HM Treasury

Review of the Balance of Competences

EU Budget

call for evidence

October 2013

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Executive summary

Subject:	The aim of this paper is to request contributions from interested parties on the balance of competences between the UK and the EU in determining the EU budget. This paper provides an introduction to the key issues and sets out questions where contributions would be most useful. After we have received contributions, we will produce a final report on the EU budget in 2014.
Scope of this paper:	The EU budget report focuses on the role of the different National and EU institutions in shaping the budget; the budget system; expenditure priorities and the revenue system. This Call for Evidence interacts with others on the specific spend areas, for example Agriculture and Cohesion which are also published in this semester. It is in those reports where issues on the reform of those policy areas will be covered.
Duration:	The call for evidence period will run from 21 October 2013 to 17 January 2014.
How to respond:	If you have knowledge or experience of the application of EU competence on the EU budget, please respond by emailing balanceofcompetences@hmtreasury.gsi.gov.uk by 17 January 2014. We will expect to publish your response and your organisation (unless you ask us not to) but not your name (unless you wish it included), in line with standard procedures. Please base your response on answers to the questions on page 26.
Enquiries:	*By email:* balanceofcompetences@hmtreasury.gsi.gov.uk *By post:* Balance of Competences Review – EU budget HM Treasury 1 Horse Guards Road Westminster London SW1A 2HQ
Next steps:	We invite expressions of interest from a variety of groups, including Parliament, industry representative groups, firms, consumer interest groups, academics, charities and civil society groups to discuss this work further. Further information is set out at the end of this document. We will be hosting a series of events in the UK and Brussels to proactively seek evidence and to give further information on the EU budget report. To register your interest in these events or if you have any other questions relating to the EU budget report, please contact the team at balanceofcompetences@hmtreasury.gsi.gov.uk.

1 Introduction

The Balance of Competences Review

1.1 The Foreign Secretary launched the Balance of Competences Review in Parliament on 12 July 2012, taking forward the Coalition commitment to examine the balance of competences between the UK and the European Union. The review will provide an analysis of what the UK's membership of the EU means for the UK national interest. It aims to deepen public and Parliamentary understanding of the nature of our EU membership and provide a constructive and serious contribution to the national and wider European debate about modernising, reforming and improving the EU in the face of collective challenges. It will not be tasked with producing specific recommendations or looking at alternative models for Britain's overall relationship with the EU.

1.2 The review is broken down into a series of reports on specific areas of EU competence, spread over four semesters between autumn 2012 and autumn 2014. The review is led by Government but will also involve non-governmental experts, organisations and other individuals who wish to feed in their views. Foreign governments, including our EU partners and the EU Institutions, are also being invited to contribute. The process will be comprehensive, evidence-based and analytical. The progress of the review will be transparent, including in respect of the contributions submitted to it.

1.3 HM Treasury (HMT) is leading on the strand of the review covering the European Union budget and is seeking views on its application.

1.4 This call for evidence document sets out the background to the review on the budget and provides a useful context for those giving evidence. The document sets out the EU budget as a general system, its application and priorities. The development of the budget system over its history is also set out, as well as covering the legal framework which underpins the budget today.

1.5 Finally, the document asks for your input, with a series of questions to encourage your evidence.

Box 1.A: What is competence?

For the purposes of this review, we are using a broad definition of competence. Put simply, competence in this context is about everything deriving from EU law that affects what happens in the UK. That means examining all the areas where the Treaties give the EU competence to act, including the provisions in the Treaties giving the EU institutions the power to legislate, to adopt non-legislative acts, or to take any other sort of action. But it also means examining areas where the Treaties apply directly to the Member States without needing any further action by the EU institutions.

The EU's competences are set out in the EU Treaties, which provide the basis for any actions the EU institutions take. The EU can only act within the limits of the competences conferred on it by the Treaties, and where the Treaties do not confer competences on the EU they remain with the Member States.

There are different types of competence: exclusive, shared and supporting. Only the EU can act in areas where it has exclusive competence, such as the customs union and common commercial policy. In areas of shared competence, such as the single market, environment and transport, either the EU or the Member States may act, but the Member States may be prevented from acting once the EU has done so. In areas of supporting competence, such as culture, tourism and education, both the EU and the Member States may act, but action by the EU does not prevent the Member States from taking action of their own.

The EU must act in accordance with fundamental rights as set out in the Charter of Fundamental Rights (such as freedom of expression and non-discrimination) and with the principles of subsidiarity and proportionality. Under the principle of subsidiarity, where the EU does not have exclusive competence, it can only act if it is better placed than the Member States to do so because of the scale or effects of the proposed action. Under the principle of proportionality, the content and form of EU action must not exceed what is necessary to achieve the objectives of the EU Treaties.

1.6 This public call for evidence sets out the scope of the review of the balance of competences in relation to the EU budget. We request input from anyone with relevant knowledge, expertise or experience. This is your opportunity to express your views.

1.7 Please send your evidence to balanceofcompetences@hmtreasury.gsi.gov.uk by 17 January 2014. Please also direct related inquiries to this address, clearly marking that your question relates to the EU budget.

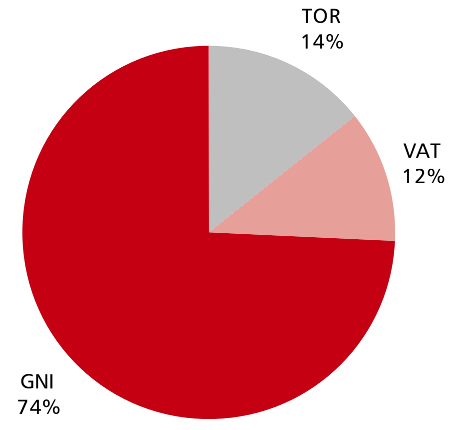
1.8 Your evidence should be objective, factual information about the impact or effect of the competence in your area of expertise. We will expect to publish your response and the name of your organisation unless you ask us not to (but please note that even if you ask us to keep your contribution confidential we might have to release it in response to a request under the Freedom of Information Act). We will not publish your own name unless you wish it included. Please base your response on answers to the questions set out on page 26.

2 The EU budget

2.1 HM Treasury is leading the part of the Balance of Competences review covering the application and effect of the budget of the European Union – referred to here as the EU budget. This report will cover the EU budget as a whole, and in particular its running, priorities and legal structure. It will also cover the financial management of the budget and fraud. It will not consider options to reform expenditure in individual areas of the budget, which will be covered in the relevant sectoral reports (e.g. the Common Agricultural Policy in the Agriculture report).

2.2 The EU budget provides for EU spending and is funded in the most part by the EU's 'Own Resources'. These are a combination of 'traditional' Own Resources ('TOR' – mostly customs duties on EU imports and sugar levies), a VAT-based Own Resource (national contributions based on harmonised VAT bases for Member States) and a GNI-based Own Resource (a uniform call rate applied to the Gross National Income (GNI) of each Member State). Other revenue (including taxes on EU staff, contributions from non-Member States and fines on companies) are also used to fund the budget.

Chart 2.A: 2013 EU budget – Own Resources revenue



Source: Official Journal of the European Union, 'Definitive adoption of the European Union's general budget for the financial year 2013' and HM Treasury calculations.

2.3 The EU budget must balance revenue and expenditure (i.e. the EU budget cannot run a deficit). The level of agreed expenditure must therefore be matched by revenue. In practice, the GNI resource is used as the balancing item (its size relative to other resources changing as necessary) and represents the largest single source of revenue.

2.4 EU budget expenditure is agreed through two processes – a Multiannual Financial Framework (MFF), lasting at least five years (although in practice, usually lasting seven years), and Annual Budgets. The MFF sets out limits on expenditure across the period (e.g. 2007-13) and on spend in the expenditure 'headings' (see below for more information on budget headings). Through this, long-term binding ceilings and priorities are set out by the Council and the European Parliament. Annual Budgets authorise the actual level of spend to be budgeted in each calendar year, subject to MFF ceilings, in negotiations usually taking place in the calendar year before the Annual Budget in question.

Box 2.A: Own Resources 2014-20

The legislation that underpins the funding system of the EU budget for each 'Financial Framework' is the Own Resources Decision (ORD). This also includes the UK's abatement. Before coming into force, this requires unanimous agreement in the Council and ratification in line with the individual constitutional requirements of Member States.

Throughout recent negotiations of the next Multiannual Financial Framework, the UK was clear that there could be no change to the UK abatement and no EU-wide taxes could be introduced as new own resource. These two objectives have been achieved.

The February European Council, which agreed the next MFF for the period 2014-20, saw minor changes to other aspects of the Own Resources system. At the June European Council we categorically rejected a further attempt to change the UK abatement and the Council confirmed the February deal that the abatement would continue to be calculated on an unchanged basis.

We will continue to get the rebate in the future on the same basis that we do now. The UK abatement remains fully justified due to continuing expenditure distortions in the EU budget. This Government will not agree to any changes to the UK abatement mechanism. The UK also remains strongly opposed to any new EU-wide taxes to fund the EU budget.

2.5 EU budgets are agreed through two ceilings: a 'commitment' appropriations ceiling and a 'payment' appropriations ceiling in Euros. This allows an element of multi-annual planning, while also controlling the level of actual expenditure. Commitments set out the amounts committed to be spent on a particular project or policy, or a strand thereof, (but not necessarily paid out fully in that year[1]); while payments are the level of actual spend in that year, which determine the contributions made by Member States towards the budget. This system creates a stock of unspent commitments sometimes known as 'RAL' (Reste à liquider) as set out in the inset box below.

[1] Annual commitments to multiyear projects pay out over a number of years, reflecting the evolution and development of the underlying projects.

Box 2.B: RAL – Commitments and payments

The EU budget system is different to the budgeting system the UK has in place domestically. The EU system operates with commitments (which are planned or budgeted spend) and payments (which are actual realised spend, determining Member States' contributions).

In some spending areas, this differentiation is of little consequence. With direct CAP payments (see 'headings' below), a commitment turns in to a payment in the same year with no time lag or uncertainty. In other areas the differentiation is important. With Structural Funds (which might include large infrastructure projects for example) there is a lag between commitments being realised into payments and some commitments are never spent. This could be because projects take time to implement or because matched funding from a Member State is not available. This creates unspent commitments, known as "RAL."

There are some rules to try to limit the build-up of unspent commitments, including rules on the expiration of unused commitments. Nevertheless, the stock of RAL has been growing in recent years, particularly over 2007-13, and now stands at over €200 billion. This creates uncertainty in planning. In the last negotiation for 2014-20 the UK put primacy on payments rather than commitments, given the uncertainty of commitments.

2.6 Money spent in Member States from the central budget is done through different systems, depending on the type of expenditure. Some expenditure is 'centralised' – either managed directly by European Commission staff (e.g. selecting contractors or awarding grants) or indirectly by agencies (e.g. research expenditure). 'Shared' management spend refers to the delegation of budget implementation to Member States such as happens with Structural Funds. Finally, some expenditure is implemented jointly with international organisations, such as external spend on development.

2.7 For 2007-13, the budget framework is split into six broad areas of expenditure (the 'headings' of the budget)[2] as set out below. These headings are likely to continue as the basic structure of the budget for 2014-20.

1 Sustainable growth

1a. Competitiveness for growth and employment (including Connecting Europe)

Research and innovation, education and training, trans-European networks, social policy, economic integration and accompanying policies

1b. Cohesion for growth and employment (including Structural and Cohesion Funds)

Convergence of the least developed EU countries and regions, EU strategy for sustainable development outside the least prosperous regions, inter-regional cooperation.

2 Preservation and management of natural resources

Includes the common agricultural policy (including market related expenditure and direct payments to farmers), common fisheries policy, rural development and environmental measures.

3 Citizenship, freedom, security and justice

3a. Freedom, security and justice

[2] As described by the European Commission, 'Where does the money go?' http://ec.europa.eu/budget/explained/budg_system/fin_fwk0713/fin_fwk0713_en.cfm

Justice and home affairs, border protection, immigration and asylum policy.

3b. Citizenship

Public health, consumer protection, culture, youth, information and dialogue with citizens

4 EU as a global player

Covers all external action ("foreign policy") by the EU. Does not include the European Development Fund.

5 Administration

Covers the administrative expenditure of all the European institutions, pensions and EU-run schools for staff members' children ("European schools").

6 Compensations

Temporary heading which includes compensatory payments relating to the latest expansion of the EU.

Box 2.C: UK Government expenditure priorities

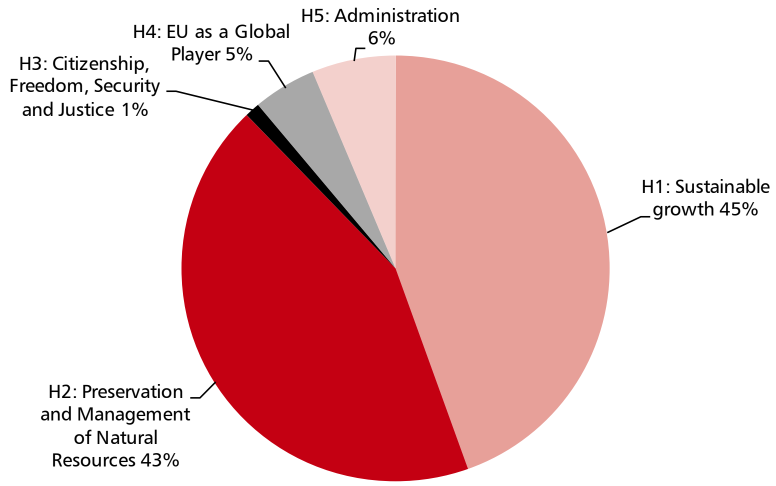
For the 2014-20 MFF negotiations, the UK Government set out a series of priorities for the expenditure side of the negotiation. The UK's top priority was to restrain the total size of the budget. Beneath that, the UK sought a budget focussed on higher priority areas of spend.

Growth and Competitiveness (1A), External Action (4) and Climate Action were all seen as high priority areas by the UK Government.

Substantial reductions were sought from the Common Agricultural Policy (focussed on direct payments) and administration (5), which were seen as very poor value for money.

2.8 In 2013, the annual budget distributed expenditure between these headings as set out in the chart below.

Chart 2.B: 2013 EU budget – Payment appropriations by budget heading



Source: Official Journal of the European Union, 'Definitive adoption of the European Union's general budget for the financial year 2013' and HM Treasury calculations.

Value for money and the EU economy

2.9 The EU economy faces major challenges. For the past two decades it has faced low productivity and low growth relative to other advanced economies, particularly the US. This has stemmed from long-term structural weaknesses: persistent barriers to trade, high levels of regulation and inflexible labour markets. Fundamental structural reform is required to address this and to tackle other long-term pressures.

2.10 The financial crisis has laid bare the weaknesses in the EU economy and the economic governance framework of the euro area, and there has been broad consensus on the necessity for some fiscal consolidation across the EU to manage public debt levels and restore market confidence in Member State public finances.

2.11 Across the EU, Member States have been reducing public expenditure to aid fiscal consolidation efforts. In this context, the size and value for money of the EU budget matters. So too does a focus on ensuring 'EU-added value' compared to domestic spend.

2.12 Three considerations provide a framework for assessing whether proposals for spending under the EU budget are appropriate:

1. the right level – the EU should act only where there are clear additional benefits from collective efforts or 'EU added value', compared with action by Member States, either individually or in co-operation. As examples, this could be when action is needed in an area of exclusive EU competence, when there is a cross-border dimension, when pooling resources generates economies of scale, when policy externalities result in free-rider problems or when EU action complements Member States' action (or is palliative to their inaction) in an area.

2. the right action – where EU-level action is appropriate, it should be proportionate and flexible, recognising the limits to EU budgetary intervention. Expenditure is just one of a number of policy levers, alongside coordination, sharing best practice, and legislation or regulation. In addition, the full range of financing options should be considered, including both grant and loan finance.

3. the right value – action should be designed in ways that are informed by the available evidence base and facilitate achievement of the stated objectives in the most cost-effective way. Action should be backed by sound financial management, including the highest standards of financial control and independent audit, and greater focus on delivery of outcomes in programme design and evaluation.

Box 2.D: Financial management, budget discharge and fraud

The European Commission implements the EU budget in accordance with the principles of sound financial management. The European Court of Auditors (ECA), the independent external auditor of the EU, publishes an Annual Report on the implementation of the EU budget, with one component being the ECA Statement of Assurance (DAS) – an opinion on the Commission's accounts (checking if the books were well kept) and EU expenditure (checking if transactions were made in accordance with the rules), along with an explanation of its findings. The ECA audits the budget based on sample transactions throughout the year, at EU, national, regional and individual beneficiary level and provides an estimate of the 'error rate' in the budget. This reflects the ECA's estimation of the degree of non-compliance with the rules governing EU spending, such as breaches of public procurement rules, ineligible or incorrect calculation of costs claimed to the EU co-financed projects, or over-declaration of land by farmers. In other words errors may or may not be suspected as fraudulent.

In its latest report concerning the 2011 accounts, the ECA concluded that some payments were affected by material error, with an estimated error rate of 3.9 per cent for the EU budget as a whole. The ECA regards 2 per cent as a material level of error, and may refuse to give a positive DAS unless error rates are below that level. On this basis, the ECA has refused to give a positive DAS for the 2011 EU budget for the eighteenth year in a row.

The budget 'discharge' is the final annual approval of the Commission's implementation of the budget. It is the responsibility of the European Parliament to decide whether it will grant this, based in part on a recommendation from the Council. The European Parliament also uses the ECA's report as a basis for this decision. Discharge refers to approval of how the Commission implemented the budget in that year and must be given to close the EU accounts. The European Parliament can refuse to grant the Commission 'discharge' for its management of EU funds in a given year, with serious political consequences for the Commission's future. For example, the non-granting of the discharge for 1996 initiated the process which led to the fall of the Santer Commission. Several Member States, including the UK, have criticised the current state of financial management. The UK Government has not voted in favour of discharge of the EU budget for the last three years.

Any suspicion of fraudulent activity involving EU funds is reported to the European Anti-fraud Office (OLAF). OLAF is an administrative investigative service of the EU, with the mission of combating fraud, corruption and other illegal activities affecting the EU, including serious misconduct within the EU institutions that have financial consequences. It aims to ensure that EU taxpayers' money is spent appropriately, that the EU is not being deprived of its due revenue, and that EU staff behave according to rules and regulations. OLAF also assists the Commission and national authorities in combating fraud and contributes to strengthening of anti-fraud measures. It works closely with national authorities' investigation services, police, legal and administrative authorities to counter fraud. In the annual Fight against Fraud report for 2012, the Commission estimates that the financial impact of irregularities reported as fraudulent for 2012 was €399 million. Of this, the Commission reports that the main items were €199 million connected to cohesion policy programmes, €69 million to agriculture and €78 million to revenue.

The Multiannual Financial Framework

2.13 The expenditure ceilings which are active today (as part of the 2007-13 Multiannual Financial Framework) were agreed in May 2006. These ceilings are set out below (figures in Euros, constant 2004 prices).

Table 2.A: 2007-13 Financial Framework (EU-28, including Croatia)

Commitment appropriations	2007	2008	2009	2010	2011	2012	1213	Total 2007-13
1. Sustainable growth	50 865	53 262	55 879	56 435	55 693	57 708	59 111	388 953
1a Competitiveness for growth and employment	8 404	9 595	12 018	12 580	11 306	12 677	13 112	79 692
1b Cohesion for growth and employment	42 461	43 667	43 861	43 855	44 387	45 031	45 999	309 261
2. Preservation and management of natural resources	51 962	54 685	51 023	53 238	52 136	51 901	51 284	366 229
of which: market related expenditure and direct payments	43 120	42 697	42 279	41 864	41 453	41 047	40 645	293 105
3. Citizenship, freedom, security and justice	1 199	1 258	1 375	1 503	1 645	1 797	2 014	10 791
3a Freedom, Security and Justice	600	960	785	910	1 050	1 200	1 390	6 625
3b Citizenship	599	568	590	593	595	597	624	4 166
4. EU as a global player	6 199	6 469	6 739	7 009	7 339	7 679	8 029	49 463
5. Administration [1]	6 633	6 818	6 816	6 999	7 044	7 274	7 106	48 690
6. Compensations	419	191	190	0	0	0	63	863
Total commitment appropriations	117 277	122 683	122 022	125 184	123 857	126 359	127 607	864 989
as a percentage of GNI	1,08 %	1,09 %	1,06 %	1,06 %	1,03 %	1,03 %	1,01 %	1,05 %
Total payment appropriations	115 142	119 805	109 091	119 245	116 394	120 649	120 731	821 057
as a percentage of GNI	1,06 %	1,06 %	0,95 %	1,01 %	0,97 %	0,98 %	0,96 %	1,00 %
Margin available	0,18 %	0,18 %	0,29 %	0,22 %	0,26 %	0,25 %	0,27 %	0,23 %
Own Resources ceiling as a percentage of GNI	1,24 %	1,24 %	1,24 %	1,23 %	1,23 %	1,23 %	1,23 %	1,23 %

Source: Decision of the European Parliament and of the Council amending the Interinstitutional Agreement of May 2006 on budgetary discipline and sound financial management, 22 July 2013

[1] The expenditure on pensions included under the ceiling for this heading is calculated net of the staff contributions to the relevant scheme, within the limit of EUR 500 million at 2004 prices for the period 2007-13.

2.14 The European Council of 7-8 February 2013 reached agreement on a new Financial Framework to cover 2014-2020. This requires the consent of the European Parliament and subsequently the unanimous approval of the Council. If agreed the MFF will come into force on 1 January 2014.

2.15 The ceilings agreed at the February 2013 European Council for 2014-20 represented a real-terms reduction on the ceilings agreed for 2007-13. For comparison, for the last Financial Framework total payments, in constant 2011 prices, are €942.8 billion (2007-13), falling to €908.4 billion for the next Financial Framework (2014-20).

2.16 The 2014-20 agreement also sees a modest shift in the expenditure priorities of the budget, with greater focus towards growth, jobs and competitiveness. Research and development, and other pro-growth investment, is set to account for 13 per cent of the budget over 2014-20, compared to nine per cent in 2007-13. Funding for transport, energy and telecoms infrastructure also received a considerable increase compared to the 2007-13 period through the new 'Connecting Europe Facility' – a replacement for the Trans-European Networks. Reductions were seen in the Common Agricultural Policy, focussed on direct payments.

2.17 There remain a number of important and evolving issues in the EU budget system, some of which are explored above. This call for evidence seeks views on these issues. The recent MFF negotiations brought out some of the most high profile issues, where input is particularly welcome. For instance, on total budget size and the balance between areas of spend, in particular on trying to drive better EU added value by focussing less on areas such as direct payments under the Common Agricultural Policy, and on Administration. We also would welcome further thoughts on issues where there has been an ongoing focus among officials, media and citizens across Europe, on propriety of spend, fraud and transparency.

2.18 But we also want this call for evidence to focus on some of the longer-term EU budget issues. It is an opportunity to consider: the future of the budget and how this might change given developments in the euro area; the duration of the multi-annual frameworks; whether reform is needed to the system of commitments and payments and whether more decisions might be taken at the national or sub national level. We are also keen to hear thoughts on other issues. The list of questions is set out on page 26 of this document, including a final question asking openly for thoughts on any other issues on the EU budget where we have not posed a specific question.

2.19 The sections which follow set out the development of the EU budget over time and the legal framework today, intended to provide useful background to the evidence we are seeking from you.

3 The developing budget

3.1 The EU budget has been, and remains, an evolving system. From the first European Communities' budgets to the multi-annual structure employed today, this evolution reflects the changing structure, priorities and challenges in the European Union over its history. This section provides the historic background to the system in force today and the broader relationship between the UK, the EU and the EU budget.

The original system pre-UK entry (1951-73)

3.2 The development of the European Coal and Steel Community (ECSC) under the Treaty of Paris (1951) began the development of a European system of budgets for the separate policies of the new communities. This system expanded with the Treaty of Rome (1957) and the creation of the European Economic Community (EEC) and the European Atomic Energy Community (Euratom), sharing institutions with the ECSC.

3.3 Separate budgets existed for the communities, covering administrative costs, operations and research and investment in each area. By 1965, these budgets were unified into the first central European budget system – the 'General Budget of the European Communities', with the ECSC and Euratom budgets incorporated into the EEC budget. Until 1970, this budget was funded solely through national contributions by Member States.

3.4 The first system of 'Own Resources' was introduced in the Own Resources Decision of 1970, which included what remain the primary 'traditional' Own Resources of the budget – customs duties and agricultural levies, along with a VAT-based contribution originally capped at 1 per cent of a VAT base and applied gradually as progress was made in harmonising the VAT bases. Over the period of 1970-77, the European Parliament gained its first limited powers to approve elements of the budget.

3.5 As a unified resource system was developed, the first common, unified expenditure policies were also being introduced, including the European Agricultural Guidance and Guarantee Fund (EAGGF), greater expansion of research policy, a new European Social fund (ESF) and European Regional Development Fund (ERDF); all three funds remain today.

Budgets before Financial Perspectives (1973-88)

3.6 The first enlargement of the Communities in 1973 saw the accession of the United Kingdom along with Denmark and Ireland, with the new Member States gradually implementing the resources system which had been negotiated by the original six Member States.

3.7 This enlargement saw the first significant pressure on the budget system, which resulted in the first corrections to contributions for the UK and Germany. The introduction of this first UK correction was seen as a necessary rectification of a budgetary imbalance – the result of a relatively small UK agricultural sector (and therefore limited UK agricultural receipts) and relatively high UK contributions to the budget as a whole.

Box 3.A: The first correction mechanisms

The first correction, introduced in 1975 (and in place 1976-80) aimed to correct the budgetary imbalance (described in 3.7) on the revenue side, with compensation on the UK's VAT-based contribution.

A second correction was introduced in 1979 to replace that of 1975, before the Fontainebleau European Council of June 1984 finally agreed the basis of what is now the UK's permanent 'abatement'. This set a reduction to the UK's contribution of 66 per cent of the difference between the UK's share in the EU VAT base and its share of total allocated expenditure.

This 1984 correction, the UK's abatement, was financed by other Member States through their usual financing shares. Germany, however, was able to argue that this created a separate imbalance and was allowed a correction of its own at Fontainebleau – a 33 per cent reduction on its share of financing the UK's abatement.

Today, several Member States receive corrections to their contributions, many of which will continue in the next MFF period.

3.8 As further Member States joined the Community (Greece in 1981 and Spain and Portugal in 1986), the policies undertaken in the budget also grew, with growth in the ESF and ERDF, new policies in fisheries and research and rapid growth in agricultural spend under the EAGGF. New efforts to match increased expenditure with new resources saw the expansion of the VAT resource. The Fontainebleau European Council in 1984 agreed new expanded powers of budgetary discipline, controlling the growth of the EAGGF, with the Council aiming to reduce the rapid increase in the size of the budget as a whole.

3.9 The Treaty of Brussels (1975) made several significant changes to the structure of the budget, establishing much of the procedure which we recognise in the budget today. By 1977, a European Court of Auditors had been established and the European Parliament had been given powers of 'discharge' of the budget, the ability to reject the budget agreed by the Council and the ability to propose its own amendments to the Council's agreed budget.

3.10 This new structure, with increased powers for the European Parliament, saw several challenging negotiations of annual budgets – with several budgets through the 1980s not agreed in time for the New Year and therefore falling into contingency procedures. This challenging system was a major factor in the introduction of the first Financial Perspective.

Reform and enlargement (1988-2013)

3.11 The crisis over annual budget agreements in the 1980s prompted a radical shift in the process and planning of the budget. European Councils in February 1988 and June 1988 adopted a series of new measures – additional resources over 1988-92 (more closely matched to Member States' relative prosperity), prioritisation of expenditure towards the new cohesion policies and new efforts to slow the growth of agricultural expenditure.

3.12 This first 'Financial Perspective' introduced multiannual planning to the budget, aiming to control growth year-by-year by setting ceilings on expenditure (total budget and category of spend) in advance by unanimity in Council, beneath which annual budgets needed to be set by qualified majority voting. In practice, the first Financial Perspective was adjusted on several occasions to reflect changing expenditure priorities, but the system brought improved certainty and stability to the budget.

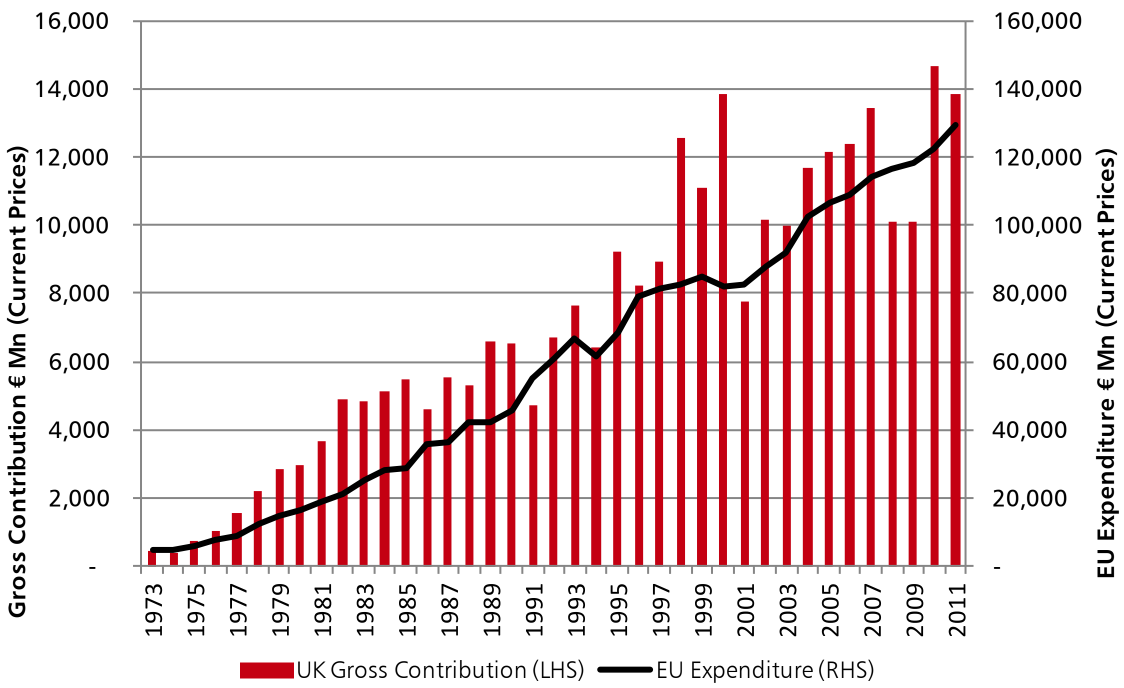
3.13 The reform of the Own Resources system in 1988 brought the system closer to that in place today. The VAT-based resource was changed to a capped system where a Member State's VAT base could no longer exceed 55 per cent of its Gross National Product (GNP), reduced to 50 per cent over 1995-99. The 'traditional' Own Resources were reformed to a system whereby Member States retained ten per cent of duties collected to cover the costs of collection and paid 90 per cent to the EU budget (over 1970-87, Member States contributed 100 per cent of their TOR revenue to the Commission, of which ten per cent was returned through the budget as expenditure in EU accounts). From 2001 the retention rate was increased to 25 per cent over the 2000-06 financial framework, with 75 per cent paid to the EU budget. 1988 also saw the introduction of a fourth category of revenue– a contribution based on Member State Gross National Product (GNP), which would be used as the 'balancing' resource. This GNP resource has, over time, become the largest element of revenue to the budget.

3.14 The Edinburgh European Council of December 1992 agreed the first elements of the second Financial Perspective, for 1993-99. This Financial Perspective introduced the new 'headings' of the budget, splitting expenditure by policy priority, rather than by the mode of expenditure. The accession of Austria, Sweden and Finland in 1995 saw further correction mechanisms applied to the budget, benefitting the new Member States. A major adjustment of the 1993-99 Interinstitutional Agreement took account of the growth of the Community to 15 Member States, raising the level of expenditure across the budget and incorporating a new, temporary 'Compensations' heading for the new Member States. Otherwise, the second Financial Perspective remained largely stable throughout the rest of the period.

3.15 The third and fourth Financial Perspectives, covering 2000-06 and 2007-13 were marked by the rapid expansion of the European Union, with a total of twelve new Member States acceding to the Union in 2004 and 2007. This had several major impacts on the budget system, most notably a substantial increase in the size of the budget, which by this time accounted for approximately €100 billion a year in payment appropriations.

3.16 A greater focus towards the Structural and Cohesion Funds (SCFs), which particularly benefited the new Member States, saw increased expenditure in that area, while expenditure on development, on climate action and on research and development also increased substantially. This increase in expenditure on SCFs (and in new Member States in particular) saw the development of a large stock of 'RAL', which put significant uncertainty on the payments side of the budget and therefore on contributions from Member States.

Chart 3.A: EU budget expenditure and UK Contributions (1973-2011)



Source: Commission Financial Report (2008) for 1973-2008 gross contributions data and 1973-2006 EU expenditure data; Commission Financial Report (2011) for 2009-11 gross contributions data and 2007-2011 EU expenditure data.

3.17 The system of Own Resources remained largely unchanged from 2000 to 2013, with a greater proportion of contributions coming through the GNI-based resource, which effectively replaced the GNP-based resource with the introduction of the Own Resources Decision (ORD) agreed on 29 September 2000. This stated "...It is appropriate to use the most recent statistical concepts for the purposes of own resources and accordingly to define gross national product (GNP) as being equal for these purposes to gross national income...". This ORD came into force from 1 January 2002 and the formal change to the GNI-based resource happened as part of the current ORD, effective from 1 January 2007.

3.18 In 2005, as part of the negotiations for the 2007-13 Financial Framework, the then UK Government agreed to adjust the UK's abatement, so that non-agricultural expenditure in the new Member States would not count towards the calculation of the UK abatement. This 'disapplication' was phased in gradually over 2009-11 and resulted in a substantial decrease in the size of the abatement[1] and increased sensitivity of the value of the abatement to rebalancing of spending towards new Member States.

The future (2014-20)

3.19 The European Council agreements on the 2014-20 Multiannual Financial Framework in February 2013 set out a new phase in the history of the EU budget. For the first time, Heads of Government agreed a real-terms reduction in multi-year expenditure ceilings. The UK's abatement was left unchanged. The impact of the new ceilings was seen in the Office for Budgetary Responsibility's (OBR) March 2013 forecasts for the UK's transactions with the European Union (in Table 3.A).

[1] In May 2013 the European Commission estimated the cost of the abatement 'disapplication' over the 2007-12 at more than 9 billion euros.

Table 3.A: Key changes to EU contributions since December 2012

	£ billion					
	Forecast					
	2012-13	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**
December forecast	7.3	6.6	7.3	6.6	5.8	6.0
March forecast	7.4	6.5	5.7	6.1	5.9	6.0
Change	**0.1**	**-0.1**	**-1.6**	**-0.5**	**0.1**	**0.0**
of which:						
2013 Budget assumption	0.2	0.7	0.0	0.0	0.0	0.0
New Multi-annual Fiscal Framework deal	0.0	-0.6	-1.4	-0.7	-0.2	-0.6
Exchange rate	0.0	-0.1	0.0	0.3	0.4	0.6
Other	0.0	0.0	-0.2	-0.1	-0.1	0.0

Source: Office for Budgetary Responsibility (OBR), 'Transactions with the European Union', March 2013

3.20 Further reform of the budget in the February 2013 European Council agreement saw greater shares of total expenditure towards research and innovation, while a substantial new area of spend, the Connecting Europe Facility, provided greater funding for infrastructure in transport, energy and the media. The UK's abatement remains, without further alteration.

3.21 For the first time, the new long-term framework was agreed under the terms of the Treaty of Lisbon, requiring formal consent of the European Parliament.

4 The Treaty framework

4.1 The Treaty on the European Economic Community (EEC) was signed in Rome on 25 March 1957 and entered into force on 1 January 1958. The EEC Treaty had a number of economic objectives, including establishing a European common market. Since 1957 a series of treaties has extended the objectives of what is now the European Union beyond the economic sphere. The amending treaties (with the dates on which they came into force) are: the Single European Act (1 July 1987), which provided for the completion of the Single Market, as we know it today, by 1992; the Treaty on European Union – the Maastricht Treaty (1 November 1993), which covered matters such as justice and home affairs, foreign and security policy, and economic and monetary union; and the Treaty of Amsterdam (1 May 1999), the Treaty of Nice (1 February 2003) and the Treaty of Lisbon (1 December 2009), which made a number of changes to the institutional structure of the EU.

4.2 Following these changes, there are now two main treaties which together set out the competences of the European Union:

- The Treaty on European Union (TEU); and
- The Treaty on the Functioning of the European Union (TFEU).

4.3 Article 5(2) of the Treaty on European Union (the "TEU") specifies that the Union has the competence to act "only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein" (the principle of conferral). The two main Treaties, the TEU and the TFEU, set out the legal basis for Union action in relation to various policy areas such as the Single Market, economic and monetary policy and energy policy.

4.4 In some policy areas, such as customs union,[1] the Union has "exclusive competence" to act, which means that only the Union may legislate and adopt legally binding acts in those areas unless the Member States are expressly empowered by the Union to act (Article 2(1) TFEU). In other areas, such as the Single Market and consumer protection,[2] the Union and the Member States share competence in which case the Member States may exercise their competence to the extent that the Union has not exercised, or has decided to cease to exercise, its competence (Article 2(2) TFEU). The Union also has "coordinating and supporting competence" in certain areas, such as the protection and improvement of human health, to carry out actions to support, coordinate or supplement the actions of the Member States without superseding their competence in those areas (Articles 2(5), 5 and 6 TFEU).

EU legislative process

4.5 EU legal acts such as Regulations and Directives are generally adopted by what, after the Lisbon Treaty, is known as the 'ordinary legislative procedure' (formerly known as the 'co-decision procedure'). In most cases, only the European Commission can propose a new legal act. But it cannot become law unless it is jointly adopted by the Council (which is composed of ministers from each Member State) and the European Parliament. Under this procedure, the

[1] See Article 3 TFEU for the list of areas in which the Union has exclusive competence to act.

[2] See Article 4 TFEU for the areas in which the Union shares competence with the Member States.

Council acts on the basis of qualified majority voting, where only a specified majority of votes is required and the share of votes of each Member State reflects its population size. The Treaties also set out a small number of cases where EU legal acts are adopted under different procedures (referred to as 'special legislative procedures'). For example, acts in some areas, such as foreign and defence policy, can only be adopted if the Council acts unanimously, so the act will not be adopted if a Minister from any one Member State vetoes it.

The Treaty

4.6 Articles 310 to 325 of the Treaty on the Functioning of the European Union (TFEU) set out the legal basis for the EU budget, covering the funding of the Budget, the multi-year budget framework and the annual budget process.

4.7 The funding of the EU budget (the Own Resources system) is covered in Article 311 TFEU. This states that the Council shall unanimously, after consulting the European Parliament, adopt a decision laying down provisions relating to the system of Own Resources. This must then be approved by all the Member States in accordance with their respective constitutional requirements. In the UK's case, approval requires an Act of Parliament.

4.8 Long-term EU budget ceilings are established in the Multiannual Financial Framework (MFF), which is covered in Article 312 TFEU. This provides that the Council, acting unanimously after obtaining the consent of the European Parliament, shall adopt a Regulation laying down the MFF. The documents that comprise the MFF are scrutinised by the UK Parliament but do not need to be approved through an Act of Parliament.

4.9 The EU Annual Budget is covered in Articles 313 to 319 TFEU. These articles set out the broad process for each year's annual budgetary procedure, including the role of the European Commission, the Council, the European Parliament and the European Court of Auditors. Each Annual Budget is agreed by a qualified majority of the members of the Council and by a majority of the members of the European Parliament. The documents that comprise each Annual Budget are scrutinised by the UK Parliament but do not need to be approved through an Act of Parliament.

4.10 TFEU sets out various rules related to the MFF and Annual Budget. Article 312 states that each MFF should last at least five years and should set ceilings in commitment appropriations (planned spend each year) and payment appropriations (actual spend each year). Article 312 and Article 315 set out what happens in the case where no MFF or Annual Budget is agreed. There is little detail in TFEU on what the EU budget should be spent on: Article 312 states only that categories of expenditure shall correspond to the European Union's major sectors of activity. These are then set out in other documents. The main categories of expenditure are set out in Chapter 2).

4.11 Further procedures on the budget are set out in a series of legal instruments, below.

The MFF Regulation

What does it do?

4.12 Article 312 of the Treaty states that the Council shall adopt a Regulation laying down the Multiannual Financial Framework. This Regulation sets out the annual ceilings on commitments (by category) and payments (i.e. the maximum amounts that can be spent). It also sets out the high level rules of the operation of the budget for that period. Agreement by Council to the MFF Regulation signals the codification of the MFF in EU law, thereby allowing spending under the MFF to proceed, subject to agreement to the various sectoral Regulations (see below).

How is it agreed?

4.13 The Council agrees the MFF unanimously after obtaining the consent of the European Parliament. When adopted by the European Parliament, this will be the first time a free standing MFF Regulation has been adopted (see 'Development of the EU budget' section for more information on the system prior to the Treaty of Lisbon).

The MFF Inter-Institutional Agreement (IIA)

What does it do?

4.14 The MFF IIA sits underneath the MFF Regulation, in effect providing more detail on the procedures of the budget, for example on how 'off budget' mechanisms (including flexibility instruments and the European Development Fund) will work and on how Annual Budgets will work. The IIA cannot set the levels of spending within the MFF, which can only be done through the MFF Regulation.

How is it agreed?

4.15 The Council agrees this instrument by Qualified Majority Voting and through the ordinary legislative procedure with the European Parliament. It would normally be agreed concurrent with the MFF Regulation.

The Own Resources Decision (ORD)

What does it do?

4.16 The ORD sets out how the budget will be financed by Member States. This instrument sets out the rules by which contributions to the EU budget are made. The current system means Member States make contributions broadly according to their relative economic size. The ORD also contains correction mechanisms, including the UK abatement, aimed at adjusting for the relative low receipts of some countries and compensating for 'excessive' budgetary burdens in relation to their relative prosperity.[3] The ORD fleshes out the Treaty obligation to finance the EU budget and the form of its adoption following national ratification requirements and procedures mean that its status is very close to that of the Treaties themselves. The successive ORDs have been designated as Union Treaties under the European Communities Act 1972.

How is it agreed?

4.17 The Council agrees the ORD by unanimous voting. The European Parliament is consulted. The ORD must then be approved by Member States in accordance with their respective constitutional requirements. In the UK's case, approval requires an Act of Parliament.

The Own Resources Regulation

4.18 Implementing measures for the Union's Own Resources are provided for by a Regulation adopted by the Council after consulting the European Parliament. This Regulation is adopted by qualified majority voting.

The sectoral Regulations and financial management

4.19 Each area of spending has a Regulation to provide the legal basis for operation. These are the legal documents which underpin all EU spending programmes under the MFF and set the

[3] The Fontainebleau Principle (1984) underpins the UK abatement and states that "Expenditure policy is ultin1ately the essential means of resolving the question of budgetary imbalances. However, it has been decided that any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time."

levels for those programmes. The majority are co-decided with the European Parliament and agreed by QMV in Council.

4.20 The detail of these areas of spending is explored in the individual Balance of Competences reports on each area. The largest spend areas (Structural and Cohesion Funds and Agriculture) will have reports published concurrent with this EU budget report.

4.21 The European Commission is obliged to take appropriate measures to ensure that, when actions financed under these Regulations are implemented, the financial interests of the European Union are protected by the application of preventive measures against fraud, corruption and any other illegal activities. This is done through effective checks and, if irregularities are detected, through the recovery of the amounts wrongly paid and, where appropriate, by effective, proportionate and dissuasive administrative and financial penalties.

4.22 Member States are under legal obligation (Article 325 TFEU and the Convention on the protection of financial interests) to counter illegal activities at the expense of the EU and make fraud against the EU budget punishable criminal conduct.

4.23 Article 325 of the Treaty on the Functioning of the European Union (TFEU) provides that Member States shall counter fraud and any other illegal activities affecting the financial interests of the EU, and effectively protect the EU budget by taking measures that act as a deterrent.

4.24 The European Commission recently proposed a new directive to protect the financial interests of the EU, which is currently being negotiated by Member States.

4.25 OLAF may carry out investigations, including on-the-spot checks and inspections, in accordance with the provisions and procedures currently laid down in Regulation (EC) No 1073/1999 of the European Parliament and of the Council of 25 May 1999 concerning investigations conducted by the OLAF. Council Regulation (Euratom, EC) No 2185/96 of 11 November 1996 permits on-the-spot checks and inspections to be carried out by the Commission and OLAF in order to protect the European Communities' financial interests against fraud and other irregularities.

What has changed?

4.26 Prior to the Lisbon Treaty a Multiannual Financial Framework was provided for in an Inter Institutional Agreement. This performed a similar role to the MFF Regulation and MFF IIA described above. The 2014-20 MFF will be the first for which a free-standing MFF Regulation will be adopted under the TFEU.

4.27 The 2007-13 IIA was adopted under a pre-Lisbon procedure by consensus in Council and with the agreement of the European Parliament.

5 Call for evidence

5.1 We welcome your views on the balance of competence on the EU budget, in response to the questions set out below.

5.2 We are requesting input from anyone with relevant knowledge, expertise or experience. We would welcome contributions from individuals, academics, companies, civil society organisations including think-tanks, and governments and governmental bodies. We welcome input from those within the UK or beyond our borders.

5.3 Your evidence should be information and judgements about the benefits or otherwise of the existing EU budget system in your area of expertise. Where possible, please give specific examples. Where your evidence is relevant to other Balance of Competences reports, we will pass your evidence over to the relevant report teams.

5.4 Please base your response on answers to the questions set out below. In responding, it would be helpful if you could indicate whether you are responding as an individual, a business, a trade union, a civil society organisation or a research institution.

5.5 You do not have to answer all of the questions. Please feel free to answer as many or as few as you like.

Discussion events

5.6 As part of the call for evidence process, we will be holding a number of events where you will be able to give your views. To register your interest in attending one of these events, or to ask any questions about the call for evidence process or the EU budget report in particular, please email balanceofcompetences@hmtreasury.gsi.gov.uk.

Box 5.A: Call for evidence questions

Role of institutions and budget system

1. What do you see as the rationale for having an EU budget?
2. What are your views on the appropriate roles of national and European institutions, particularly the voting rules and relationship between the domestic and European Parliaments, the Council and the Commission, in agreeing the EU budget?
3. What are the advantages and disadvantages of having unanimously-agreed long-term budget periods? How long should they be?
4. What are the advantages and disadvantages of the existing system of commitments and payments? Can you think of ways to improve that system?
5. What are your views on the current financial management system, in particular the Discharge process, in ensuring EU budget funds are properly spent and audited?
6. What are the advantages and disadvantages of having some expenditure, including to provide flexibility, held 'off-budget'?
7. What are your views on the future structure of the EU budget and should the system change to reflect developments in the Euro Area? Should there be differentiated systems between Euro Area and non-Euro Area Member States, for example to allow fiscal transfers?

General value of spend

8. In your view, is the EU budget focussed on areas of EU added value in expenditure?
9. What modes of expenditure (e.g. bid-based expenditure, automated expenditure, loans, grants) in the budget represent the most effective use of EU funds?
10. What is the right level for the EU budget?
11. What are the arguments for and against increasing or decreasing the degree of national flexibility in spending money allocated to Member States under one part of the EU budget in other parts of the budget?

The resource system

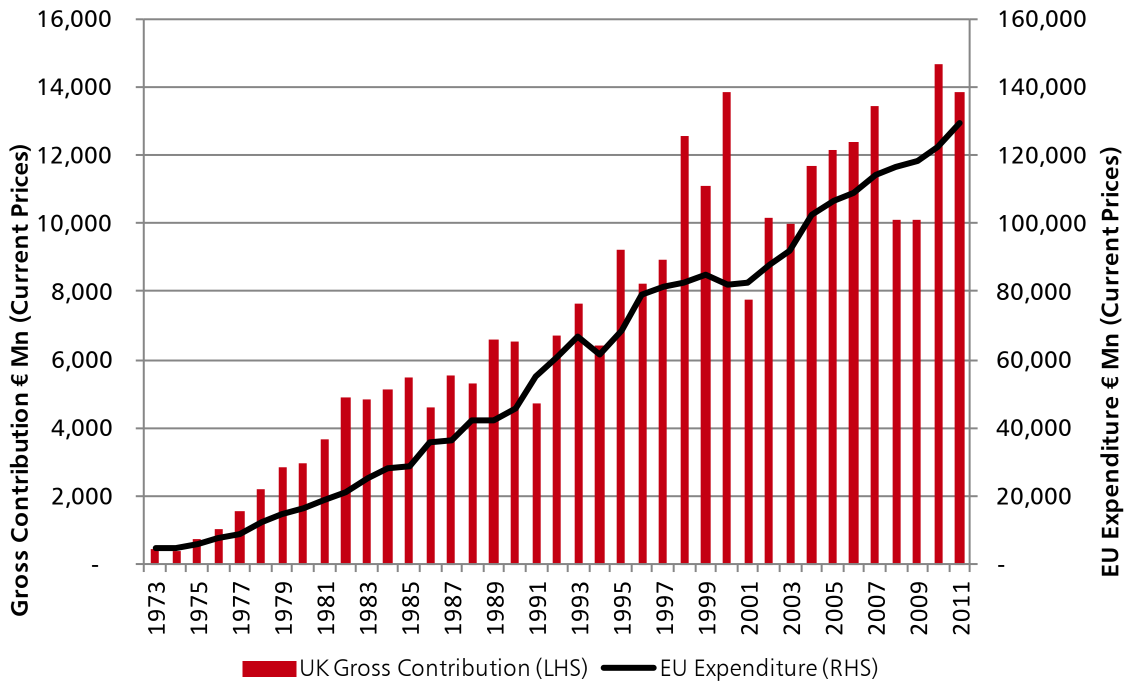
12. What are your views on the current system whereby the EU budget is resourced on the basis that Member States contribute in relation to their income, with corrections where necessary?
13. Do you have any other points to raise relating to the EU budget system, not covered by the questions above?

A Supporting charts and tables

A.1 The following pages set out some of the charts in the main text in greater detail, and supplementary charts which may be useful background to the EU budget system as described in this document, or as supporting information for your evidence. Data are taken from public sources, as marked by each chart.

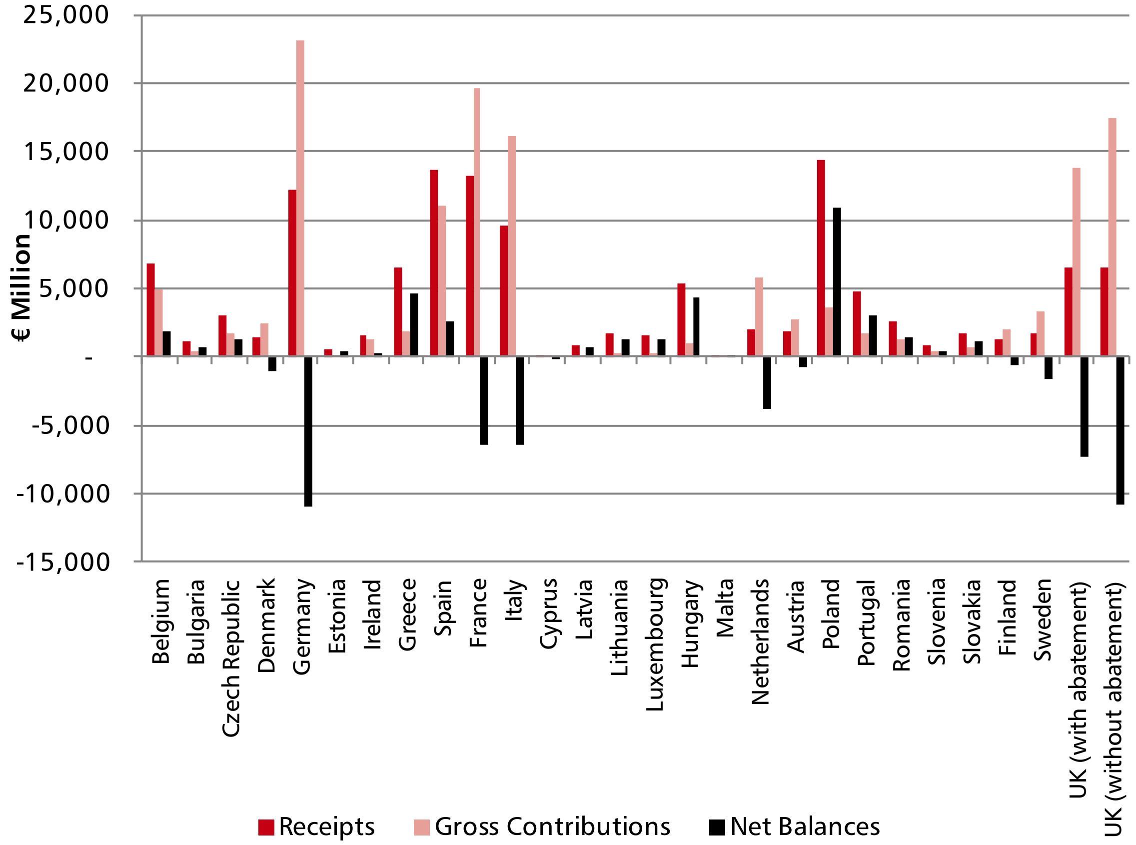
A.2 For more information about these charts, or for any further information, please contact the project team at balanceofcompetences@hmtreasury.gsi.gov.uk.

Chart A.1: EU Budget Expenditure and UK Contributions (1973-2011)



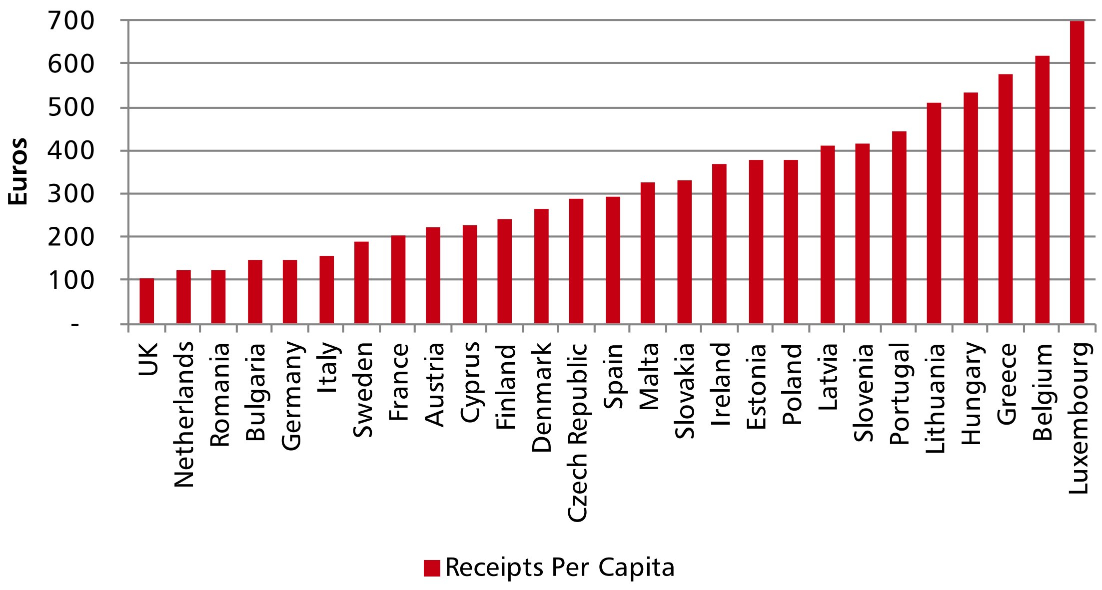
Source: Commission Financial Report (2008) for 1973-2008 gross contributions data and 1973-2006 EU expenditure data; Commission Financial Report (2011) for 2009-11 gross contributions data and 2007-2011 EU expenditure data.

Chart A.2: Member State receipts, contributions and net balances



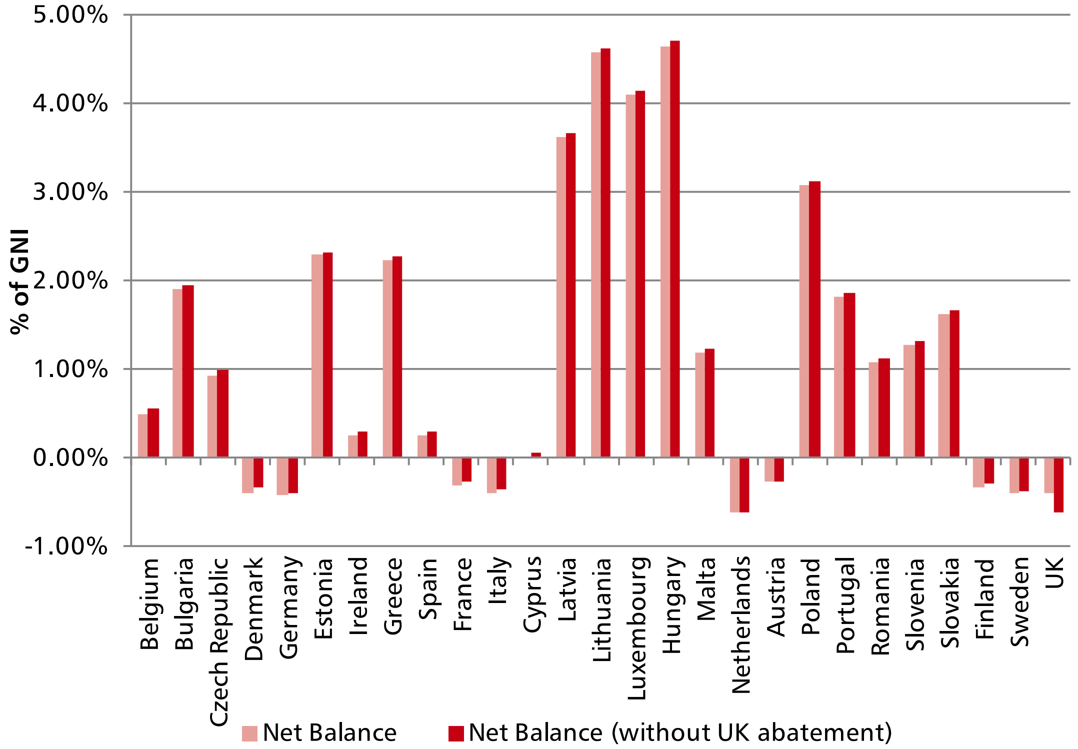
Source: 2011 Commission Financial Report. UK (without abatement) figure is HMT calculation based on 2011 Financial Report data. Note: Net Balance is defined as "receipts less gross contributions".

Chart A.3: Receipts per capita by Member State



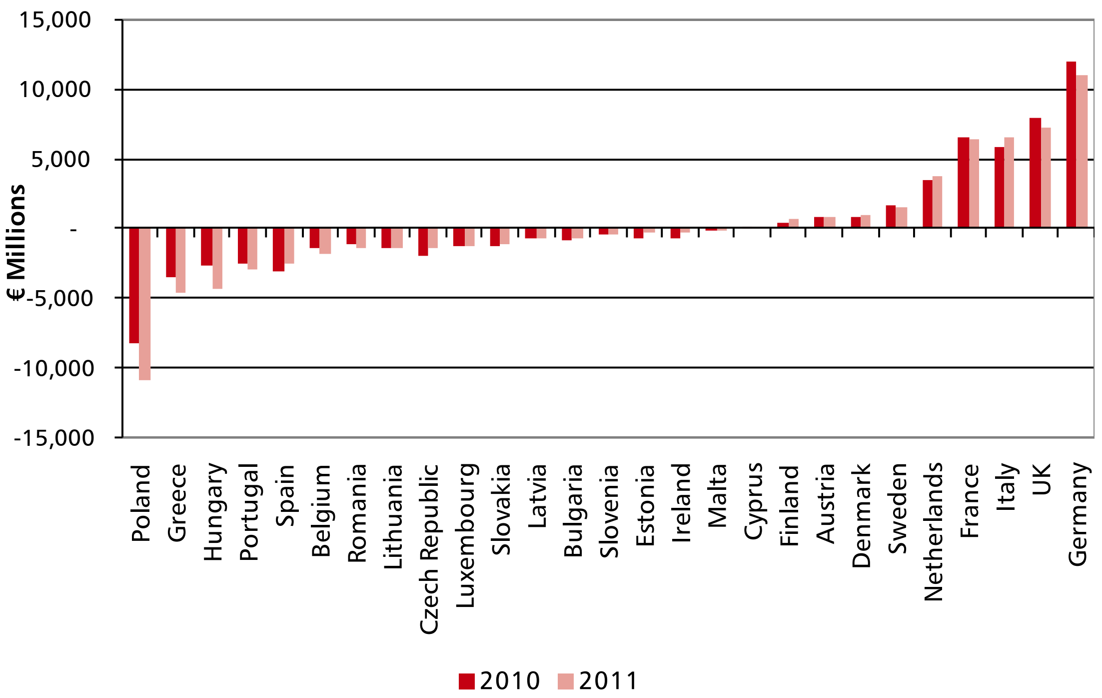
Source: 2011 Commission Financial Report. Note: Figure for Luxembourg (3,025) is an outlier in the series. In order to allow easy comparisons between other Member States, the left-hand axis is limited to €700. Receipts include administration (Heading 5).

Chart A.4: Net balance as a percentage of Gross National Income by Member State



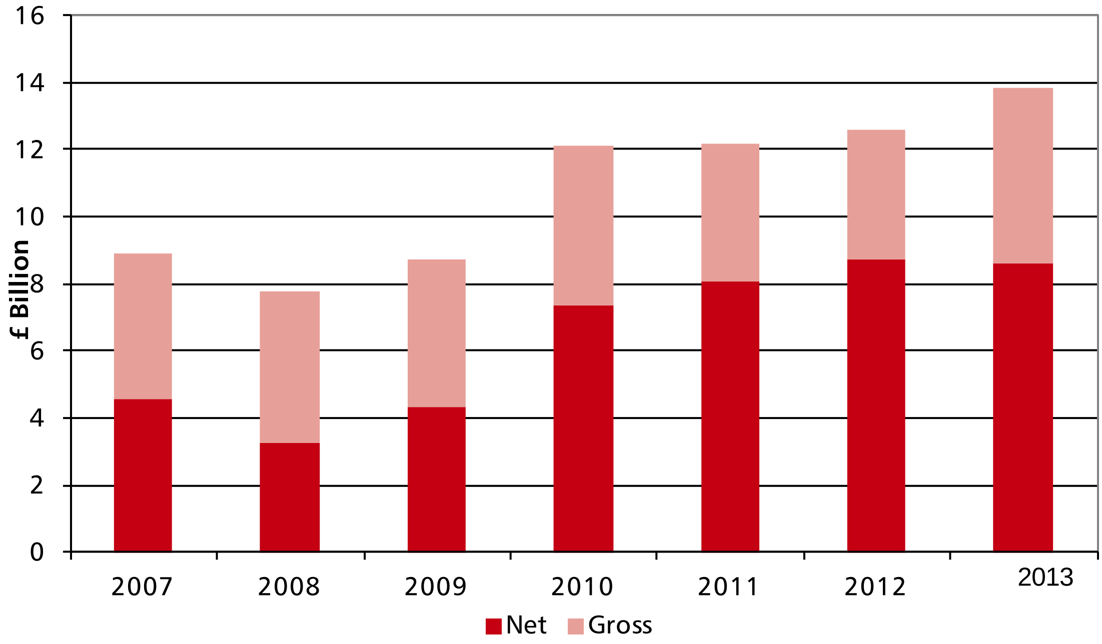
Source: 2011 Commission Financial Report. UK (without abatement) figure is HMT calculation based on the 2011 Financial Report data. Note: Net balance is defined as "receipts less gross contributions".

Chart A.5: Net receipts/contributions of Member States in 2010 and 2011 (€ million)



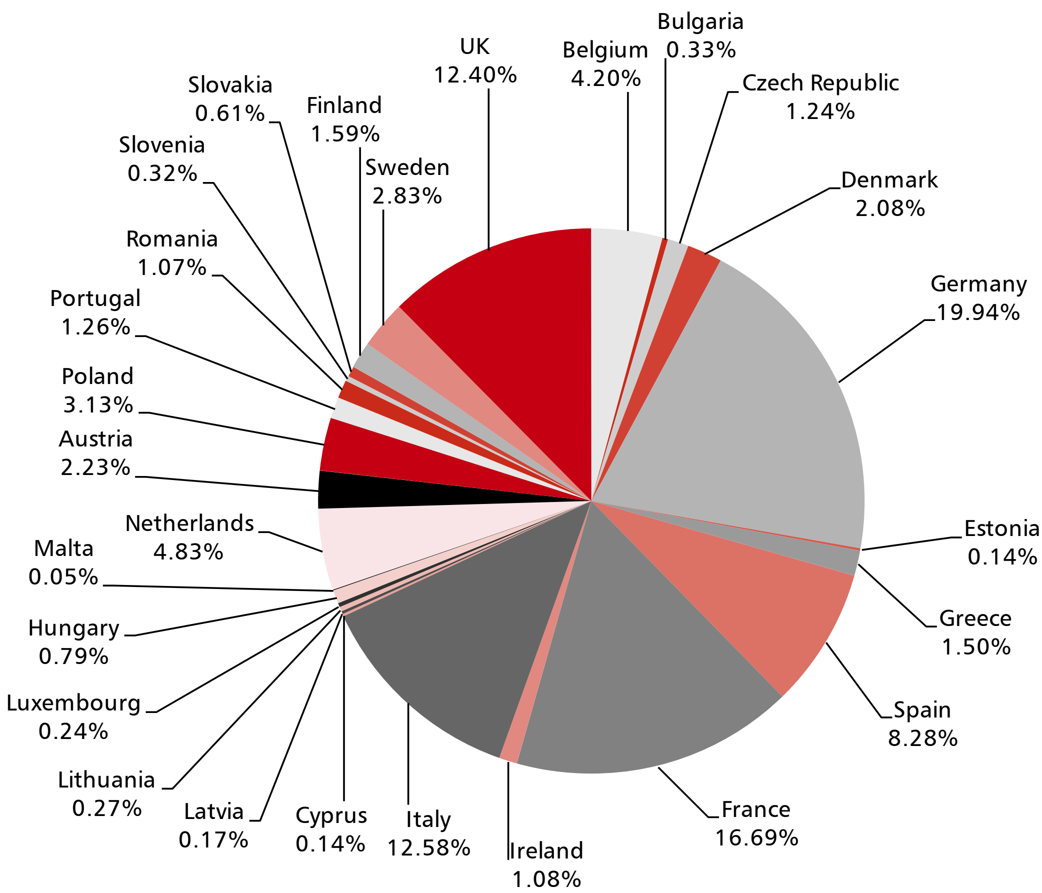
Source: Based on data published in EU budget 2010 Financial Report and EU budget 2011 Financial Report, published by the European Commission in September 2011 and September 2012 respectively.

Chart A.6: Profile of UK gross and net contributions (£ billion)



Source: HM Treasury. Note: 2013 is an estimate.

Chart A.7: Own Resources Revenue 2013: percentage shares after abatement by Member State



Source: Official Journal of the European Union, 'Definitive adoption of the European Union's general budget for the financial year 2013' and HM Treasury calculations.

Table A.1: UK transactions with the European Union

	£ billion						
	Outturn		Forecast				
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Expenditure transfers to EU institutions							
GNI based contribution	11.2	12.3	12.0	11.6	11.6	11.3	11.4
UK abatement	-3.5	-3.2	-3.7	-4.2	-3.8	-3.8	-3.7
Receipts from the EU to cover the costs of collecting Traditional Own Resources [2]	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
less Attributed Aid [3]	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
less Common Foreign and Security Policy and other attributed costs [4]	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0
Total contribution to TME and PSNB [1]	**5.9**	**7.4**	**6.5**	**5.7**	**6.1**	**5.9**	**6.0**
Traditional Own Resources [2]	2.9	3.0	3.1	3.3	3.4	3.6	3.7
VAT payments to the EU [5]	2.3	2.4	2.3	2.4	2.6	2.8	2.9
Public sector receipts from the EU [6]	-4.8	-4.1	-4.7	-5.0	-5.1	-5.1	-5.6
Net payments to EU institutions	**6.4**	**8.7**	**7.3**	**6.5**	**7.1**	**7.2**	**7.0**
plus Attributed Aid [3]	0.8	0.9	0.9	0.9	0.9	0.9	0.9
plus Common Foreign and Security Policy and other attributed costs [4]	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Net contribution to the EU budget	**7.4**	**9.7**	**8.3**	**7.4**	**8.1**	**8.1**	**8.0**
Gross contribution to the EU budget [7]	**12.2**	**13.7**	**13.0**	**12.4**	**13.1**	**13.2**	**13.5**

[1] These contributions are included in current AME – see Table 4.18 in the March 2013 Economic and fiscal outlook.

[2] Traditional Own Resources (TOR) consists of customs duties and sugar levies. These duties are excluded from public sector current receipts because they are collected on behalf of the EU. Customs duties include duties on agricultural products. The UK, li

[3] The UK's contribution to the cost of the EU aid to States outside the EU, which is attributed to the aid programme. This spending is removed from TME as a National Accounts adjustment because it is included within PSCE in RDEL and it is covered by the G

[4] The UK's contribution to the cost of the EU's Common Foreign and Security Policy, which is attributed to the FCO's programme. This spending is also removed in the OBR's forecasts of TME to prevent double-counting, as with attributed aid.

[5] Contributions calculated by applying a call-up rate, currently 0.3%, to a notional 1% harmonised VAT base. Not included in public sector current receipts because treated as an EU tax in the National Accounts.

[6] These receipts are not netted off public sector current expenditure in the national accounts, because they are deemed to finance spending by the EU.

[7] Calculated as the net contribution to the EU budget, excluding public sector receipts from the EU.

Source: Office for Budgetary Responsibility (OBR), 'Transactions with the European Union', March 2013

The elements of transactions with the European Union that directly affect the UK's public finances, measured using National Accounts principles, are the GNI-based contributions, the UK abatement and the receipts that cover the collection costs of Traditional Own Resources (TOR). These are all included within Total Managed Expenditure (with the receipts netted off) as part of Annually Managed Expenditure. The UK's TOR and VAT contributions and receipts of structural and other funds are treated as being direct transactions with the EU with former in effect being forgone revenue and the latter being expenditure financed by the EU rather than the UK government.

HM Treasury contacts

This document can be downloaded from www.gov.uk

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