Review

NO 10

The European Coal and Steel Community: winding-up is according to plan, but funding for research is no longer sustainable

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EUROPEAN COURT OF AUDITORS

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Contents

Executive summary

I The European Coal and Steel Community (ECSC) expired as scheduled on 23 July 2002. All assets and liabilities existing at this expiry date were transferred to the European Community, the Commission being responsible for winding-up the financial operations and managing the other assets of the ECSC in liquidation. The net proceeds from asset management were used exclusively for funding EU coal and steel research projects.

II This review analysed the winding-up of the financial operations, the management of the other assets, and the rationale applied for funding coal and steel-related EU research projects.

III Although the ECSC made long-term commitments before its treaty expired, the winding-up process is almost complete and only non-material amounts remain.

IV Over the years, the ECSC's equity accumulated to €1.5 billion. However, due to the low interest rates environment, investment income dramatically decreased. As a consequence, funding the coal and steel research projects on the sole basis of asset management net proceeds is no longer sustainable.

V At the same time, there is a move towards an alignment between the management of coal and steel research projects and the other research projects funded through the EU's research framework programme and drive innovation-led sustainable growth.

Introduction

01 The European Coal and Steel Community (ECSC) was established for a period of fifty years by the ECSC Treaty signed in Paris on 18 April 1951 by Belgium, Germany, France, Italy, Luxembourg, and the Netherlands. Having entered into force on 23 July 1952, it expired as scheduled on 23 July 2002.

02 All assets and liabilities of the ECSC existing at this expiry date were transferred to the European Community on 24 July 2002. On the entry into force of the Treaty of Nice on 1 February 2003, these assets and liabilities were transferred to the European Union with retroactive effect from 24 July 2002.

03 Taking into account the desire to use these funds for research in the coal and steel industrial sectors, the European Council decided at its meeting in Nice to annex to the EU Treaties a Protocol[1] providing for the following special rules:

(a) The net worth of the assets and liabilities of the "ECSC in liquidation (ECSCil)" were to be considered as assets intended for research in the sectors related to the coal and steel industry.

(b) On completion of the liquidation of the ECSC, these assets would be referred to as "assets of the Research Fund for Coal and Steel" (RFCS).

(c) The revenue from these assets would constitute the "Research Fund for Coal and Steel" (RFCS) and would be used exclusively for research in the sectors related to the coal and steel industry, outside the research framework programme.

(d) Acting in accordance with a special legislative procedure and after the consent of the European Parliament, the Council would adopt the necessary implementing provisions. In particular, the Council would adopt, on a proposal from the Commission, multiannual financial guidelines for managing the RFCS's assets, as well as technical guidelines for the RFCS's research programme.

[1] Protocol 37 on the financial consequences of the expiry of the ECSC treaty and on the research fund for coal and steel.

04 Since the Treaty of Nice entered into force, the following implementing provisions have been adopted by the Council:

(a) the decision on the financial consequences of the expiry of the ECSC Treaty and on the RFCS[2];

(b) the decision laying down multiannual financial guidelines for managing the assets of the ECSC in liquidation and, on completion of the liquidation, the assets of the RFCS[3]; and

(c) the decision laying down the multiannual technical guidelines for the research programme of the RFCS[4], repealed by decision on the adoption of the research programme of the RFCS and on the multiannual technical guidelines for this programme[5].

05 In this context, the Commission (DG ECFIN[6]) has been responsible for:

(a) the winding-up of the loan and borrowing financial operations remaining on the expiry of the ECSC treaty[7], and

(b) the management of the other assets of the ECSC in liquidation[8].

06 Each year, the net revenue from these assets has been assigned to the funding of the RFCS in the general budget of the European Union. The Commission (DG RTD[9]) manages the RFCS.

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[2] 2003/76/EC: Council Decision of 1 February 2003 (OJ L 29, 5.2.2003, p. 22), amended by Council Decision (EU) 2018/599 of 16 April 2018 (OJ L 101, 20.4.2018, p. 1).

[3] (2003/77/EC: Council Decision of 1 February 2003 (OJ L 29, 5.2.2003, p. 25), amended by 2008/750/EC: Council Decision of 15 September 2008 (OJ L 255, 23.9.2008, p. 28.

[4] 2003/78/EC: Council Decision of 1 February 2003 (OJ L 29, 5.2.2003, p. 28).

[5] 2008/376/EC: Council Decision of 29 April 2008 (OJ L 130, 20.5.2008, p. 7).

[6] DG ECFIN: Directorate-General for Economic and Financial Affairs.

[7] Article 1 of Council Decision (2003/76/EC).

[8] Article 2 of Council Decision (2003/76/EC).

[9] DG RTD: Directorate-General for Research and Innovation.

Scope and approach of the ECA review

07 The main reasons for undertaking the review were that the decision on the winding-up of the ECSC was taken more than fifteen years ago and is still ongoing and the fact that it had not been subject to any specific review other than the annual ECA financial audit in addition to the yearly audit by an external private auditor.

08 This review should be of benefit to the European Parliament, the European Council, and the European Commission, who are the main stakeholders of the ECSCiL winding-up process.

09 This review focuses on the processes used for winding-up the loan and borrowing financial operations, and those used to manage the other assets over the last three financial exercises (2016, 2017 and 2018). It also analyses the rationale behind the earmarking of funds in the context of EU research programmes.

10 The review does not cover the whole asset management function of DG ECFIN, but is limited to the services provided to the ECSC in liquidation. Nor does it cover the management of the Coal and Steel Research Fund by the Commission (DG RTD).

11 A review is not an audit. The information and documentation relevant to the scope of the review was gathered through a desk review of management and audit reports obtained from the Commission, and through a series of interviews with Commission officials from DG ECFIN and DG RTD.

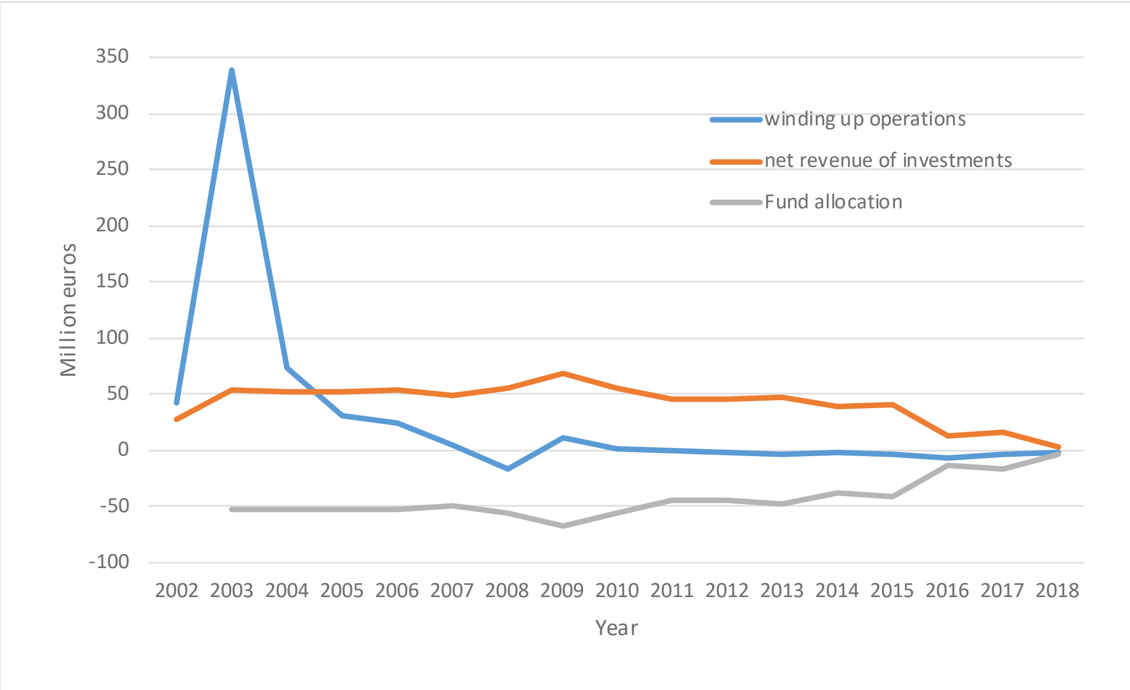
Overall performance of the ECSC in liquidation

12 The equity value of the ECSC in liquidation was €420 million in July 2002. In 2005, a change in accounting policies led to this value increasing by €389 million. Following the 2004, 2007 and 2013 enlargements, new Member States contributed to the assets, their total contributions amounting to €212 million.

13 Each year, the overall performance of the assets of the ECSC in liquidation varies resulting from the progress of the winding-up operations, the result of asset management activities, and the funding of the RFCS. At the end of 2018, the equity of the ECSC in liquidation amounted to €1.5 billion.

14 The history of the performance of the ECSC in liquidation is detailed in ***Figure 1***.

Figure 1 – Performance of the ECSC in liquidation (2002 – 2018)



Source: Financial statements of the ECSC in liquidation.

Winding-up is almost complete

15 The ECSC made long-term commitments before its Treaty expired in 2002. Even after the Treaty's expiry, these obligations still needed to be fulfilled. Consequently, the ECSC's liquidation operations resulted only in a gradual decrease of the ECSC's outstanding loans. According to the maturity schedule, the loan portfolio decreased from €964 million in 2002 to €95.2 million at year-end 2018. This latter amount is composed of the following[10]:

(a) The balance of two loans made to the European Investment Bank (EIB) in British pounds, with an outstanding amount of €92 million. These loans were contracted as debt securities and were fully repaid in July 2019.

(b) The balance of loans made for social houses of coal and steel workers through financial intermediaries, with an outstanding amount of €2.4 million. The last loans were granted in 1998 and will be repaid by 2024.

(c) The balance of housing loans made to staff, with an outstanding amount of €0.8 million. These loans are managed by the Paymaster's Office (PMO) of the Commission. The last such loans were granted in June 2002 and will expire in 2027.

16 Borrowings and debts have also gradually decreased since the ECSC ceased operations, from €742 million in July 2002 to €92 million at year-end 2018. This remaining amount represented two borrowings denominated in British pounds, which were linked to the EIB loans and matured in July 2019.

17 The history of operations indicates that between 2012 and 2018, the winding-up of the loan and borrowing operations resulted in losses totalling €22.2 million, coming following a forced restructuring of a loan, and represented average annual losses of €3.2 million.

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[10] Source: Financial report of the ECSC in liquidation at 31 December 2018.

Proceeds from asset management have sharply decreased due to fall in interest rates

18 Where the assets of the ECSC in liquidation are not needed to meet obligations, they are invested to ensure long-term profitability. The objective of the investment is to obtain the highest possible yield that is securely attainable[11].

19 The investment strategy guidelines set up by the Council[12] state that the ECSC's assets should be invested in such a way as to ensure that funds are available as and when needed, while still generating the highest return possible.

20 This investment strategy was translated into an operational strategy, which sought to provide a mix of availability and security. Each year, an economic analysis is performed and various different scenarios are assessed. This is an integrated approach common to all portfolios managed by the Commission (DG ECFIN): not only for the ECSC in liquidation, but also for example the BUFI, the EFSI, and the PGF[13]. From decision-making to implementation, the portfolio of the ECSC in liquidation is managed using the same operational arrangements (in terms of staff or tools) as other asset management mandates for which the Commission (DG ECFIN) is responsible.

21 However, the low level of interest rates since 2013 has adversely impacted the performance of asset management activities. In 2018 and 2019, interest received on term deposits, money market instruments and sovereign bonds, which ensure availability of funds and security of investments, has been substantially less.

22 The Commission (DG ECFIN) uses a benchmark to assess the performance of its asset management. The benchmark is a dynamic basket of indices mirroring the asset classes and maturities of the portfolio of the ECSC in liquidation. Achieved performance has consistently been above the associated benchmark. However, for the reasons detailed above, the net amount of income generated has become very low.

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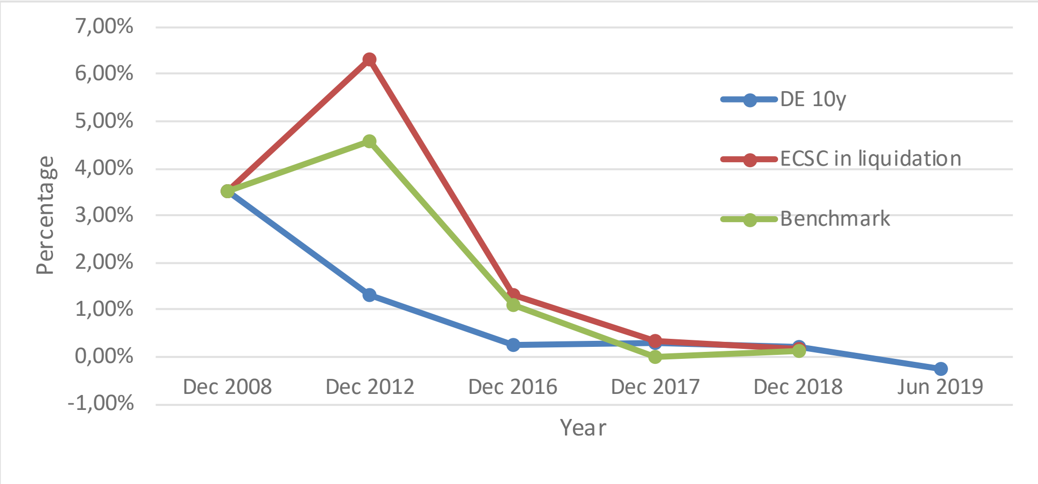
[11] Article 2 of Council Decision (2003/76/EC).

[12] Council Decision (2003/77/EC).

[13] BUFI (Budget fund from cashed "Competition" fines), EFSI (European Fund for Strategic Investments), PGF (Horizon 2020 Participants Guarantee Fund).

23 *Figure 2* shows the evolution of the benchmark, the performance of the management of the assets of the ECSC in liquidation, and the performance of German 10-year bonds (which is a typical benchmark for sovereign bonds with a medium maturity). In June 2019, the performance of German 10-year bonds went below 0 %.

Figure 2 – Performance of the assets of the ECSC in liquidation



Source: Financial statements of the ECSC in liquidation – ECB.

24 Every five years, the Commission reassesses the operation and effectiveness of the financial guidelines for the asset management of the ECSC in liquidation and proposes amendments as appropriate. The last assessment, the results of which were published in March 2018, identified the issue of the declining revenues from the asset management and the need to submit a proposal to amend the financial guidelines. However, 18 months after this assessment, no proposal for change has been submitted to the Council.

The Coal and Steel Research funding model has reached its limits

25 In accordance with paragraph 2 of Article 1 of Protocol 37 annexed to the EU Treaties, the RFCS is funded by the revenue generated by the assets of the ECSC in liquidation. The net revenue generated during year n is made available to the EU budget of year n+2, to be used exclusively for research in the sectors of coal and steel[14]. In order to reduce as far as possible, the fluctuations that movements in the financial markets could cause in the financing of research, a smoothing arrangement is applied[15].

26 Following declining revenues from asset management, the feeding of budget line 08 05 from the net income and from the smoothing reserves dropped from €42 million in 2017 to €22 million in 2019. Judging from 2018 revenue, this budget line will only reach about €12 million in 2020. The €12 million allocated for 2020 comprise three million euro of the net proceeds of asset management during 2018, and nine million euro transferred from the smoothing reserve. The smoothing reserve has decreased from €55 million at the end of 2008 to €22.9 million at the end of 2017, and €13.4 million at the end of 2018. This evolution is illustrated in ***Figure 3***.

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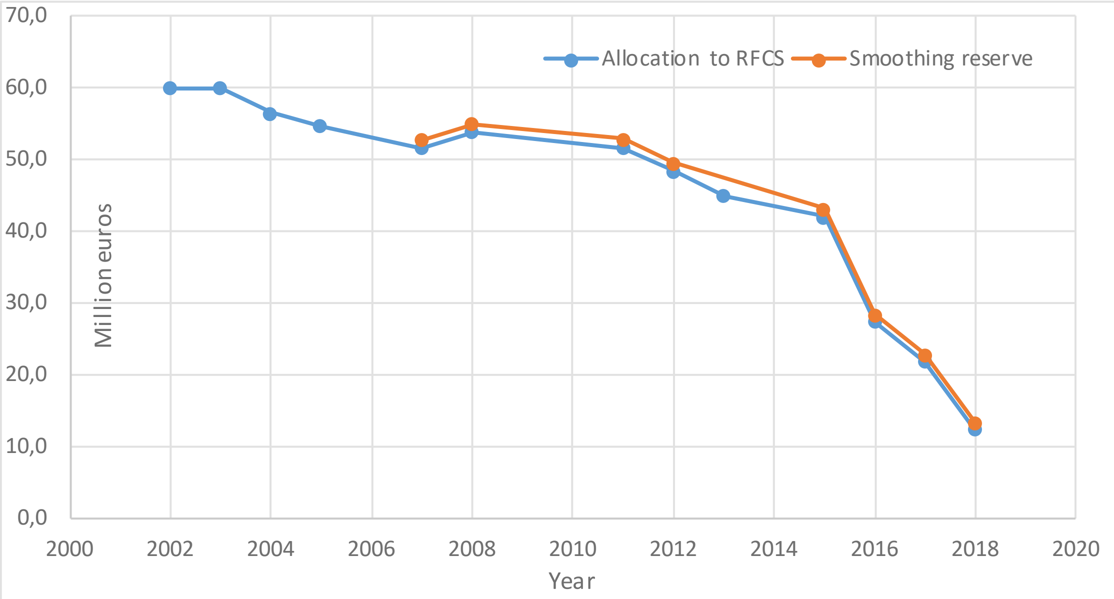
[14] Revenue: budget line 6113 – Revenue from the investments provided for in Article 4 of Decision 2003/76/EC – Assigned revenue.
Expenditure: budget line 0805 – Research programme of the research fund for coal and steel.

[15] Annex to Council Decision 2003/76/EC of 1 February 2003 (OJ L 29, 5.2.2003, p. 22).

Figure 3 – Allocation to RFCS and of the smoothing reserve (2002 – 2018)



Source: Annual accounts of the ECSC in liquidation.

27 According to the Commission, annual funding of at least €40 million is necessary to successfully implement the research programme of the RFCS. In the current interest rate environment this amount cannot be sustained by the proceeds of asset management alone.

28 In line with Article 4(5) of the implementing measures decided by the Council in 2003, cancelled commitments by the RFCS were returned to the ECSCil's assets. This measure was amended in 2018[16] to make these cancelled commitments available for spending under the RFCS, including those made since 24 July 2002. This will provide €52 million of additional funding, which would address the issue of funding the RFCS in 2018, 2019, and 2020. However, this measure will not be sufficient to ensure the sustained funding of the RFCS beyond 2020 in the current context of very low interest rates.

29 Besides the issues associated with decreases in revenue, the Fund may also be adversely affected by the consequences of the United Kingdom's initiated withdrawal from the EU. In particular, Article 145 of the draft withdrawal agreement on the future relationship between the UK and the EU states, "the Union shall be liable to the United Kingdom for its share of the net assets of the European Coal and Steel Community in

[16] Council Decision (EU) 2018/599 of 16 April 2018 (OJ L 101, 20.4.2018, p. 1), amending Council Decision 2003/76/EC (OJ L 29, 5.2.2003, p. 22).

liquidation on 31 December 2020 in five equal annual instalments on 30 June of each year, starting on 30 June 2021”.

The RFCS: a separate research programme in the EU framework

30 The Research Fund for Coal and Steel supports research projects in coal and steel sectors. These projects cover production processes; the application, utilisation, and conversion of resources; safety at work; environmental protection, and reducing CO_2 emissions from coal use and steel production[17].

31 Examples of RFCS projects are outlined in ***Box 1***.

Box 1 – Examples of RFCS projects

Opti-mine

Demonstration of process optimisation for increasing the efficiency and safety in coal mines by integrating electronic information and communication technologies.

HUGE2

Investigation on contamination of underground aquifers and potential leakage of poisonous and explosive gases into the surrounding strata. The works were focused on finding practical solutions of possible leakages prevention by use of reactive barriers.

Oncord

Understanding of the processes occurring during the co-combustion of low-grade fuels with coal.

HISARNA B and C

A new ironmaking method involving very low CO_2 emissions and the direct use of coal and ore.

GREENEAF2

Use of char from biomass as a substitute for fossil coal in the electric arc furnace.

ACE-PICK

An innovative electrolytic pickling process for carbon and stainless steels with a much higher efficiency than conventional treatment, in terms of reduction of pickling time, reducing the need for fresh chemicals and minimisation of environmental impact.

[17] https://ec.europa.eu/info/research-and-innovation/funding/funding-opportunities/funding-programmes-and-open-calls/research-fund-coal-and-steel-rfcs_en.

HIPEBA

A project, which developed safer and more competitive road restraint systems by using high-performance steels.

PUC

Investigation on the quality and monetary benefits from application of continuous product uniformity monitoring in the steel industry.

Source: European Commission, DG RTD.

32 The RFCS complements other European financial instruments for research and innovation, but has remained outside the research framework programmes of the EU as provided for by Article 1(2) of Protocol 37 to the EU Treaties. The distribution of funding has also remained at 27.2 % for coal-related research and 72.8 % for steel-related research, as provided for by Article 4(2) of the implementing measures, decided by the Council in 2003.

33 To ensure complementarity with the Seventh Framework Programme established in December 2006[18], the Research Programme of the RFCS was adopted together with a revision of the multiannual technical guidelines in April 2008[19]. To maintain coherence and complementarity with the Horizon 2020 Framework Programme established in December 2013[20], the Research Programme and multiannual technical guidelines of the RFCS were further amended in May 2017[21]. However, this amendment took place more than three years after the launch of Horizon 2020.

34 The Commission (DG RTD) manages the RFCS programme with the assistance of several high-level groups of experts:

(a) the Coal and Steel Committee (COSCO), composed of representatives of all Member States;

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[18] Decision No 1982/2006/EC of the European Parliament and of the Council of 18 December 2006 (OJ L 412, 30.12.2006, p. 1).

[19] Council Decision (2008/376/EC) of 29 April 2008.

[20] Regulation (EU) No 1291/2013 of the European Parliament and of the Council of 11 December 2013 (OJ L 347, 20.12.2003, p. 104).

[21] Council decision (EU) 2017/955 of 29 May 2017 amending decision 2008/376/EC (OJ L 144, 7.6.2017, p. 17).

(b) the Coal Advisory Group (CAG) and the Steel Advisory Group (SAG), composed of experts representing industrial producers and users, research centres, and universities; and

(c) seven technical groups (TGs)[22], which monitor the ongoing projects, evaluate the project results, and give support to the Commission and to the advisory groups.

35 The main features of the RFCS programme and the Horizon 2020 Framework programme are compared in ***Table 1***.

Table 1 – Comparison between RFCS and H2020 Framework

	Legal basis	Funding	Operationnal		
			Advisory	Management	Evaluation
Coal and Steel Research Programme	Council Decision 2003/76/EC of 1 February 2003 (OJ L 29, 1.2.2003)	Revenues earmarked from the management of dedicated assets	Similar comitology and use of peer groups	Similar participation and costing rules	Similar evaluation criteria
H 2020 Research Framework Programme	Regulation (EU) No 1291/2013 establishing Horizon 2020 (OJ L, 20.12.2013, p. 109).	Research budget			

Source: ECA.

36 In 2013, the assessment report of the RFCS research programme concluded that it had contributed effectively to the economic sustainability of the concerned sectors. The assessment report classified the benefits generated by the RFCS projects in six major categories[23]:

— financial returns: cost reduction, productivity increase, energy and raw materials savings, and increase of market shares;
— environmental benefits;
— health and safety issues;
— development of knowledge, including modelling;
— development of innovative applications; and
— means for better use of coal and steel.

[22] Minutes 21 SAG meeting, 5/12/2018: Following the advices of its advisory groups CAG and SAG and endorsement of COSCO in 2018, the Commission has decided to reduce the number of the Technical Groups from 12 to 7.

[23] Assessment Report of the Research Programme for the Research Fund for Coal and Steel – DG Research and Innovation, 2013, p. 80.

Conclusion

37 Between 2002 and 2018, the equity of the ECSC in liquidation increased from 420 million euros to €1.5 billion. The winding-up process is almost complete and only non-material amounts remain for loans at year-end 2019 (see paragraphs ***15*** to ***17***).

38 These amounts available for investment have been managed by the Commission in line with the approved investment guidelines and the same as those used for other portfolios under Commission's (DG ECFIN) responsibility (see paragraphs ***18*** to ***20***). However, due to the low interest rates, the proceeds from this asset management are currently very low: only three million euros in 2018 (see paragraphs ***21*** to ***23***).

39 Funding the RFCS on the sole basis of asset management revenue is not sustainable in the current interest rate environment (see paragraphs ***25*** to ***29***). The revision of the multiannual financial guidelines, currently pending, provides an opportunity to re-consider the purpose of the RFCS (see paragraph ***24***). The revision of the financial guidelines is urgent and should answer how the equity of the ECSC in liquidation could be made productive within the EU's framework research programmes.

40 The recent evolutions illustrate the welcome move towards greater integration and alignment of the RFCS with the EU's framework research programmes and drive innovation-led sustainable growth (see paragraphs ***30*** to ***36***). This integration will allow the mainstreaming of support for research in the coal and steel sectors into the EU research framework programmes, thereby simplifying the management of research funding.

This review was adopted by Chamber IV, headed by Mr Alex BRENNINKMEIJER, Member of the Court of Auditors, in Luxembourg at its meeting of 3 September 2019.

For the Court of Auditors

Klaus-Heiner LEHNE
President

Glossary

Budget Fines Fund (BUFI)

A fund set up in 2010 via which the Commission manages provisionally cashed fines and invests these in certain categories of financial instruments.

European Coal and Steel Community (ECSC)

A common coal and steel market, established in 1952, aimed at regulating supply, access, pricing and working conditions in order to promote employment, economic growth and international trade. Comprising six member countries (Belgium, Germany, France, Italy, Luxembourg and the Netherlands), the organisation was the precursor to the EU institutions.

European Investment Bank (EIB)

The EU's bank, which is owned by and represents the interests of the EU Member States. It works closely with the other EU institutions to implement EU policy.

Paymaster Office (PMO)

A European Commission department that determines, calculates and pays the salaries and other financial entitlements of EU staff.

Winding-up

The process of dissolving a legal entity, which involves closing its financial operations, selling or transferring its assets and distributing any revenue generated among partners, shareholders or transferees.

Research fund for coal and steel (RFCS)

Created in 2002 to build on the success of the European Coal and Steel Community, a fund supporting innovative projects to enhance the safety, efficiency and competitiveness of the EU coal and steel industries.

Performance of the ECSC in liquidation

The overall performance of the ECSC in liquidation is affected by the result of winding-up of the ECSC's financial operations, net revenue on investments and the funding of Coal and Steel Research.

ECA team

This report was adopted by Chamber IV Regulation of markets and competitive economy, headed by ECA Member Alex Brenninkmeijer. The task was led by ECA Member Alex Brenninkmeijer, supported by Raphael Debets, Head of Private Office and Di Hai, Private Office Attaché; John Sweeney, Principal Manager; Marc Hertgen, Head of Task; Richard Moore provided linguistic support.

From left to right: John Sweeney, Alex Brenninkmeijer, Marc Hertgen, Raphael Debets.

This review assesses whether the winding-up process of the European Coal and Steel Community (ECSC) has been carried out effectively. The process is almost complete and the equity of the ECSC has increased to €1.5 billion. However the coal and steel research funding is no longer sustainable because of low interest rates due to the present situation of financial markets. This review presents facts and analysis but is not an audit.

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