BALANCE OF COMPETENCES REVIEW: EU BUDGET

Response by the Institute for European Environment Policy

1. Introduction

The Institute for European Environmental Policy (IEEP) is an independent research organisation concerned with policies affecting the environment in Europe and beyond. Our aim is to disseminate knowledge about Europe and the environment and to analyse and present policy options. We undertake research and consultancy on the development, implementation and evaluation of environmental and environment-related policies in Europe. We work closely with the full range of policy actors from international agencies and the EU institutions to national government departments, NGOs and academics. We are a charity with offices in London and Brussels and a network of partners in other European countries. The London office of IEEP was founded in 1980, the Brussels office in 2001. A presence was established in Finland in 2008. For further information, see: http://www.ieep.eu.

2. Sources of evidence

IEEP has some familiarity with the EU budget and the Multiannual Financial Framework (MFF), the way different EU funding instruments are managed and their reporting requirements and systems. Our activities in this sphere have included both academic and applied research work, sustained interaction with the European Institutions, national officials engaged in EU matters and other stakeholders from civil society, business, science, research and elsewhere.

We have undertaken studies on a range of issues relating to the reform of the EU budget and specific funding instruments for various Directorates-General (DGs) within the European Commission including DG CLIMA, DG ENV, DG REGIO, and DG AGRI, the European Parliament, independent foundations and Member State governments. Different aspects of the reform of the EU budget have been addressed in studies, including the mainstreaming and financing of climate change in the 2014-2020 EU MFF[1,2], approaches and policy instruments for climate[3] and biodiversity[4] proofing EU

[1] Medarova-Bergstrom, K., Volkery, A., Schiellerup, P., Withana, S., Baldock, D. (2011) *Strategies and Instruments for Climate Proofing the EU Budget.* Institute for European Environmental Policy, London/Brussels.

[2] Medarova-Bergstrom, K., Baldock, D., Gantioler, S., Hart, K., Kettunen, M., Volkery, A. (2011) *Mainstreaming the environment and climate change in the post-2013 EU budget*, Directions in European Environmental Policy, No 4, August 2011

[3] Hjerp, P., Volkery, A., Lückge, H., Medhurst, J., Hart, K., Medarova-Bergstrom, K.,Tröltzsch, J., McGuinn, J.,Skinner, I., Desbarats, J., Slater, C., Bartel, A., Frelih-Larsen, A., and ten Brink, P., (2012), *Methodologies for Climate Proofing*

financed expenditure, and using innovative instruments at the EU level to mobilise public and private financing for low carbon and related activities[5,6,7]. Many of the observations below are derived from this experience but may not be referenced to specific reports as they respond to questions which are framed in very broad terms.

3. Background

The European Union (EU) is a rare example of an economic and political alliance between 28 countries that goes beyond the essentials of a free trade area or a single market to pursue a much wider set of goals. These extend to fields as varied as development cooperation, research and innovation, the environment and transport. Formal objectives are set out in the Treaties and in individual pieces of legislation. The EU budget is **one important tool in the array of EU policy levers which can be utilised to pursue the Union's common objectives and aspirations**. Representing about 1 per cent of the Union's GDP, the EU budget can be, and frequently is, used to address cross-cutting challenges, including many environmental and climate change concerns, and the fostering of a sense of solidarity among Member States.

The budget helps to balance the strong legislative focus of many of the EU's spheres of activity and to enlarge its capacity to capture synergies and reduce conflicts in Europe. These could be more difficult to address in a simpler free trade area without the common resources available to the EU through the budget.. A budget that is harnessed to commonly agreed objectives, including a measured level of redistribution in favour of less affluent regions, can facilitate the attainment of these objectives in a way which is not possible in a multi country group that does not have this facility.

The political realities of the EU are changing, as is the context in which the budget is framed. Long-term challenges such as climate change, energy security, the need to adjust to resource scarcity (raw materials, water), biodiversity loss, declining global competitiveness, and an aging society have become some of the key strategic priorities in Europe.. The Union's objectives need to be aligned more closely with these new challenges and not with certain historic concerns that are now less pressing. The budget in turn needs to be aligned with these objectives, including, rather fundamentally, the pursuit of long term sustainability, building on the provisions of the Treaty. The **availability of well targeted EU funding will be critical in helping to address these common challenges in an effective way and appropriate scale and so facilitating the transition towards more sustainable models of development**.

Investments and Measures under Cohesion and Regional Policy and the Common Agricultural Policy, A report for DG Climate, August 2012

4 IEEP, GHK and TEPR (2012) *Background Study Towards Biodiversity Proofing of the EU Budget*. Report to the European Commission. Institute for European Environmental Policy, London/Brussels.

5 Núñez Ferrer, J., Volkery, A., Withana, S., Medarova-Bergstrom, K., (2012) *The implications for the EU and national budgets of the use of innovative financial instruments for the financing of EU policies and objectives*, Study for European Parliament Committee on Budgets, CEPS/IEEP.

6 Medarova-Bergstrom, K., Volkery, A., Sauter, R., Skinner, I. and Núñez Ferrer, J. (2013) *Optimal use of the EU grant and financial instruments in the next multiannual financial framework to address the climate objective*. Final report for DG Climate Action, European Commission. Institute for European Environmental Policy, London/Brussels.

7 Withana, S., Nunez Ferrer, J., Medarova-Bergstrom, K., Volkery, A., and Gantioler, S. (2011) *Mobilising private investment for climate change action in the EU: The role of new financial instruments*, Institute for European Environmental Policy, London/Brussels.

4. Response to specific questions

4.1 What do you see as the rationale for having an EU budget?

As noted above, the rationale for the budget in our view is to support the EU's objectives and to complement other mechanisms available for this purpose. This does not always occur in practice and this problem needs to be addressed. Distributional issues between Member States are clearly important but frequently over- ride other considerations and lead to both rigidities in the structure and balance of the budget and to poor decisions on expenditure. The UK is far from alone in focusing heavily on distributional issues but it has played a notable part in placing this at the heart of negotiations on the MFF. The sense that positive change must be subordinate to the current distributional logic is increasingly a barrier to greater public benefit from the budget.

Although small in size compared to national public budgets, the EU budget has an important role to play in **directing expenditure to certain priority areas including** research and innovation, low-carbon investments, not least cross-border actions, strategic energy supply and conservation investments, sustainable land management and building human capital. Within this spectrum is a limited but sometimes important role in supporting the implementation of national obligations under EU policy (e.g. meeting the standards set out in the urban waste water treatment Directive), mainly in parts of Europe where the costs of implementation are relatively high in relation to national resources. This has been the case particularly in less affluent Member States in Central and Eastern Europe.

To fulfil its role the EU budget should target those areas where it can add the most value. In other words, it should **target investments which can deliver genuine added value with a clear European dimension**. Achieving this has been recognised as challenging in the past in several spheres, underlining the importance of efforts now being undertaken to improve the results-orientation of the post-2013 EU budget. The political commitment in the 2014-2020 Multiannual Financial Framework (MFF) to 'mainstream' climate change obligations across different policy areas and for at least 20 per cent of the EU budget to support climate change related activities is arguably a step in this direction.

An example of where there is a strong rationale for the use of the EU budget is in the area of **climate change**. The EU's ambition to move towards a low carbon, climate resilient economy requires a massive shift in the pattern of national and trans-frontier investments and EU funding has a number of roles to play in this context. The EU budget offers opportunities to support and incentivise market action in climate-related investments, particularly through the use of financial instruments, such as debt and equity and the provision of technical assistance. EU funding is valuable as a complementary measure to Member State action, helping to overcome bottlenecks, address trans-boundary issues, capture economies of scale in the development and deployment of some technologies, reinforce existing efforts in Member States with particular constraints on investment and support innovation.[1] The Commission's roadmap for moving to a low carbon economy by 2050 identifies key investment needs in various sectors such as boosting renewable energies, smart grids, passive housing, carbon capture and storage, advanced industrial processes and electrification of transport systems.

While the current distribution of Member State receipts and contributions certainly is not ideal (as indicated in the supporting charts and tables in the call for evidence), it is worth nothing that expenditure through the EU budget brings both direct and indirect benefits to net contributing countries such as the UK. For example this occurs through the trade-related benefits of the single market, improved access to labour, and increased exports. One study estimated **additional benefits** for the EU-15 Member States (mostly net contributors to the EU budget) from Cohesion Policy interventions in the Visegrad countries for the period 2004-2010.[8] It showed that, on average, 1 net Euro spent by the EU-15 countries on the Cohesion Policy in the Visegrad countries resulted in 61 cents of additional exports to them. For the UK, this translates into €4.8 billion of additional exports.[9]

4.2 What are the advantages and disadvantages of having unanimously-agreed long-term budget periods? How long should they be?

One of the key advantages of having a medium-term budget period (of between five to seven years) is that it **provides a degree of certainty** which is particularly relevant for long-term investments for example in the area of climate change and cohesion policy. Given the time it takes to reach agreement on the overall MFF and respective fund-specific legislative measures between the Council and the European Parliament (roughly between two and a half to three years), one could argue a longer budget period would be preferable to avoid constant negotiations and uncertainty. Regardless of the budget period agreed, the importance of a **robust mid-term review** process should be emphasised as this should help to ensure that spending can be reviewed earlier and adjusted to reflect the priorities of the day. The Mid-Term review that led to the 2003 reform of the CAP was a good example of this.

4.3 In your view, is the EU budget focused on areas of EU added value in expenditure?

The challenges currently facing the EU are very different to those at the time when the budget was first created. These include long-term challenges of globalisation, climate change and an aging society as well as shorter-term challenges relating to the economic and debt crises. These issues, particularly the longer-term challenges, are not adequately reflected in the priorities or expenditure of the EU budget. The preoccupation with the scale of the EU's budgetary resources continues to overshadow more important discussions on substance. This has resulted in only incremental changes to the overall structure and focus of the EU budget over the years.

The central question for the EU budget is how to ensure spending is effective and focuses on key priorities. The budget has not kept pace with the changing needs of an expanding Europe and there is a corresponding requirement to re-align goals with current and future challenges. This discussion needs to be led by a focus on areas of outstanding **'EU added value'** recognising that this will not be defined in an entirely static way and clearly has a political dimension but equally can be more rigorously identified and pursued than at present. Areas of longer-term strategic relevance, such as research, innovation and the building of sustainable infrastructure are critical in this regard. So is the need to focus more on public goods, especially in the fields of agriculture and fisheries where measures too frequently slide away from this principle. Without a well-managed, better targeted and quality-focused EU budget many of the EU's objectives will not be achieved.[10] Progress in this direction across the budget as a whole might be facilitated by a set of workable criteria to guide the identification of future spending priorities in a more transparent way. The decision to devote 20 per cent of the budget to climate related expenditure is an example of a useful step towards greater value added.

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[8] Poland, Czech Republic, Slovakia and Hungary

[9] IBS (2011) *Evaluation of the benefits of the EU15 countries resulting from the implementation of the Cohesion Policy in the Visegrad group countries*. Final Report.

[10] Euractiv (2012) EU budget debate: Some one trillion euro questions and answers, by Keti Medarova-Bergstrom and Pawel Swidlicki available at: http://www.euractiv.com/priorities/eu-budget-debate-euro-questions-analysis-515336

Ensuring the added value of EU spending is 'a key test to justify spending at the EU level'[11] and is one of the main principles that is proposed to govern future EU expenditure in the 2014-2020 MFF. The EU budget is intended to finance EU public goods and actions that Member States and regions cannot finance solely themselves, or where it can secure better results than could have been achieved by funding purely under national schemes. However EU added value is a complex, multi-faceted concept which is interpreted differently by different actors. Moreover given that EU funding instruments have their own rationale and support different policy objectives, developing a common approach to assessing EU added value applicable across all funding instruments is a challenging task with numerous conceptual, methodological and political difficulties[12]. Despite these challenges, agreeing a more operational approach to EU added value and explicit consideration of broad criteria for EU added value would help to improve the transparency of decision-making, increase coherence and strengthen the role of EU expenditure in meeting key EU policy objectives[13].

The **'additionality'** of EU spending is another key criterion which should guide EU spending more vigorously than now. In other words, EU funds should in principle be used to address existing market failures, deliver public goods and complement existing national/private funding, rather than crowding it out. This is for example a key issue in the development of financial instruments which are being introduced under different EU funding programmes within the 2014-2020 MFF. The role of such EU instruments needs careful consideration in the context of existing national schemes so as to avoid duplications of action and/or possible crowding out effects[14].

The political commitment in the 2014-2020 Multiannual Financial Framework (MFF) to **'mainstream' climate change obligations** across different policy areas and **for at least 20 per cent of the EU budget to support climate change related activities** is an example of how the EU is trying to increase the added value of its spending across the MFF and over time. While this is to be welcomed and is a step in the direction of ensuring that the future budget is focused on areas of EU added value, more needs to be done to ensure this commitment is implemented in practice in the different EU funding instruments[15]. A robust and credible system to track and report on expenditure under the EU budget is needed to be able to assess progress towards this commitment[16].

4.4 What modes of expenditure in the budget represent the most effective use of EU funds?

Although grants will remain the main form of expenditure under the 2014-2020 MFF, the Commission plans to simplify and expand the use of **financial instruments** under the 2014-2020 EU MFF. The role and significance of financial instruments is to be increased to help address sub-optimal investment situations where activities or operations are potentially capable of being financially viable, but are not able to attract funding from market sources that is either adequate or available on reasonable terms. The Commission has put forward proposals for financial instruments

[11] EC (2010) EU Budget Review. Communication from the Commission, (COM (2010)700), 19.10.2011, Brussels.

[12] Medarova-Bergstrom, K., Volkery, A., (2011), *Maximising the European Added Value of EU climate change spending: priorities, criteria and indicators*, Institute for European Environmental Policy, London/Brussels.

[13] Ibid.

[14] Withana, S., Nunez Ferrer, J., Medarova-Bergstrom, K., Volkery, A., and Gantioler, S. (2011) *Mobilising private investment for climate change action in the EU: The role of new financial instruments*, Institute for European Environmental Policy, London/Brussels.

[15] Medarova-Bergstrom, K., Baldock, D., Gantioler, S., Hart, K., Kettunen, M., Volkery, A. (2011) *Mainstreaming the environment and climate change in the post-2013 EU budget*, Directions in European Environmental Policy, No 4

[16] Withana, S., Baldock, D., Illés, A., Rayment, M., and Medarova-Bergstrom, K., (2014 forthcoming) *Tracking system for climate expenditure in the post-2013 EU budget: Making it operational*, Final summary report for the European Commission - DG CLIMA, Institute for European Environmental Policy, London/Brussels

in different areas of the EU budget including equity or quasi-equity investments, loans, guarantees, and other risk-sharing instruments, which can be combined with grants where appropriate.[17]

EU financial instruments can be seen to add value by multiplying the effect of EU funds when they are pooled with other funds or include a leveraging effect that enables private finance to be attracted. In our view these instruments do have a clear role in supporting the development of a more sustainable European economy. In the area of climate change for example, given some of the initial financing risks and cash flow barriers facing certain forms of low carbon energy sources, technologies, associated systems, and infrastructures; supporting such investments with financial instruments could help to overcome risk barriers and market failures/imperfections and thus support investments identified as having real EU added value[18].

Financial instruments can help to leverage funding to support strategic investments with the highest European added value[19], thus achieving more with limited EU funds. However, financial instruments are not a silver bullet and should not be considered as a potential solution for all financing requirements. In many areas public goods such as biodiversity conservation and sustainable land management will continue to require grant financing. Moreover, even if well-designed and targeted, financial instruments could fail to exhaust their full potential if they are not backed by supportive political framework conditions[20].

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[17] Núñez Ferrer, J., Volkery, A., Withana, S. and Medarova-Bergstrom, K. (2012) *The implications for the EU and national budgets of the use of innovative financial instruments for the financing of EU policies and objectives*. Study for the European Parliament's Budgetary committee

[18] Medarova-Bergstrom, K., Volkery, A., Sauter, R., Skinner, I. and *Núñez* Ferrer, J. (2013) *Optimal use of the EU grant and financial instruments in the next multiannual financial framework to address the climate objective*. Final report for DG Climate Action, European Commission. Institute for European Environmental Policy, London/Brussels.

[19] EC (2010) EU Budget Review. Communication form the Commission, (COM (2010)700), 19.10.2011, Brussels.

[20] Withana, S., Núñez Ferrer, J., Medarova-Bergstrom, K., Volkery, A., and Gantioler, S. (2011) *Mobilising private investment for climate change action in the EU: The role of new financial instruments*, IEEP, London/Brussels, http://www.ieep.eu/assets/868/Mobilising_private_investment_for_climate_action_in_the_EU_-_IEEP_report.pdf