COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

PREFACE BY PRESIDENT BARROSO

Europe needs a budget that looks in the future, accompanies the modernisation of the Union's policies and creates the conditions for an effective promotion of European interests and values in a more interconnected but less structured international context.

Europe is recovering from the biggest economic and financial crisis affecting the world in a generation. This crisis has touched citizens, families and businesses in every part of the continent. It had a deep impact on their lives and the confidence with which they are looking in the future. It has put immense pressure on national budgets and their ability to meet budgetary positions consistent with sustainable public finances.

The crisis has also dramatically shown the need for Europe to act united and with determination, to develop a positive, forward-looking agenda, transforming the challenges ahead into opportunities. It has highlighted the essential role of public authorities as well as the extent to which the well-being and quality of life of Europeans depends on external developments and Europe's interaction with the world. This global perspective and the important trends, tensions and transitions characterising the international environment, constitute the framework in which Europe will evolve in the next decades.

The main challenges have been identified in the Commission's consultation paper "Reforming the Budget, Changing Europe" of September 2007. The demographic, economic and political rise of new powers will require a new quality of international cooperation and global governance. Global approaches are needed to constructively address geopolitical tensions, preserve natural resources, manage migration and contain climate change and trans-national security threats, including terrorism and proliferation of weapons of mass destruction. Promoting stability, better governance and economic development, in particular in our neighbourhood, will not only be an important expression of European solidarity, but also reflect the increasing nexus between external action and Europe's own economic and security interests.

The consultation and the subsequent conference have shown that these challenges are also at the heart of citizens' concerns, with the improvement of Europe's global competitiveness and the fight against climate change receiving particular attention. Assuming 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, as well as addressing security threats are also frequently mentioned in the consultation. This general trend is confirmed by recent Eurobarometer surveys, which consistently place these challenges among the top priorities of Europeans.

In order to participate more effectively in global efforts to confront the challenges the world will be facing in the 21st century, EU spending priorities need to be redefined.

The EU needs a reform budget robustly geared towards growth and jobs, sustainable resource management in a low-carbon society and an ambitious external projection of European interests. Three lines of actions, called "axes", show the *directions for change*. All of them cover important aspects. They are not mutually exclusive, but the intensity put on individual axes may vary according to different scenarios.

The present Communication presents the Commission's vision for the EU budget reform. It takes a long time horizon, to see how the budget can already be shaped to serve EU policies and to meet the challenges of the decades ahead. By doing so, it should also form the basis for further debate with the European Parliament and the Council, with a view to preparing the next multi-annual financial framework to be presented in principle in the first half of 2011.

The EU Budget Reform: A Broad Mandate for Change

1 INTRODUCTION

The EU budget is a key instrument for shaping and delivering EU policies. It has evolved significantly over past decades, promoting and reflecting the evolution of political priorities and key steps of European integration. Though limited in size, the EU budget has a considerable potential in terms of leveraging public and private resources and creating synergies at European, national and regional levels, notably through medium-term programming and partnership arrangements.

Globalisation, the increasing pace of innovation and change, evolving social and environmental realities and the consolidation of a larger Union with enhanced responsibilities have raised new questions on how the limited resources at the Union's disposal can be used best to address the challenges of the coming decades. This has placed the EU budget at the centre of political debate about the future direction of the European project. Against this backdrop, 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]. Discussions and analyses in key areas like agriculture, cohesion, research, energy and climate change have fed into the preparatory work. Most importantly, 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. Most importantly, it engaged into a dialogue with national parliaments on the reform of the own resources system on the basis of which it adopted a resolution on 29 March 2007[4]. And it made a proposal on the review of the current financial framework, including its possible prolongation so as to allow for a transition towards financial frameworks of five years' duration[5].

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

2 Communication from the Commission: Reforming the Budget, Changing Europe. A Public Consultation Paper in View of the 2008/2009 Budget Review, SEC52007) 1188 final of 12.9.2007 (http://ec.europa.eu/budget/reform/library/issue_paper/consultation_paper_en.pdf).

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

4 European Parliament resolution of 29 March 2007 on the future of the European Union's own resources [INI/2006/2205 - P6_TA(2007)0098].

5 European Parliament resolution of 25 March 2009 on the mid-term review of the 2007-2013 financial framework [INI/2008/2055 – P6_TA(2009)0174].

The Commission received close to 300 different contributions under the public consultation[6] reflecting a broad range of opinions and approaches. They include 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 as well as from some individual Members of Parliament. A major conference organised in November 2009 allowed the contributors and other stakeholders to express their views and provided a further opportunity for dialogue with the European Parliament[7].

The public consultation underscored that solidarity and equity, European added value, transparency and simplification as well as sound and efficient management, should be the guiding principles of any reform. Competitiveness and innovation, climate change and energy security were mentioned by most as the areas to which the EU budget should devote more funds. Some major traditional spending priorities, the opacity and inconsistency of the present financing system based on a multiple layer of "financial corrections", as well as the growing role of "net balances" in determining not only the priorities, but also the principles and delivery mechanisms for EU spending, attracted considerable criticism.

The preparatory work and public debate have clearly acknowledged that the EU budget suffers from an inbuilt inertia, which contrasts with the extraordinary acceleration of the pace of globalisation. Today, the Commission considers that a root and branch reform of the EU budget is needed. A more efficient budget is needed not least against the background of the situation and longer-term perspectives of the Member States' public finances, which have considerably deteriorated as a result of the unprecedented global financial and economic crises.

2 THE FIVE PRINCIPLES OF THE BUDGET REFORM

A reform of both the spending and the financing side of the EU budget is needed on the basis of a shared approach to solidarity, burden-sharing and equity in order to move away from the current focus on net balances. The Commission proposes this reform to be based on the following **five principles**:

2.1 Generating European added value

The EU budget must focus more on activities which produce high levels of European added value. Given the need to reinforce budgetary discipline in the years to come, this will imply hard political choices. Without prejudice to spending obligations resulting directly from the Treaties, the Commission proposes that EU spending should be considered as generating European added value to the extent that each of the following conditions are met:

6 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).

7 The European Parliament has in the meantime also adopted a Resolution on the Mid-term Review of the 2007-2013 Financial Framework, A6-0110/2009.

- **Policy relevance**, or the extent to which spending addresses Europe's key policy challenges as defined in the Treaties and the political agenda set by the institutions.
- **Subsidiarity**: The key criteria which have been established for determining the compliance of EU legislation with the subsidiarity principle should be applied: Is EU spending needed for addressing cross-border or transnational issues which cannot be satisfactorily handled by Member States (for example if decisions made in one Member State entail positive or negative consequences in another Member State)? Can EU spending produce economies of scale compared with action at the level of Member States? Or would national spending alone or the lack of Community spending conflict with the requirements of the Treaty?
- **Proportionality**, i.e. any action by the Union shall not go beyond what is necessary to achieve the objectives of the Treaty. With regard to EU spending, this should include an assessment of the effectiveness and efficiency of the delivery mechanisms.

2.2 Concentrating on key priorities

This means ensuring a direct link between EU policy priorities and the EU budget, focusing the majority of EU spending on a limited number of core axes rather than disbursing it across a wider range of (still important but less justifiable at EU level) priorities. In times of strong fiscal tensions, this requires an even greater sense of priorities.

It is proposed to focus on the following **key axes**: (i) sustainable growth and jobs, (ii) sustainable resource management in a low-carbon society [BUDG/CAB AS: climate and energy] and (iii) an ambitious external projection of European interests [BUDG/CAB AS: Global Europe]. In parallel, there should be more conditionality in the allocation and use of EU funds so as to create stronger links with and leverage on the delivery of agreed EU priorities. [SG - Such a budget would not abandon more traditional spending areas, but step up a reform path which ensures that they fully reflect these priorities.]

Tight budgets call for scarce European resources to focus on problems for which a substantial trans-national dimension is established and where Member States would face major difficulties in acting and succeeding alone. [BUDG/BEPA - At the same time, down-sizing existing EU spending policies in a given area does not necessarily imply a reduction in overall support to that policy. The restructuring of EU spending has to be considered in the broader context of how best to allocate policy tools and, in particular, public spending across different levels of government. Moreover, the EU budget needs to further increase its leverage effect in terms of mobilising private investment – where appropriate in close cooperation with the European Investment Bank or other International Financial Institutions.]

2.3 Greater flexibility and responsiveness

The stability of the financial framework needs to be counterbalanced by **a far greater degree of flexibility** so as to enable the Union to respond effectively to new challenges and needs.

The multiannual financial framework is a key tool to translate the Union's policy priorities in financial terms. It allows long term consistency and ensures that expenditure develops in an orderly manner and within the limits of available resources. It guarantees budgetary discipline, predictable resources and the smooth functioning of the budgetary cycle. At the same time, these positive and stabilising factors have to be balanced against the need for quick adaptation to unexpected events and new priorities. Sudden temporary funding needs, emerging as a consequence of the economic and financial crisis, urgent action to address climate change and energy security, or Europe's new role in a rapidly evolving global environment have shown that in today's fast moving world this balance, which is determined to a large extent by the duration of a financial framework and its flexibility mechanisms, cannot remain the same as in previous decades.

The last three financial frameworks were concluded for a period of seven years. The European Parliament, as well as a significant number of consultation participants, has taken the view that this duration should be brought down to five years. Reducing the duration of the multiannual financial framework from seven to five years would indeed allow for better adapting the priorities of the budget to the evolving political agenda set by the European institutions. However, this would not in itself solve the needs resulting from unexpected events arising within the lifetime of a financial framework. The advantages and inconveniences of such an approach have thus to be assessed in the light of practical challenges and the overall flexibility provided by the financial framework. Chapter 6 makes a few suggestions on how to increase that flexibility.

2.4 Simplification and efficiency of delivery

Primarily, this means looking to improve the efficiency and quality of delivery by further streamlining or reorganising both programming and management modes. Further improvements to the transparency of EU funding will also play a role, as will rigorous but cost-efficient controls on spending. See chapter 7.

2.5 Fairness and added valued in the financing of the budget

This means a clear commitment to reform on the financing side of the budget in line with the refocusing of the budget on shared EU priorities. In particular, it implies the gradual phasing out of *all* corrections and consideration of a genuine EU own resource to help overcome the focus on net balances. See chapter 8.

The present Communication is not about presenting a new multi-annual financial framework. It does thus not reflect upon the overall size and detailed breakdown of the EU budget. However, it aims at setting out the structure and direction of the Union's future spending priorities with a view to offering the best added value and most effective results. It will also examine whether the EU budget should be managed differently, and take a fresh look at the best way of providing the resources necessary to fund EU policies.

Shaping the Budget of the Future

Placing European value added at the heart of the budget should allow for effectively gearing spending towards activities which help addressing present and future EU wide and global challenges. A new consensus on EU spending should be built around the following three priority axes:

- **Sustainable growth and jobs**, focusing the budget on accelerating change towards a knowledge-based low-carbon economy through research, securing high skills and employability of the workforce, accelerating economic and social convergence and enhancing competitiveness through innovation.
- **Climate and energy**, using the budget to leverage the technological revolution needed in terms of energy efficiency and supply, transport infrastructures and other mitigation and adaptation activities, notably with regard to natural resources.
- A **Global Europe** promoting security, prosperity and solidarity throughout the world, with a focus on fighting poverty, migration management and strengthening cooperation with the European neighbourhood.

This will require a reshaping of existing instruments and delivery mechanisms so as to refocus them on the above priorities, increased financing and the development of new instruments where needed, and reductions of expenditure in other areas.

Once institutions will have validated these axes it will be possible to b[illegible]d scenarios where the intensity put on individual axes, delivery mechanisms, and/or the time[illegible] varies.

3 SUSTAINABLE GROWTH AND JOBS

Growth and jobs have been at the heart of this Commission's agenda. But in the context of increased global competition, lasting unemployment and demographic change, Europe needs to redouble its efforts.

3.1 Redoubling our efforts to invest in research and innovation

More and better targeted research spending

A substantially improved public finance effort for research, whilst at the same time improving conditions for mobilising private capital, seems crucial in terms of meeting the Lisbon objective of devoting 3 % of its GNI to research. The European added value of EU spending on research activities is undisputed, but the focus must be placed on activities which promote excellence of European research efforts or produce economies of scale:

- World excellence in basic research: Europe's future agenda for science driven frontier research should be set by the scientific community, principally working through the European Research Council.

- Industry-driven applied research and development in areas ranging from nanotechnologies to space, to bring new, leading edge products and clean technologies to markets and to boost the competitiveness of EU industry.
- New opportunities for researchers, by extending exchange programmes like Marie Curie, and attracting world class researchers to the EU.
- A bigger focus on spreading R&D capacities to the regions.

Mobilising additional resources for, in particular, energy research is urgent. That is one of the reasons why the European Economic Recovery Plan has placed particular emphasis on energy technologies to address short-term needs.

Enhanced links with private research and innovation

Increased European research and innovation funding should be complemented by a renewed effort to improve coordination between the public and the private sector as well as between the European, the national and the regional levels. Joint programming in a limited number of key areas as well as integrated financing solutions in the framework of industrial initiatives of sufficient scale would contribute to optimise the scope of research programmes across Europe and increase their visibility and strategic focus.

European Technology Platforms, Joint Technology Initiatives and Joint Undertakings, as well as coordinated calls for proposals have proven very valuable to that effect. The potential of facilities like the Risk-Sharing Finance Facility developed jointly with the European Investment Bank should also be fully exploited to engage highly research-intensive companies involved in large scale research programmes.

Improved governance for research and innovation

The coordination of policies to support innovation at regional, national and EU level has to improve significantly. A much improved governance system is needed, based on the principles of subsidiarity and better exploiting the added value of setting common objectives, agreeing on common actions, networking, and sharing best practises among Member States. The problem is less a lack of funding, but of critical mass and coherence. Indeed, the complexity of Community funding programmes adds to the multitude of schemes existing at national and regional level and makes access to relevant funding difficult. This calls for clear structures and substantial simplification of participation rules for all innovation funding, regardless of its origin[8].

EU research funding should in principle be provided exclusively on the basis of quality and relevance of research. But the EU has also a responsibility to ensure the optimal deployment of research potential and balanced access to capacities in Member States with lower income levels. This objective can be pursued in different ways, by supporting national and regional development strategies through the EU cohesion policy, or through creating appropriate incentives within the European Research Framework Programme for bringing those regions which do not yet have good research capabilities closer to the top standards. Whatever the

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8 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Reviewing Community innovation policy in a changing world, COM(2009) 442 final of 2.9.2009.

balance between these approaches, it will be important to ensure that all policy levers aimed at the upgrading of research capacities are complementary, coherent and sufficiently linked to EU level objectives. An appropriate "division of labour" between the EU, national and regional levels should be aimed at as requested by the 'Lund Declaration' adopted by the major research conference hosted by the Swedish Presidency in July 2009[9].

A reinforced European research policy will also require improvements in terms of how the EU research activities are delivered, drawing on the experiences and evaluations of past and current programmes, as well as best practices such as the European Research Council (ERC) or the Marie Curie Actions. The forthcoming mid-term evaluation of the 7th Research Framework Programme will provide a first opportunity to review the balance between its thematic priorities and the current delivery mechanisms.

3.2 A comprehensive European Employment Initiative

The European Social Fund presence has a positive impact on what Member States do and achieve in the context of the European Employment Strategy: Above all it helps them widening existing action by supporting social groups or policy areas that would otherwise receive no or less support. It plays a crucial role in integrating gender equality issues in employment and other policies. And it encourages innovations to be 'mainstreamed' at national and EU level.

But Europe needs a far more ambitious approach. A well educated workforce is a precondition for Europe's continued relevance in the world economy. This not only requires ambitious objectives, but also effective investment to step up educational systems and adapt them to new competence requirements and demographic change. With the ageing of our population there will be a need for more health and care services. Together with new "green jobs", these "white jobs" (health care and social services for children and the elderly) have a big growth potential.

Equipping all Europeans with the qualifications they need throughout their longer working lives is a shared task, but the Union has a special responsibility to promote mobility and break down barriers across Europe– even if most of the competences for employment policy lie with Member States: It can bring the leverage of the EU budget into play, as was done in adapting the European Social Fund; it can help national actions to take the EU dimension fully into account; it can use its authority to bring expertise together to promote exchange of good practices and find new ways of dealing with unemployment and creating new jobs. Through the Structural Funds, the Union can also provide significant added value in encouraging adaptability and lifelong learning in its less prosperous Member States, in particular by assisting them in reforming their education and training systems and in improving their institutional capacity.

A truly ambitious lifelong learning and mobility programme

The EU is not a mere market - it is first and foremost about serving its people. Existing instruments should be framed into a comprehensive European Employment initiative for improving skills, mobility and adaptability through joint initiatives in the area of education,

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9 The Lund Declaration: Europe must focus on the Grand Challenges of our time: http://www.se2009.eu/polopoly_fs/1.8460!menu/standard/file/lund_declaration_final_version_9_july.pdf.

employment and integration. To have a fully coherent set of action, a restructuring and reorientation of existing instruments, notably the European Social Fund (ESF) and Lifelong Learning programmes, is needed.

Experience with existing mobility schemes in education shows that they both improve the skills, knowledge and education of the beneficiaries and stimulate competition between universities and educational systems. A key challenge for extending their benefits to society at large is, however, to create enough visibility and critical mass (Erasmus, the highly successful mobility programme, reaches currently just about 5% of students). At the same time, individual mobility grants should be attractive enough and more attention should be given to the needs of disadvantaged social groups.

The Union should be able to significantly increase the number of mobility grants, particularly for students and vocational training, in the framework of an ambitious lifelong learning and mobility programme and the extension of support for training measures targeting persons wishing to work in another Member State could also be considered. The distribution of funds among the Member States in the relevant mobility schemes could take account of the share of persons covered by the schemes exercising their mobility rights and present on their territory, thus promoting a more balanced sharing of costs and benefits linked to mobility in Europe.

Integration of migrants

Economic migration should better match the needs of the labour market. This will help to take more account of the skills of migrants and facilitate their integration. A common approach towards integration of migrants will be needed in the framework of a common migration policy. The bulk of the activities and spending linked to integration will continue to be a matter for the Member States. However, in the framework of a European employment initiative, the integration of migrants, notably by ensuring their social inclusion and legal rights in the society and by providing them education and training, should be encouraged by all means, including through exchange of best practice, additional incentives, etc.

Unity in diversity

On a different scale, cultural and citizenship programmes also contribute to a well educated and flexible workforce. They help preparing Europeans to overcome cultural barriers and facilitate their full participation in the European space. However, activities in this area tend to be relatively dispersed and not sufficiently well known. Their visibility and synergy could be increased by integrating the different programmes aiming at promoting cultural cooperation and Europe's cultural heritage, citizens' interaction and the involvement of young people in European society into one highly visible programme promoting European unity in diversity.

3.3 Managing globalisation across Europe

Increasing concentration, conditionality and performance of cohesion spending

While income disparities among Member States have declined substantially since the early 1980s, they have increased across regions. The reasons for this have been widely discussed: they are partly structural (geographical, political and related to governance) and partly linked to natural forces of territorial agglomeration which are important drivers of overall economic growth within countries. It raises the question of how to target EU cohesion spending in order to effectively improve convergence.

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The debate focuses in particular on whether more emphasis should be put on convergence of low-income Member States. A concentration on national convergence could be complemented with criteria that measure regional dispersion or per capita income within Member States. Concretely, Member ~~States with~~ per capita income above the convergence threshold could qualify for increased competitiveness spending if regional income disparities within the country were particularly ~~large. The~~ focus on low-income Member States is coupled with more flexibility since the same eligibility and programming rules shall apply across the entire territory of the Member State concerned.

In any event, **conditionality** based on the achievement of agreed and measurable objectives must be strengthened in an effort to make cohesion spending both simpler and more efficient and to counterbalance the increasingly dominant focus on mere spending absorption. This requires, first, a clearer focus on a more limited number of well-defined strands of action. They should focus on human capital development, sustainable infrastructures connecting lagging peripheral areas to national and regional growth centres, climate and biodiversity investments, as well as to the promotion of research and innovation.

Secondly, making cohesion policy more **performance-oriented** will require improving evaluation mechanisms, but also shifting the emphasis from formal compliance to genuine performance objectives. Credible performance indicators should be agreed between the Commission and the Member State concerned. Part of the envelope could be kept in reserve to reward particularly successful programmes, and "sunset clauses" could be used both to reduce support for Member States which have failed to progress, and to limit the expectation of continuing support for those Member States which have achieved a reasonable degree of prosperity. [A further element taking account of both the objectives of cohesion policy and their successful pursuit could be to reflect the length of EU membership in the allocation formula for the funds. This would recognise the particular challenge facing newer Member States to adapt to competition in the internal market.]

Cohesion policy has considerable potential to help achieving the Union's climate, energy and environmental objectives. It can complement the differentiated approach in the emissions trading scheme and the Renewable Energy Directive by supporting Member States that lack the means for necessary investments in innovation, energy efficiency and adaptation measures. Structural and Cohesion fund investments should be "climate proofed", inter alia through better assessing climate impacts and developing sustainability criteria for infrastructure investments.

Strong and sound institutions at national, regional and local levels, which are capable of identifying development potential and implementing complex investment programmes, are an important measure for the success and lasting effect of cohesion policy. They will continue to deserve particular attention, including through know-how capacity building, strategy development and networks. They should be underpinned by appropriate incentives and conditionalities.

Reorganising competitiveness spending

Sharing the benefits of globalisation implies addressing the divisions created by national borders and securing a balanced economic and social development throughout the Union. Despite the common problems faced by border regions and transnational areas with shared geographic features, borders often lead to fragmentation of markets, labour, investment patterns, infrastructures or institutions. Cross-border and transnational cooperation helps addressing these difficulties with a view to ensure that citizens are able to make the most of the inherent features of these territories.

From that perspective, the European added value of current Cohesion support in well-off regions can be questioned, in spite of some progress achieved in realigning it on the priorities of the renewed Lisbon strategy. The traditional focus of Cohesion competitiveness spending on individual regions prevents it from focussing on the transnational or cross-border dimensions which should be at the core of EU spending. The considerable administrative and opportunity costs of a setup which channels funding from well-off Member States to well-off regions, without generating appropriate levels of added value compared with national funding are generally ignored.

At the same time, other EU programmes provide for considerable amounts of spending, notably in the areas of research, innovation, trans-European networks, though remaining significantly below cohesion spending levels. This represents an even greater challenge in terms of creating the needed synergies between policies and instruments at different levels.

The Lisbon strategy will need to be revised next year. It should be turned into a strategy for an integrated vision of "EU 2020". The possibility to establish a Single Strategic Framework providing strategic orientations for all Community funds under shared management and related direct management should be explored. Any new strategy will, however, need to be underpinned by a new approach to competitiveness spending which combines the advantages of decentralised, bottom-up management and partnerships mobilising territorial actors in the delivery of EU priorities, with those of centralised spending based on strong European guidelines. Such a new spending framework would secure European added value by focusing on transnational or cross-border activities and having projects selected by independent experts on a competitive basis. It should strengthen the consistency of activities at EU and national level in the areas of research, technological development and innovation, and enable a more efficient and transparent use of funds, ensuring better participation by SMEs and other territorial actors. It could ensure a better use of resources required to develop a modern, sustainable transport network throughout Europe, with a special emphasis on improving networks between leading and lagging regions.

A new emphasis on cross-border cooperation

Cross-border cooperation has a crucial role in helping the regions concerned to overcome the disadvantages resulting from their location at the internal and the external borders of the Union. The benefits of enlargement and the resulting huge increase of cross-border economic activities are now becoming more and more tangible for the regions which were located at the formal external borders of the Union. With a view to ensuring a more balanced development of the Union, cross-border cooperation of regions at the current external border should be considerably strengthened in the framework of a more ambitions neighbourhood policy. A more ambitious EU policy on climate change will also increase the importance of cross-border and transnational cooperation in terms of addressing shared environmental challenges.

Solidarity in the face of the economic crisis

EU cohesion and competitiveness policies are central tools for responding to the challenges of globalisation. As a complement, instruments like the European Globalisation Adjustment Fund can play an important role in addressing short-term consequences of major economic and social crises linked to globalisation, showing concrete solidarity with workers being made redundant and promoting active measures allowing them to find new and better jobs. The fund has recently been temporarily extended in scope to address the consequences of the recent global crisis. It could evolve into a more permanent instrument to help absorbing major disruptions on the labour market of a Member State caused by structural changes in world trade patterns or serious economic shocks. Likewise, the European Union Solidarity Fund plays an important role in pooling risks linked to extraordinary circumstances. As recent events have shown, it is however not yet sufficiently well equipped to back up Member States in emergency situations other than natural disasters, such as public health emergencies, industrial and technologic disasters, or acts of terrorism. It could in the future become an important tool to translate the solidarity clause of the treaties into swift concrete action. Both funds would benefit from their full integration in the budget in order to accelerate their mobilisation.

4 CLIMATE AND ENERGY

The European Union should keep its global leadership on addressing climate change. Whilst fiscal and regulatory instruments and international target setting are essential, considerable public and private investments will be required for both mitigation and adaptation. Similarly, the role of the EU budget in the area of energy should reflect the increasing importance of this sector at EU level.

4.1 A new Climate and Energy policy for Europe

Climate change and challenges related to sustainable energy supply have been identified as two of the key priorities for the EU budget reform in the public consultation. The long term planning and the scale of EU programmes, as well as the capacity to mobilise actors across borders within and outside the EU are key to ensure a high added value of EU expenditures.

In recent years, the Union has made historic steps to develop an integrated climate and energy policy for Europe. The key objectives of this policy, sustainability, competitiveness and security of supply are closely linked and mutually reinforcing. Cutting greenhouse gasses in line with European objectives will bring down oil and gas imports. Ensuring a functioning internal energy market and the diversification of energy sources and transport routes will make Europe more resilient against supply shocks and help ease the pressure on prices. Promoting energy efficiency and the use of renewable energy, including through new or enhanced energy networks to link renewable power generation with consumers, will play a critical role for achieving a highly competitive low-carbon economy.

So far, the EU budget's contribution towards achieving these objectives has been very limited. There is broad agreement that current levels of investment are largely insufficient to transform the energy system in line with the requirements of a low carbon society and ensure security of supply. For instance, if Europe invested today at the same rate as in 1980, total EU public expenditure for the development of energy technologies would represent four times the current level. Recent initiatives in the framework of the climate and energy package as well as the European Economic Recovery Plan are starting to address this deficit, but will remain largely insufficient to bring about the change which is required. Stepping up European efforts for energy and environment-related research and innovation, with special emphasis on renewable energy and mitigation and adaptation technologies, is therefore indispensable.

In the future, the EU budget could play a crucial role to achieve the EU objectives, both directly through spending targeted to climate change and energy priorities and indirectly by ensuring mainstreaming of climate priorities into existing EU policies. This communication proposes integrating the relevant direct spending for climate and energy policies within a European Framework Programme for Climate and Energy. To ensure mainstreaming, both cohesion and CAP expenditure should be "climate proofed" and linked to the achievement of national emission targets. Important efforts will also need to be done in other policies to ensure that climate-related priorities are properly reflected at all stages of the preparation and implementation of the policies.

A European Framework Programme for Climate and Energy

Given the necessity to integrate Europe's climate and energy objectives in a wide range of policies, including research, cohesion, agriculture and rural development, it is difficult to concentrate funding for these purposes in one single fund or budget Heading. However, some degree of concentration would help to exploit synergies and increase the effectiveness and efficiency of EU action in the areas of climate change and energy security. An ambitious European [Framework Programme] for Climate and Energy could provide the framework for such action. It could pool the resources mobilised for climate and energy policy within the EU budget as well as possible new measures to support greenhouse gas reductions, and manage them in a focused, flexible and coherent manner..

It should be able to receive additional resources from Member States, in particular to honour their international financial obligations under a future climate change agreement, and from third countries. Substantially increased EU expenditure could be pooled with national public and private resources into joint research programmes and industrial initiatives in areas like wind and solar energies, electricity networks, bio-energy, fuel cells as well as carbon capture, transport and storage. Leveraging private investment through smart blending solutions will also be an important part of the policy mix offered in this new [Framework Programme].

- A first axis of the [Framework Programme] would contribute to the realisation of **a fully interconnected and flexible European energy network**. This requires a more proactive EU policy addressing missing links and promoting strategic infrastructures, including new import routes contributing to the diversification of supply. It involves the modernisation of Europe's ageing power grid to better assimilate smart technologies and renewable energy sources. The inadequate funding available so far for energy networks has severely limited the impact of the TEN-E programme. Synergies should be sought between network policies and with other actors, in particular with the European Investment Bank, and by channelling all EU funding available for energy networks and their possible extension to third countries through one single funding stream.

- The [Framework Programme] should also support, in particular through leverage financing solutions, **the demonstration and market replication of complex low-carbon technologies**, measurement methods or testing procedures. . Due to economies of scale, an EU approach for energy efficiency in wind and solar energies, hydro-electric or geothermal plants, and carbon capture, transport and storage can prove cheaper and more efficient than national approaches to ensure that these technologies take off and become available very quickly. The Union can also help leveraging resources through the appropriate loan or loan guarantee mechanisms.

– A further component of the [Framework Programme] could provide for **a performance incentive for investments beyond the greenhouse gas reduction and renewable energy targets** decided in the framework of the Union's climate and energy package. The cohesion budget, the allocation mechanism for emission allowances and the renewable energy targets already reflect the different capacities of Member States to achieve the existing targets. But the [framework programme] could add value in stimulating, on a competitive basis, efforts to go beyond the short term requirements and indicative trajectories, as well as broader efforts to reduce energy consumption. In this way, it would promote early investments, contribute to the Union's longer term strategy and address emitters currently not properly covered by the system.

– Success to achieve the EU's climate and energy objectives will partly depend on similar efforts being made throughout the world. The European Union should contribute to global efforts and solidarity through **transfer of technology and assisting the least developed countries in preventing and adapting to climate change** and securing access to and sustainable use of natural resources. The [Framework Programme] could thus have an ambitious external dimension, without which it will not be possible to reach the Union's climate and energy objectives. The budgetary implications of an ambitious climate agreement in Copenhagen for the EU and its Member States are likely to be substantial as from 2013. In this context, the EU budget could play a crucial role to support effective mitigation action through performance-based incentives and adaptation measures in developing countries. Likewise, Europe has to use all available tools to make sure that the necessary investments for infrastructure of major importance to its energy security are being made, in particular in the framework of the European Neighbourhood Policy.

4.2 Modernising transport and communication infrastructure

Considerably more EU funds are needed with a view to securing sustainable transport of persons and goods, both in terms of competitiveness and climate change mitigation.

The right European transport and communication networks offer considerable potential to help addressing Europe's environmental and energy challenges. By enabling efficient communication as a substitute to physical mobility as well as physical mobility through environmentally-friendly, multi-modal infrastructures, they combine the requirements of a competitive market economy with those of a low-carbon society. They improve energy security by making transport more efficient, integrating the network and shifting freight and passenger flows towards more sustainable transport modes. These benefits are further strengthened in combination with large-scale space applications like Galileo or Copernicus, or intelligent transport systems such as the Single European Sky Air Traffic Research, which will increasingly move from the research to the implementation and management stage.

A more concentrated and integrated priority network approach

The necessary investments for such European infrastructures are too large and economic benefits spread too wide to rely on national or commercial initiatives alone. They require a truly European planning dimension and the best possible combination of European loan and grant support as a catalyst for projects to go forward. Like for energy networks, there is a need to concentrate scarce resources available on a limited number of priorities to link up and extend major trans-national axes and important inter-modal connection nodes. With the help of appropriate sustainability criteria, the European network should become as "climate proof" as possible and pay due attention to adaptation requirements linked to a new generation of intelligent transport systems and low-carbon alternatives for vehicles, aviation and shipping.

EU level support should mobilise all available funding sources, including funding provided through the Cohesion Fund, the European Fund for Regional Development, the European Investment Bank and public-private partnerships, in a well coordinated and coherent way. The option of pooling resources into a Single trans-European networks (TEN) Fund for transport could be considered. Alternatively, strong joint programming could be established, which would increase regional and national ownership and mobilise capacities at the appropriate level for planning and implementation of such investments. A part of the budget should be earmarked for cross-border interconnections. Cross border programming, cooperation and coordination could be strengthened by better exploiting and where necessary adapting existing mechanisms such as the European Grouping for Territorial Cooperation and the TENs Agency.

4.3 Land and maritime resources

In the 25 years between the start of the first financial framework in 1988 and 2013 the overall share of direct agricultural support in the EU budget will have shrunk from 61% to 32%. This significant long term downward trend has been driven both by a major reform of market measures and by increased modulation to rural development measures. As a result of the Health Check measures, this downward path is set to continue beyond 2013 even in a no change scenario.

For the future, further reform and modernisation of agricultural spending is required to bring it fully into line with the principles of European value added, concentration on priorities and fairness. While it is too early to define the detailed contours or the exact intensity of the future reform of the CAP, it is clear that it should be driven by two objectives. First, it should resolutely pursue the modernisation of the CAP, enabling it to respond to new challenges and concentrating spending where it adds most value. Second, it must stimulate a further significant reduction in the overall share of the EU budget devoted to agriculture, freeing up spending for new EU priorities.

New opportunities and challenges

Major reforms have gradually brought European agriculture closer to the markets. The main focus has shifted from underpinning agricultural commodities prices to providing support largely decoupled from production. 'Cross compliance', makes these payments subject to environmental, food safety, and animal welfare legislation. To achieve a better balance between policy tools a system of compulsory progressive reduction of direct payments ('modulation') was introduced.

The Union has become the largest agricultural exporter in the world, exporting mainly high value products. It is at the same time the largest importer and the largest market for developing countries. The "Health Check" is the most recent step in the direction of more competitiveness and greater market orientation.

Market conditions have changed over time. Increasing global demand for food and bio-energy has reversed the downward trend of past decades and led to structurally higher prices. This trend has created new opportunities for farmers while posing new challenges for consumers and society at large. Europe is well positioned to deal with these challenges, as its production capacity and purchasing power will continue to provide it with enough food at all times.

At the same time, European agriculture is extremely diverse, with very different farm structures and conditions of production. Some areas and some types of farms will have more difficulties than others to cope with the volatility of prices and competitive pressures linked to globalisation.

New challenges are emerging. Agriculture must do more to mitigate climate change while its competitiveness and viability must be maintained. Innovation and joint research in agricultural production technologies, in climate change mitigation potential and in new pathogens and diseases are key factors in this respect. European agriculture will have to contribute to reduce greenhouse gas emissions and to developing the use of land as a carbon sink. It will also have to meet expectations of European society to help safeguarding food quality, biodiversity, water resources and animal welfare. The outcome of the public consultation pointed in the same direction, indicating the need for a continuous reform to adapt to new challenges and to develop the role of rural development.

Continuing reform towards a more targeted and cost-effective approach

Agriculture will continue to have an important place in Europe's future development, but its place and role have to be defined in the context of a global EU 2020 vision. Public investment and innovation efforts should be geared to deliver a thriving rural economy. Financing should be provided at the level where it creates real EU added value and the EU budget should primarily be targeted to the provision of public goods.

The decoupled direct payment system allows farmers to be market oriented and is compatible with the WTO. It brought about a substantial simplification of the CAP support and contributed to reducing the administrative burden. However, decoupled direct payments are subject to substantial criticism for being insufficiently targeted and based on a historic model which becomes more and more difficult to justify as reference periods for payments become more distant. For the CAP to be a policy of the future, it needs to send the right signals to its farming community. Common support schemes have to be adapted to changing developments, and beneficiaries cannot rely on support conditions remaining unchanged.

For the CAP to respond to these multiple demands the following way forward could be considered:

Market intervention mechanisms could be rolled back further to become a genuine safety net. Sufficient food supply for a growing world population should be ensured by increasing overall agricultural productivity through strengthening research, technical assistance and knowledge dissemination.

As to **income support** provided by the EU budget:

- The main elements of the single payment scheme could be maintained, whilst **focusing more on the provision of public goods** (food safety and quality, sustainable farming and climate change). Direct payments would no longer be paid on the basis of historic production levels. Support could target, among others, non-compulsory environmental services, sustainable farming practices, or improving the countryside in high nature value areas. This could involve a reduction of direct payments, without leading to a re-coupling of support on a sector by sector basis.

- New challenges and environmental concerns could be addressed as part of a **broader strategy** and be dealt with by other policies, whilst CAP spending would focus on the main CAP objectives such as agro-food production. Some funds resulting from this shift could be invested in measures to promote competitiveness in the agro-food sector, or could be used to finance activities targeted at the agricultural sector but covered by other policies such as research, employment and transport.

In both the above cases a larger responsibility of current CAP spending could be assigned to the Member States, or direct aids could be co-financed by national contributions.

In any event, the reform of income support shall be implemented gradually and could be accompanied by transitional measures. The pace of this evolution will have to strike the right balance between ensuring a smooth transition and the opportunity cost of delayed action and its impact on the European response to the new challenges. Decisions regarding the transitional character of basic support payments and their duration will therefore have an impact on Europe's policy response in other priority areas.

Rural development has a particular role to play in the transition to a higher value added, more flexible economy facilitating increasing employment in full respect of the sustainable use of natural resources.

- **New challenges**, of which some were identified in the Health Check could continue to be supported through the rural development policy. Therefore, increased compulsory modulation could be an option to continue the path sketched out by the most recent CAP reforms.
- A different approach would be to go for further intensification of CAP spending on new challenges related to climate change. By addressing these objectives in **a 'third pillar' of the CAP**, specifically linked to climate change issues, EU funds could be better targeted at climate change measures.
- Rural development could be further developed as an instrument for **diversification of economic activities and employment opportunities in rural areas**. To increase added value of EU spending, more funds could be directed towards non-agricultural and environmental activities with a clear link to EU regulation and cross-border externalities. This raises the question of the relationship between cohesion policy and rural development.

Any adaptation of the future CAP will have to take account of the specific situation of farmers in very low income Member States. In this respect, rural development policy could be designed as a flexible instrument so as to make it feasible in all Member States. A special transition for very low income Member States, to allow the modernisation of their agriculture should be provided for.

Protection of wildlife and maritime resources

The Union's environmental and maritime policies also have an important contribution to make for a more responsible and sustainable management of natural resources. Both policies have a strong cross-border dimension. The level of protection of wildlife, maritime resources and habitats in one Member State has an impact on biodiversity in other Member states, as have measures affecting the quality of air and water. Although these issues will continue to be addressed mainly through regulatory approaches, an appropriate level of financial support can provide additional incentives for the creation of protection zones and other preservation measures, and accompany the structural adjustments linked to such measures. European level support can also act as catalyst to improve the monitoring of marine environment and fight against polluters. EU financial action in these areas should focus on biodiversity and nature protection, aqua-environmental measures, measures to achieve a sustainable balance between resources and the fishing capacity of the fisheries fleet, the prevention of illegal fishing and destructive fishing practices, as well the access to and sustainable use of fishing waters of third countries. [It should be provided through well coordinated shared management approaches in the framework of the Union's cohesion, rural development and maritime policies.]

5 GLOBAL EUROPE

Distinctions between domestic and external policies are disappearing. Addressing issues such as climate change and biodiversity, energy security, demographic change and migration, competitiveness, terrorism and organised crime can only be tackled in an international context. The internal agenda of securing growth and jobs in Europe must be complemented with an external agenda promoting security, prosperity and solidarity throughout the world, encompassing our trade and other external policies. [The Lisbon Treaty, if ratified, will provide the Union with new tools to manage our external action and will help to improve its consistency.] [A larger share of the EU budget will need to be devoted to such an agenda.]

5.1 Global responses for global challenges

None of the Union's priority challenges can be addressed effectively without a powerful external presence in its neighbourhood and the wider world. [A new and more coherent treaty framework for external action with the European External Action Service at its core, the existence and role of which will have to be reflected in future budgets in an overall neutral way, will help achieving that objective.]

The budgetary pressure created by the economic and financial crisis does not change the fundamental fact that, particularly in our immediate neighbourhood, Europe has a choice between helping to create stability, prosperity and reliable partners or facing importing insecurity, confronting high levels of unrestrained migration and wasting growth potential.

A reinforced European neighbourhood policy

The situation in the neighbouring regions determines the European Union's own economic, energy and security outlook, and no other country or group of countries has both the means and comparable interest to promote stability and prosperity in this part of the globe. Providing credible reform and cooperation incentives, not necessarily linked to a perspective of ultimate EU accession, clearly calls for an improved financial offer to these countries.

A substantially reinforced neighbourhood policy building on the Union for the Mediterranean and the Eastern partnership and potentially leading towards an extended European economic area will require a much stronger involvement of the EU budget. It should be established on the basis of strategic partnerships on issues of common interest, such as energy, transports and environment, migration and border controls.

Fighting global poverty more effectively

The EU's collective commitment to dedicate 0.7% of GNI by 2015 to official development aid recognises the important role external financial action plays in reaching our objectives and implies a substantial increase of the overall volume of development assistance. Against this backdrop, it is particularly worrying that the share of the EU budget in meeting these targets will decrease sharply, despite the fact that the European level has a lot to offer to enhance the impact of these resources. It allows for a better division of labour between donors, and important economies of scale can be achieved through a greater ability to pool and leverage resources and secure effective support for key foreign policy objectives. EU assistance offers a single contact point for beneficiaries in an ever more complex multi-donor context, with new emerging economies entering the external cooperation arena. It also carries the weight and legitimacy associated with 27 [and more] Member States acting together.

Assistance to Africa should remain a priority. It will, however, require substantial delivery improvements which will rely to a large extent on the Union's ability to ensure better donor coordination, both internally and externally. This includes in particular better division of labour between all parties involved. Real and tangible progress in the governance arrangements between the EU and Member States level could significantly ease the pressure on the external aid budget, replacing quantity by quality improvements. More generally, a real effort to simplify procedures and to make them more accessible would certainly contribute to enhance Europe's visibility on the ground and make its punch commensurate to its weight as provider of more than 55% of official development assistance worldwide.

There are various, alternative or complementary options for achieving this:

- A more effective approach is needed towards helping the least developed countries embarking on a sustainable growth path. The EU budget should foster **development partnerships** with identified developing countries, notably in Africa. These partnerships would set concrete and verifiable targets and conditionalities (e.g. in relation to human rights, combating illegal immigration and trafficking in human beings) in a number of key areas. Their geographical spread would be defined in close consultation with international organisations and other donors, including EU Member States.

- Following the adoption of the European consensus on development[10] in 2006, several initiatives have been launched in order to pool resources from all European aid actors with regard to specific regions or aid instruments. **EU trust funds** such as the EU-Africa Infrastructure Trust Fund have been created, which channel grant resources from the Commission and Member States in such a way that they can be blended with the lending capacity of the EIB and Member State development banks. More recently, a discussion has started on creating a general framework for **loans and grants blending mechanisms** in the context of external assistance. Such mechanisms could allow for financing projects that would otherwise not be financed thanks to the pooling of resources and the complementary use of grants and loans, and enhance the efficiency and visibility of EU action in partner countries.

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10 Joint Statement by the Council and the representatives of the governments of the Member States meeting within the Council, the European Parliament and the Commission on European Union Development Policy: 'The European Consensus", OJ No C 46, 24.2.2006, p.1.

– The above proposals for better coordinating or pooling resources should not, however, limit ambitions to take more radical steps for improving European aid effectiveness, such as **integrating the European Development Fund into the EU budget**. In the meantime, the EDF's policy and programmes' objectives and management modes should be aligned as much as possible on the EU budget.

Increasing the Union's response capacity

With the recent reform of external spending instruments, the Union has made progress in terms of simplification, coordination and better targeting of external assistance. It has streamlined more than thirty ad hoc instruments into a limited number of geographic and thematic approaches, increasing overall consistency, policy coherence and dialogue with beneficiaries and other donors, as well as between institutions. The budget review should continue this path and maximise the benefits for both the beneficiaries in third countries and the citizens of the Union.

Geographic approaches will remain at the centre of our external spending policies. Their relative stability is a major asset and provides the Union with the means to engage in long-term working relations with partner countries. At the same time, an ever faster moving world also requires greater responsiveness within the external budget. While certain mechanisms are in place to address one-off emergencies, the Union's responsiveness is currently rather limited when it comes to coping with sudden, large-scale conflicts or disasters. Possible mechanisms to address this could take the form of an extraordinary reserve or the inclusion in existing instruments of a sufficiently funded thematic component allowing for sustained medium-term support in situations of transition. A sufficiently funded common foreign and security budget also is an important factor in that respect.

The external dimension of internal programmes

Beyond the need for increased flexibility in dealing with unexpected events, the ever closer links between the Union's internal policies and their external projection make it increasingly difficult in some areas to differentiate between internal and external components of a particular action. This is the case, for example, where third countries participate in EU programmes, like the research framework programme, or where crucial infrastructures concern both the territory of the Union and that of neighbouring countries. In such instances, it can be difficult or not in the interest of the efficient pursuit of EU objectives to determine the share of investments outside the Union or benefitting third country contributors beforehand. The need for an integrated, coherent and flexible overall approach in such situations requires that future financial frameworks do not exclude instruments from relevant internal headings to contribute to associated external objectives. This would enable, for example, a more efficient energy network policy, taking into account energy security potential and addressing needs wherever they occur. It would create possibilities for flexible external ad hoc rapid reaction as part of the financing instruments in the areas of migration, border management or the fight against terrorism and transnational international crime. It would also provide a degree of flexibility where headings other than the external relations heading have the potential to efficiently deal with unexpected external pressures.

5.2 Managing migration and addressing trans-national security threats

In an area without internal frontiers, migration is by definition characterised by a strong cross-border dimension. It affects Member States and third countries differently, depending on their geographic, social and economic situation. It cannot be addressed effectively by 27 different migration policies. The Global Approach to Migration as well as the European Pact on Immigration and Asylum have therefore developed a comprehensive vision covering all dimensions of migration, including both legal and illegal migration, border controls, a European asylum system and the partnership with countries of origin and of transit.

Migration Management Support Fund

Although this vision relies mainly on non-financial instruments and cooperation between the Member States, financial support will have to remain an important part of the policy mix. Continued efforts will be needed, in particular, for the equitable distribution of burdens linked to integrated border and visa management, the European asylum system and the fight against illegal immigration. The visibility of EU financial support action could be enhanced by consolidating these funding streams into a Migration Management Support Fund, which could integrate activities both internal and external to the Union.

Such a Fund could build on a more pro-active, **global approach to migration** to be realised by means of "mobility packages" with selected third countries accepting to cooperate on illegal migration and effective mechanisms for readmission. This would enable their citizens to have better access to the EU labour market. Mobility packages would bring together the possibilities offered in the European Union and take account of the potential benefits to third countries of labour migration.

The next generation of external assistance programmes could provide for additional incentives for the conclusion of readmission agreements with the European Union.

5.3 Pooling resources to counter security risks

In a multipolar world, the EU will need to considerably enhance its **conflict prevention and crisis management capacity** in order to safeguard peace and its own security and defend its values based on universal human rights.

Border controls, fight against terrorism, organised crime and trafficking in human beings, as well as preventing and combating fraud and the spread of mass diseases, are issues where the EU can demonstrate high value added through providing practical solidarity, coordination and economies of scale and call for more means from the EU budget. Although Member States will remain the core providers of security and continue to have the monopoly of enforcing the law, the Union has an important role in **linking together security services and pooling resources for certain response assets.** This requires the promotion of appropriate information systems, based on the availability of information, as well as appropriate cooperation structures. Such systems and mechanisms are also crucial when it comes to other trans-national security threats such as health threats or food and product safety. In all these areas, considerable European added value is generated with relatively modest investments. Consideration should also be given to extending the scale and scope of the European Union Solidarity Fund, as indicated under section [3.3].

Ensuring flexibility, efficiency and fairness

Insert introductory text (box from consultation)?

6 INCREASING THE FINANCIAL FRAMEWORK'S FLEXIBILITY

Increasing the flexibility of the EU budget within the financial framework has been identified as one main objectives of the budget reform. It can be achieved by different, alternative or complementary means:

- The number of Headings of the financial framework should be limited with a view to adopting an approach that breaks through compartmentalisation of existing policies so as to better respond to cross-cutting challenges at domestic and global level.
- The scope of the flexibility instruments established under the current rules (Emergency Aid Reserve, European Union Solidarity Fund, Flexibility Instrument and European Globalisation Adjustment Fund) could be widened and/or their size increased.
- A reallocation flexibility could be established which would allow for transfers between Headings in a given year, within the limits of the margins available.
- A limited transferability of unused margins for clearly identified expenditure could also be established in the framework of the annual budgetary procedure. The possibility for the annual budgetary procedure to front- or back-load expenditure within the agreed overall expenditure limits of a Heading could usefully complement such flexibility provision and increase the Union's capability for countercyclical action and efficient emergency measures in major crisis situations.
- Lack of flexibility also stems from the fact that multiannual programmes tend to use up the ceilings in advance, at the stage of the adoption of the legal basis and of subsequent programming. The mid-term reviews of those programmes should be the occasion to effectively reassess their financial allocations. This could be warranted by keeping, within the respective ceiling, a reserve amounting to [5] % of the total allocation to the Heading concerned.

7 IMPROVING THE EFFICIENCY OF DELIVERY MECHANISMS

A major reorientation of EU spending priorities will not be feasible without a fresh look at delivery mechanisms. Many delivery improvements are linked to policy design and have been examined in that context. In addition, a series of principles can be developed which the next generation of financial programmes – whether new or carried over from the current period – as well as the forthcoming revision of the Financial Regulation should be guided by and tested against:

Simplification

The consultation has conveyed a clear message that implementation procedures and control requirements are too complicated and sometimes effectively discourage potential beneficiaries to participate in EU programmes. The triennial review of the financial regulation in 2010 should be the occasion for simplifying financial rules and streamlining modes of management before the next financial framework will be agreed.

Simplification needs to be placed in the context of efforts aimed a making the budget more performance-oriented and cost-efficient whilst at the same time ensuring sound financial management. This includes a reflection about how to apply lighter procedures for smaller grants. For certain types of action or beneficiaries, lump-sum and budget support approaches combined with more performance-based control systems could lead to efficiency gains without putting at risk the requirements of sound financial management.

A more radical change would consist in basing EU reimbursement under shared management on the declaration of payments by Member States rather than on expenditure by beneficiaries. Member States would receive claims from beneficiaries and verify the eligibility, and then pay the appropriate contribution to them. These payments would be declared to the Commission for reimbursement at the appropriate rate. The advantages would be an incentive to the Member State to make effective use of the pre-financing and to ensure full control of the expenditure declared by the beneficiaries. Such a system could also provide a means to achieve the de-coupling of the legality and regularity of reimbursements of EU funds made to Member State from the control of the compliance with EU law of the underlining transactions.

Performance incentives and conditionality

Programmes should pay greater attention to results and their evaluation They should provide for the definition of specific, measurable, achievable, relevant and timed objectives as well as appropriate performance indicators. The EU strategic guidelines for cohesion policy and a too wide defined 'Lisbon-earmarking' are cases of relative weak conditionalities, which do not provide a sufficient policy content focus. And the option of a – fairly modest - national performance reserve has been picked up by very few Member States only.

Where beneficiaries have considerable discretion in using EU funds, like in cohesion policy or external budget support, good progress in achieving specific objectives should be rewarded and support discontinued or suspended in case of qualified and persistent failure to deliver results, until the authorities concerned have taken effective action to remove the underlying reasons for that failure.

Providing visibility and critical mass

Spending programmes should place particular emphasis on structural changes and networking effects. The EU budget can be particularly effective where it is able to induce structural changes, bridge gaps insufficiently addressed by other actors and promote new ideas and best practices leading to overall policy improvement. The beneficiaries' commitment and ownership, which can be strengthened through the enhanced use of local implementation systems, are important considerations in assessing the structural impact of EU financial action.

As a rule, EU spending should intervene only when sufficiently important to have a real impact on achieving a specific objective. Whilst small scale action can be politically important and thus relevant for the achievement of European objectives, even in that case the resources mobilised should offer the necessary critical mass in relation to the objectives set and for making sure that it is visible.

Implementation methods - Creating synergies between instruments and government levels

The reality of existing arrangements is much more complex than the mere distinction between centralised and decentralised or shared management suggests. The variety of implementation methods appears often to be rooted in the past rather than being based on efficiency criteria. It requires to be reviewed in the light of the new scale and scope of activities to be financed at the EU level.

The choice of the appropriate implementation method should take account of all relevant factors: It should ensure high levels of European added value and create synergies with the private sector and between instruments implemented at different government levels. For that purpose, joint programming in areas where the national and the European level are both active should be contemplated. Further efforts are needed to integrate cohesion policy with national strategies, based on the National Reform Programmes, and with other relevant policies, in particular rural development and the maritime policy. One way of achieving greater synergies at European level would be to better align the governance provisions for cohesion, rural development and the maritime policy and consolidate programming and reporting in cross-cutting documents covering all relevant aspects of these policies.

In a number of areas, such as spending related to the growth and jobs agenda, the strength and weaknesses of the current centralised and decentralised implementation arrangements should be carefully assessed. The new European policies and spending priorities may require streamlining existing instruments into a single framework in order to improve the leverage effect and efficiency of EU spending.

Executive agencies can be an efficient tool to improve the effectiveness and efficiency of programme implementation, in particular where a high level of technical expertise is needed, or where economies of scale can be achieved by encouraging specialisation or entrusting a range of similar programmes to a single agency. However, new agencies should only be created if a careful cost-benefit analysis clearly shows a need that cannot be met by the extension of the scope of existing implementation arrangements.

Coordination with the European Investment Bank and financial instruments involving the private sector

Whenever appropriate, the EU budget contribution should be leveraged by finance through the private and banking sectors, notably via the European Investment Bank (EIB) and the

European Bank for Reconstruction and Development (EBRD). This will also allow for drawing on their financial and technical expertise.

The Commission and the EIB have already developed a number of common financial instruments and are working on new ways to finance the investments of the future. Raising the profile of financial engineering will have to go hand in hand with greater coordination between the Commission and the EIB to ensure coherence, as well as new rules specifically designed to address the needs of blended instruments.

The main inconvenience of the more structured forms of public-private partnerships lays currently in the lengthy process for their creation and the heavy regulatory and administrative procedures to be put in place before they become operational. To the extent possible, the next generation of instruments should therefore strive to simplify implementation rules and better align them with industry needs.

European added value is also great for high-leverage loan and grant blending instruments pooling innovation risks at European or even global scale. Such instruments target activities with potential for positive economic development, which cannot attract bank financing due to the immaturity of the market or crisis-related credit constraints. They allow banks across Europe to mobilise significant additional resources for investments involving complex technologies, unproven markets or intangible assets, investments which are crucial for Europe to maintain and further develop its competitive edge.

National public co-financing

Co-financing is a very effective tool for limiting the risks of EU funds being used for programmes with little value for money, to facilitate better assessment of the costs and benefits of actions, to leverage additional resources for European objectives and to increase national ownership and accountability for EU policies and their implementation. However, when setting the co-financing rates, the next generation of expenditure programmes will also have to take into account the extraordinary strain that the economic and financial crisis has put on national budgets and the need for Member States to return to their mid-term budgetary objectives as soon as possible.

More effective and efficient control

Public spending requires effective, efficient and proportionate control. It must provide the necessary assurances for taxpayers and their representatives in the European Parliament and the Council that European money is being well spent.

Transparency about the use of funds is a key ingredient of such control. The European Transparency Initiative has progressively put in place a system informing about beneficiaries and amounts received from the EU budget. This system is a precious tool for taxpayers and policymakers to scrutinise what EU money is being spent for and whether it fulfils the intended purposes.

As far as control systems are concerned, they should be designed so as to optimise the relationship between their costs and the level of error prevented. The idea of modulating management and control requirements under shared management to take into account the differentiation of the administrative capacities of the respective Member States and the levels of funds for which they are responsible, should be further explored. The Union should also continue working towards a common understanding of the tolerable risk of error for different policy areas.

The requirement of full accountability in all areas implies a clearer delimitation of responsibilities between government levels as well as an effective integrated control framework operating on the basis of common standards. National management declarations and synthesis reports could make a major contribution towards increased accountability. The institutions should endeavour to address remaining obstacles for the generalisation of such declarations and contribute to the improvement of the overall control context through clear programme design and performance-based control indicators.

8 ENSURING FAIRNESS AND ADDED VALUE IN THE EU FINANCING SYSTEM

Just like the expenditure side of the budget, the structure of the financing side has evolved considerably over time. Among the most striking features of this evolution are the growing importance of the GNI-based contribution (which is expected to represent 74% of the budget in 2013), an increasing number of corrections and special arrangements, both on the revenue and expenditure side of the budget, as well as budget negotiations more and more driven by *"juste retour"* considerations.

At this stage, in view of the overall aim of developing an EU financing system in line with the principles of fairness and added value, this communication provides a first assessment of the current financing system and outlines possible orientations to reform it

The public consultation highlighted that dissatisfaction with EU financing is widespread. Criticism covers a wide range of issues:

- Many Member States consider the system as unfair, partly as a result of the correction mechanisms. For instance, Member States benefiting from redistributive policies, such as the cohesion policy going to the poorer regions, must pay increased contributions to the EU budget to finance correction mechanisms.

- Justifications for net balances underpinning correction mechanisms are rather weak. The conventions which determine net balances calculations are arbitrary. Revenue and expenditure allocation assumptions are highly questionable[11]. More generally, these calculations do not reflect the gains and mutual benefits related to the EU spending.

- Since EU financing is based mainly on contributions by Member States, the EU and the Member States compete for the same revenues. This is at the heart of the *"juste retour"* issue, an issue which poisons every debate on the EU Budget. This excessively narrow perspective of the advantages linked to EU membership affects *all* policies. As a result, the Member States tend to favour instruments with geographically pre-allocated financial envelopes rather than those which may warrant a greater EU added value in line with the principles of subsidiarity and proportionality.

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11 [This can be illustrated by European programmes such as Socrates -Erasmus, under which exchanges of students between member countries of the Union are organised and financed. Do student exchanges benefit the state of origin of students leaving to study in another member state or the latter country? It is difficult to break down expenditure by beneficiary Member State except in very special cases.]

- The financing system is opaque and incomprehensible for most stakeholders. It is almost impossible for EU citizens to ascertain who effectively bears the cost of financing the EU. In particular, the VAT-based resource is levied on a 'virtual' basis which is complex to the point of incomprehensibility. Correction mechanisms based on net balances calculations are equally difficult to understand.

- Finally, except for the traditional own resources, the EU resources display almost no link to - nor do they support - EU policy objectives. Alternative financing sources at EU level could potentially lead to efficiency gains in the form of economies of scale or by taking into account cross-border externalities and could therefore contribute to the overall added value of the EU budget.

For these reasons, there exists a widespread consensus that a reform is needed in order to obtain a more transparent, efficient and fair EU financing system.

At the same time, the public consultation also made it clear that a stable and sufficient financing of the EU budget, budgetary discipline as well as a mechanism to ensure a balanced budget should remain essential elements of the EU financing system.

Framing the EU financing reform agenda

A reform of EU financing could comprise four main elements:

(1) **A simplification of Member States contributions**: Eliminating the VAT-based own resource would considerably simplify the system of contributions. It should, however, be accompanied by the introduction of a new own resource.

(2) **The progressive development of a new, policy-driven, own resource**: A resource contributing to the effectiveness of EU policies and replacing part of the GNI-resource could help solving the *juste retour* issue by shifting the focus from net balances to the economic impact of the resource. The resource should be closely linked to a fully developed key European policy to increase the coherence and effectiveness of the entire budget in the achievement of EU policy priorities. It should be cross-border in nature and based on a system covering the whole territory of the Union. It should also have a harmonised base, so as to ensure an equal application of the resource throughout the Union. Lastly, reforming the EU financing should not increase the overall tax burden for the EU citizen.

Several options have been envisaged in the past, such as a resource based on VAT, energy or, as a longer term possibility, corporate income. Following important policy developments, other resources have recently been mentioned in the context of the consultation as possible new own resources. [Examples include communication charges (SMS), financial transactions and levies related to aviation (departure tax or kerosene).] Furthermore, considerable changes have occurred in relation to climate change and energy policies. In particular, the EU Emission Trading System (ETS) has been in operation since 2005. Since 1 January 2008 it applies to all EU Member States. An amendment to the EU ETS Directive will bring the aviation sector into the system from 2012. A resource based on the auctioning of greenhouse gas emissions allowances would fully respect the above principles. It would notably allow to integrate the pursuit of the environmental, competitiveness and cohesion objectives pursued with the allocation of auctioning rights and earmarking of revenue into the more efficient and coherent framework of the EU budget. [In line with the decisions taken by the European Parliament and the Council on the 2008 energy and climate package, a new own resource stemming from emission proceeds cannot be envisaged in the short term. However, depending on the experiences and the longer-term perspectives of the system, deriving notably from an international climate change agreement in Copenhagen and the development of an OECD-wide carbon market [by 2015], and in view of the required preparatory work, it could be considered [for a further trading period][progressively from 201X].]

(3) **The progressive phasing out of all correction mechanisms**: The present Communication seeks to create the conditions to reverse the trend of an increasingly excessive focus on net budgetary positions and corrections by proposing an attractive reform agenda maximising the added value of EU expenditure. Most corrections provided for in the own resources decision are limited in time and will automatically expire in 2013. The justification for the existence of the remaining correction in favour of the United Kingdom, and corrections on this correction, disappears progressively. The UK correction was introduced when more than 70% of the EU budget was spent on agricultural market measures. At the time, the United Kingdom was one of the least prosperous Member States. And large VAT-based contributions to the budget were particularly unfavourable to the UK. Today the UK is one of the most prosperous Member States and the share of VAT-based financing as well as agricultural expenditure in the EU budget has decreased significantly. The proposed simplification of Member States contributions, agricultural reform and reinforced spending for growth and jobs, energy, climate change and the external projection of Europe's interest would further change the budgetary balance.

In this context, [it should be recalled that a number of proposals have been put forward to solve problems related to correction mechanisms. Most prominently, it has been suggested to extend the UK correction to all Member States to ensure fair treatment of net contributors to the EU budget. More recently, refined proposals have proposed limiting such a generalised correction mechanism to certain types of expenditures, which would not be considered as EU public goods by the Member States. In any event,] the ultimate objective is to eliminate all the correction mechanisms. This will require a clear timetable, reflecting the overall ambition of the budget reform, for phasing out the remaining corrections. A transparent and simple transitional mechanism based, for instance, on lump-sums could be considered.

A package approach will be crucial for achieving a budget reform: The financing and spending sides of the budget are strongly interlinked. The phasing-out of corrections will not be possible without significant expenditure reform and the phasing in of a new, policy-driven own resource. Similarly, the various steps and the main principles of the reform of own resources and the correction mechanism should be part of one single Decision [covering the duration of one or several multiannual financial frameworks][12].

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12 This Own Resources Decision could define the list of own resources, including the new own resource, and the framework for the phasing-out of all existing correction mechanisms. [Pursuant to Art. 311, fourth paragraph, of the Treaty on the functioning of the European Union, detailed implementation of this Decision would be set out in the relevant regulation in due time by qualified majority.]

Next Steps and Conclusions

The present Communication sets out the main principles, which in the Commission's view should guide the reform of the EU budget. It proposes a reform agenda that will direct future European budgets towards the promotion of growth and jobs, climate and energy security, and strengthening a Global Europe projecting solidarity, prosperity and security. It shapes a vision on how European spending policies should develop to fully reflect those priorities and points out the choices necessary in a situation characterised by strict spending limitations. This vision should also help framing the negotiations on the next financial framework.

But reform will only succeed if it is conceived as a political package bringing win-win solutions. It could consist of the following main elements:

- **A major refocusing of EU spending priorities**, with more emphasis on growth and jobs, climate and energy security and a Global Europe projecting security, prosperity and solidarity, and less emphasis on agriculture and transfers towards well-off regions.

- **A reform and simplification of the own resources system**, with a gradual phasing out of financial corrections and a phasing in of a new, genuine own resource.

- **Significantly increased flexibility** so as to enable the Union to respond effectively to new challenges and needs.

- **Full respect of budgetary discipline.**

The European Parliament and the Council are invited to examine the proposals set out in this Communication and provide their orientations on

- **the overall approach to budget reform**, including the pace of change towards the vision set out in this Communication;

- **the broad direction of the priority areas** proposed by the Commission and the relative effectiveness of implementing certain expenditure policies at the EU level, based on the three conditions put forward by the Commission to assess European added value;

- **the best way to increase the flexibility and responsiveness of** the financial framework;

- **the governance and delivery principles** guiding the next generation of expenditure programmes as well as cross-cutting implementing rules;

- **the short and medium term perspectives for the financing system**, including the phasing in of a new own resource and the phasing out of all the remaining financial corrections.

Deliberately, the present Communication did not discuss the issue of the size of the EU budget and of its main components. It is obvious, however, that the scale and importance of new spending priorities will require either an increase of the EU budget or a significant shift from traditional to new spending areas. One way or another, the success of the reform will depend on our ambition to reshape the budget so that it reflects the challenges we are, and will increasingly be, facing in the decades to come.