HOUSE OF LORDS

European Union Committee

20th Report of Session 2008–09

The EC Budget 2010

Report with Evidence

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The European Union Committee

The European Union Committee of the House of Lords considers EU documents and other matters relating to the EU in advance of decisions being taken on them in Brussels. It does this in order to influence the Government's position in negotiations, and to hold them to account for their actions at EU level.

The Government are required to deposit EU documents in Parliament, and to produce within two weeks an Explanatory Memorandum setting out the implications for the UK. The Committee examines these documents, and 'holds under scrutiny' any about which it has concerns, entering into correspondence with the relevant Minister until satisfied. Letters must be answered within two weeks. Under the 'scrutiny reserve resolution', the Government may not agree in the EU Council of Ministers to any proposal still held under scrutiny; reasons must be given for any breach.

The Committee also conducts inquiries and makes reports. The Government are required to respond in writing to a report's recommendations within two months of publication. If the report is for debate, then there is a debate in the House of Lords, which a Minister attends and responds to.

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The Members of the Sub-Committee which conducted this inquiry are listed in Appendix 1.

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(Q) refers to a question in oral evidence
(p) refers to a page of written evidence

SUMMARY

This report informs the House about the Commission's proposals for the 2010 General Budget of the European Communities. The report summarises the significant proposed changes to funding under each of the budget headings. We have been aided in this by oral evidence from the Economic Secretary to HM Treasury (Ian Pearson MP) and a written Explanatory Memorandum from HM Treasury.

This is the fourth budget to be drawn up under the current Financial Perspective, the agreement which sets spending ceilings over a seven year period. The Commission has stated that the budget aims to aid economic recovery. However, the EU's relatively small budget limits its potential to contribute to stimulus efforts, and the system of multi-year ceilings, though useful for discipline and stability, inevitably reduces flexibility. In the report, we also express concerns over the size of the margin—the difference between the Financial Perspective ceiling and proposed spending levels—under Heading 1a (competitiveness and growth), which is not currently big enough to accommodate spending as part of the European Economy Recovery Plan and other unforeseen expenditures.

We have also briefly considered the large proportion of the budget which is spent on agriculture. We conclude that it is disappointing in the context of the financial crisis that this proportion remains so large. We do however welcome the efforts of the Government to reallocate unspent funds under Heading 2 (natural resources) to Heading 1a (growth and employment).

We have also briefly considered the forthcoming budget review, which is due to be published before the end of 2009. We look forward to scrutinising this document on its publication.

The EC Budget 2010

THE 2010 PRELIMINARY DRAFT BUDGET

1. The Committee has scrutinised the EC Budget annually since 2004 on the basis of oral evidence provided by the Government before the First Reading of the Preliminary Budget in the European Council. The Committee decided in the last Parliament that taking evidence from the Government at an early stage in the budgetary process was the most effective way in which we could fulfil our parliamentary obligation to scrutinise proposed EU legislation and so ensure greater accountability and transparency.[1]

2. HM Treasury provided an Explanatory Memorandum on the Preliminary Draft Budget (PDB) on 11 June; on the basis of this document we took oral evidence from the Economic Secretary to the Treasury, Ian Pearson MP, on 30 June. Both the Explanatory Memorandum and the transcript of oral evidence are printed with this report. As this report was published after the First Reading of the Preliminary Budget on 10 July, we expressed our views to the Minister in a letter of 8 July, which is published in Appendix 2 of this report.

3. The annual EC Budget is largely determined by the previously agreed Financial Perspective. Despite this, scrutiny of the annual EC Budget plays an important part in making the budgetary process in the EU more transparent. Accordingly, the aim of the Committee's annual report on the Budget is to inform the House of the issues relating to the Budget and to scrutinise the Government's position on the Commission's Preliminary Draft Budget. Scrutiny of the Government's position is particularly important given that the UK is a net contributor to the EC Budget. We will continue to consider the Budget until it is adopted and also any Preliminary Draft Amending Budget presented by the Commission.

4. This report was prepared by Sub-Committee A, whose Members are listed in Appendix 1. A guide to the annual European budget procedure and a glossary are presented in Appendix 3 and 5 respectively. **We make this report to the House for information.**

5. Spending in the annual EC Budget is divided into eight categories under six Headings, which are pre-determined by the multi-annual Financial Perspective:

   (1) Sustainable growth:

   (a) Competitiveness for growth and employment;

   (b) Cohesion for growth and employment;

   (2) Preservation and management of natural resources;

   (3) Citizenship, freedom, security and justice:

   (a) Freedom, security and justice;

   (b) Citizenship;

[1] European Union Committee, 1st Report (2002–03): *Review of Scrutiny of European Legislation* (HL 15).

(4) The EU as a global player;

(5) Administration; and

(6) Compensation.

No funding has been allocated to Heading 6 in the 2010 EC Budget.

6. The current Financial Perspective runs from 2007 to 2013, making the 2010 Budget the fourth under the current Perspective. This agreement between the European Council, the Commission and the European Parliament provides the financial framework for the EC for seven years, setting a ceiling for total EC expenditure over the seven years and annual ceilings for each expenditure Heading. Total EC expenditure is defined in terms of a percentage of EU Gross National Income (GNI).

BOX 1

Commitment and Payment appropriations

The Preliminary Draft Budget makes a distinction between commitment and payment appropriations.

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

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

Total appropriations

7. The PDB proposes commitment appropriations in 2010 of €138,564 million or 1.18% of EU GNI, an overall increase of 1.5% compared to 2009. For the entire budget there is a margin of €1,754 million below the Financial Perspective ceiling for 2010. The PDB allocates total payment appropriations of €122,322 million, an increase of 5.3% compared to 2009. This leaves a margin of €12,162 million below the Financial Perspective ceiling. A full table of commitment appropriations and payments can be found in Table 1. The Minister told us that this increase was in line with that outlined in the Financial Perspective for 2010 (Q 21).

8. In his Explanatory Memorandum, the Minister argued that the PDB had insufficient margins to accommodate the commitments already agreed as part of the European Economic Recovery Plan (see below), but not allocated funding within the Budget. Foreseen external action requirements in Palestine and Kosovo, and further unforeseen requirements will also need to be incorporated within the margin (p 5). The Minister told us that the Government would argue for increased margins across all Headings, but with particular focus on Headings 1a, 3 and 4. He said that the ability to finance the Economic Recovery Plan using the budget margins has shown their importance, but he noted that there were disagreements between Members States over how big these margins needed to be (QQ 31–32). He explained that the margins enabled a disciplined approach to the budget, so that unexpected events can be dealt with, without needing revision of Financial Perspective ceilings (Q 8).

9. **We agree that a sufficient margin under Heading 1a must be maintained under the Financial Perspective ceiling to ensure that unforeseen commitments and the European Economic Recovery Plan can be accommodated. We agree with the Government that the margin allowed by the Preliminary Draft Budget is likely to be insufficient.** To increase the margin, appropriations have to be reduced under Headings 1a, given that the ceiling is fixed. Where relevant we comment below on commitments and appropriations that should be reduced to allow for an increased margin.

The European Economic Recovery Plan

10. The Minister explained in the Explanatory Memorandum that in March 2009 additional funding of €5,000 million outside the 2009 Budget was agreed to fund broadband and energy efficiency infrastructure projects as part of the European Economic Recovery Plan (EERP). Of this, €2,600 million was committed from the 2009 Budget and €2,400 million will be committed from the 2010 Budget, allocated from the Heading margins. The 2009 Budget has been updated to include these commitment appropriations and payments, whereas the 2010 PDB does not yet include these appropriations (p 1). Comparisons between 2009 and 2010 figures are therefore not always accurate. We refer to this in the report where appropriate.

11. The Minister told us that the €2,600 million allocated to EERP projects in the 2009 Budget was partly funded using excess funds for agricultural projects under Heading 2 (QQ 8–9). Of the €5,000 million total, €1,020 million will go toward broadband infrastructure and CAP health check projects and €3,980 million towards energy infrastructure projects. The financing for the €1,020 million allocation will come exclusively from Heading 2, €600 million of which will be covered by the existing 2009 Heading 2 margin. Financing for the energy projects in 2009 will come from an increase to the Heading 1a margin of €2,000 million offset by a corresponding decrease in the Heading 2 margin. Excess funding originally allocated for agriculture projects is therefore being used to fund the EERP.

12. The Commission describe the 2010 Budget as an "instrument of economic recovery." The Minister emphasised increased spending under Heading 1a and the provision of extra funding for core tools to aid recovery (such as the European Globalisation Adjustment Fund as well as EERP projects) as examples of how the PDB fulfils this claim (Q 4). He welcomed the increases in these areas and said that he was "confident that this can play a part" in stimulating the economy (Q 7). In particular he praised the energy projects which form part of the EERP, such as development of carbon capture and storage, which he believed should remain a key priority at both Member State and EU level (Q 21). He acknowledged that many of these projects would only have a significant impact in the long term, but argued that the Recovery Plan should contain a mix of short-term stimuli and longer-term projects that will benefit the EU after the recession. He said that the EERP should have policies "that provide real assistance, support jobs and employment now" whilst ensuring that there is a longer-term "forward facing agenda". He concluded that "essentially that means spending less on the Common Agricultural Policy and more on competitiveness, growth and jobs" (Q 14).

13. The Minister argued that it was correct to fund the EERP through the existing budget margins, as this allowed the use of funds from Heading 2, under which funds for the Common Agricultural Policy are allocated. He described agricultural spending as poor value-for-money for the EU taxpayer (Q 12). He said that spending under Heading 2 distorted markets and did not support a prosperous EU and argued that the Budget "could do more" to aid economic recovery by further reducing spending under this Heading and increasing spending under Heading 1 (Q 3). He described it as "curiously bizarre" that the EU is still spending a significant proportion of the Budget on agriculture when Europe is focused on climate change and the economic crisis (Q 19).

14. He argued that in some respects the operating mechanisms of the Budget forced the use of margins to fund the EERP as there is no provision within the Budget to react to unexpected events (Q 10). He agreed that seven-year budgeting through the multi-annual Financial Perspective makes it harder for the Budget to be adjusted to respond to a crisis and admitted "privately I might have some sympathy" for a zero-based budgeting system.[2] He commented that the Financial Perspective remains a key tool for budgetary discipline, but added that the system does need a "fundamental review". He said that "until we reshape and modernise the EU Budget overall I think its ability to effectively support a prosperous EU is limited". However, he did note that the Budget was just one of many tools the EU had to respond to the economic crisis along with coordination of Member State action (QQ 3–4). We discuss this further in the section on the Budget Review below.

15. The economic crisis has created a need to focus the budget on aiding economic recovery, which the Commission has recognised. **We support the Commission's attempts to focus the Preliminary Draft Budget on economic recovery. However, the EU's relatively small budget limits its potential to contribute to stimulus efforts, and the system of multi-year ceilings, though useful for discipline and stability, inevitably reduces flexibility.[3] In the light of the recession the distribution of the Budget in favour of agriculture is deeply frustrating.**

2 This budgeting system reviews all departmental spending annually, and all expenditure must be approved, rather than only approving increases to spending.

3 The Committee commented on the length of the multi-annual financial programmes in its Report *Future Financing of the European Union* (European Union Committee, 6th Report (2004-05) HL 62).

TABLE 1
Summary of 2010 PDB Proposals—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
1. Sustainable Growth	**62,202**	**54,296**	**46,070**	**40,215**	**62,152**	**54,252**	**47,365**	**41,345**	**-0.1%**	**-0.1%**	**2.8%**	**2.8%**
1a. Competitiveness for Growth and Employment	13,775	12,024	11,106	9,694	12,769	11,146	10,982	9,586	-7.3%	-7.3%	-1.1%	-1.1%
1b. Cohesion for Growth and Employment	48,427	42,272	34,963	30,519	49,382	43,106	36,382	31,758	2.0%	2.0%	4.1%	4.1%
2. Preservation and Management of Natural Resources	**56,721**	**49,512**	**52,566**	**45,885**	**59,004**	**51,505**	**58,075**	**50,694**	**4.0%**	**4.0%**	**10.5%**	**10.5%**
Of which market related expenditure and direct payments	41,127	35,900	41,080	35,859	43,745	38,185	43,626	38,081	6.4%	6.4%	6.2%	6.2%
3. Citizenship, Freedom, Security and Justice	**1,527**	**1,333**	**1,308**	**1,142**	**1,629**	**1,422**	**1,360**	**1187**	**6.7%**	**6.7%**	**3.9%**	**3.9%**
3a. Freedom, Security and Justice	864	754	617	539	980	855	720	628	13.5%	13,5%	16.6%	16.6%
3b. Citizenship	663	579	691	603	649	567	640	559	-2.0%	-2,0%	-7,4%	-7.4%
4. EU as a Global Player	**8,104**	**7,074**	**8,324**	**7,266**	**7,921**	**6,914**	**7,665**	**6,691**	**-2.3%**	**-2.3%**	**-7.9%**	**-7.9%**
5. Administration	**7,695**	**6,717**	**7,695**	**6,717**	**7,858**	**6,859**	**7,858**	**6,859**	**2.1%**	**2.1%**	**2.1%**	**2.1%**
6. Compensation	**209**	**182**	**209**	**182**	**-**	**-**	**-**	**-**	**-**	**-100.0%**	**-**	**-100.0%**
TOTAL	**136,458**	**119,114**	**116,172**	**101,407**	**138,564**	**120,953**	**122,322**	**106,775**	**1.5%**	**1.5%**	**5.3%**	**5.3%**
Margin					1,754	1,531	12,162	10,616				
Compulsory Expenditure	42,799	37,359	42,784	37,346	45,248	39,496	45,152	39,413	5.7%	5.7%	5.5%	5.5%
Non-Compulsory Expenditure	93,658	81,754	73,388	64,060	93,316	81,456	77,170	67,362	-0.4%	-0.4%	5.2%	5.2%
Appropriations as % of GNI	**1.18%**	**1.18%**	**1.00%**	**1.00%**	**1.18%**	**1.18%**	**1.04%**	**1.04%**				

Notes: (1) CA = commitment appropriations (2) PA = payment appropriations
(3) Due to rounding, the sum of the lines may not equal the total
(4) Compulsory/non-compulsory expenditure = Compulsory expenditure is determined by the European Council, non-compulsory expenditure by the European Parliament (p 9)
(5) The exchange rate used to calculate all values in pounds sterling is €1 = £0.8729, the exchange rate on 31 May 2009
(6) Financial Perspective ceilings are adjusted to current prices (i.e. the ceilings for the 2010 Budget are presented in 2009 prices). The 2009 Budget is presented in 2008 prices, whilst the PDB 2010 is presented in 2009 prices

Detailed expenditure by Heading

Heading 1 Sustainable Growth

TABLE 2

Sustainable Growth—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
1. Sustainable Growth	**62,202**	**54,296**	**46,070**	**40,215**	**62,152**	**54,252**	**47,365**	**41,345**	**-0.1%**	**-0.1%**	**2.8%**	**2.8%**
1a. Competitiveness for Growth and Employment	13,775	12,024	11,106	9,694	12,769	11,146	10,982	9,586	-7.3%	-7.3%	-1.1%	-1.1%
1b. Cohesion for Growth and Employment	48,427	42,272	34,963	30,519	49,382	43,106	36,382	31,758	2.0%	2.0%	4.1%	4.1%

16. Under Heading 1a, commitment and payment appropriations have decreased by 7.3% and 1.1% respectively. The Minister explained that this decrease is due to EERP commitments being factored into the 2009 Budget, but not yet the 2010 PDB (p 2). (If the EERP commitments and payments are excluded from the 2009 Budget, the 2010 PDB sees an increase of 8.4% and decrease of 6.3% for commitment and payment appropriations respectively.) The reduction in payments is accounted for by:

- Decrease of funding to the 7th Framework Programme, which includes all EU research initiatives as part of the Lisbon Strategy for Growth and Jobs. Funding for the 6th Framework Programme has been phased out;
- A 40% decrease in funding for the Galileo satellite navigation project, on which the Committee has recently taken oral evidence from the Government and the Commission.[4]
- A 24% decrease in funding for the competitiveness and innovation framework programme.

17. Under Heading 1b, the increase in commitments relative to the 2009 Budget is largely accounted for by a 9.6% increase in funding to the Cohesion Fund. The Minister explained that allocations for the Fund included €158bn of funding for Cohesion policy projects in new Member States. Cohesion funding in new Members States accounts for 56% of total Cohesion fund spending in 2013, compared to 24% in 2007 (Q 22). The Committee's recent report *The Future of EU Regional Policy* (HL Paper 141, 19th Report of Session 141) argued that Regional Policy spending should be focused on poorer Member States. We are pleased to note that Cohesion Fund will in future focus on spending in new Member States.

18. As Cohesion funding has previously had a low implementation rate, we asked the Minister why funding is being increased in this area given that it may not all be allocated or spent. He told us that the increase in funding to new Member States was written into the Financial Perspective as part of a

[4] Oral evidence transcripts can be viewed online at: www.parliament.uk/hleub

previous political agreement, which he argued the Government should not go back on (Q 27). He did, however, agree that the implementation or take-up levels of Cohesion funding were nearly 10% lower than those of the Heading as a whole (Q 25). However, there is a mechanism for cancelling commitments that are not turned into payments and the Minister told us that the Government were seeking to ensure that payment levels take into account "genuine implementation capacity" (Q 29 and p 5). In recent years the Commission has worked closely with Member States to increase implementation rates of Cohesion policy funding which have risen from 68% in 2001 to 87% in 2008 (Q 30). We are concerned that commitment appropriations have increased for the Cohesion Fund when it has previously had a low implementation rate. However, we are pleased to see that real progress is being made in increasing implementation rates.

19. The Minister expressed concern that the margin of €130 million under the Financial Perspective for Heading 1 is not big enough to accommodate the financing of the EERP. He said the Government would seek to agree a larger margin, particularly under the commitments budget ceiling of Heading 1a (p 5). **The margin under Heading 1a should be increased to meet these and other currently unforeseen commitments**. This requires a decrease in commitment appropriations, particularly under Heading 1a, where the margin is very small (Q 31).

Heading 2 Preservation and Management of Natural Resources

TABLE 3

Preservation and Management of Natural Resources—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
2. Preservation and Management of Natural Resources	**56,721**	**49,512**	**52,566**	**45,885**	**59,004**	**51,505**	**58,075**	**50,694**	**4.0%**	**4.0%**	**10.5%**	**10.5%**
Of which market related expenditure and direct payments	41,127	35,900	41,080	35,859	43,745	38,185	43,626	38,081	6.4%	6.4%	6.2%	6.2%

20. Increases in commitments under Heading 2 are largely accounted for by a 6.4% increase in market-related expenditure or direct aids, as a result of phasing-in of direct aids to new Member States. The increase in payments arises largely because of a 31% increase in funding for rural development. The Minister commented that a large proportion of direct payments had already been agreed, making it hard for the increase to be lower than that described in the PDB (p 5).

21. The Minister told us that the large part of the budget spent on agriculture does not represent good value for money for either the UK or EU taxpayer (Q 19). The Government has been arguing for complete reform of the budget in this area and will closely scrutinise increases in these areas in the 2010 PDB, particularly given the low implementation capacity, with much funding remaining unspent (p 5). He explained that the Government were

able to argue successfully for the unallocated expenditure under Heading 2 to be used as funding for the EERP in the 2009 Budget. He hoped that this would continue to be the case in 2010 (QQ 8–9). The Committee has previously commented on spending as part of the Common Agricultural Policy, which is funded under Heading 2, in its report *The Future of the Common Agricultural Policy*.[5]

Heading 3 Citizenship Freedom, Security and Justice

TABLE 4

Citizenship, Freedom, Security and Justice—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
3. Citizenship, Freedom, Security and Justice	**1,527**	**1,333**	**1,308**	**1,142**	**1,629**	**1,422**	**1,360**	**1187**	**6.7%**	**6.7%**	**3.9%**	**3.9%**
3a. Freedom, Security and Justice	864	754	617	539	980	855	720	628	13.5%	13.5%	16.6%	16.6%
3b. Citizenship	663	579	691	603	649	567	640	559	-2.0%	-2.0%	-7.4%	-7.4%

22. Under Heading 3a, the substantial increases in commitments and payments are accounted for by:

- A €30m increase in commitments and a €44 million increase in payments to Solidarity and management of migration flows; and
- An allocation of €80 million to fund EUROPOL.

Decreases in commitments and payments under Heading 3b are largely accounted for by the absence of specific resources allocated to the European Union Solidarity Fund (EUSF). The EUSF is used to provide emergency funding in response to natural disasters within the European Union.

23. When asked whether he agreed with the increase in funding to EUROPOL, the Minister said that this €12m increase was indeed "very substantial". He told us that a large proportion of this increase was down to a building proposal for a new headquarters; this requires scrutiny to ensure that it provides good value-for-money. He was not convinced that the increase in funding for EUROPOL represented worthwhile expenditure (QQ 33–34). The Committee commented on the role of EUROPOL in its report *EUROPOL: coordinating the fight against serious and organised crime* (29th Report Session 2007–8, HL Paper 183).

24. The Minister argued that security was an area of the Budget, along with Growth and Jobs and Climate Change and Development, where EU spending would have an important positive effect (QQ 1, 12). However, the Government were looking to reduce appropriations for commitments and payments to ensure a sufficient margin below the Financial Perspective, which is currently €64 million (pp 5–6).

[5] European Union Committee, 7th Report (2007-08): *The future of the Common Agricultural Policy* (HL 54).

Heading 4 The EU as a Global Player

TABLE 5

The EU as a global player—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
4. EU as a Global Player	**8,104**	**7,074**	**8,324**	**7,266**	**7,921**	**6,914**	**7,665**	**6,691**	**-2.3%**	**-2.3%**	**-7.9%**	**-7.9%**

25. The inclusion of the Food Facility in the 2009 Budget largely accounts for the decrease in commitments, along with a significant reduction in funding for Development and Relations with ACP States. The reduction in payments is largely explained by a €516 million reduction in the Instrument for Pre-Accession.

26. The Minister explained that further expenditure is expected in Kosovo, Palestine and Georgia and a sufficient margin must be maintained under the Financial Perspective ceiling to meet these possible future contingencies (pp 5–6). The Government were considering whether these financing proposals are realistic given implementation levels.

Heading 5 Administration

TABLE 6

Administration—EUR million and GBP million

Heading	2009 Budget				2010 PDB				% change			
	CA		PA		CA		PA		CA		PA	
	€	£	€	£	€	£	€	£	€	£	€	£
5. Administration	**7,695**	**6,717**	**7,695**	**6,717**	**7,858**	**6,859**	**7,858**	**6,859**	**2.1%**	**2.1%**	**2.1%**	**2.1%**

27. The increase in payments is accounted for by a 5.1% increase in pensions over all institutions, as well as a 2.4% increase in budgets of Other Institutions and a slight increase in commitments and payments to the Commission. The budget of European Schools has risen by €6 million because of an increase in the number of pupils.

28. Although the Minister welcomed the lower increase in the allocation compared to previous years, he told us the Government intended to question whether it could not be reduced further (p 6). Increasing efficiency in Administration spending was a key Government objective for the Budget negotiations (Q 1).

29. Heading 6, Compensation, no longer has an allocation as part of the PDB which represents a €209 million reduction to the PDB compared to 2009.

Budget Review 09

30. The European Council of December 2005 agreed that the Commission "should carry out a comprehensive reassessment of the financial framework, covering both revenue and expenditure, to sustain modernisation and to enhance it, on an ongoing basis". The Commission was asked to conduct a "full, wide ranging review covering all aspects of EU spending, including the

CAP, and of resources, including the UK rebate, to report in 2008/9”.[6] This review began in late 2007 with the publication of a consultation paper by the Commission. Our response to the 2008 consultation paper is published in Appendix 4.

31. The Government response to the consultation paper called for the re-orientation of the budget towards three areas:

- Building a prosperous Europe within a strong global economy;
- Addressing the challenges of climate change; and
- Ensuring security, stability and poverty reduction.

32. The Government’s response focused on the argument for the abolition of price support and direct intervention in agricultural markets, and for other payments under the CAP to focus on delivering environmental benefits to society that would not otherwise be delivered by the market. The Minister explained that while the United Kingdom will push for the Budget Review to have an ambitious reforming agenda, other Member States may be “less than enthusiastic” (QQ 38–40). The Budget Review will be published in 2009 and we expect to conduct a full inquiry in due course.

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6 15915/05.

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

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

Lord Browne of Madingley
Baroness Cohen of Pimlico (Chairman)
Lord Haskins
Baroness Hooper
Lord Jordan
Lord Moser
Baroness Northover
Lord Renton of Mount Harry
Lord Steinberg
Lord Trimble
Lord Watson of Richmond
Lord Woolmer of Leeds

Declaration of Interests

Lord Browne of Madingley
Member, Deutsche Bank Advisory Board for Climate Change
Member, Brevan Howard Advisory Board
Managing Partner and Managing Director, Riverstone LLP
Member, PCCW Group of Advisors
Member, Schlumberger Business Consulting Advisory Group
Chairman, Accenture Energy Advisory Board
Member, McKinsey Knowledge Council
President, Royal Academy of Engineering
Chairman, Board of Trustees, Tate Galleries

Baroness Cohen of Pimlico
Non-executive Director, London Stock Exchange plc.
Vice Chairman, Borsa Italiana SA
Non-executive Director, Management Consulting Group plc
Chairman, Trillium Partners Ltd

Lord Haskins
Non-executive Director, JSR Farms Ltd
Advisory Director, Montrose Associates
Chair, Airtrack Railways Ltd
Director, Quarryside Farms Ltd
Pro Chancellor, Open University
Trustee, Lawes Agricultural Trust

Baroness Hooper
Chairman, Advisory Committee of two Barclays European Infrastructure Funds
Council Member, Institute for the Study of the Americas, University of London
Development Trust, National Museums Liverpool
Chairman, European Foundation for Heritage Skills
Chairman, Dance Teachers Benevolent Fund
Executive Council Member, Commonwealth Parliamentary Association
Governor, Royal Academy of Dance
Governor, Centre for Global Energy Studies (20 January 2009)
Vice-President, Hispanic and Luso Brazilian Councils (Canning House)
President, Waste Watch
President, British Educational Equipment & Supplies Association (20 January 2009)

Trustee, The Tablet
Trustee, Anglo Romanian Educational Trust
Trustee, Industry and Parliament Trust
Trustee, St. George's House, Windsor Castle
Fellow, Royal Geographical Society
Fellow, Royal Society for Arts and Manufacturing
Anglo Ecuadorian Society
Galapagos Trust
Anglo Mexican Society
Anglo Chilean Society

Lord Jordan
Chairman, Homes and Communities Agency Pension Scheme

Lord Moser
Consultant, Askonas Holt Ltd (unpaid)
Board Member, Open University of Israel
Board Member, Menuhin School
Advisory Council Member, London Symphony Orchestra
Chairman, Educational Committee, London Symphony Orchestra
Trustee, Hermitage Rooms, Somerset House
Trustee, Jewish Museum
President, Playhouse Theatre, Oxford
Chairman, Executive Committee, Jerusalem Music Centre
Chairman, Music at Oxford
Trustee, Rayne Foundation
Trustee, Paul Hamlyn Foundation
Trustee, National Centre for Social Research
Committee Member, Zoo Development Committee

Baroness Northover
Farm, West Sussex

Lord Renton of Mount Harry
Ownership of agricultural land in Sussex with wife
Partnership with wife and son in Mount Harry Vines

Lord Steinberg
Life President, Genting Stanley Plc
Executive Chairman, E.G.M.I
Non-executive Director, Medgenics
Director and Chairman, Stanleybet UK Investments

Lord Trimble
No relevant interests

Lord Watson of Richmond
Chairman, CTN communications
Chairman, Havas Media
Chairman, The Cambridge Foundation
President, The European Atlantic Movement
Chairman, Nexus Publishing
Chairman, Raisin Social Wine Importer

Lord Woolmer of Leeds
Member of the All Party Parliamentary Group on Wholesale Financial Markets

A full list of registered interests of Members of the House of Lords can be found at http://pubs1.tso.parliament.uk/pa/ld/ldreg/reg01.htm

APPENDIX 2: LETTER FROM RT HON THE LORD ROPER, CHAIRMAN OF THE SELECT COMMITTEE ON THE EUROPEAN UNION, TO IAN PEARSON MP, ECONOMIC SECRETARY TO HM TREASURY, 8 JULY 2009

Thank you for your Explanatory Memorandum dated 11 June and for meeting with Sub-Committee A on 30 June. The Sub-Committee have now considered the Preliminary Draft Budget (PDB) and have cleared the item from scrutiny. As is usual practice, the Committee plan to publish a Report on the Budget by the end of July.

We broadly agree with your position. We support the Government's efforts to ensure that EC expenditure delivers value for money, appropriations are based on realistic spending forecasts and Financial Perspective ceilings are respected.

As the Sub-Committee discussed with you at the meeting last week, the Committee shares your concern that the PDB has insufficient margins to accommodate the European Economic Recovery Plan and unforeseen commitments. We believe that appropriations should be reduced under Heading 1a to increase the margin under the Financial Perspective ceiling.

We support the Commission's attempts to focus the Preliminary Draft Budget on economic recovery as a result of the financial crisis. However, we believe that without fundamental reform of the budget system it is difficult for annual budgets to respond to changing situations, as a significant review of the Budget is carried out only once every seven years. The size of the EC Budget also limits any realistic attempts to stimulate economic recovery through this funding source. We were pleased to hear that you will push for the Budget Review to have an ambitious reforming agenda, looking to create a budgetary system that will be able to react effectively to unexpected events.

We are concerned that in the light of the recession the distribution of the Budget favours agriculture because we believe that greater spending in other areas could better contribute to economic recovery. We agree with you that spending on agriculture under Heading 2 should be reduced.

We would be grateful if you could write to the Committee after 10 July to update us on progress at Budget ECOFIN. We look forward to working with you both on this issue and on other dossiers in the future.

APPENDIX 3: EUROPEAN BUDGETARY PROCEDURE

Current Procedure

The budgetary procedure is set out in Article 272 of the Treaty establishing the European Community, which stipulates the sequence of stages and the time limits which must be respected by the two arms of the budgetary authority which together establish the annual budget: the Council of Ministers (acting by qualified majority) and the European Parliament.

Under the present budgetary procedure, the Council has the final say on compulsory expenditure. This is spending that is a direct result of Treaty application or of acts adopted in accordance with the Treaty. In practice, this mainly means spending on agricultural guarantees. The European Parliament has the final say on all other categories of spending, which are defined as non-compulsory expenditure. Examples of non-compulsory expenditure include spending on regional policy, research policy and energy policy.

The Lisbon Treaty

If the Lisbon Treaty is implemented, changes will be made to this procedure. Most significantly, the distinction between compulsory and non-compulsory expenditure will be abolished and the Council and Parliament will have to reach agreement on all parts of the budget. In our impact assessment of the Lisbon Treaty, we concluded that this change would increase transparency and make the agricultural budget more open and balanced between market related expenditure and funding for rural development.[7]

The Lisbon Treaty also introduces a "subsidiarity check" which allows Member State Parliaments to express concerns on subsidiarity directly to the institution which initiated the proposed legislation. Member State Parliaments working together can request a review of legislative proposals.

The stages of the annual budget

In practice,[8] the stages in the negotiations over the annual budget are as follows:

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

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

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

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

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

Preliminary Draft Budget

This report deals with the Preliminary Draft Budget as issued by the Commission on 29 April 2009. This version of the Budget represents the first stage of the

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7 European Union Committee, 10th Report (2007–08): *The Treaty of Lisbon: an impact assessment* (HL 62).

8 Article 272 of the Treaty establishing the European Community contains later backstop dates.

procedure and provides the basis for subsequent negotiations between the Council and the European Parliament. The Draft Budget was established on 10 July at the Economic and Financial Affairs Council.

The Council's Second Reading

After the Parliament's first reading, a delegation from the Parliament attends a conciliation meeting with the Council prior to the Council conducting its second reading in early November. The Draft Budget is amended in the light of the European Parliament's amendments (for non-compulsory expenditure) or proposed modifications (for compulsory expenditure). As a general rule, the Council's decisions on second reading determine the final amount of compulsory expenditure: unless the entire Budget is subsequently rejected by the European Parliament, the Council has the "last word" on this category of expenditure. The Draft Budget as amended is then returned to the European Parliament.

The European Parliament's Second Reading and the adoption of the Budget

In December, the European Parliament reviews non-compulsory expenditure, for which it can accept or refuse the Council's proposals. If there is agreement, the President of the European Parliament then declares the Budget adopted and it can be implemented; alternatively the Parliament may reject the draft budget and ask for a new draft to be submitted.

Resources for the EC Budget

The revenue side for the annual EC Budget has four main sources, collectively known in the Community as the 'Own Resources'. These are:

(1) customs duties;

(2) agricultural levies, including sugar levies;

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

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

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

Over time, the proportions of income from each resource have adjusted to the current position whereby the GNI-based contribution is the primary source of income for the EC Budget. In 2007, we supported this development; we found that no new form of taxation put to us provided the same level of clarity and certainty as the GNI-based resource.[9]

[9] European Union Committee, 12th Report (2006–07): *Funding the European Union* (HL 64).

APPENDIX 4: THE COMMITTEE RESPONSE TO THE 2008/9 EU BUDGET REVIEW CONSULTATION PAPER

1 Has the EU budget proved sufficiently responsive to changing needs?

No. The allocation of funding from the EU Budget remains dominated by historic influences. We welcome the review as an opportunity to remove many of these and start afresh with a budget which is suitable for the issues which the Community currently faces.

2 How should the right balance be found between the need for stability and the need for flexibility within multi-annual financial frameworks?

We support the principle of multi-annual financial frameworks. The stability and certainty of funding that they produce is particularly welcome for regions and projects that are receiving funds from the Cohesion and Structural Funds, and similar schemes, as it allows the project managers to plan over several years rather than rush to distribute funding.

3 Do the new policy challenges set out in the consultation document effectively summarise the key issues facing Europe in the coming decades?

Yes. The list of challenges in section 2.1 of the document is comprehensive and wide-ranging. As the document implies, financial resources are just one policy lever that is available to the Commission, and we would not expect the European Union budget to have to fund activities under all of these headings. National governments must take steps to address many of these factors themselves. All areas clearly need to be properly justified against the criterion of EU value added.

4 What criteria should be used to ensure that the principle of European value added is applied effectively?

The Consultation Paper summarises the case for spending from the EU budget. European action should provide clear additional benefits compared to action by individual Member States alone in pursuing policies that promote the European common interest. It is important to remember that the Commission can act as a repository of information and best practice, and co-ordinate Member States' activities, rather than directly spending money itself.

5 How should policy objectives be properly reflected in spending priorities? What changes are needed?

Direct income support under the CAP should be progressively phased out over the course of the next Financial Perspective. A significant proportion of the funds released should remain earmarked for the rural development element of the policy. There is a place for collective EU investment in ensuring that Europe has a dynamic economy—because that depends on the EU as a whole improving capacity and therefore investment in innovation and human capital. As long as the principle of subsidiarity is respected, we believe there is a place for collective EU investment in Research and Development (R&D), education and infrastructure programmes, but this investment can only reach its potential in a fully realised Internal Market.

We are currently considering the Structural & Cohesion Funds and a report will be published in May. Our preliminary conclusions are that funding should be concentrated on the new Member States, where the lack of administrative capacity is a significant impediment to growth; spending on these programmes should not occur in wealthier regions. EU cohesion spending should remain transitional, time limited and geographically focused to assist with economic convergence, restructuring or diversification. The support should be tapered and it should not become a permanent policy instrument used by the EU to prop up regions on a continuing basis.

6 Over what time horizon should reorientations be made?

Reorientations should be completed as soon as possible. A prompt conclusion to the Budget Review would allow the necessary groundwork to be laid for new programmes and policies before the end of this Financial Perspective.

7 How could the effectiveness and efficiency of budget delivery be improved?

Developments in the value for money and performance auditing side of the Court of Auditors' work would be particularly valuable. The Court already produces some special reports which go beyond simple audit function, and this is a role that could be expanded further. We also support work undertaken by Eurostat to ensure that reliable and comparable statistics are available in all countries: these are often the only means by which the success or otherwise of an intervention can be measured. It is important that this work continues and that comprehensive economic data is available for all regions of the EU.

8 Could the transparency and accountability of the budget be further enhanced?

The lack of a positive assurance from the European Court of Auditors in their annual Statement of Assurance is a serious problem for the European Union and the governments of its Member States. We recognise, however, that the EU budget is relatively small compared to the total government spending in many Member States and that the resolution of the failure to produce a positive assurance will require Member State commitment to change.

We encourage the Court to put in place measures clearly to distinguish between irregularity and fraud and to publish separate figures for the level of fraudulent transactions and administrative mistakes. Whilst the distinction between fraud and other irregularities must be made clear, we consider that administrative mistakes could still indicate deficiencies in the control systems operated by the Member States or the Commission. Attention should therefore be drawn to both categories and all sources of error should be taken into account when calculating material error rates.

The European Court of Auditors should produce a list of those Member States demonstrating poor management of European funds. We consider that such a list would encourage all the governments of the Member States to take this issue seriously. We consider it particularly unacceptable for the government of a Member State to treat European money with less care than national funds and urge the Council to make this clear. We are also concerned about the variability of control standards between Member States. We consider that all European expenditure should be subject to equivalent standard of control to ensure that the risk of fraud and error is minimised.

We are strongly in favour of a national Statement of Assurance on the monies disbursed in each Member State. Such a Statement should be sent to national parliaments as well as to the Commission as we consider that this will encourage the Member States to take responsibility for the systems and controls they operate. Consideration should be given to ensuring the length of time the discharge procedure takes is not extended. We do not consider that a national Statement of Assurance requires a political signature.

We recognise the commitment that the Commission has shown to improving its accounting system. This must continue and the Commission must always aim to be a global leader in public accounting.

9 Could enhanced flexibility help to maximise the return on EU spending and political responsiveness of the EU budget?

This is not necessary. The EU budget is best placed to consider wide-ranging, long-term issues where a multinational approach is most likely to effect change. It should not aim to be responsive to political pressures which vary more frequently. National government budgets can fulfil this role instead.

10 What principles should underpin the revenue side of the budget and how should these be translated in the own resources system?

In principle we would welcome greater simplicity, transparency and a reduced administrative burden. But we would not wish to propose change for change's sake. We therefore see no need for change with respect to the Traditional Own Resources. On balance we believe it would be no great loss if the VAT Resource were eliminated. We welcome Eurostat's continuing work to enhance the comparability, exhaustiveness and reliability of Gross National Income data, but we believe it already is sufficiently reliable to provide the statistical base for a revenue stream. We reject suggestions that the GNI-based revenue stream, or any other transfer from a Member State, is not a valid funding mechanism.

We do not think a tax on citizens is needed to fund the EU. Any assessment of the suitability of a tax or revenue generating measure will be subjective and dependent on the weightings placed on the different attributes considered desirable. Considered against the criterion of suitability for revenue raising (which should be the Commission's sole concern), none of the alternatives as currently set out demonstrate compelling advantages over the present system.

11 Is there any justification for maintaining correction or compensatory mechanisms?

If real reform of the expenditure side of the Budget were secured, the scale of, and possibly the need for, the corrections and compensatory mechanisms would be reduced. The pressing need for reform is on the expenditure side, and in particular in the area of direct agricultural income support for farmers: without it, the case for maintaining rebate mechanisms will remain strong.

12 What should be the relationship between citizens, policy priorities, and the financing of the EU budget?

We welcome the changes to the budget that have been made by the Lisbon Treaty, in particular the removal of the principle of "compulsory" expenditure which will enhance the role of the European Parliament.

There is also a role to be played by national Parliaments. We have found it very useful to produce a report on the draft annual budget each year. Sub-Committee A of the House of Lords European Union Committee meets a United Kingdom Treasury Minister between the publication of the Preliminary Draft budget and the July Budget ECOFIN meeting. The Minister is asked to outline the Government's stance on the budget and is made aware of Parliament's views.

Wider publicity could be given to the Annual Policy Strategy (APS) by the Council and national governments. The Commission must also explain clearly in the APS the financial constraints around it, and the ways in which the Commission can or cannot change its spending priorities within the financial framework. Political priorities must be matched in budgetary terms, and to do that it needs to declare which areas of action are receiving less funding in order to allow it to prioritise others. The Commission, the Council and the Parliament need to forge a closer link between the budgetary and legislative processes.

Ultimate responsibility lies in the Council, so it is crucial that it assists any effort to increase the correlation between political priorities and financial resources. The APS must provide the clear, overarching strategy for the Commission's coming year, indicating in each area what are to be the key policy intentions to be prioritised for implementation of that strategy.

As outlined in our answer to question ten, we oppose a direct tax on citizens or business.

This response draws on reports recently published by the Committee, including:

- The Future of the Common Agricultural Policy (7th Report, 2007–08; HL 54) 6 March 2008
- The 2008 EC Budget (33rd Report, 2006–07; HL 160) 30 July 2007
- Funding the European Union (12th Report, 2006–07; HL 64) 14 March 2007
- Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals (50th Report, 2005–06; HL 270) 13 November 2006
- The 2007 EC Budget (39th Report, 2005–06; HL 218) 10 July 2006
- Future Financing of the European Union (6th Report, 2004–05; HL 62) 9 March 2005

These are all available online at

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

The response also draws on comments made by Lord Grenfell in the House of Lords on 28 February 2008, during a debate on the report of the European Union Committee, The Commission's Annual Policy Strategy for 2008 (23rd Report, Session 2006–07, HL Paper 123).

http://www.publications.parliament.uk/pa/ld200708/ldhansrd/text/80228–0013.htm#08022878000205

The Committee plan to conduct an inquiry into the proposals for the Budget Review when they are available.

APPENDIX 5: GLOSSARY

ACP	African, Caribbean and Pacific Group of States
CAP	Common Agricultural Policy
EC	European Communities
EERP	European Economic Recovery Plan
EU	European Union
EUROPOL	European Law Enforcement Cooperation
EUSF	European Union Solidarity Fund
GNI	Gross National Income
GNP	Gross National Product
PDB	Preliminary Draft Budget

APPENDIX 6: RECENT REPORTS

Recent reports from the Select Committee

Access to EU Documents (15th Report session 2008–09, HL Paper 108)

The Review of the Less Favoured Areas Scheme (13th Report session 2008–09, HL Paper 98)

European Contract Law: the Draft Common Frame of Reference (12th Report session 2008–09, HL Paper 95)

Correspondence with Ministers—May to October 2007 (11th Report session 2008–09, HL Paper 92)

Recast of the First Rail Freight Package (10th Report session 2008–09, HL Paper 90)

Procedural rights in EU criminal proceedings—an update (9th Report session 2008–2009, HL Paper 84)

Reports prepared by Sub-Committee A

Session 2008–2009

The future of EU financial regulation and supervision (14th Report, HL Paper 106)

EU Legislative Initiatives in response to the Financial Turmoil (1st Report, HL Paper 3)

Session 2007–2008

Developments in EU Trade Policy (35th Report, HL Paper 200)

The Future of EU Regional Policy (19th Report, HL Paper 141)

The 2009 EC Budget (18th Report, HL Paper 140)

The euro (13th Report, HL Paper 90)

Solvency II (6th Report, HL Paper 42)

Minutes of Evidence

TAKEN BEFORE THE EC COMMITTEE

TUESDAY 30 JUNE 2009

Present	Cohen of Pimlico, B. (Chairman)	Steinberg, L.
	Haskins, L.	Trimble, L.
	Moser, L.	Woolmer of Leeds, L.
	Northover, B.	

Explanatory Memorandum by HM Treasury SEC(2009) 610

PRELIMINARY DRAFT BUDGET (PDB) OF THE EUROPEAN COMMUNITIES 2010

Subject Matter

Commission Proposals, the Budget Structure and the Annual Procedure

1. The Preliminary Draft Budget (PDB) sets out the Commission's proposal for European Community expenditure in 2010. It represents the first stage in the *annual budget procedure*,[1] and provides the basis for negotiations between the two arms of the Budgetary Authority (the Council and the European Parliament), which will result in the adoption of the 2010 General Budget in December 2009.

2. The context for the PDB is determined by the multi-annual *Financial Perspective* (FP) which sets out annual ceilings for the six headings of budget expenditure:

(i) Sustainable Growth;

(ii) Preservation and Management of Natural Resources;

(iii) Citizenship, Freedom, Security and Justice;

(iv) The European Union as a Global Player;

(v) Administration; and

(vi) Compensation (temporary measures for Bulgaria and Romania in the first years of accession and no longer applying after 2009).

The PDB for 2010 will be the fourth of the 2007–13 FP.

3. The PDB is presented in *Activity-Based Budgeting* (ABB) format with budget appropriations, resources and staff allocations organised by activity. ABB seeks to tie budgetary resources to clear policy objectives using appropriate performance indicators and evaluation measures. As part of the 2010 PDB the Commission also published *Activity Statements* providing performance information for each activity. These present specific objectives, planned outputs, and performance measures at the level of individual budget lines as well as higher-level activity areas, in line with ABB. Negotiations on the 2010 budget will be conducted on the basis of ABB documentation.

4. The 2010 PDB presents a Budget Memorandum for the first time. This provides an overview of the main achievements which have been or will be achieved by the EC Budget. The budget memorandum is organised around the four priority areas of the Lisbon Strategy and based on information from activity statements.

5. At the European Council on 20 March 2009 agreement was reached between heads of Government on an additional €5,000 million (£4,365 million)[2] package to support energy and broadband infrastructure projects as part of the wider European Economic Recovery Plan (EERP). Agreement was reached on financing €2,600 million (£2,270 million) of commitment appropriations in 2009 Financing the remaining €2,400 million (£2,095 million) to be committed in 2010 will be discussed and decided on in the context of the 2010 budget negotiations. The 2009 budget therefore includes commitments and payments for the EERP while the commitments for 2010 are not yet entered in the PDB. This is acknowledged by the Commission in the presentation of its PDB and the comparisons made with the 2009 budget.

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

2 "This and all subsequent exchange rates will be calculated using the exchange rate on 31 May 2009 for June 1 Euro £0.8729 and rounded to the nearest million.

6. As in previous years, the PDB consists of a General Statement of Revenue and draft estimates of required appropriations for the nine separate EU institutions (European Parliament, Council, Commission, Court of Justice, Court of Auditors, Economic and Social Committee, Committee of the Regions, European Ombudsman; European Data Protection Supervisor). In addition, the Commission publishes Working Documents alongside the PDB, including a document containing the *Activity Statements* and a document containing *Financial Statements*.

PDB 2010—Overview

7. The Commission's Annual Policy Strategy for 2010 highlighted the effect of the economic crisis on EU citizens and businesses and stressed the importance of EU action towards building the conditions for recovery. Consequently, the main focus of the 2010 PDB is the role of the budget in relation to the reactivation of economic activity in Europe and it is described, by the Commission, as being "an instrument for economic recovery".[3]

8. The PDB proposes *commitment appropriations* of €138,564 million (£120,953 million). This is 1.18% of EU Gross National Income (GNI). The increase in commitments is €2,106 million[4] (£1,838 million) or 1.5%[5] above 2009 levels.

9. For *payment appropriations* the PDB proposes €122,322 million (£106,775 million), or 1.04% of EU GNI. This represents an increase of €6,150 million (£5,368 million). The percentage increase in payment appropriations, in comparison to the 2009 Budget is 5.3%.

10. The margin under the FP ceiling is €1,754 million (£1,531 million) for commitments. The margin under the FP ceiling is €12,162 million (£10,616 million) for payments.

11. *Compulsory expenditure* accounts for €45,248 million (£39,497 million) of commitment and €45,152 million (£39,413 million) of payment appropriations. This represents increases of 5.7% and 5.5% respectively.

12. *Non-Compulsory expenditure* accounts for €93,316 million (£81,456 million) of commitment and €77,170 million (£67,362 million) of payment appropriations. This represents a decrease of 0.4% for commitments and an increase of 5.2% for payments, relative to 2009 levels.

13. Tables summarising the key figures of the 2010 PDB are provided in Annex 1 (in both Euros and Sterling).

PDB 2010—Detail of Proposed Expenditure by Heading

Heading 1 Sustainable Growth

14. Overall, proposed expenditure of Heading 1 is €62,152 million (£54,252 million) for commitment appropriations and €47,365 million (£41,345 million) for payment appropriations leaving a margin of €130 million (£113 million) under the FP ceiling for commitments; Heading one is divided into two further headings: Heading la (Competitiveness for Growth and Employment) and Heading lb (Cohesion for Growth and Employment).

15. For *Heading 1a (Competitiveness for Growth and Employment),*[6] the PDB proposes €12,769 million (£11,146 million) for commitments and €10,982 million (£9,586 million) for payments. Compared to the 2009 Budget this represents decreases of €1,005 million (£877 million), or −7.3% in commitments and a decrease of €124 million (£108 million), or −1,1% in payments.

16. The presented decrease in commitment appropriation levels is, in part, due to the inclusion in the 2009 Budget of €2,000 million (£1,746 million) for Energy projects to aid economic recovery (as part of the EERP) and the fact that EERP commitments are not yet factored into the 2010 PDB. Financing of the remaining EERP commitments for 2010 will be decided towards the end of 2009 as part of the wider 2010 budget negotiation. If the Economic Recovery Plan is excluded commitment appropriations increase by 8.4% and payment appropriations decrease by 6.3%.

17. The reduction in payment appropriations is largely accounted for by:

- The phasing out of the 6th Framework Programme.
- Seventh Framework Programme—a €479 million (£418 million) or a 6.9% decrease.

[3] Document 1; Expenditure analysis by multiannual financial framework headings, p 3.
[4] Compared to the 2009 EC Budget.
[5] This and all subsequent percentage figures include the EERP unless otherwise stated.
[6] Excluding European Econoinic Recovery Plan.

— Galileo—€306 million (£267 million) or 40.2% decrease.

— Competitiveness and Innovation Framework Programme—a €117 million (£102 million) or 24.2% decrease.

18. For Heading lb (Cohesion for Growth and Employment), the PDB proposes commitment appropriations of €49,382 million (E43,106 million) and 4payment appropriations of €36.382 million (£31,758 million). These represent an increase of €955 million (£834 million) or 2.0% in commitments and an increase of €1,419 million (£1,239 million) or 4.1% in payments relative to the 2009 Budget. The proposed increase in commitments within H1b is largely due to a €894 million (£780 million), or 9.6% increase in proposed expenditure to the Cohesion Fund.

Heading 2—Preservation and Management of Natural Resources

19. The PBD proposes commitments of €59,004 million (£51,505 million) and payments of €58,075 million (£50,694 million). These represent an increase of €2,282 million (£1,992 million) or 4.0% for appropriations and €5,509 million (£4,809 million) or 10.5% for payments compared to the 2009 Budget. The PDB reserves a margin of €1,109 million (£968 million) under the FP ceiling for commitments.

20. The increases in commitments within Heading 2 are largely accounted for by a €2,618 million (£2,285 million) increase (6.4%) in market related expenditure and direct aids. The PDB attributes this increase largely to the phasing-in of direct aids to the new Member States and an increase in market related expenditure. The increases in payments are largely due to an increase of €3,203 million (£2,796 million) or 31.3% in rural development and an increase of €2,547 million (£2,247 million) or 6.2% in market related expenditure and direct aids. As with Heading la, the 2010 PDB does not include commitments for the EERP which will be decided on in the course of negotiations.

Heading 3—Citizenship, Freedom, Security and Justice

21. The proposed expenditure on Heading 3 is €1,629 million (£1,422 million) for commitments and €1,360 million (£1,187 million) for payments. This represents an increase in commitments of €103 million (£90 million) or 6.7% and an increase in payments of €52 million (£45 million) or 3.9% relative to the 2009 Budget. The PDB leaves a margin of €64 million (£56 million) under the FP ceiling for commitments. Heading 3 is divided into two further headings: 3a (Freedom, Security and Justice) and 3b (Citizenship).

22. For *Heading 3a (Freedom, Security and Justice),* the PDB proposes commitment appropriations of €980 million (£855 million) and payment appropriations of €720 million (£628 million). This represents an increase of €116 million (£101 million) or 13.5% for commitments and €103 million (£90 million) or 16.6% for payments. This leaves a margin of €45 million (£39 million) under the FP ceiling.

23. The increase in commitment and payments within Heading 3a include:

— "Solidarity and management of migration flows"—a €30 million (£26 million) or 6.3% increase in commitments and a €44 million (38 million) or 14.8% increase in payments.

— "Decentralised agencies"—a €95 million (£83 million) or 68.4% increase in commitments and a €69 million (£60 million) or 49.8% increase in payments. This increase is largely due to the allocation of €80 million (£70 million) of non-differentiated expenditure to fund the European Police College (EUROPOL) as 2010 is the first year that this is to be financed from the EC Budget.

24. For *Heading 3b (Citizenship)* the PDB proposes €649 million (£575 million) for commitments and €640 million (£559 million) for payments. This represents a decrease of €13 million (£11 million) or 2% for commitments and a decrease of €51 million (£45 million) or 7.4% for payments relative to the 2009 Budget. This leaves a margin below the ceiling for commitments of €19 million (£17 million).

25. The decrease in commitments and payments under Heading 3b is largely accounted for by the absence of specific allocated resources in the PDB for the European Union Solidarity Fund (EUSF) which as a contingency instrument is provisioned as needs arise. in addition, for "other actions and programmes" under this heading there is a reduction of €8 million (£7 million) or 32.7% in commitments and a decrease of €11 million (£10 million) or 12.9% in payments. A further reduction of €15 million (£13 million) for payments under the "public health and consumer protection programme" helps to explain the large reduction in payments under Heading 3b of the PDB.

Heading 4—The EU as a Global Player

26. Heading 4 of the PDB proposes commitments of €7,921 million (£6,914 million) in commitments and €7,665 million (£6,691 million) in payments. This represents a decrease of €183 million (£160 million) or 2.3% in commitments and a decrease of €660 million (£576 million) or 7.9% in payments relative to the 2009 Budget. There is a margin of €221 million (£193 million) below the FP ceiling for commitments.

27. The reduction in commitments in Heading 4 is largely accounted for by the inclusion in the 2009 Budget of appropriations for the Food Facility and by a €333 million (£291 million) or 59.7% reduction in "Other actions and programmes—Development and relations with ACP States". In addition, the €67 million (£58 million) decrease in the "European Neighbourhood and Partnership Instrument" and €57 million (£50 million) decrease in "Instrument for pre-accession assistance—Enlargement" contribute to the overall fall in commitments.

28. The significant reduction is payments within Heading 4 is largely due to the €516 million (£450 million) or 22.4% decrease to the "Instrument for Pre-Accession". The other decreases of €103 million (£90 million) or 18.6% for "Other actions and programmes—Development and relations with ACP States" and €87 million (£76 million) in "European Neighbourhood and Partnership Instrument" explain the majority of the fall in payments.

Heading 5—Administration

29. For Heading 5 the PDB proposes commitments and payments of €7,858 million (£6,859 million). This represents an increase of €163 million (£142 million) or 2.1% in both commitments and payments and leaves a margin of €230 million (£201 million) under the FP ceiling for commitments.

30. The increase in payments and commitments is accounted for by a €58 million (£51 million) increase or 5.1% in pensions over all the institutions, a €68 million (£59 million) increase or 2.4% in the budgets of "other institutions" and a 0.9% increase of €32 million (£28 million) in commitments and payments for the Commission. In addition, the budget of the European Schools has increased by €6 million (£5 million) due to the increase in the number of pupils according to the Commission.

Heading 6—Compensation

31. The 2010 PDB has no allocation for Heading 6 and the temporary compensation measures for new Member States. The last year for these measures was 2009. This represents a reduction to the overall budget of €209 million (£182 million) for both commitments and payments.

Ministerial Responsibility

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

Interest of Devolved Administrations

33. Policy concerning the EC Budget is a reserved matter under the UK's devolution settlements but the devolved administrations may have an interest in some aspects of EC expenditure and have been consulted in the preparation of this EM.

Legal and Procedural Issues

Legal basis

34. The PDB is presented under Article 272 of the EC Treaty.

European Parliament procedure

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

Voting procedure

36. The Council votes by qualified majority and has the final say in setting the level of *compulsory expenditure.*

Impact on United Kingdom Law

37. None.

Application to Gibraltar

38. Not applicable.

Analysis of Fundamental Rights Compliance

39. No fundamental rights issues arise from this proposal.

Application to the European Economic Area

40. Not applicable.

Subsidiarity

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

Policy Implications

42. As a net contributor to the EC Budget it is in the UK's interests to control growth in the EC Budget, whilst working to enhance efficiency in the use of EC resources. The Government will work with other Member States to maintain budget-discipline and subject all areas of EC spending to rigorous scrutiny. However, it should be noted that for multiannual programmes agreed under co-decision procedure (including in relation to agriculture and structural funds) the Budgetary Authority is not able to a agree significant changes to the levels of EC expenditure set out in the financial envelopes in the relevant legislative acts.

43. The Government's primary aim in the upcoming negotiations will be to respect agreed and established budgetary principles. In particular, to ensure that: spending delivers genuine value for money; global appropriations for payments are based on realistic implementation forecasts (to prevent the emergence of a large budget surplus); and that FP ceilings are respected by ensuring adequate margins to absorb additional pressures in relation to the EERP and unforeseen contingencies.

44. It is of concern to the Government that the Commission has presented a preliminary draft budget which has insufficient margins to accommodate known and anticipated further expenditure requirements, including the remaining €2.4 billion part of the EERP package to be financed in 2010 and several expected external action requirements in Palestine, Kosovo and other areas. The Government will seek to address this unrealistic budgeting on the part of the Commission in the course of negotiations and will argue for a clear resolution to financing of the EERP and other expected expenditure needs that maintains budget discipline. A heading-by-heading outline of the Government's initial intended approach towards the PDB follows.

45. *Heading 1 a (Competitiveness for Growth and Employment)*. The Government remains fully committed to the Lisbon Agenda and supports much of the spending under this heading such as that on R&D where EU spending can add real value. The Government will continue to press for further justification on some of the levels of payment appropriations proposed and suggest appropriate reductions to reflect anticipated implementation levels and absorption capacity. It will also seek to agree a larger margin under the commitments budget ceiling to help accommodate the needs of financing the remaining portion of the EERP €5 billion package to be committed in 2010.

46. *Heading 1b (Cohesion for Growth and Employment);* With regard to the Structural and Cohesion Funds under this heading where an increase of 4.1% has been proposed for payments, the Government will also seek to achieve realistic levels of payments that take into account genuine implementation capacity.

47. *Heading 2 (Preservation and Management of Natural resources)*. The Government considers interventions in agricultural markets and direct aids to represent poor value for money for EU taxpayers. The Government intends to question the Commission's proposed increases in these areas, particularly in light of absorption capacity. Although it is recognised that much of the increase in direct payments has already been agreed—as is the case for direct payments related to the phasing in of the new Member States—the Government intends to scrutinise the remaining increases closely.

48. *Heading 3 (Citizenship, Freedom, Security and Justice)*. The Government is supportive of appropriate EC expenditure in relation to shared challenges relating to migration, health, crime and terrorism. However, it will be looking for appropriate reductions to the commitment and payment levels proposed to ensure that the margin under the financial perspective commitment ceiling is sufficient to meet any unforeseen future

expenditures, and that payment levels more accurately reflect absorption capacity. The Government will scrutinise the amounts proposed for EUROPOL closely.

49. *Heading 4 (The EU as a Global Player).* The Government supports appropriate expenditure under this heading believing that EU external actions can add value to Member States' independent efforts to support development, prosperity and stability in third countries and to address regional and global challenges. We will continue to look carefully at payments absorption capacity and priorities under this heading to ensure that financing proposals are realistic. The Government will also press for a sufficient margin to be maintained under the FP commitments ceiling to meet possible future contingencies and given the expected further expenditure requirements for Kosovo, Palestine and Georgia as highlighted in the PDB.

50. *Heading 5 (Administration).* The Government will argue strongly for enhanced efficiency and value for money from EC institutions administration expenditure Although the Government welcomes the reduction in the proposed increase compared to previous years, it intends to scrutinise this increase closely and question whether or not it might be reduced further. The Government also intends to work with like-minded Member States to closely scrutinise and propose reductions to the allocations for EU agencies across all headings.

Regulatory Impact Assessment

51. Not applicable.

Financial Implications

52. The UK contribution to the 2010 PDB is expected to be 14.1% pre-abatement, 10.7% post-abatement. The actual net financial cost to the UK of the 2010 EC Budget will depend not only on the size of the budget that is finally adopted, but also on the balance between different spending programmes within the budget. This determines the level of UK receipts and subsequently affects the size of the UK's abatement in the following year.

Consultation

53. Not applicable.

Timetable

54. Discussion of the PDB began in Council's budget committee on 5 May 2009. On 10 July the Council will establish the Draft Budget on the basis of these discussions, which will then be forwarded to the EP. It is expected that the Draft Budget will be debated by the EP in a plenary session in October. The EP's amendments and modifications will be considered at the Council's second reading in November. A revised Draft Budget will then be submitted to the EP for its second reading, and formal adoption of the budget is expected by mid-December.

Annex 1

Table 1a

SUMMARY OF 2010 PDB PROPOSALS—EUR MILLION

Heading	*Budget 2009*[1]		*PDB 2010*		*Difference 2010–09*		*Difference 2010–09*	
	CA	*PA*	*CA*	*PA*	*CA*	*PA*	*CA*	*PA*
1. Sustainable Growth	62,202	46,070	62,152	47,365	−0.1%	2.8%	−50	1,295
1a Competitiveness for Growth and Employment	13,775	11,106	12,769	10,982	−7.3%	1.1 %	−1,005	−124
1b. Cohesion for Growth and Employment	48,427	34,963	49,382	36,382	2.0%	4.1%	955	1,419
2. Preservation and Management of Natural Resources	56,721	52,566	59,004	58,075	4.0%	10.5%	2,282	5,509
Of which Market related expenditure and direct payments	41,127	41,080	43,745	43,626	6.4%	6.2%	2,618	2,547
3. Citizenship, Freedom, Security and Justice	1,527	1,308	1,629	1,360	6.7%	3.9%	103	52
3a. Freedom, Security and Justice	864	617	980	720	13.5%	16.6%	116	103
3b Citizenship	663	691	649	640	−2.0%	−7.4%	−13	−51
4. EU as a Global Player	8,104	8,324	7,921	7,665	−2.3%	−7.9%	−183	−660
5. Administration	7,695	7,695	7,858	7,858	2.1%	2.1%	163	163
6 Compensation	209	209	—	—	—	—	−209	−209
Total	136,458	116,172	138,564	122,322	1.5%	5.3%	2,106	6,150
Margin			1,754	12,162				
Compulsory Expenditure	42,799	42,784	45,248	45,152	5.7%	5.5%	2,448	2,368
Non-Compulsory Expenditure	93,658	73,388	93,316	77,170	−0.4%	5.2%	−342	3,782
Appropriations as a % of GNI	1.18%	1.00%	1.18%	1.04%				

Notes

(1) CA = commitment appropriations.

(2) PA = payment appropriations.

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

Table 1b

SUMMARY OF 2010 PDB PROPOSALS—GBP MILLION

Heading	*Budget 2009*[1]		*PDB 2010*		*Difference 2010–09*		*Difference 2010–09*	
	CA	*PA*	*CA*	*PA*	*CA*	*PA*	*CA*	*PA*
1. Sustainable Growth	54,296	40,215	54,252	41,345	−0.1%	2.8%	−44	1,130
1a Competitiveness for Growth and Employment	12,024	9,694	11,146	9,586	−7.3%	−1.1%	−877	−108
1b. Cohesion for Growth and Employment	42,272	30,519	43,106	31,758	2.0%	4.1%	834	1,239
2. Preservation and Management of Natural Resources	49,512	45,885	51,505	50,694	4.0%	10.5%	1,992	4,809
Of which Market related expenditure and direct payments	30,900	35,859	38,185	38,081	6.4%	6.2%	2,285	2,223
3. Citizenship, Freedom, Security and Justice	1,333	1,142	1,422	1,187	6.7%	3.9%	90	45
3a. Freedom, Security and Justice	754	539	855	628	13.5%	16.6%	101	90
3b Citizenship	579	603	567	559	−2.0%	−7.4%	−11	−45
4. EU as a Global Player	7,074	7,266	6,914	6,691	−2.3%	−7.9%	−160	−576
5. Administration	6,717	6,717	6,859	6,859	2.1%	2.1%	142	142
6 Compensation	182	182	pm	pm	−100%	−100%	−182	−182
Total	119,114	101,407	120,953	106,775	1.5%	5.3%	1,838	5,368
Margin			1,531	10,616				
Compulsory Expenditure	37,359	37,346	39,496	39,413	5.7%	5.5%	2,137	2,067
Non-Compulsory Expenditure	81,754	64,060	81,456	67,362	−0.4%	5.2%	−299	3,301
Appropriations as a % of GNI	1.18%	1.00%	1.18%	1.04%				

Notes

(1) CA = commitment appropriations.

(2) PA = payment appropriations.

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

Annex 2

GLOSSARY

Abatement

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

— the abatement applies only in respect of spending within the EU. Expenditure outside the EU (mainly aid) is excluded;

— the UK's contribution is calculated as if the budget were entirely financed by VAT;

— the abatement is deducted from the UK's VAT contribution a year in arrears.

Activity-Based Budgeting (ABB)

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

Activity Statements

The presentation of performance information for each area of activity of the European Union, providing the main elements justifying the level of resources requested by the Commission in the PDB. The statement includes details of the resources allocated to the activity, as well as associated objectives, indicators, outputs and outcomes.

The annual budget procedure

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

— establishment of the preliminary draft Budget by the Commission,normally in May;

— establishment of the draft Budget by the Council in late July;

— first reading by the Parliament in late October;

— second reading by the Council in mid-November; and

— second reading by the Parliament and adoption of the Budget in mid-December.

Commitment and Payment Appropriations

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

Compulsory and Non-Compulsory expenditure

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

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

Financial Perspective

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

Financial Statement

The presentation of financial data including balance sheets, revenue and cash flow statements, or any supporting statement that is intended to communicate an entity's financial position at a point in time and its results of operations for a period then ended.

Flexibility Instrument

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

Inter-Institutional Agreement

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

Own Resources Decision

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

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

— Customs duties including those on agricultural products;

— Sugar levies;

— Contributions based on VAT; and

— GNI-based contributions.

Examination of Witnesses

Witnesses: Ian Pearson, a Member of the House of Commons, Economic Secretary, Mr Mike Glycopantis, Head of EU Finances Team, HM Treasury, and Mr Mark Collins, Policy Adviser, Annual Budget, EU Finances Team, HM Treasury, gave evidence.

Q1 ***Chairman:*** Minister, welcome to you and your colleagues. Thank you very much for tottering over here on such a hot day. This time last year we had Kitty Ussher to speak to us and she had been in post for ten minutes, so we are very grateful to have you, who have been in post for somewhat longer and you will have less difficulty with some of our questions. This is all being broadcast. You are on the record. You will be provided with a transcript before we print it. You will have in front of you a list of the questions that we have asked and a list of our various interests. We can either start just by asking you questions or, if it is easier, please make a statement.

Ian Pearson: Let me start by making a few introductory comments. Despite the weather, I am delighted to be here and I am grateful to you for accommodating a change in the time for this session. I know the Committee has a very well established reputation for analysis and scrutiny of EU affairs and I really believe that this session can help inform the government's position during negotiations over the 2010 EC Budget. I am accompanied by officials from the Treasury. On my right is Mike Glycopantis, the team leader of the Treasury's EU finances team and on my left is Mark Collins, policy adviser working on the EU annual budget. I am sure they will answer all the very difficult questions and certainly some of the more technical ones. The Government will scrutinise closely and, where appropriate, challenge the Commission's proposed 2010 Budget. It might be helpful to say something about our overriding objectives in terms of setting the context which builds on the information that we have previously supplied. Our overriding objectives are to ensure budget discipline, value for money and sound financial management of EC Budget spending. These objectives will underpin our position in the negotiations. Our main priorities are going to be to push for reductions to payments in areas of the Budget that are over budgeted, in our view, to push for sufficient headroom under the relevant financial framework ceilings to allow in year spending pressures that may emerge to be accommodated and also support for reductions to areas of spending that we believe represent poor value for money including, as has been mentioned by successive ministers, agricultural spending and the continued need to bear down on administration spending as well. We do however recognise that appropriate EC Budget spending can play a role alongside other policy tools in meeting shared EU and global challenges and therefore we will continue to support sufficient spending in those areas of the Budget that we believe represent good value for money, including in particular spending for jobs, climate change and development. We also strongly continue to support the European economic recovery plan and the additional budget funding for energy and infrastructure projects. We will be pushing for this additional funding to be met through the redeployment of existing resources and margins. I think that is one of the areas that we will come onto in our discussions. We also want to continue to work closely with other EU Member States to achieve our priorities and I am cautiously optimistic that the position that will be adopted by the Council at the Budget Ecofin next Friday will represent an improvement on the Commission's proposals. Due to legal and decision making limitations, the annual Budget negotiations are not the place for fundamental budget reform, but we do continue to attach great importance to the Budget review as a means of achieving what we want to see, which is a reorientated Budget equipped to meet the challenges of the 21st century. The last thing I would want to say by way of introduction would be to assure the Committee that we continue to champion improved financial management of EC Budget funds. As the majority of EC Budget funds are managed by other Member States, the government considers that the core responsibility for such improvements must fall to those Member States. We try to lead by example. We will shortly be publishing the second annual consolidated statement on the use of EU funds in the UK and we have certainly encouraged other Member States to do likewise. Thank you very much for inviting me to make some introductory comments and I am more than happy to answer any questions.

Q2 ***Chairman:*** In introducing this draft Budget to my Committee I did rather have to explain to some Members of the Committee that this was not a Budget as we knew it. It had all been set some time ago and what we were doing was at best tinkering at the margins. In commercial funding one would no doubt make substantial alterations faced with a crisis such as we have seen but this is not what the issue is at the moment. We are not doing that. Against that background however, I was a little startled to see the Commission describe the Preliminary Draft Budget as an instrument for economic recovery. Do you feel that it can act as such?

Ian Pearson: At a time of economic downturn when there are pressures on growth and jobs, EU activities in those areas have a more important role to play. The PDB does contain proposals for continued and in some cases increased spend in those areas, particularly under heading 1a, on competition, research and innovation, and under 1b on structural and cohesion funds. We certainly welcome that activity to that extent. It also contains core tools to help both mitigate the effect of the economic crisis on individuals and to aid economic recovery. I very much accept the broad point you make that, if you were in business, you probably would not be doing things like this but the reality of this is that we are where we are with EC budgets and within that there have been some changes. It is legitimate to point to those changes that will help the economic recovery face in the right direction. Of course there remain certain things in the EC Budget that we think are not facing the challenges of the 21st century and even immediate challenges. We want to see changes and no doubt we will come on to those as well.

Q3 ***Chairman:*** Perhaps I could put the point more directly. Given that the financial perspective plans spending over a seven year time frame, are the annual EC budgets able to respond effectively to things like the financial crisis?
Ian Pearson: The Budget could do more, particularly I believe on the agricultural side. Our longstanding position has been that the Common Agricultural Policy distorts markets and trade and makes for higher prices for consumers. It does not support a prosperous EU. It is also important to remember in general as well that the Budget is just one of a range of policy tools that are being deployed in terms of responding to the economic crisis. Action that has been taken in virtually every Member State in Europe is important. Specifically on the seven year time frame, we believe that the financial perspective remains a key tool for budget discipline and underneath this flexibility to respond to significant and sudden challenges we believe can be secured by maintaining sufficient margins beneath the financial perspective ceilings and through the flexibility and other contingency instruments that are also available in specific cases. There is scope within the Budget to be able to respond but your basic point is that if this was a business you would be going back to zero based budgeting and a completely fundamental review. While privately I might have some sympathy for that as a statement, I do not sense that there is a great desire in Europe to completely scrap our budgets and start from a blank piece of paper. One of the arguments we have made in the Budget review in the UK is that there does need to be fundamental reform. I think it strengthens the case that the UK has been making for a long time about the overall structure within EU budgets needing to change.

Q4 ***Chairman:*** In terms of that case, would it be fair to say that you need greatly more significant changes in the PDB than those outlined, the ones they plan to make, in order to make a meaningful boost to the economy?
Ian Pearson: Yes, I would agree with you. The activities in the PDB, particularly initiatives such as widening the scope for the European Globalisation Adjustment Fund, can certainly help but until we reshape and modernise the EU Budget overall I think its ability to effectively support a prosperous EU is limited. That is why I was making the point about the Budget review process. We believe very strongly in the UK that this is something Europe needs to do. It has been part of our strategy to convince other Member States that there needs to be fundamental reform. This is not the only tool by which the EU can respond to the crisis. EU budgets compared with the budgets of individual Member States collectively are relatively small and the ability of Member States to coordinate their action has been an important feature of what has taken place over recent months. The European Social Fund, the European Globalisation Adjustment Fund and measures that are in there are helpful and welcome but we would like to see far more radical changes.

Q5 ***Lord Woolmer of Leeds:*** Could I return to the European economic recovery plan? In the explanatory memorandum, you remind us that the funding of that plan for 2010 is not yet included in the commitments. As I understand it, just less than £4.5 billion was the amount going into the recovery plan, around 2.3 billion spending in the current year and around 2.1 billion to come in 2010. Do you expect funding in 2010 to be contained within that £2.1 billion or do you think there could be a desire to increase the amount in 2010?
Ian Pearson: We have been talking about a five billion euro package for the European economic recovery plan. 2.6 billion euros of that was identified through the European Council and the decisions taken there. We see that as consistent funding for projects such as energy and broadband infrastructure. There is an issue about how the remaining 2.6 billion of funds to be committed in 2010 will be financed within the Budget. That is still to be decided and will be done towards the end of this year as part of the wider 2010 Budget negotiation. It has been agreed within the financial perspective and the UK has been successful in negotiating that this should be within the spending commitments. That is very much our policy and it will be our approach in the negotiations that will continue.

Q6 ***Lord Woolmer of Leeds:*** You do not expect there to be further projects put forward by the Commission as part of the recovery plan? What we see is what we get, is it not?
Ian Pearson: I never want to rule out entirely that either the Commission might want to respond to new pressures that it identifies or that it might have other good reasons for wanting to come up with new projects. What we have agreed however at EU level is

the economic recovery plan and 5 billion euros as a stimulus as a contribution to the overall fiscal stimulus. Most of this is in areas that we believe are important for growth and jobs for the future, which is why we very much welcome it.
Mr Glycopantis: There is a list of projects that totals five billion euros agreed by the Council. Many Member States made the point that those projects have to deliver spend and stimulus in 2009 and 2010. If a project on that list falls by the wayside and it does not look like it is going to start spending in 2010, the agreement is that another project can be brought forward to substitute, so long as it can provide the stimulus in 2010.

Q7 ***Lord Woolmer of Leeds:*** Given that the spending proposals are in the areas of energy and broadband infrastructure, given the lead times in that area of spend, realistically can spending on those key areas in this year and next year have an effect on helping the economy in 2010? Is there not a danger that, in saying we are going to spend on those things with unrealistic times, we will lead to hasty spending and poor value for money?
Ian Pearson: The latter point that you make needs to be watched because we want to make sure that these are not hasty decisions but that they are quick decisions and the right decisions and value for money is secured. We have always been very strong in wanting to push to ensure strong value for money. I believe there is a realistic list of projects that has been drawn up. A lot of work has gone into looking at timescales for delivery. I cannot promise you that some projects will not slip or, in Mr Glycopantis' terminology, fall by the wayside because they will not be able to deliver in the right time, but a substantial amount of work has gone into this in terms of putting together the package of projects in the first place. We are confident that this can play a part in helping to provide the fiscal stimulus that we have been talking about for some time and want to see.

Q8 ***Lord Woolmer of Leeds:*** If these proposals are so important and significant as a European contribution to the recovery, is it right to be scratching around to find ways of funding this from the margins of other programmes and not even taking a decision on what else is going to replace it until December? It seems a very odd way to do business.
Ian Pearson: Yes, we believe it is right to fund it through the margins. Part of our strategy has always been to ensure that there are adequate margins to be able to respond to unexpected events. It is important we believe to maintain the overall financial framework envelope and to limit our exposure to costs. We have tried to look at using margins in general and argue for bringing forward expenditure where it is appropriate. At the spring European Council, we were the leading country arguing for this budget disciplined financing solution for the whole five billion package. We think it is the right thing to do but our wider policy objectives will still remain to be strict on budget discipline and looking at modernising the EU Budget overall. When you have budgets that are under spending in areas like agriculture where there are margins, it is right that those margins are used on the projects and areas that you have been talking about that can help to stimulate recovery.

Q9 ***Chairman:*** You got other people to agree with you that we should use the agricultural margins?
Ian Pearson: Yes. That was partly the decision that was reached on the 2.6 billion.
Mr Glycopantis: That was the agreement for 2009 and that is the decision that we want to settle for the 2010 funding as well.

Q10 ***Chairman:*** In a downturn it seems a pity not to use every ounce of money you can find profitably.
Mr Glycopantis: Yes. This comes back to the point about having a proper Budget which is a modern Budget. At the moment, this is a mechanism through which we are forced to exert downward pressure on programmes. A more modern Budget would provide funding in areas that we support as priorities to start with and would provide a mechanism to do this more effectively.

Q11 ***Chairman:*** Or the funding mechanisms to cover real emergencies?
Mr Glycopantis: Yes.
Ian Pearson: All of the 2.6 billion came from agriculture. Two billion has been allocated for energy infrastructure and 600 million to cover broadband and CAP health checks which we were not particularly keen on wanting to do but it was part of the compromise and the overall fact that it has all come from heading two is an important success.

Q12 ***Baroness Northover:*** Within these constraints that you have just been describing and noting what you said in your introductory remarks about priorities focusing on jobs, climate change and development in terms of policy areas, what will be the government priorities during the negotiations on this project?
Ian Pearson: There is the need to ensure budget discipline and value for money from the Budget. We, along with like minded states, will be wanting to push for sufficient head room under the relevant spending ceilings to absorb any future spending increases; reductions in line with spending capacity to reduce budgetary under spend where there has been a previous history; reductions in areas of spending that represent poor value for money. We want to highlight a number of areas of agricultural spending where we believe there is poor value for money. We also want to

ensure adequate funding for those areas of the Budget that we believe represent best value for money for the taxpayer, which would be in areas like climate change, focusing on jobs and security as well. We would like to see that fundamental reorientation of the Budget. There are limits to what you can do in the negotiations that will go on from the Preliminary Draft Budget to the Budget being agreed for 2010. That is why I have been keen to stress that our approach needs to be seen within the context of our wider policy and what we want to do through the Budget review process for the future. We will do what we can within the constraints and we have to push in the right direction.

Q13 ***Chairman:*** Much of what you have said suggests that, when you are looking at what you can bring forward or spend to help with the recession, you would think about jobs first. Everybody would be thinking about what jobs could be safeguarded or brought forward.
Ian Pearson: Competitiveness and jobs, which go hand in hand, are important to the European economy. Projects and initiatives that add value, that are facing in the direction of the Lisbon agenda that promote competitiveness as well as employment, are important. As a former Science Minister, I believe that the whole R&D area is important for Europe and can represent good long term value for money for the UK and for the European taxpayer. Those areas of jobs, growth and competitiveness, climate change and also the wider security areas are where we believe the Budget should best be focused.

Q14 ***Chairman:*** These are all good ideas and good things but they may not short term have a huge effect on the recession.
Ian Pearson: We have to distinguish between measures that can have some sort of immediate impact and provide a response to current circumstances and those that will help prepare the European economy for the upturn. Just as in the UK we have been designing sets of policies that will be providing real help now for people and businesses and also a range of longer term measures that will we believe help best place the UK economy for the future. We believe very strongly that a similar strategy is appropriate to Europe's circumstances. We want to do things that will provide real assistance, support jobs and employment now and support companies now, at the same time making sure that we have that forward facing agenda that we believe Europe needs. Essentially that means spending less on the Common Agricultural Policy and more on competitiveness, growth and jobs.

Q15 ***Baroness Northover:*** How does development fit into that? What would be the priorities that the UK Government would be supporting as far as development is concerned?
Ian Pearson: We provide a lot of support for development through UK budgets and other EU Member States do similar things. There is an EU budget in terms of development. It is dwarfed in significance by a lot of other budgets. I do not have the exact figures to hand. Certainly it has been a feature of EU budgets in recent years.
Mr Collins: Within heading four, the external actions part of the EU Budget, the UK has been pushing for sufficient funding for priorities such as Pakistan, Afghanistan, Iraq and the Middle East. That is, where it is supported by spending capacity in those areas.

Q16 ***Baroness Northover:*** You are not tying it into jobs?
Ian Pearson: I do not think we are tying everything into jobs. The primary responsibility for tackling jobs issues lies with EU Member States. Actions that can be taken at a European level that will help support people who have been thrown out of work, the European Globalisation Adjustment Fund being a case in point. The main responsibility does have to lie with individual countries. I would want to point to the "real help now" measures that we have taken as a UK Government.

Q17 ***Chairman:*** Your explanatory note says that on the whole budgets under heading four have gone down, but this is partly because we have stopped giving people pre-accession payments, or at least stopped temporarily.
Ian Pearson: I think that is the reason, yes.

Q18 ***Chairman:*** There is less agreed development going on at the moment?
Ian Pearson: In pre-accession payments, yes.

Q19 ***Lord Moser:*** You referred to value for money for the taxpayer and obviously that is terribly important. Nobody would question it as an ideal but I notice in the Treasury memorandum that in regard to growth and employment there is pressure for a reduction in the case of agriculture. The memorandum says that this is not value for money. Is there anything generally you can say about how you look at the Budget in terms of value for money? It is quite a difficult argument, is it not? I wonder how sophisticated it is these days to argue that this is not value for money and this is value for money and whether there are any general comments.
Ian Pearson: It is very difficult to give a yes or no answer, if the question is: is the EU Budget value for money overall, yes or no? Clearly there are parts of the EU Budget that we do believe offer value for

money. Those tend to be in the areas that we believe are forward focusing, particularly on competitiveness and growth. We do not believe that large parts of the EU Budget that are spent on agriculture offer good value for money for either the UK taxpayer or, we would argue, the EU taxpayer as a whole. It is one of the reasons why we have been arguing for a number of years now that we want a fundamental reorientation of the Budget. It strikes me and the Government as being curiously bizarre that at this time in the 21st century, when we are focusing on the challenges of climate change and globalisation in a hugely competitive world, so much of our budget is spent on agriculture. We believe fundamentally that that has to change and that any budget that has such a significant proportion of it devoted to that pillar we do not believe can offer good overall value for money. That is not to say that there are not good bits within agriculture, let alone good bits within other parts of the Budget headings which can offer value for money. You are right to say it is more sophisticated than just a straight yes or no.

Q20 ***Lord Moser:*** When you go and negotiate, is it quite a powerful bit of your negotiating stance or is it just what everybody has to say: "We must have value for money"?

Ian Pearson: Everybody says that they believe in value for money. Everybody has slightly different views about what that means. I have been involved in negotiations in a range of different fora over a number of years and particularly when it comes to agriculture there are some clear divisions within Europe between Member States that want to see more agricultural spend and others that want to see a fundamental reorientation of the Budget. We will continue to have those debates within the Council of Ministers. I have no doubt about that because they are not going to go away but I do think that, on our side, we have some very compelling arguments when we look at the priorities for the European economy as a whole. Without wanting to talk about the Lisbon agenda in great detail, it set out a clear sense of future direction for the EU and the policy statements that we have had since in terms of growth and competitiveness do show the direction that we need to be going in. The UK finds it very difficult to accept that we have this real legacy of providing such significant amounts of funding from the EU Budget to one agricultural pillar.

Mr Glycopantis: We look at whether we think it is an area where the EU should be acting. We have identified three priority areas which are jobs, climate change and security. We then look at the second level, at what kind of action we want. It could be action through the Budget or the European Investment Bank or the way that the state aids rules are operated or other legislation and other regulations are applied. Obviously the best form of action is sometimes Member State action. The third level we look at is can we exercise sound financial control over this area. That is the framework and we set that up in our Budget review publication last year and we have started to increasingly use that in our annual budget discussions as well.

Lord Moser: I accept all that of course. I remember my days when I was at Whitehall statistics and if I had a project the Treasury would say, "Does this produce value for money?" I would answer by saying, "There is no way of calculating that." I used to get away with that.

Q21 ***Lord Trimble:*** The explanatory memorandum notes that commitment and payment levels have increased compared to 2009 by something of the order of five per cent. Will the extra funding be spent on worthwhile projects?

Ian Pearson: You are right to say that overall commitment and payment levels have increased in the 2010 Preliminary Draft Budget compared to 2009 levels. That is broadly consistent with the fact that the financial framework ceiling is higher for 2010 than for 2009. Where reprioritisation of existing resources is possible, we believe we should continue to push for that. There are worthwhile projects within this higher ceiling. We support the European economic recovery plan and the 5 billion euro package within that. We have already touched on the energy infrastructure projects and the support for broadband infrastructure as well, so there are some important measures within this 2010 Budget which we strongly support. There are parts of the Budget that we do not think offer good value for money and we would like to see changed. I particularly want to highlight the energy projects and the development of carbon capture and storage, where we have been taking action in the UK. It is a key priority for us, but we believe it is right as well that action should be taken at an EU level. The other area I want to highlight where we have been strong in our support has been cohesion policy. For the former accession countries, we have been one of the ones arguing very strongly for making sure that they have budgets to help build their economies to cope with the transition. Funding for that continues in the 2010 Budget.

Q22 ***Lord Trimble:*** I have noticed a quite considerable increase in cohesion fund support.

Ian Pearson: There certainly has been an increase. It has been an area where spend has been somewhat lower than in some other areas, mainly because some of that can take time. The figures show a nine per cent proposed increase to commitment appropriations to 10.2 billion euros for the cohesion fund. I think there is an issue about what the spending levels are likely to be in 2010.

Mr Glycopantis: Over the whole financial perspective in 2007 to 2013, new Member States will receive 158 billion euros in structural and cohesion funds, an increase of 250 per cent compared to the last financing period where we were still increasing the percentage that was going to new Member States. The EU 12's receipts will rise from 24 per cent at the start of the financial perspective to 56 per cent in 2013.

Q23 ***Lord Trimble:*** I wonder whether the particular increase in the cohesion fund, heading 1b, is intended try to help some of the comparatively new Member States that are currently experiencing difficulties in terms of their economies and fiscal positions?
Mr Glycopantis: They had a number of projects in the European economic recovery plan and they are receiving a lot of funding from the European Investment Bank at the moment. The flow of funds through the structural and cohesion line varies quite a lot. It was set at the beginning with the framework and there is a profile of commitments that have been made over the whole of the framework. Sometimes you will see rises; sometimes you will see falls.

Q24 ***Lord Trimble:*** It is not really a response to the crisis but something that was built into the framework at the outset?
Ian Pearson: It was certainly built into the framework as part of the deal with the accession countries and the recognition, in the same way as funds were used to help support the Portuguese, Spanish and Irish economies. We believe it was strategically important and there was agreement at EU level to provide increasing support to the accession countries over the 2007 to 2013 period. Some of those accession countries have been looking at how they can best use that money within the overall financial perspective to respond to some of the current difficulties that they have. They have a number of long term programmes in place as well. Some of those in the early days spent at a slower rate than was anticipated but over the period this will be addressed.

Q25 ***Lord Steinberg:*** In your explanatory memorandum, which I thank you for very much because it is very detailed, you talk about an increase of 4.1 per cent being proposed for payments. In your initial remarks you are talking about trying to ensure that we get value for money and so on and a proposal of a nine per cent increase. A nine per cent increase at the moment on anything seems to me to be outrageous. I am sure you probably agree with me. Could you tell me how you propose to try and convince them to the figure of 4.1 that you have put in your explanatory document and nine per cent which has been proposed?
Ian Pearson: My understanding is that the proposed nine per cent increase is to commitment appropriations, the legal obligations to spend on funds. It is in line with the financial programming in the financial framework that has been agreed. We are concerned about this increase and the implication it will have for spending in 2010 and in future years, because commitments can roll forward. It is the payment appropriations which directly affect Member State contributions. Given previous problems with implementation, it is more encouraging to see a 5.9 per cent decrease in payments in the 2010 PDB, bringing it down to 6.9 billion euros. If we are talking about implementation rates, the 2008 implementation rate for cohesion fund payments was 78.6 per cent. The overall implementation rate for heading 1b is 87.7 per cent and that includes the structural plans as well as the cohesion funds. It is right that the area of the Budget is contained to reflect past under-implementation and we believe that the payment reductions could go further. If, during the course of the year, implementation improves and more resources are required, our view would be an amending budget could always be proposed and considered by the Council and Parliament. There is a real issue here in terms of what we said previously about margins.

Q26 ***Lord Steinberg:*** There is no doubt that this Committee has never been happy—I am sure the same applies to you, Minister, and your Department—with the composition of the EU Budget and the way it is dealt with. I understand that the cohesion fund has not been spent on a regular basis over the past number of years. What is the sense in putting in a higher figure and then saying that we have managed to have a surplus on that because we have not spent the money?
Ian Pearson: That relates to the point I was trying to make about implementation rates and the fact that there have been low implementation rates overall. Although past performance is not always necessarily a guide to future performance, you need to bear in mind the ability to ramp up expenditure to meet some targets.

Q27 ***Lord Steinberg:*** It is a guide?
Ian Pearson: It is a guide. We believe it is an important guide and part of our strategy has been to focus on areas where there has been under-implementation and say, "If this money is not going to be spent, it can either be reallocated to other areas or we can look at having more realistic budgets in the first place that are more likely to affect the ability to spend and value for money considerations." It is an area we want to have a close look at, I can assure you. I do not disagree however with the view that accession countries should be entitled to the support that was politically given to them when determining the overall financial perspective. We agreed 158 billion euros. It is money that politically in the UK we should feel committed to continuing to support. If it is not going to be able to be spent within the appropriate time frames, we will

reflect that in budgets. That would be a sensible thing to do.

Q28 ***Lord Steinberg:*** Thank you very much. That is the first time I have had a minister agree with me.
Ian Pearson: I do not know whether that means I am doing something wrong or right.

Q29 ***Lord Trimble:*** If you are getting a situation where there is persistent under spend in a programme, do you not think it appropriate to suggest that there might be something wrong with the design of the programme?
Ian Pearson: There has been questioning by the Commission of individual projects within that budget heading. The Commission will monitor the performance of Member States who have responsibility for implementing the measures within those programmes. I want to get back however to the wider political point that there was political agreement here over the financial perspective that money would be transferred to the former accession countries. It is legitimate for them to say, "This is our money. We want to spend it." It is right to ensure that there are value for money constraints and that there are good projects being invested in. That is arguably one of the reasons why the spend has been slower than anticipated. There has been perhaps some over-optimistic programming in the assumptions in terms of how quickly some of this money can be spent.
Mr Collins: There is also a rule that exists. It is an N plus two or N plus three rule. After a certain duration, commitments in this area, if they are not turned into payments, will be cancelled; there is a mechanism that seeks to mitigate this potential under-implementation.

Q30 ***Lord Trimble:*** It does not address the point I was making. If you are getting persistent under spend in something, it might be worthwhile looking at the design of the programme because in some cases there is a tendency at the Commission to over engineer a programme.
Mr Glycopantis: Raising implementation rates is a key objective for the Commission working with the Member States. Implementation rates were 68 per cent in 2001 and they are 87 per cent in 2008. We have seen some improvement and we continue to work with the Commission and other Member States. When we look at the annual Budget in year, we always make a realistic appraisal of what we think will be spent.
Chairman: That is not only interesting; it is surprising. It is a huge improvement in the time and a very effective piece of work.

Q31 ***Lord Woolmer of Leeds:*** Could we return to the question of margins? The Treasury memorandum says that margins between commitment appropriations and the financial perspective ceilings are too low for several headings. Paragraph 44 says that the Government is concerned that the Commission has presented a Preliminary Draft Budget that has insufficient margins to accommodate known and anticipated further expenditure requirements. Why has this come about? Why is a Budget coming forward that clearly has margins too tight? In so far as you can say something other than what you have already told us, where do you think spending should be reduced in order to increase Budget margins?
Ian Pearson: As a rule, we would want to ensure that the inevitable additional demands on the Budget that tend to be seen throughout the year can be met within the Budget margins rather than by requiring extensive reprioritisation or an increase in the size of the Budget. That follows the Budget discipline approach that we were talking about earlier. With that in mind, we would like to see increased Budget margins pretty much right across the Preliminary Draft Budget. The margin between commitment appropriations and the financial perspective ceiling in the overall Budget is just under one per cent. Specifically, we are pushing for reduced commitment appropriations to ensure increased margins in several key areas, where we judge that the PDB proposals are inadequate. These are in heading one, specifically under heading 1a, competitiveness, growth and employment, and heading three, citizenship, freedom, security and justice and in heading four, the EU as a global player. Again, it is part of our budget discipline approach. We need to make sure that there is sufficient margin to accommodate those inevitable demands that occur through the year. Let us not be too optimistic in terms of the size of the programme and then have things happen which we know are likely to happen, which mean that the Budget would be exceeded and we have to take other measures in year. We want to try and guard against that and try to make sure that we have an appropriate budget and appropriate margins in the first place.

Q32 ***Lord Woolmer of Leeds:*** My question in part was why do you think this happens. Why has a Preliminary Draft Budget been put forward that clearly has a fundamental problem in terms of margins? You are happy to raise the question and try to do something about it, but why has the Commission put forward a Budget that has this problem with it? Surely their job is to put forward a Budget that does not have this problem? Member States should not be arguing about that. It is a matter of good production and sound Budget proposals.
Ian Pearson: I agree with you that this should be an area where there is common ground and acceptable margins should be built into budgets as a matter of course. Often there can be disagreements about what is an acceptable level of margin. We have been able to

find 2.6 billion in 2009 for the European economic recovery package and this emphasises the importance of margins. You have things that happen unexpectedly. You need some margins in your budgets to be able to take them into account. The fact that so much of that came from the policy budget and the margins in that was a positive thing to do. We should be having adequate margins in the first place. Inevitably the Commission will want to see as many projects as possible going forward and will want to try to push those margins within its envelope. It is right that Member States should want to push back a bit and say, "You need some room in case there are over spends in particular projects or because more important priorities emerge." That is essentially the debate that we are having with the Commission on this.

Q33 ***Baroness Northover:*** Are you happy with the 80 million euro financing of Europol?
Ian Pearson: The short answer to that is "no". The Preliminary Draft Budget proposes a budget of 80 million which is a 12 million euro increase on the 2009 budget. In changing economic circumstances, that is a very substantial rise in the Budget. We do not believe Europol's budget fits in with the budget neutrality principle agreed by the JHA Council. We want to work with like minded Member States to propose efficiency savings in all agency budgets and to push for efficiency savings until the external evaluation of agencies which we have called for have been completed. I understand that the major increase in the Budget that Europol are proposing is accounted for by a building proposal for new headquarters. We are concerned about the increase in building costs and the lack of information that has been provided to Member States in sufficient time for this to be fully considered by the Council so far. We believe there needs to be greater scrutiny of the building proposals to ensure that there is a thorough cost benefit analysis on them.

Q34 ***Baroness Northover:*** You have people to go in and do the building?
Ian Pearson: I am sure whoever were the contractors would want to be assured that there is value for money and that this is good value for the taxpayer. That is the key point. That has not been demonstrated to us yet.

Q35 ***Lord Steinberg:*** Minister, this is a pretty general question but may have a very potent answer. It would appear from the questions that we have been asking you, particularly the last one from Baroness Northover, that you have got a degree of scepticism about the whole way in which the EU budget is proposed. If that is the case do you fight that corner very rigidly and try and get other Members to support you, or am I wrong in my summation and that you are basically happy with the EU budget and the way it is prepared?
Ian Pearson: I am not sure 'scepticism' is the term that I would want to use for my views about the EU budgeting process. Having seen it for a number of years, it is quite an amazing spectacle about how budgets get agreed. It is a big horse trade. It is a negotiation between Member States themselves, between Member States and the Commission and between Member States, the Commission and the European Parliament. The Commission tends to be very much in the middle on this. We tend to want to support other Member States who are net contributors and rightly, in our view, want to ensure rigorous value for money and want to ensure appropriate subsidiarity so that when there are things that should be done by Member States they are being done by Member States.

Q36 ***Lord Steinberg:*** Would 'uncertainty' be a better word than 'scepticism'?
Ian Pearson: If what I have said indicates to you that I am sceptical about budgets, as I say, I think it should indicate really that I have got a degree of realism about how a deal gets done here. This is not a perfect world in which we are living and, as your Chairman rightly said, if this was a business it would be done very differently. It is not a business; it is a dirty big horse trade.

Q37 ***Lord Steinberg:*** Everybody fights their own corner of course, Minister.
Ian Pearson: And we have to use our best endeavours to make sure that we can produce an outcome that is good for the UK taxpayer and good for UK interests and in line with our view about what the EU's interests as a whole ought to be. That is what we have been trying to do over a good number of years now. I have been immensely proud about the pro-European way in which we have sought to pursue policy objectives. We have not been doing this just with a narrow British self-interest. We have been pushing at an EU level for budget discipline because we believe it is good for Europe. We have been pushing for the reform of the EU budget because we believe it is good for Europe. We believe it is good for the UK as well but if we can have a more competitive Europe that is focused on growth and a modern agenda then that has got to be in Europe's interests. We spend an enormous amount of time at this and sometimes you reflect on this and you say, "Why do we take this quite so seriously when we know there is going be a carve-up here in the end and a budget will be determined?" and I think the fact that we do take it so seriously reflects well on the UK and on the good financial management and disciplines that we seek to ensure are adopted within Europe. Sorry, that was a bit of a rant!

Chairman: We have just got time to look perhaps a bit to the future. Lord Haskins?

Q38 ***Lord Haskins:*** Last year your predecessor discussed the Budget Review which apparently has been significantly delayed. You can imagine that some of my colleagues who are of a suspicious nature wonder why the delay is. Perhaps you would be able to comment on that. When is it likely to be published? Is it going to have any relevance to the real issue ahead which is the new Financial Perspective and the Budget Review process, which I understand starts next year?
Ian Pearson: There are a number of things I would want to say on this particular subject. Firstly, I would emphasise the importance which the UK attaches to the Budget Review process. We believe that it is an opportunity to fundamentally reassess and take some ambitious and strategic views about how the EU budget can change for the future. It is something that was an important concession that we gained in negotiations a number of years ago. We need to make sure that the EU Member States and the Commission actually stick to this. We are shortly going to have a new Commission and I think it is right that we expect the new Commission to take forward the Budget Review. It is something that is really outside of the Financial Perspective negotiations but we want to see this happening sooner rather than later. I think it would be better for a new Commission rather than the old Commission. I have not got a date that I can give you when the Commission have said that they are going to announce the Budget Review, but I do think that it is an important opportunity for again a commitment to be made at a level far above my pay grade, by European leaders, to modernise fundamentally the EU budget. If during these current incredibly difficult economic times we cannot be taking some big fundamental decisions for the future then to my mind that shows a lack of political will at EU level to deal with the real issues that are going to be affecting our citizens in the future, and that is why I think we should be moving forward with this.

Q39 ***Chairman:*** You do not see any sinister connotation in the delay of the Budget Review? You think it is just in terms of the fact that the Commission is changing and of course the whole of the European Parliament is changing as well this year?
Ian Pearson: There certainly are big changes taking place so I think there are good grounds for believing that there are reasonable reasons why the Budget Review has not been moved forward so far. I am sure, though, that we in the UK will want to press very strongly to ensure that this does take place. I know that there are other Member States, who I would not want to name, who would be less than enthusiastic about this, but I believe it is just of such fundamental importance not just to the UK but to Europe that we have a long hard look at budgets and spending priorities for the future. This is something that I think has got to come and I would like to think that there is going to be increasing pressure from other EU leaders and other EU countries to say we need to have a fundamental look at our budgets and how the EU operates.

Q40 ***Lord Haskins:*** It sounds to me like we will maybe be waiting for it in a year's time.
Ian Pearson: The sooner this is done, in our view, the better. I understand that there is a commitment that there will be a Commission White Paper by the end of 2009. The original wording said it would be in 2008/2009, as you will be aware. What is vitally important in my view is what this document says, the fact that it has been ambitious scope, and that it provides an opportunity for EU leaders to come together and to really discuss and debate what a modern set of priorities for the EU should be going forward. I think that is the key challenge.

Q41 ***Lord Haskins:*** That is a Commission document?
Ian Pearson: It will be a Commission White Paper.

Q42 ***Chairman:*** We hope so too because we have specifically set aside the time of this Committee to have a look at whatever it produces, so it is our assumption indeed that the Budget Review will take place. Minister, I am conscious that we have already kept you just over an hour when I know you have some place else to be. It only remains for me to say thank you very much indeed for coming and to say how very useful you have been. I am sure you will find that out when you see the transcript!
Ian Pearson: Thank you very much for your kind questioning and generous chairmanship. I have thoroughly enjoyed this session.

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