EUROPEAN
COURT
OF AUDITORS

EU budget: time to reform?

A briefing paper on the mid-term review of the Multiannual Financial Framework 2014-2020

12, rue Alcide De Gasperi - L - 1615 Luxembourg
T (+352) 4398 – 1 **E** eca-info@eca.europa.eu **eca.europa.eu**

CONTENTS

INTRODUCTION

Our briefing paper

1. This briefing paper responds to the Commission's communication on the mid-term review/revision of the Multi-annual financial framework 2014-2020 (MFF) as well as the proposals amending the MFF Regulation, the Interinstitutional Agreement and the decision on the mobilisation of the Contingency Margin[1]. We will respond to other legislative proposals in the mid-term review "package" in due course[2].

2. We focus on the budgetary aspects of the functioning of the MFF covered by the mid-term review/revision and invite the EU's political, legislative and budgetary authorities to seize the opportunity in this legislative period to begin long-term EU budgetary reform. Our observations follow the main sections of the communication, namely those on the state of implementation of MFF 2014-2020, the proposals in the mid-term review package, and the issues to be dealt with in the proposal for the next MFF.

An opportunity for EU budget reform

3. The mid-term review/revision of MFF 2014-2020 is an opportunity to consider how to improve financial management and accountability and move towards an EU budgetary system fit for regaining the trust of citizens.

4. Based on our audit experience, as reported in our annual and special reports, we believe it is time to develop a new approach to EU spending and investment. Reform should aim at improving the EU budget system's capacity to:

- direct EU funds quickly and flexibly to where they can add most value for the EU and its citizens;

---

[1] COM(2016) 603 final, COM(2016) 606 final and COM(2016) 607 final.

[2] We are currently preparing opinions on the proposals to amend the Financial Regulation (966/2012) and the proposal for amending the EFSI Regulation (2015/1017).

- deliver funds and results efficiently at a reasonable risk; and

- demonstrate how the EU funds policies and achieves results.

5. Achieving these goals is not straightforward within the current MFF framework. The Commission's room to propose a re-prioritisation of EU spending and change financial rules at this stage is heavily constrained by:

- the current MFF reflecting the funding priorities of the Union at the time of adoption;

- the MFF regulation limiting the adjustments that can be made mid-way through the period[3];

- the seven year spending programmes for the 2014-2020 period only just being underway after significant delays; as well as

- the fact that the EU budget is operating close to the spending limits.

6. Against this background, the Commission presents proposals to focus more resources on current priorities, make budgetary management more flexible, and simplify aspects of the financial rules.

THE COMMISSION'S MID-TERM REVIEW OF MFF 2014-2020

State of implementation of the current MFF and new challenges

More evidence required for a debate on reform

7. The information that the Commission presents on "the state of implementation" of the current MFF largely focuses on the likely use of commitment and payment ceilings and margins up to the end of 2020. The Commission does not provide enough information on:

---

[3] Article 2 of Council Regulation No 1311/2013 laying down the multiannual financial framework for the years 2014-2020.

- the economic situation affecting EU budget spending by Member States[4], including the risks of EU funds:

  (a) not being fully used by Member States[5];

  (b) crowding out other investment and sources of funding;

  (c) potentially not being paid out if a Member State does not make recommended structural reforms ("conditionality");

- projected spending under the current MFF compared to actual spending of the previous MFF to highlight recurrent delays;

- unused funds held in financial instruments[6];

- the stock of pre-financing, commitments still to be cleared by payments, and other liabilities and contingent liabilities[7];

- likely cash flows over a seven to ten year period covering budgetary ceilings, payment needs, capacity constraints and potential commitments[8], so as to highlight the situation beyond 2020;

- the overall financial impact on the EU budget of the proposals in the mid-term review package, including the increase in commitments and payments compared to the status quo as well as the total value of reserves and guarantees that are implied; and

---

[4] Article 2 of Council Regulation No 1311/2013 laying down the multiannual financial framework for the years 2014-2020.

[5] Paragraph 2.6 and Figure 2.6 of Annual Report on the Implementation of the 2015 Budget.

[6] Special Report 19/2016 and Paragraph 1.66 of Annual Report on the Implementation of the 2014 Budget.

[7] Paragraphs 2.5 to 2.9 of Annual Report on the Implementation of the 2015 Budget.

[8] Paragraphs 2.10 and 2.47 of Annual Report on the Implementation of the 2015 Budget.

- how the areas of the EU budget with persistently high levels of error would be affected by the proposals[9].

8. We also note that, for some Member States, funds from the EU budget represent a significant share of total government spending and investment[10].

9. Such information could have been produced at this stage to **illustrate the budgetary management challenges** and help **inform the inter-institutional dialogue** on potential long-term solutions.

History risks being repeated

10. As a result of the considerable delays at the start of the MFF 2014-2020, most of the operational spending to date in the current MFF relates to commitments from the previous period. Delays in spending also occurred at the start of the previous periods.

11. In 2015, the most recent year for which there are audited figures, more than three-quarters of operational spending went to schemes operating under the rules of the previous MFF[11].

12. Although the backlog of payments from the previous period has now been cleared, the pressure on payments is likely to return in future years, if full use is made of the MFF commitment ceilings up to the end of the period. This is in large part due to the gap between commitments and payments originally agreed in the MFF.

13. In this context, the Commission's proposal to compensate the 2014 mobilisation of the contingency margin against 2016 rather than the years 2018-2020 will help ensure payments

---

[9] Paragraph 1.66 of Annual Report on the Implementation of the 2014 Budget.

[10] See Figure 1.1 of Annual Report on the Implementation of the 2015 Budget.

[11] Paragraph 2.3 of Annual Report on the Implementation of the 2015 Budget.

can be made in those years[12]. Nevertheless, the next MFF still looks set to start with a large volume of commitments from the current MFF remaining to be paid, as less than 60 % of available European Structural and Investment funds under the current MFF will have been paid out by 2020[13]. This means that the mid-point for spending in the largest area of the budget will not be reached until the last year of the period.

14. Therefore, delays in starting programmes and pressure on the payments budget under the current MFF look likely to present two key risks, if the timetable for adopting the next MFF and related spending programmes is to be met:

- there will be another build-up of commitments and backlog of payments in the years to come as some Member States struggle to absorb available funds by 2020, or even by 2023 when the eligibility period of 2014-2020 spending programmes comes to an end. This risks low value-for-money projects being funded to avoid losing funding[14].

- there will be little opportunity to learn from fact-based assessments about the design, operation and results of EU spending programmes under MFF 2014-2020 before the Commission will have to present its proposal for the post-2020 MFF by the end of 2017. In addition, many ex-post evaluations will take place before the programmes under MFF 2007-2013 have closed.

A comprehensive EU spending review is needed before a new long-term budget is set

15. The EU budget should offer clear and visible benefits for the EU and its citizens that could not have been achieved by spending only at national, regional or local level.

---

[12] Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Decision (EU) 2015/435 on the mobilisation of the Contingency Margin COM(2016) 607 final.

[13] Commission estimate in SWD (2016) 299 final– Annex 6.

[14] Paragraph 38 of Landscape review: Making the best use of EU money: a landscape review of the risks to the financial management of the EU budget.

16. Our annual and special reports highlight cases where EU spending could have been planned more strategically and so achieved better results and higher added value for the EU as a whole. For example, amongst other things, recent reports have highlighted how:

- rural infrastructure investment from the EU budget provided only limited value for money and had in some case replaced rather than added to national and regional funding[15].
- a third of EU spending on maritime facilities examined was ineffective or unsustainable because it duplicated existing facilities nearby[16];
- EU funding for rail projects between 2007 and 2013 did not succeed in shifting freight from road to rail[17];
- the European Institute of Innovation and Technology is hampered by a complex framework and management problems[18]; and
- financial instruments under the ERDF and ESF during 2007-2013 struggled in practice to control costs/fees, disburse the funds available, attract private capital, and re-use financial support[19].

17. Moreover, high performance and added value in the past are no guarantee of high performance and added value in the future. So, it is essential that all major spending programmes and schemes are not only periodically monitored and evaluated, as is required, but also that the performance and added value of the various programmes and schemes are compared.

---

[15] Special report No 25/2015.

[16] Special report No 23/2016.

[17] Special report No 08/2016.

[18] Special report No 04/2016.

[19] Special report No 19/2016.

18. In our view, a comprehensive EU spending review should be carried out before the EU adopts another long-term budget and a new set of spending programmes. A comprehensive spending review would provide an opportunity, amongst other things, to improve:

- the performance and added value of the EU budget both at political priority level (i.e. MFF heading level) and at programme level;

- the process by which the political objectives of the Union are translated in the operational objectives of its main spending programmes and schemes; and

- the monitoring, evaluation and reporting of performance and value added at each level.

The Commission's mid-term review of the MFF does not constitute a much needed comprehensive EU spending review of the performance and added value of the different areas of the EU budget and spending programmes. Such an exercise should be carried out before a new long-term financial plan is agreed, if the lessons of the current period are to be learned and available EU funds are to deliver better value-for-money in the future.

Comments on key proposals in the Commission's Mid-term review

19. This section follows the structure of section 3 of the Commission's communication.

Focusing further on priorities and new challenges?

20. The Commission's proposals for "focusing further on priorities and new challenges" are about allocating additional resources to certain headings and programmes without increasing the overall MFF allocations as set out in the financial annex of the communication.

21. The total package of nearly 12.8 billion euro up to 2020 includes:

- 1.8 billion euro in the 2017 budget for migration;

- 4.6 billion euro for cohesion as a result of automatic adjustments to reflect inflation and changes in Member States GNI (Heading 1b);

- 6.3 billion euro for growth and jobs, security, migration and refugees (Headings 1a, 1b, 3 and 4); and
- no proposals to change agricultural funding (Heading 2) or administration (Heading 5).

22. The additional 6.3 billion euro represents about 1 % of the total commitments to the end of the period. It does not significantly change the overall proportion of resources allocated to each heading, although security and citizenship (Heading 3) will increase by 23 %.

23. The extra investment depends on the EP and Council agreeing that funding from "special instruments" is not counted under the ceilings for commitments and payments for 2014-2020. As a rule, priorities and new challenges should be financed from the EU budget and not from "special instruments" outside it. The "special instruments" are reserves to be called to deal with unforeseen events.

24. Out of the 6.3 billion euro, 2.4 billion is for the Youth Employment Initiative (YEI) and a number of competiveness programmes directly or indirectly managed by the Commission. We note that the extra investment in these programmes is being proposed before spending under the current period has been evaluated. We will publish an audit of the implementation of the Youth Guarantee and YEI in Member States in early 2017.

25. Part of the 6.3 billion euro also includes provision for increasing guarantees to investment funds outside the budget. 150 million euro will be added to the EFSI guarantee fund to support the proposed increase in its lending capacity and 250 million euro will be used to establish a similar guarantee fund for the new European Fund for Sustainable Development (EFSD). We note that the EFSD will have a broader range of counterparts than the EFSI and therefore a different risk profile. To minimise the cash to be held to cover calls on the guarantees provided from the EU budget, the Commission is proposing a "common provisioning fund". It will cover the guarantee funds for the EFSI, the EFSD and external actions.

26. The Commission is also proposing to establish new internal trust funds to help attract additional funding from Member States and other sources for dealing with migration and refugees within the EU.

In our view, these proposals would not significantly change the proportion of resources of each MFF heading up to 2020. The fact that the proposed new spending on current priorities is not based on reallocating resources serves to illustrate the budgetary, programming and political constraints (see paragraph 7 above) currently on the EU budget and so too the case for reform. In addition, the increasing reliance on financial instruments, trust funds and investment funds guaranteed by the budget makes it essential to strengthen risk management and reporting on the increasing contingent liabilities of the EU.

Improving flexibility and agility in mobilising and delivering funds?

27. The Commission proposes a number of measures to make it easier to find additional funds for new challenges from within the existing ceilings of the current MFF. They consist of:

- measures to relax the annual budget on commitments and payments by maximising the use of margins and carry-overs; and
- further increase the capacity of the reserves in the budget and in "special instruments", including a new European Union Crisis Reserve (the Crisis Reserve).

28. The goal of the proposals on margins and carry-overs would be to ensure maximum use of the commitments and payments under the ceilings for the period. In other words, the gap between the MFF ceilings and the annual budgets would effectively disappear as the ceilings in any given year could be exceeded so long as the overall ceilings for the whole period are not exceeded.

29. As regards reserves in the budget, the Commission proposes to create a flexibility "cushion" of 10 % of the funds in three external action instruments[20]. In addition, the Commission is proposing to expand two "special instruments", the Flexibility Instrument and the Emergency Aid Reserve, and establish a Crisis Reserve.

30. The Crisis Reserve is intended to allow the EU to react rapidly to crises, as well as to events with serious humanitarian or security implications. It would be funded from de-committed appropriations from year n-2. The Commission estimates that such de-committed appropriations will provide around 3 to 4 billion euro per year. As unused reserves could be carried forward for one year, the capacity of the fund would represent up to two years' worth of de-committed appropriations.

In our view, these proposals would increase budgetary flexibility and reserves. However, they risk adding to the complexity of the system, undermining the annuality, specificity and transparency of the EU budget, and making the task of scrutinising EU budgetary management more challenging. Furthermore, it should be made more clear how much extra spending would be possible as a result of the proposals and what the total capacity of all the reserves and margins would be.

Simpler rules and more performance orientation?

31. The Commission proposes an extensive re-write of the general financial rules for the implementation of the EU budget accompanied by changes in sectorial financial rules. As stated in the introduction, we will present our views on the specific elements of these changes in a separate opinion. However, we would make the following points about the proposals at this stage.

32. The Commission is essentially updating and expanding the "toolbox" of instruments that can be used in spending programmes and encouraging them to be used in combination. There will be some scope to apply the new provisions to 2014-2020 spending programmes

[20] Instrument for Pre-accession Assistance (IPAII), the European Neighbourhood Instrument (ENI) and the financing instrument for development cooperation (DCI).

to make them more performance oriented and less prone to risk and there will be more scope to do so for the programmes and schemes for the next period. While financial corrections and recovery of misspent amounts are necessary features of good EU financial management, we maintain the view, expressed in our annual report, that it is better to design programmes to be less error prone in the first place.

33. Many "simplifications" of differing types are proposed. Most measures are aimed at making it easier to manage EU spending programmes and schemes and receive funds. Others aim to facilitate a more consistent use of non-grant based instruments such as trust funds, financial instruments and financial assistance. And a number aim to regulate situations where multiple grant and non-grant based instruments can be combined to meet the same objectives.

In our view, with the proposed changes, care needs to be taken to avoid unnecessary complexity in funding arrangements as a result of increasing the possibilities to combine different types of instrument.

Towards the next Multiannual Financial Framework

34. The Commission states that it plans more far-reaching changes in the next MFF and identifies a number of issues to be tackled. Our views of the issues raised by the Commission are presented below along with our view on the key issue that is not addressed in the mid-term review – the growing complexity of the arrangements for funding EU policies.

Issues raised by the Commission

Reforming own resources

35. The Commission plans to take account of the result of the High-level group on Own Resources and we are ready to provide our observations on legislative proposals that may result. We consider that there is room to improve the arrangements for own resources and we suggest that the results of a reflection on the revenue side of the budget would be best considered alongside the results of a spending review.

Duration of the framework

36. The Commission notes that the seven year duration of the current MFF is not well synchronised with the five years mandates of the European Parliament and the Commission.

37. It is worth noting that the whole MFF cycle is actually over 13 years, as proposals are first made two years before the next period and the eligibility for programme spending extends three years after the programming period ("n+3") and programmes are not closed until 1.5 years after that eligibility period ends. If the current MFF is followed by a new 5 year MFF (and no other substantial changes are made), most of the spending during the new period will relate to 2014-2020 programmes.

38. Furthermore, in recent annual reports[21], we have noted the scope for improving the process by which spending from the EU budget is aligned to the strategic priorities of the Union. In particular, we have observed that:

- the ten year strategic planning cycle is not aligned with the seven year cycle for managing the EU budget; and
- the current budgetary arrangements do not facilitate the translation of political aspirations (Europe 2020 strategy / Commission's 10 political priorities) into useful operational objectives for spending programmes and schemes[22].

39. Hence, there is now a need and an opportunity to bring the long-term strategy and policy-making in to line with the budgetary cycle. We also suggest that it is time to explore other options, for example:

- a rolling budgeting with a medium-term planning horizon and rolling evaluation programme;

[21] See Chapter 3 of Annual Reports on the Implementation of the 2014 and 2015 Budgets.

[22] Paragraphs 3.86 and 3.87 of Annual Report on the Implementation of the 2015 Budget.

- determining the duration of programmes and schemes on policy needs rather basing it on the length of the financial planning period; and
- requiring Member States and the Commission to present well justified needs for EU funding and results to be achieved before spending is set.

40. It would also be in the interests of good financial management and transparency for the EU political, legislative and budgetary authorities to consider in which policy areas the EU budget should be spent before deciding the next long-term financial plan.

Flexibility

41. The Commission identifies the pre-allocation of funds under shared management to Member States as the main limit on the current budget's ability to respond to evolving needs. It also proposes re-examining the setting up of reserves that can be rapidly mobilised.

42. We have also identified pre-allocation as a source of inflexibility. However, this issue should be considered as part of a high-level reflection (see also paragraph 40) on what should be financed from the EU budget and over what period of time.

"Budgetising" the EDF

43. We agree that the legislative and budgetary authorities should consider funding the EDF from the EU budget. We suggest that this should be discussed within the wider context of an initiative to bring greater order to the growing complexity of the arrangements for funding EU policies.

Building on the innovations of the current MFF

44. The Commission plans to build on conditionality, leverage and simplification measures introduced in the current MFF and developed further in the proposals of the mid-term review.

45. As regards conditionality, we agree that there should be an assessment of how this feature has performed over the current MFF before it is developed further.

46. Similarly, the attempt to double the use of leverage over the current period through financial instruments, the European Fund for Strategic Investments and trust funds should also be thoroughly assessed to ensure they provide value-for-money at a reasonable risk and in a transparent manner. Our audit work indicates, for example, that previous estimates of leverage were based on inconsistent methodologies and were generally too optimistic[23].

47. As regards further simplification, we agree that a fresh look is needed for programmes under shared management given the delays which occurred once again in their implementation. Similar attention should be given to programmes under direct and indirect management. These issues could be cover as part of a general spending review (see paragraph 18).

Overall funding arrangements

48. In addition to the issues raised above, we consider that there needs to be a wide-ranging reflection on how to make the overall arrangements for funding EU policies as clear, simple and coherent as possible.

49. In our view, the current arrangements are already difficult and costly to manage, audit and scrutinise effectively. The Commission's proposals to create new EU funds and encourage funding from multiple sources risk adding to an already overcrowded and complex EU financial landscape.

50. That landscape now includes programmes, structural funds, trust funds, strategic investment funds, guarantee funds, facilities, financial instruments, macro-financial assistance instruments, various reserves, and a number of provisions.

---

[23] Paragraphs 62 to 91 of Special Report No 19/2016.

51. Terminology is also a problem. Terms such as “commitment”, “instrument”, “fund”, “reserve”, and “provision” often mean different things in different policy areas[24]. This makes communicating clearly with stakeholders about them more challenging than it needs to be.

CONCLUSIONS AND PROPOSALS

52. The EU budgetary system needs evidence-based reform, if it is to become more:

- **agile** at directing limited resources quickly and flexibly where they will add most value;
- **efficient** in delivering funds and results at a reasonable risk; and
- **transparent** about how policies are funded and what results are achieved.

53. The Commission has presented proposals which will help to focus more resources on current priorities, make the budget more flexible, and simplify aspects of the financial rules. It is not the role of the auditor to comment on the size, structure or allocation of the EU budget. However, it is our role to note that value-for-money is put at risk if funding decisions are taken before reflecting on future priorities and past performance. Delays in implementing programmes under the current MFF and delays in closing previous programmes mean that the proposals have not benefited from any assessment of spending under the current period and that there will be little opportunity to assess performance before the next MFF must be presented by the Commission at the end of 2017. In addition, there is now a pressing need to tackle the growing complexity of the arrangements for funding EU policies, which certain mid-term review proposals may exacerbate. To address these issues, we make four proposals.

[24] Paragraphs 2.5 and Figure 2.1 of Annual Report on the Implementation of the 2015 Budget give examples of budgetary commitments for each MFF heading.

Proposal 1: Reconsider the timetable for developing the next MFF

54. We propose reconsidering the timetable for developing the next MFF and accompanying spending programmes to allow sufficient time to first debate future funding needs and priorities, review spending in the current period and improve funding arrangements.

Proposal 2: Conduct a comprehensive EU spending review

55. We propose carrying out a spending review before a new MFF and set of spending programmes are proposed. The spending review should assess the extent to which:

- the allocation of resources in the EU budget reflects the EU's strategic priorities and opportunities to add value;
- EU programmes and schemes contribute to the achievement of strategic priorities, provide value-for-money, and control the risk of irregularity.

Proposal 3: Develop clearer, simpler and more coherent funding arrangements

56. We invite the Commission to propose measures to make EU funding arrangements clearer, simpler and more coherent and better equipped to ensure sufficient transparency, accountability and public understanding of how EU policies are funded and the benefits they bring.

Proposal 4: Make EU budget priorities the subject of a high-level debate

57. We propose that the EU's political authorities launch as soon as possible a reflection on the extent to which the different EU policies should be financed from the EU budget, taking account of possible developments in the policies and membership of the EU.