework closes in 2013.

The Commission also carried out a public consultation from 19/10/2009 to 18/12/2009 in order to benefit from contributors' experience as project managers and beneficiaries of public funding. In the consultation, the Commission was specifically seeking for stakeholders views on how to make the rules for grants and contracts more effective for everyone.

Drawing on the Commission’s own experience, the consultation paper highlighted key areas that concern fund beneficiaries. The first looked at improving the process of public calls for proposals in the award of grants. Experience here has shown that procedures are often too long and cumbersome. The paper also raised a series of questions such as: should the rules on co-financing requirements for the recipients of EU grants be more flexible? Would the introduction of performance-based grants (i.e. based on results rather than on reimbursement of costs) make life easier for everyone? Or what about loosening up the current non-profit rule, where EU grants at the moment cannot generate any top-up revenue for beneficiaries?

The second focus in the consultation was on how to simplify the Commission's own handling of financial files. The current rules are designed to minimise the risk of error and fraud, yet practical experience shows that they can often create additional red tape. This is why the Commission will be examining ways to adapt the rules to ensure effective project management, as well as maintaining a high level of protection for taxpayers' interests.

The consultation encouraged interested parties to send 235 contributions, reflecting a broad range of opinions and perspectives. The contributions received largely agreed with the following points:

[20] Regulation (EC) No1605/2002 of 25 June 2002.

- internal Guidelines and best practice/tools should be improved;
- use of lump sums and flat rates;
- shift towards a performance-based system;
- the application procedure for grants should be improved;
- the real-cost regime should be maintained but it should be clarified and streamlined;
- thresholds for low value grants should be raised;
- rules on the recovery of interests generated by pre-financing generate excessive administrative burden and misunderstandings with operators and partners.

The Commission adopted its proposal for the revision of the Financial Regulation on 28 May 2010[21]. At the same time, it has endorsed a Staff Working Document on the Implementing Rules of the Financial Regulation so that European Parliament and Council can examine both texts, which are complementary, simultaneously.

10.4. European External Action Service (EEAS)

The Commission has also proposed an ad-hoc revision of the Financial Regulation in order to facilitate the establishment of the EEAS[22]. This is a separate exercise from the triennial review of the Financial Regulation at the end of the first semester of 2010. In budgetary terms, the EEAS will be treated as an institution in the sense of Article 1 of the Financial Regulation so that it will have budgetary autonomy, i.e. its own section in the EU budget. It will implement its own administrative expenditure (like all other institutions) and will therefore receive discharge from the European Parliament for it. The European Parliament will therefore exercise its full budgetary and control powers towards the EEAS.

[21] COM(2010) 160.
[22] COM(2010) 85.

11. ANALYSIS OF POTENTIAL ALTERNATIVE OWN RESOURCES TO FINANCE THE EU BUDGET

11.1. Introduction

This technical annex presents a summary of a number of potential alternative own resources pointing at key issues related to these alternatives, and putting forward indicative quantitative estimates. More refined analyses and concrete proposals will be developed in 2011.

Six options have drawn particular attention in the budget review consultation. These include the three options put forward by the Commission in 2004, namely a resource based on VAT, energy and corporate income. In addition, three options that gained prominence in recent years have been added, namely resources related to the auctioning of greenhouse gas-emission allowances, to aviation and to financial sector taxation.

This list of options should be seen as purely indicative, to enable an illustration of some of the issues which need to be considered. These and other potential options will need further study in the coming months in view of concrete proposals.

11.2. Financial sector taxation

Outline of the option

The Commission recently adopted a Communication on taxation of the financial sector[23], which addresses both a financial transactions tax (FTT) and a financial activities tax.

The FTT is designed to tax the value of single transactions. For a wide coverage, it should be applied to a broad range of financial instruments (i.e. equities, bonds, currencies and derivatives), even if some current proposals envisage limiting the scope to a subset (e.g. currency transaction levy).

Another potential instrument to improve taxation of the financial sector and reduce potential negative externalities is the Financial Activities Tax (FAT) as proposed by the IMF. It can tax total profit and wages (addition-method FAT) or can specifically target economic rents and/or risk. In contrast to an FTT, whereby each financial market participant is taxed according to her transactions, the FAT taxes corporations.

Qualitative assessment

A FTT would be levied on activities that are notoriously difficult to tax at national level and usually benefit from favourable tax treatment. To be viable and mitigate competitive distortions, such a tax needs to be levied at the international level and it requires a harmonised approach. In the light of the analysis undertaken to date, FTT appears less suitable for unilateral introduction at EU level since the risks of relocation are high and would undermine the ability to generate revenues. In the current international context, there are substantial obstacles to a global agreement on a broad-based FTT and while a narrow-based financial transaction tax could be considered at the EU level only, there are uncertainties about how to ensure a fair and workable solution without global consensus.

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[23] COM(2010) 549.

Existing studies suggest that applying a very low rate on a large tax basis would allow raising significant amounts of tax revenues. The FTT would respect well the ability-to-pay principle as it would primarily affect high-income taxpayers active on the financial market and shareholders of financial institutions. The ultimate impact very much depends on the scope of the financial instruments that would be taxed and would require careful design.

Introducing a FTT would not be easy, however. The operating costs related to this system could be initially high if the FTT covered all the main type of transactions, because of the different characteristics of the financial market segments involved. Control and incentive systems would need to be installed in order to avoid massive tax avoidance and migrations of markets. This could include financial incentives to the agent(s) collecting the tax on behalf of the Union. The legality of any FTT could also be challenged with regard to the EU treaties and WTO GATS provisions. Revenue flows could vary significantly in the short run, depending on the activity of the financial markets. There could also be a perceived national imbalance as, due to network externalities, financial asset transactions are highly concentrated in certain markets.

The geographical distribution of revenues from a FAT would by and large reflect the actual distribution of the financial sector in the EU. However, the revenue is not as concentrated as in the case of a broad-based FTT. The reason is that the base is not trading activity, which takes place mainly in a few financial centres, but rather remuneration and profit, which is more evenly spread. In this sense the FAT would be better suited to raising revenue for budget consolidation purposes.

As regards economic burden, the effects also depend on the concrete design of the tax. In practice there is no available empirical evidence on the real incidence of a FAT. If the tax were to be shifted to the customer, and given that there is no deduction for business consumers, the tax burden could also partly fall on users of financial services.

Quantitative assessment

The range of revenue estimates in the academic literature is extremely broad. In the staff working paper on innovative financing published in April 2010, the Commission services estimated that a FTT levied on spot transactions on exchanges with a rate of 0.1% could bring revenues of around EUR 20 billion per year for Europe (EU + Norway and Switzerland). A narrower Currency Transaction Levy of 0.005% on global Euro transactions could yield an amount of US$ 13 billion annually (equivalent euro).

For the 22 developed economies considered in the IMF report to the G-20, a 5% rate of the addition-method FAT would create revenue corresponding to the average of 0.28% of GDP. Using the country-level estimates for the share in GDP to calculate absolute figures, this would translate into total revenue for the 22 countries of roughly EUR 75 billion for the addition-method FAT. For the EU-27, the addition-method FAT could raise up to EUR 25 billion.

11.3. Auctioning of greenhouse gas emission allowances

Outline of the option

The EU Emission Trading Scheme (ETS) has been in operation since 2005. From 2013 to 2020 (and beyond), there will be an annually declining EU-wide emissions cap. During this period, an increasing share of emission allowances will be auctioned. The proceeds from allowances auctioning could be transferred to the EU budget. Part of the revenue collected would have to be removed from EU revenues and transferred to Member States to maintain the redistribution agreed in the legislation.

The revenue could be partially 'earmarked' for climate and energy priorities as envisaged in the relevant legislation.

Qualitative analysis

The EU ETS is part of the acquis. The system runs on a harmonised EU basis and the auctioning revenue would be closely linked to a core EU policy.

Revenue from auctioning is not a tax revenue, though it does represent a source of income for public authorities. As a charge closely related to pollution by economic operators, it is in line with the polluter-pays principle (article 191 of the Lisbon Treaty). This resource may not need to transit via Member States treasuries. The total administration cost of a centralised auctioning system would be lower and the recently agreed regulation governing auctions provides for a common platform.

It could be argued that the revenue flow related to emissions auctioning will decrease over time as emissions diminish. This argument appears unconvincing as the scope of the EU ETS is likely to expand over time and the price of carbon should increase as the emissions cap is reduced in line with a trajectory to a low-carbon economy in 2050. The revenue is dependent on the evolution of the carbon price, which has been variable in phase 1 (2005 to 2007) but is less so in the current phase 2. Varying revenue would be offset by the fact that the residual GNI-based resource would still be in place and could in any case compensate for any such possible volatility in this as in other resources.

Auctioning revenue will arise disproportionally in more energy-intensive Member States. However, assuming that part of the revenue from auctioning would be geared at climate and energy priorities (political earmarking of 50% of the revenue), it could be expected that heavy emitters per unit of output would also benefit from a higher share of expenditures. On the other hand, some Member States already earmark some auctioning revenues to support climate and energy policies at the national level.

Quantitative analysis

The revenue for the EU budget resulting from auctioning could amount to some EUR 20 billion[24] in 2020 after the transfer of 12% of the revenues to some Member States in line with the European Council agreement of December 2008. Revenues for earlier years would probably be lower due to the reduced share of auctioning and likely lower price of emission allowances as the EU economy recovers from the crisis.

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[24] Estimate assuming a price per emission allowance of EUR 20.3 and an auctioning of 65% of total allowances. This estimate does not include the revenue from auctioning in the aviation sector and other potential sectors included in the scope of the EU ETS as of 2013.

11.4. Aviation charge

Outline of the option

An aviation duty could apply to freight and passenger flights entering, operating and/or leaving the so-called European Flight Information Region. This would not be a duty on passengers or a duty related to kerosene consumption, but a charge per flight. The amount of the duty could depend on the aircraft technical characteristic and other variables. The duty would be such that the more efficient planes would pay less, ceteris paribus.

Qualitative analysis

Aviation is an example of how Community law helps to achieve safe, orderly and efficient business operations throughout Europe. Liberalisation of air transport in the EU has allowed considerable efficiency gains, the emergence of new, low-cost companies, and considerable price reductions for passengers over the years.

An aviation duty would serve various EU policy objectives. It would provide incentives to reduce air pollution, including greenhouse gas emissions not covered by the EU Emission Trading Scheme, such as nitrogen oxides (NOx), noise and airport congestion. It would contribute to the functioning of the internal market and reduce current distortions of competition vis-à-vis other modes of transportation (e.g. the current absence of VAT on air tickets or fuel tax on kerosene for international flights gives an undue advantage to aviation compared to other modes of transportation). An aviation duty may also be justified by the large free allocation of emission allowances (85%) foreseen in the Emission Trading Scheme.

Regarding the implementation of the aviation duty, start-up and operating costs could be small, since the data bases required and the technical facilities necessary for a precise and timely computing of the aviation duty due are already in place and in use. The charging system could be based on existing solutions already proved to be successfully operational and accepted over the years. However, this would require active participation of Eurocontrol in the duty collection and the agreement of all parties concerned. This may lead to lengthy political and legal proceedings. Lastly, aviation duties would not need to transit via the Member States budgets.

Quantitative analysis

Based on a standard duty of EUR 1.0 per kilometre for a reference plane, the total estimated income would have been EUR 12.8 billion for the year 2006. The corresponding aviation duty per average flight (freight and passenger flights) would have been EUR 1,331. This would correspond, for passenger flights, to a few Euros per passenger. The amount collected for the aviation duty could be expected to be increasing significantly in the post-2013 period considering the growing trend of aviation activity.

11.5. EU VAT

Outline of the option

A combined VAT rate could consist of the national and the EU rate. The Member States could determine the national rates as today. An EU rate could be defined separately in the framework of the own resource Decision and/or its implementation rules. The EU VAT payments could be clearly denoted on each individual invoice, next to the national VAT payment[25]. Different rates could be applied to different categories of goods and services in line with the existing differences in the Member States. This resource would thus be completely different from the existing VAT-based own resource which is in practice a contribution from the Member States based on statistical calculations. The Member States would collect the EU VAT and transfer the proceeds to the EU budget.

Qualitative analysis

VAT is an important and stable source of revenue. Moreover, tax receipts grow in line with increased spending on goods and services without any change in the VAT rate(s).

As a new own resource, it would be very visible to the citizen, which is why it has sometimes been advocated as a potential own resource. The low VAT rate (1-2%) necessary to finance the EU budget could put in perspective the size of the EU budget. However, the very high visibility of the EU VAT could also be seen as a problem if the population perceived EU VAT as an additional tax burden rather than replacing a national contribution paid for from other taxes.

The technical preparation for the implementation of an EU VAT could be relatively limited and it would probably not take more than a few years to put the system in place. However, harmonising further the structure of rates (notably zero-rated goods) and remaining differences of VAT bases could prove challenging. In absence of this, the system could also function, but not all EU taxpayers would be faced with the same EU VAT for a number of goods. Furthermore, the omission of existing zero-rated goods might be seen as unjustifiable relief from the proposed new EU VAT for certain Member States an issue that would need to be examined as part of a balanced overall proposal.

Quantitative analysis

Applying a 1% EU VAT to both reduced and standard rates, combined with the elimination of the current ('traditional') VAT-based own resource, and exempting zero-rated goods from the EU rate would yield revenues corresponding to close to half of total EU financing. More precisely, in its 2004 report on EU financing, the Commission estimated that revenues of a 1% EU VAT would amount to EUR 41.0 billion (estimate for 2001).

11.6. EU energy levy

Outline of the option

Existing taxes on energy consumption (in particular on motor fuels) could fully or partially (up to the level of the EU minimum tax rates) serve as own resources for the EU budget or could be replaced by an EU levy on energy/CO2 emissions. Member States could apply national duties ('surcharges') on top of the EU duties. Member States would collect the energy levy and transfer the proceeds to the EU budget.

Qualitative analysis

The main advantage of this option would be practical feasibility and easy implementation (existing tax with a large degree of harmonisation) combined with the fact that such a tax

[25] Although not all transactions, particularly retail B2C, would generate an invoice.

would be clearly linked to various Community policies and would support them (internal market, energy, transport and environmental policies).

However, these efficiency gains would only be possible if the total rates resulting from the EU rate combined with Member States surcharges were more harmonized than the current rates or if a reform of the existing framework for energy taxation could be facilitated by linking it to a reform of own resources.

Quantitative analysis

In its 2004 report on EU financing, the Commission showed that with a levy of 330 euros/1000 litres of motor fuel (the minimum rate), an energy tax could yield EUR 109.8 billion (estimate for 2002). Introducing a rate corresponding to half the minimum rate currently defined in the energy taxation directive, the EU energy levy on petrol and gasoil only would bring revenues close to half of the total EU financing requirements.

11.7. EU Corporate Income Tax

Outline of the option

An EU Corporate Income Tax (EUCIT) would first require a common corporate tax base. A relatively small, uniform EU corporate tax rate could then be applied to the common corporate base of corporations. Member States could continue to apply a national rate to this new base, or the EUCIT could be a percentage of each national company tax.

Qualitative analysis

If a common basis replaced current national rules and bases, this could lead to substantial efficiency gains (fewer tax distortions in investment decisions) and help to reduce compliance costs for companies operating cross-border in the internal market. In addition, it could contribute to a "clearer" distribution of tax bases for multinationals across Member States.

Challenges to implement a EUCIT are considerable. The work on a possible EU tax base, which was first suggested in 1962, is notoriously difficult, given the competences of Member States in taxation, as it relates to essential differences in Member States tax systems. Even the completion of an optional Common Consolidated Corporate Tax Base (CCCTB), which has not been conceived as a basis for a new own resource, has proved controversial.

Quantitative analysis

Corporate income tax represents on average between 2% and 3% of GDP in the EU so that in the scenario of a new compulsory base for all companies with all or part of the revenues accruing to the EU, there would be enough revenues to finance the EU budget even with a relatively low EU rate. However, the amount raised would fluctuate with the taxable profits of the EU private sector and would be difficult to predict. In the absence of any clear proposals on how such a proposal would ultimately be implemented, precise revenue estimates appear premature.