INVESTING WHERE IT MATTERS

AN EU BUDGET FOR LONG-TERM GROWTH

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CEPS TASK FORCE REPORT

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This report is based on discussions in the CEPS Task Force on Aligning the EU Budget with the Europe 2020 Objectives. The group met six times over a concentrated period from May to December 2011. The participants included senior executives from a broad range of stakeholders, such as business and industry, business associations, academic experts, EU officials and members of the European Parliament. A full list of members and invited guests and speakers appears in Appendix 2.

The members of the Task Force engaged in extensive debates over the course of several meetings and submitted comments on earlier drafts of this report. Its contents reflect the general tone and direction of the discussion, but its recommendations do not necessarily represent a full common position agreed by all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong.

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PREFACE

One percent of our common GDP? 1.05%? 0.95%? Once again, the member states are locked in an unrelenting and sterile battle about the size of the EU budget.

They are barking up the wrong tree. The amount is not decisive. When it comes to EU spending, quality matters far more than quantity. And it is on the quality side that we can make the most significant improvements.

The weaknesses of the Union have been brutally revealed by the financial crisis. Within a few months, Europe has lost assets considerably exceeding the costs for the EU budget over a full seven-year cycle. In spite of its unquestionable achievements over the last few decades, the ground is shaking under the entire European project.

The four freedoms and a host of accompanying regulations and practices have set the scene for unprecedented economic and social development in Europe. The historical cleavages of the continent are being overcome through the accession of the new member states and evolving relations with the new neighbours. Centuries of parochialism are at last giving way to widening horizons.

The Task Force set out to examine how the next multi-annual financial framework of the EU could become more growth-oriented. We found this to be entirely in line with the expressed intentions of the European Commission, but less so with its actual proposals.

In the course of our inquiries and deliberations, we noted that the role of the EU budget in stimulating growth is principally indirect. Some investments in infrastructure, research and innovation promise lasting returns, but many expenditures have only short-term and transient effects. Such success indicators as 'jobs created' or 'jobs maintained' testify to a myopic vision in several areas of EU policy.

For enduring results, we should identify investments with a long-term impact and a clear European dimension. The strongest generators of economic expansion are probably found in the regulatory sphere. Important engines for this development are the internal market, the monetary union and the growing mobility of skills and knowledge.

In stimulating lasting growth, EU rules matter more than EU expenditures. But the budget has an important role in promoting the many processes needed to secure this positive influence. Institutional support is crucial for future success. A knowledge-based economy needs knowledge-based governance. The elaboration, implementation and refinement of the regulatory framework require considerable investment in policy analysis, policy evaluation and policy learning.

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EXECUTIVE SUMMARY

Historically, large parts of the EU budget have been devoted to redistributive measures purporting to build and sustain support for European integration. With the challenges now facing the European Union, more weight must be given to allocative efficiency and investments in European common goods. This report describes how the budget could be adapted to promote long-term growth and identifies the expenditures that are most conducive to this end. These are in particular expenditures that develop the single market and support research and innovation.

The European Commission recently unveiled its proposals for the next multi-annual financial framework (MFF) for the period 2014 to 2020. The proposals do not radically change the structure of the EU budget, but make a serious attempt to improve the quality of strategic planning and the implementation of the policies, aligning the expenditures with the Europe 2020 objectives. The documents have been released at a delicate moment at one of the worst points of the financial crisis, which has induced severe austerity measures across the EU to cut budget deficits.

The Commission's Communication skilfully balances the need to address new and pressing EU objectives and the demands for funding increases with a freeze in expenditures.[1] The document seems to square the circle of limiting expenditure to 2013 levels while increasing it, at least theoretically, to the levels sought by the European Parliament if one combines the provisions for special budgetary lines now outside the MFF.

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[1] European Commission, Communication on a Budget for Europe 2020, COM(2011) 500 final, Part I, Brussels, 29 June 2011(a).

Presentational skills, however, are not what Europe needs from the EU budget, but rather a real overhaul of how it is managed and what the expenditures are used for. The EU budget has substantial untapped and poorly understood potential as a long-term investment tool at the European level. The proposals do show important steps forward, demonstrating the Commission's willingness to press for a budget centred on areas that matter to long-term economic growth, putting the accents in the right places in many of its proposals. Yet the proposals fall short of abolishing existing measures of low European added value.

Nevertheless, the Commission has published proposals that offer fertile grounds for negotiation. The budget is now under discussion in the Council and European Parliament. While the Parliament aligns itself closely with the Commission's proposals, the discussions in the Council are still not based on policy considerations, but rather on the budget size and distribution. Driven by the present economic climate and the desire to reduce budget deficits at the national level, a number of member states are focusing on cutting the budget.

The Commission is also proposing a complex set of strategy and oversight reforms, to rectify what many member states and the Court of Auditors have complained about over the years. But even in this regard serious discussions are not yet taking place.

Unfortunately, the politically most expedient cuts are those in the areas of highest added value and highest growth returns to the EU. These correspond to areas that in theory are recognised by the net contributors as being vital to Europe's future. Thus, member states should not treat the budget as a mere cost, but as an investment opportunity. It is time that member states discuss seriously the quality of EU expenditures and take very careful decisions on any 'austerity cuts'.

The EU budget is an essential instrument for Europe and it is important to remember the reasons for such a financial mechanism:

- *The functioning and sustainability of the internal market requires a system of targeted budgetary transfers* at the EU level owing to the uneven distribution of benefits across countries and regions of integration.
- In the areas of *research and innovation*, crucial for Europe's future competitiveness, there are *important economies of scale* that can be fostered by the budget.

- *Without the EU budget many objectives of the EU cannot be achieved* and poorer member states will not be able to comply with all of the obligations of the *acquis*.
- *The EU budget has a very important role in steering policies and leveraging funding* from the private and public sectors.

Key recommendations

In the negotiations on the multi-annual financial framework, the member states need to *focus on the long-term impacts, the European added value and the efficiency and effectiveness of the EU budget.* Expenditures should be geared towards *investing in long-term growth, the development of the internal market, European public goods and financing important EU objectives*.

There is a strong consensus among the Task Force members that the *EU budget has a key role to play in the development of the internal market and thus long-term growth in the EU*.

The Task Force considers that it is of paramount importance that the emphasis on *research and innovation is protected and reinforced*. Cuts to the EU budget cannot be undertaken in areas that will undermine Europe's capacity to compete globally and generate growth and jobs. No compromise can be acceptable in these areas. In practice, this means that:

- *Funding for research and development under the Horizon 2020 programme should not be reduced*.
- *Funding to support the Strategic Energy Technology Plan, which will fundamentally change Europe's way of using energy and therefore Europe's economy, should be increased*. The EU's share of funding in the energy sector is highly important and significant.
- *The European Commission's proposals on the governance of the cohesion policy should be supported.* The coherence among strategies for different funds has to be reinforced, including with member states' own programmes in view of avoiding duplication. The proposal for smart specialisation strategies for the structural funds needs to be implemented, along with that for peer review of the strategies. More weight should be put on *ex ante* conditionality, monitoring and outputs, and less on procedures and *ex post* auditing. Procedures to act upon weak strategies and the lack of outputs, however, need to be clarified.

- *The proposed increase in the use of innovative financial instruments should be supported and even further expanded*. Regarding *project bonds, the Task Force considers that this instrument offers clear added value to the EU*, as long as certain preconditions are met to ensure that only projects of a high level of European added value are pursued.

On cross-border infrastructure, one of the crucial instruments to develop the internal market is the *Connecting Europe Facility*. It is thus recommended that *the proposed level of funding is maintained*. Notwithstanding the support for this budget line, the Task Force considers that the way in which funding is allocated has to be reviewed, increasing the share devoted to energy.

If savings are necessary in the budget, they should be found in areas of low European added value, not in areas investing in the future innovative capacity of the EU. The Task Force agreed that the Common Agricultural Policy has an important role to play in the EU, but that policies are still suboptimal and thus the expenditure level unjustified based on the European added value and public goods criteria. *Judicious savings in this policy can be achieved without compromising the positive aspects of the policy*. *Other savings could also be achieved by reducing expenditures in wealthier regions, when such spending does not have a clear European dimension in impact.*

The Task Force is concerned about the blind budgetary cuts on 'administration' of the EU at a time when the governance of the EU needs to be reinforced. Savings in this area may well mean higher costs for the EU economy, not less. The development of agencies and institutions at the European level to handle the single market, such as air-traffic and rail-traffic control, food safety, maritime safety and others, already reduce the cost of disparate regulatory bodies at the national level. Reinforcing the EU institutions is in many cases a saving, not a cost.

The Task Force did not deliberate on the EU's own resources, but it hopes that the discussion on resources does not overshadow the important discussions on the focus and quality of expenditures.

The EU budget is an important tool to promote long-term sustainable growth in Europe. It is time it is recognised as such and decisions are taken in line with ensuring it operates effectively and efficiently towards this goal.

INTRODUCTION

In its 29 June 2011 Communication on the next multi-annual financial framework ("A Budget for Europe"), the European Commission makes a strong commitment to the objective of knowledge-based growth and investment in European public goods.[2] The principles espoused in this document deserve strong support.

But when it comes to translating these ambitions into concrete proposals, there are far too many side-glances at the short-term national interests of various member states. This may be politically astute if success is measured by the ability to reach consensus, in the manner long established in European politics. Yet such victories are gained at the expense of policy foresight.

Through creative accounting, a mainstreaming of climate and energy objectives and a judicious but demanding set of strategy, management and oversight proposals, the European Commission has offered a compromise proposal that has been accepted as a base for negotiation by all member states and the European Parliament. That is no minor feat. If this budget had been presented in 2004 for the 2007–13 period, it would have been a radical step forward. Today, however, this politically astute budget may not be ambitious enough to fulfil its potential role in helping to achieve the EU's objectives.

According to the Commission Staff Working Paper published simultaneously with the Communication, only 43% of present EU spending is devoted to initiatives supporting the Europe 2020 objectives.[3] This will not change much in the reformed budget proposed for the next multi-

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[2] Ibid.

[3] European Commission, *A Budget for Europe 2020: The current system of funding, the challenges ahead, the results of stakeholders consultation and different options on the main horizontal and sectoral issues*, Commission Staff Working Paper, SEC(2011) 868 final, Brussels, 29 June 2011(b).

annual financial framework (MFF). By giving priority to continuity and vested interests, we are about to miss yet another opportunity to make the EU budget forward- rather than backward-looking.

The Europe 2020 formula presented by the Commission of "smart growth, sustainable growth, inclusive growth" is attractive but it does not offer much help when it comes to making sharp budgetary choices. Almost any kind of EU spending produces short-term growth somewhere, but a multitude of such effects does not add up to a sensible and durable policy for growth. In this report we emphasise the need for investment in long-term growth, and for impact the spread of investment across a wider area than a single country or region. European money should first and foremost be used for projects with a clear European dimension.

The stakes are high. The financial turbulence now shaking Europe has made it even more obvious how much we depend on high-quality governance. If decisions are made under uncertainty, as they often must be, it becomes even more important to invest in follow-up, analysis and appropriate mechanisms for corrections. The missed opportunities and resources lost directly and indirectly through weak economic governance far exceed the costs linked to the EU budget.

At the same time we should not underestimate the formidable gains made through European integration. Imperfect as they still are, the internal market and the monetary union have already provided very significant stimuli for growth and employment throughout the continent. Increasing mobility and an emerging common legal sphere create fertile preconditions for future economic exchange and cooperation.

EU rules are in many ways more crucial for long-term European growth than EU expenditures, but the budget has an important role in supporting rule-making, rule implementation and learning from our experience with rules.

This rule-making influence of the budget seems to be grossly undervalued by member states. Formally, one can summarise the roles of the budget as the following three: first is to assist poorer countries and regions to develop and to help them integrate into the single market; second is to support these countries in complying with costly obligations of the EU *acquis*; third is to help the EU achieve its objectives in areas where common action generates economies of scale with results of a higher value than separate actions by member states, i.e. the creation of the often-misunderstood EU added value. Without EU budgetary assistance many core EU objectives will not be achievable. But there is another powerful indirect influence, i.e. rule-making. EU budget procedures, from formal administrative rules and budgetary oversight down to drafting strategies and programmes, deeply transform the governance systems and the investment policies of countries at record speed. This influence is far from negligible.

While small and in no way sufficient by itself to address the crisis in Europe, the EU budget is the principal financial instrument for *joint action* by member states to face common challenges and reach common objectives. Given the limited size of the budget and the importance of its objectives, the costs of wasting resources for political expedience have increased. In economic terms it means that the opportunity costs of badly spent budgetary resources are greater. To a certain extent this has been understood, and proposals by the Commission that would most likely have been rejected outright a decade ago are today accepted as negotiable, such as the rather strong strategic planning, management and oversight requirements of the proposals. Even so, member states seem not to understand in this age of austerity that the opportunity costs of inefficient policies are not cuts, but better EU-financed interventions. It is also important to stress that the decisions are for a budget for the future running from 2014 to 2020, hopefully stretching beyond the era of financial crisis. Decisions on the future need to be based on future objectives rather than immediate, often short-term realities.

This Task Force report focuses on key aspects that should be preserved and enhanced in the budget in line with the need to promote growth, employment and competitiveness in the long run. It highlights areas of European added value and where it would help to rationalise overall EU public expenditure. It is divided into four chapters: the first discusses the need to direct the EU budget towards long-term growth; the second identifies the policies to promote as long-term investments; the third considers the need to reinforce the targeting of European public goods; and finally, the fourth looks at governance.

1. THE EU BUDGET SHOULD BE A LONG-TERM INVESTMENT TOOL

Since its establishment by the European Economic Community, the function of the EU budget has not been clearly defined. The EU budget is historically unique and has played a pivotal role in the development of the internal market by making it acceptable for member states. The budget has evolved over the years from a mainly political instrument of compensation to one for economic development and pan-European objectives. It is today a hybrid between a political and an economic instrument.

While this is perfectly understandable, there has been a lack of synchronisation with the addition of objectives, changes in policies and the size of the budget. In size, the budget has remained stable or even fallen in terms of the share of GNI over the last decade, despite the enlargements to significantly poorer member states. In the meantime, the ambitions of the EU have increased considerably in domains in which the EU budget is a necessary instrument. If the budget had been restructured in line with new needs as a consequence, this would not pose a significant problem. Yet such a restructuring has not occurred, nor does it seem politically possible that it will be undertaken to the level desirable for the next MFF. New ambitions are thus cash-starved and will remain partially so.

There has nonetheless been a realisation at the political level that there is a mismatch between the demands, expectations and the principles that should govern a common budget. The subsidiarity principle, for example, indicates that the EU should not intervene in areas that can be better handled domestically.

The budget deviated significantly in its policies and actions from applying the criteria that theories of fiscal federalism[4] and the legally enshrined principles (subsidiarity, additionality and added value) would suggest. This means that the European dimension and added value of a number of actions financed by the EU budget are dubious. That has led to increasing calls for reform that would reinforce the targeting of the EU budget on those areas with a clear European added value.

Defining the European added value of policies has not been straightforward. The European Parliament's reflection paper on European added value[5] by the SURE Committee[6] mentions that "these enigmatic words are often used, unfortunately also in an inflationary way. Their multi-purpose use bears the risk that the phrase turns into 'fashionable buzz words' that quickly lose their meaning." Despite this warning, the SURE Committee did identify features with which EU interventions should comply that include the added value criterion. These are expressed in terms of policies and expenditures having a transnational dimension, generating economies of scale from common action, bringing together a critical mass that single member states cannot provide alone, developing common policies and preferences that facilitate integration, helping member states to reach EU objectives or to reduce the costs of doing so through common coordination (or both).

A number of concepts of European added value have been offered by the academic literature. According to one study dedicated to defining European added value, it exists in two cases. The first case is based on the simple economic rationale of economies of scale "where the limited scope of the member states and the existence of economic externalities reduce their propensity to take appropriate action". The second case concerns the value of enhancing European cohesion, through common action and

[4] Fiscal federalism is a branch of public policy analysis that seeks to determine the optimal distribution of responsibilities among different levels of governance based on cost efficiency.

[5] European Parliament, *Reflection Paper on the Concept of European Added Value*, SURE Committee, Rapporteur: Salvador Garriga Polledo, 21 September 2010.

[6] SURE refers to the Special Committee on Policy Challenges and Budgetary Resources for a Sustainable European Union after 2013.

projects that "make substantial contributions promoting the sense of community and the effective interaction in the European Union".[7]

Still, these concepts are not easy to make operational at today's stage of negotiations on the budget. Given the diverse nature of the objectives and needs of the European Union, the list of policies and programmes that can be viewed as adding value is large. Furthermore, it is important to pinpoint that the European added value of a policy is not only dependent on its stated objectives, but also on the management system, funding tools and implementation. Policies that at face value appear to have a high added value fail to deliver it in practice.[8]

This report tries to bring a view that is more operational and immediately applicable to the negotiations based on the current situation in the EU and the problems and objectives outlined in the Europe 2020 strategy.[9]

The EU faces difficult economic challenges and has complex objectives in the areas of energy and climate change. Defining the role of the EU budget in those areas needs to be the central focus of the budget for 2014–20. The Task Force members agree that in addition to expenditures offering European added value, EU funding should represent an *investment tool* for long-term sustainable growth in the EU. The EU budget is not the appropriate instrument for expenditures aiming at short-term gains.

This notion of using the budget as an investment tool for long-term growth has not been taken seriously enough in the past. It is true that the main instruments of the EU to promote growth are the development of the single market, the functioning governance of the euro and the influence of national macroeconomic policies. Common rules and the free movement of goods and services are the cornerstones of European economic growth. The EU budget is certainly too small to play a major role in promoting growth

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[7] D. Tarschys, *The Enigma of European Added Value: Setting Priorities for the European Union*, SIEPS Report 2005:4, Swedish Institute for European Policy Studies, Stockholm, 2005, p. 100.

[8] Contribution by Danuta Hübner (Task Force member) to the debate on European value added in the SURE Committee meeting of 23 September 2010.

[9] European Commission, Communication on EUROPE 2020: A strategy for smart, sustainable and inclusive growth, COM(2010) 2020, Brussels, 3 March 2010(a).

directly. But that does not mean that the EU budget has no influence, as it can operate as a *powerful interface*.

The EU budget can, through its leverage capacity, mobilise a multiplicity of funds from the public and private sectors for European objectives. Through the requirements to develop strategic plans for its use at the EU, national and regional levels, it influences policy decision-making on general public expenditures, particularly in cohesion countries. EU procurement rules also influence the way national public funding is directed. The EU budget, small as it is, affects the investment priorities of regions and member states. It clearly communicates with its funding what the EU is seeking.

Unfortunately, the role of the EU budget has never been unambiguously defined as a tool for long-term growth. The strategic planning and monitoring of a large share of the budget expenditures has been left to national and regional authorities, which may not have had a long-term vision of investment and have understandably been interested in local preferences and fund absorption instead of European objectives. It is thus not surprising that the European Commission's term review of the budget[10] primarily considered strategy and oversight issues rather than general policy priorities. Approximately 80% of the EU's funding and its day-to-day management are in the hands of national authorities,[11] but the accountability of their actions to the European Commission and European Parliament is weak. [12]

EU budget expenditures for the cohesion policy and rural development are governed at the national/regional levels by strategies and operational programmes approved by the Commission. Through better *ex ante* conditionality, better reviews and stronger technical assistance, the focus of the funds on long-term investment can be sharpened.

Influence in the member states is not limited to those two areas. Through its much smaller investment in research & development (R&D) – a

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[10] European Commission, *Review of the EU budget*, Commission Staff Working Document, SEC(2010) 7000, Brussels, 2010(b).

[11] More specifically, 80% of the EU budget is handled through shared management, which de facto means mainly at the national and regional levels.

[12] G. Cipriani, *The EU budget: Responsibility without accountability*, CEPS Paperback, Centre for European Policy Studies, Brussels, 2010.

mere 5% of the total EU expenditures on R&D – the EU budget has contributed considerably to promoting collaboration among research institutes in the EU with encouragingly positive outcomes.[13] The development of the European research area and the European Research Council are further results of this collaboration. The European Commission has been using these experiences to move forward and develop new public–private partnerships in the area of research with the Joint Technology Platforms and the new energy-related European Industrial Initiatives. The developments in R&D show substantial achievements with limited resources, because these efforts act as a steering tool to foster joint European capacities.

The EU budget thus has the potential to enhance the EU's single market and growth by offering support to develop missing links that require joint EU action and by investing in capacity building, joint standards, strategic planning and monitoring instruments. One can conclude that the main objective of the EU budget is the efficient mobilisation of local resources towards EU objectives through financial incentives.

The Europe 2020 strategy outlines the EU's present objectives for smart, sustainable and inclusive growth, which call for a better, long-term investment approach to public expenditures, including (or especially) by the EU budget. Yet the present budget bears little resemblance to the Europe 2020 objectives. The new proposals by the European Commission have made an effort to integrate the Europe 2020 strategy without restructuring the budget radically. As a result, the proposals for the cohesion policy, the research and development policy (Horizon 2020) and the policy on trans-European networks (the Connecting Europe Facility) incorporate the Europe 2020 objectives. Nevertheless, by preserving the funding distribution and structure of the budget close to the present one, the funding levels and distribution are still some distance away from corresponding to new priorities.

We can, however, identify the key areas of investment with a high degree of European added value and long-term growth implications, namely

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[13] European Commission, *Interim Evaluation of the Seventh Framework Programme*, Final Report of the Expert Group, Brussels, 12 November 2010(c).

- reinforcing the innovative capacity of the Union and through this its future competitiveness;
- investing where needed to complete the infrastructure necessary to fully develop the single market;
- investing in EU public goods; and
- investing in knowledge-based governance and institutional support.

This report concentrates on those areas, their importance and how they can be enhanced.

In a nutshell:

- The EU's budget is small in relation to its functions and needs to be very well targeted and efficient in seeking to achieve its objectives.
- The EU budget has a strong influence beyond its mere investments in redirecting national strategies and funding towards specific EU objectives. Badly targeted expenditures have important repercussions, not only wasting EU funds but also wasting national funds and administrative resources.
- The EU budget needs to assist in the completion of the internal market, including the energy market through cross-border power interconnectors.
- The EU budget needs to use its leverage instruments to promote growth-enhancing investments, especially where economies of scale at the EU level are important, as in the case of R&D and innovation.
- The Commission's capacity to evaluate strategies and monitor performance needs to be reinforced.

2. INVESTING IN THE FUTURE OF EUROPE AND THE SINGLE MARKET

This chapter identifies the actions that the EU budget should prioritise for the highest returns to investment in line with long-term growth objectives. The central instrument for long-term growth for the EU is the full realisation of the single market for goods, services and capital, underpinned by the freedom of movement for people. The main mechanisms to develop the single market are of course regulatory; nevertheless, the EU budget can intervene in a number of areas:

1) investing in collaboration across borders through multiregional cross-border programmes that take advantage of the multitude of opportunities for increasing economies of scale, particularly in the areas of research and innovation;
2) developing the physical elements of a single market that promote economic integration and competitiveness;
3) facilitating the integration of regions and countries, by helping regions lagging behind to develop, to climb up the ladder of innovation and to benefit from the single market; and
4) financing European public goods that generate European added value, which would not have been created in the absence of EU support.

While these four points seem very clear and are supported by theories of fiscal federalism and their adapted versions for the case of the EU, the implementation of the budget in practice has markedly deviated from them. The origin of the budget was to a large extent a political construct aimed at compensating groups or territorial entities considered rightly or wrongly at risk of loss from the creation of a single market. The use of the budget as an instrument of European economic policy has been gaining importance with the deepening of the single market. The economic crisis is reinforcing the case for a budget that is used effectively as an investment instrument. These investments also need to be coordinated, building on synergies among the different policies and also national actions.

This chapter explores the areas of the EU budget that are oriented towards investment and long-term growth, pinpointing the policies that need to be protected or promoted. These are research and development, the emphasis on innovation in the structural funds, the development of core cross-border infrastructure and the development of social and human capital.

2.1 Investing for excellence in research and innovation

The economic welfare of European nations in today's highly competitive international market will greatly depend on the existence of industry that produces a high level of added value. Europe's welfare depends on long-term growth and hence sustained industrial competitiveness. This requires a strong foundation of innovation on which to build, and such a basis can only be developed through investment in research, development and innovation (RDI)[14] and a pooling of resources and efforts at the European level.

It is a widely accepted fact that there are considerable advantages in funding research at the EU level, mainly through economies of scale given that research becomes more efficient when it is undertaken on a larger scale. But there is much less consensus on how the funding should be allocated, and how much of the EU budget should be spent on RDI.

The central funding mechanism at the EU level for basic and industrial research and innovation comes through the Framework Programmes, which started in 1984. Today we are at the Seventh Framework Programme (FP7) with a budget of just over €50 billion for the 2007–13 programming period. This represents less than 5% of total government expenditure on research in the EU, but it can be significant in

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[14] RDI is used throughout the report to refer to support going beyond basic research and development, funding in addition the stages before commercialisation – such as testing, demonstration and deployment – that the private sector is reluctant to support.

the specific areas in which it intervenes. Public RDI expenditure in the member states also covers capital costs that the FP7 programme does not finance. In addition, it is important to point out that the cohesion policy invests an amount equivalent to the FP7 programme on research and innovation, albeit with a different focus, namely developing capacity, promoting innovation through the integration of key enabling technologies and fostering collaboration between businesses and industries (see section 1.2).

Up to FP6, the main aim was to facilitate collaboration among research centres and expand economies of scale in research and development, rather than promote concerted action to reach specific objectives. Today the EU's RDI policies increasingly seek to foster the competitiveness of European industry, leveraging private investment in RDI and progressively assisting demonstration, deployment and commercialisation. This is particularly striking for energy, where the RDI policy has transformed into a 'mission-oriented' policy.

This new central relevance of RDI has allowed the budget to increase in size and enabled this formerly loose policy to take centre stage and develop into a fully-fledged EU policy. The Europe 2020 strategy by the European Commission again calls for a substantial increase in RDI expenditure and coordination in the EU. This is reflected in the proposals for the EU budget, which call for a rise in funding for the successor Horizon 2020 programme. The budget proposals bring together under one financial heading the FP7, the entrepreneurship and innovation part of the existing Competitiveness and Innovation Framework Programme (CIP) and funding for the European Institute for Innovation and Technology, in a single programme with €80 billion for the 2014–20 period – representing an increase of about 50% compared with the present 2007–13 budget even after deducting the addition of programmes presently not under FP7.

The EU needs an active policy for RDI because it has important ambitions, such as creating a single European research area, reaching a total RDI expenditure (private and public) of 3% of EU GDP (presently at 1.9%) and providing a technology push in the area of energy through the Strategic Energy Technology (SET) Plan.[15] Without instruments at the EU

[15] J. Nuñez Ferrer, C. Egenhofer and M. Alessi, *The SET-Plan: From Concept to Successful Implementation*, CEPS Task Force Report, Centre for European Policy Studies, Brussels, May 2011.

level these targets cannot be achieved. Furthermore, without coordination at the EU level, the risk of duplication between EU and national funding programmes increases.

Nevertheless, it is very important to keep in mind that the central weakness in the EU in the area of research is in the private sector. The share of public sector investment in RDI on average is not less than in the US or Japan.[16] Therefore, instruments need to concentrate on engaging the private sector through active collaboration and new financial instruments to leverage their investment.

2.1.1 Reasons for public and specifically EU support in the area of RDI

There are clear reasons for the support of RDI by the public sector, as well as assistance by the EU in particular. Public intervention is necessary when

- the research has no immediate commercial value and the results are unknown. Basic research can fundamentally only be financed by grants;
- the market and financial risks are too high for a private investor, i.e. the benefits are realised beyond a period in which a private investor requires a payback;
- the technology risks are too high, i.e. if large-scale technologies carry high risks of failure, for example at the demonstration or early deployment stages;
- a market failure exists, i.e. the real costs to society of some existing technologies are not internalised because of subsidies or because a technology does not pay its full cost, giving existing technologies an advantage over new ones; and
- investment in RDI is not rewarded by the market because the technology becomes freely available before a private investor can make a profit from it, i.e. there is insufficient return on intellectual property rights.

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[16] For comparisons of R&D expenditures among countries and sectors, see K. Uppenberg, *R&D in Europe, Expenditures across Sectors, Regions and Firm Sizes*, CEPS–EIB report, Centre for European Policy Studies, Brussels, 2009.

A particular need for the EU to take a leadership role arises in the case of RDI with important cross-border implications or with EU-wide scale effects. A leading EU role is especially indicated if the EU

- promotes cross-border collaboration and economies of scale, thereby capturing the full capacity within the EU and building upon the European research area and the more applied 'Innovation Union'[17] by improving cooperation and coordination;
- copes with the risks associated with new RDI projects and helps to reduce the risk of duplicating national or regional initiatives implemented in an uncoordinated fashion; and
- addresses RDI projects that are too big for any one member state or requires coordinated actions among member states to provide value.

2.1.2 Bringing research from concept to market

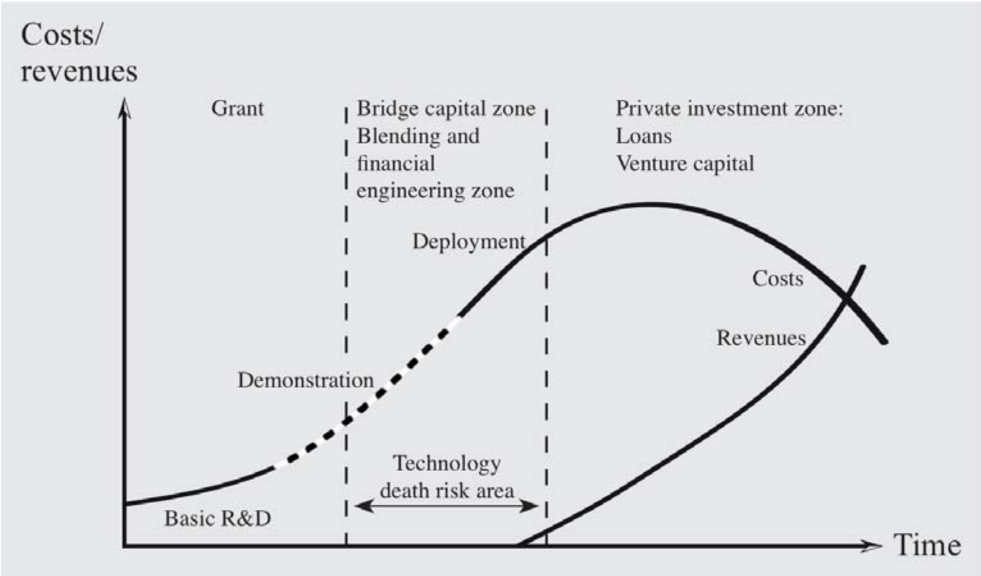
In the area of RDI, the EU needs to expand the scope of its support beyond basic research to drive innovation across the testing and demonstration phases until it is ready to attract venture capital. While maintaining the investment in basic and frontier research, there is a need to create a bridge-financing mechanism to bring discoveries with potential commercial viability from the drawing board to the market. Expanding support through grants and innovative financial instruments is crucial to Europe's research, technological and industrial leadership. The logic is illustrated in Figure 1. Basic research and early demonstration phases need to be funded by grants, as has been the case until now, because their commercial value is unknown. Once it is clear that the technologies could have potential, the costs of development may be so high and lead times so long that even if the economic rate of return (ERR) is theoretically positive, the risks make the project far too costly for private venture capital. Funding in the form of grants combined with risk capital by the EU budget and institutions like the European Investment Bank (EIB) can overcome the gap to the point where private financing alone is possible.

A key to expanding RDI investment by the private sector is the development of instruments that allow the reduction of the risk premium of credit. For this the EU has created the Risk Sharing Finance Facility

[17] The European Commission launched the Europe 2020 Flagship Initiative – Innovation Union in October 2010 (COM(2010) 546 final, Brussels, 2010(d)).

(RSFF), providing risk capital to cover potential losses in the financial sector from RDI investments over the advanced stages of innovation, demonstration and deployment. The RSFF covers risks through a guarantee set aside of €2 billion (€1 billion by the EU budget and an equivalent amount by the EIB) over the entire 2007–13 period to raise private risk capital in the value of approximately €10 billion, a leverage factor of 5.[18]

Figure 1. Technology cycle and financial needs



Source: Núñez Ferrer & Figueira (2011), p. 32.

The RSFF has been taken up very quickly, with demand outstripping resources. Given its leverage factor and limited costs, this instrument has to be further expanded. It is also a vital instrument for promoting the SET Plan, as discussed in the next section.

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18 For more information on the RSFF, refer to EIB, *Evaluation of Activities under the Risk Sharing Finance Facility (RSFF)*, Operations Evaluation Unit, EIB, Luxembourg, 2010.

2.1.3 *Investing to achieve the climate and energy objectives: The SET Plan*

The SET Plan deserves particular attention. The SET Plan is part of the EU's research and development policy targeting the low-carbon technologies of the future. The Commission devised this policy because of the low level of investment and slow rate of development in the area of new energy technologies, given that without fundamental advances, the long-term decarbonisation objectives cannot be achieved. In addition, energy technologies are important economic drivers. The EU has been at the forefront of renewable energy technologies, but risks losing its competitive advantage in an increasingly competitive global market.

The European Commission considers that there is a need to increase the investment in RDI in the energy sector from the present €3 billion a year to over €8 billion, seeking a total additional investment of €50 billion over the period to 2020. This is the amount considered necessary to bring to the market the technologies required to achieve the long-term objectives of the EU.[19]

Getting the SET Plan right is a priority and it is deeply interlinked with the growth objectives of the EU, as indicated in the 'Innovation Union' strategy launched by the European Commission in October 2010.[20] Investing in energy transformation in the EU is an investment in a new economic model and new growth opportunities.

The SET Plan brings a new dimension to the research policy of the EU, as it clearly addresses the need to cover the full development cycle of innovations, from basic research down to commercialisation. It offers the needed bridge financing as earlier shown in Figure 1.

The SET Plan is a key policy because the financial role of the EU budget in the energy sector is very important. It covers approximately a third of total public expenditures on RDI in the sector or 11% of the total combined private and public RDI expenditures in the EU (data from JRC-

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[19] European Commission, Communication on Energy 2020: A strategy for competitive, sustainable and secure energy, COM(2010) 639 final, Brussels, 10 November 2010(e).

[20] European Commission (2010d), op. cit.

IPTS, 2009). Changes in the level of support by the EU can have a large bearing on the sector.

For the EU to reach the investment targets in the sector, it is crucial that the EU budget invests more than the present share of the total funds, as every push to speed up technology development also represents a push towards more risky and less well-known technologies. A rise in investment by the EU budget of €2 billion annually for the SET Plan was considered necessary by a previous CEPS Task Force[21] in order to leverage the necessary funding. It is unfortunate that this critical growth investment seems to be threatened by pressure to cut the EU budget. The Horizon 2020 proposals, while increasing financial support for this sector, still fall short of the estimated needs calculated by CEPS research.[22]

Along with higher EU grant support, the SET Plan needs risk-capital support, such as that provided by the RSFF. This instrument will be influential in helping to raise the level of RDI in energy and bring new, significant technologies to the market. If it is to make an impact in the energy sector, the RSFF will have to be strengthened substantially. The European Commission's proposals for Horizon 2020 offer to set aside €1.1 billion of the RSFF for the energy programme over the 2014–20 period. In the best of cases this would increase total public and private funding from €3 billion to €6.5 billion, with the remaining having to come from other private and national public sources. This assumes, however, that the leverage effect of the RSFF would remain constant, while a higher number of projects or a higher number of more risky projects would reduce the leverage size.

[21] See Nuñez Ferrer, Egenhofer and Alessi (2011), op. cit.

[22] Ibid.

In a nutshell:

- RDI needs a greater level of funding and the Commission's proposed budget increases should be fully supported.
- The SET Plan is a key policy that needs a strong support by the EU budget. The funding that has been allocated to it should be increased.
- Member states should investigate and remove potential barriers that discourage private investment in innovation.
- There is a need to expand bridge capital to bring discoveries from the drawing board to the market, such as is provided by the Risk Sharing Financing Facility.
- The Risk Sharing Financing Facility instrument is vital to the technological and industrial competitiveness of the EU and needs to be expanded at least to the level proposed by the European Commission.

2.2 Investing in innovation as a fundamental priority of the structural funds

The European Commission has rightly proposed substantial reforms to the European structural funds, because in spite of the potential of the structural and cohesion funds to generate long-term growth, this has not happened in many regions. The policy has been very controversial; the link between growth and the structural funds has been difficult to establish and the performance of the funds across regions has greatly varied. High-growth regions have been presented as examples of regional policy successes by its defenders, and low-growth regions as negative examples by critics. The results of the EU's structural policy have been particularly controversial because while there has been convergence of GDP per capita among member states, regional disparities have persisted. The present debt crisis, which is having particular effects on the cohesion countries, has in addition raised questions that undermine the policy – notably concerning why countries that have been supported for decades are so vulnerable.

Still, much of the criticism and also praise for the funds is based on substantial misconceptions about economic development and the impact of assistance. First of all, even if poor regions are assisted to develop, this does not mean that their comparative disadvantage in relation to high-growth regions and economic centres will disappear or that their GDP per capita will catch up. The potential of regions to grow depends on a number of factors, from geographical to demographic ones. Second, the impact of regional funds depends substantially on national plans for the distribution of the funds, and thus performance is strongly linked to the quality of strategies and their implementation. The European Commission has not been able to ensure quality across the board. Serious attempts to improve the strategies of member states and regions have really just started in the present programming period with the requirement for member states to present a more integrated and coherent National Strategic Reference Framework (NSRF), the results of which are too early to assess.

A general philosophy in the past and current programming periods has been that the funds belong to the regions and that their use should therefore not be dictated by Brussels. Member states have prevented the build-up of appropriate monitoring systems and indicators, with the exception of funds' 'absorption' measures – which would by their nature encourage the selection of 'quick-to-spend programmes' rather than investments with the highest level of added value and with long-term benefits. The oversight of strategies and accountability has been and remains weak.[23]

With the growing realisation that the EU budget needs to be directed at achieving core EU objectives and address weak growth performance, the Commission has proposed to integrate rather strong strategic and monitoring instruments in the cohesion policy. These aim at promoting strategies that develop the endogenous growth potential of regions.[24]

What regional policy strategies need, and what successful regions have generally applied, are the following characteristics:

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[23] See Cipriani (2010), op. cit.

[24] Endogenous growth is defined as the economic growth generated in a region based on its internal resources. A short overview of the integration of endogenous growth elements in EU policies can be found in J. Núñez Ferrer, *The Evolution and Impact of EU Regional and Rural Policy*, FAO–World Bank Working Paper, FAO, Rome, September 2008.

- better integrated, long-term strategies that are growth-oriented, with coherence and a deep level of integration among the different programmes, as well as with national policies;
- the use of effective indicators and monitoring systems;
- a reduced emphasis on large infrastructure as a growth strategy, which can lead to overcapacity and generate considerable maintenance costs; and
- much higher investment in human capital and innovation.

There is today as much need for a strong cohesion policy as before, but its objectives, planning and implementation require a far subtler approach. In the absence of an active cohesion policy Europe could face two consequences: first, the internal market could be put into question by poorer countries in particular, which opened their borders; and second, many EU objectives would not be achieved in poorer regions and countries, for example the environmental *acquis* or the renewable energy objectives.

It is clear that the cohesion policy should go beyond solidarity and financial transfers to poorer regions. The main function of the funds has to be to help the regions become more competitive and increase the rate of growth in a sustainable fashion, improving living standards and employment prospects. In addition the funds should provide financial assistance to help the regions comply with the EU's standards, such as environmental regulations, and to achieve EU objectives. Given the economic crisis, the increasing international competition in trade and new climate and energy challenges, there are significant and serious areas in which the EU's cohesion policy could and should intervene.

The proposals of the European Commission[25] have correctly identified the need to focus on developing the economic potential of regions, placing competitiveness and innovation at the forefront of the strategies in place. In the present financial perspectives, investments linked to developing the research and innovation capacities already rival in size the Framework Programme for research and development, but the quality of strategic planning needs improving. "Strengthening research,

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[25] European Commission, *Proposal for a regulation on specific provisions concerning the European Regional Development Fund and the investment for growth and jobs goal and repealing Regulation (EC) No. 1080/2006,* COM(2011) 614 final, Brussels, 6 October 2011(c).

technological development and innovation" is priority no. 1 for the structural funds in the proposed new regulations (Article 5).

To this end, the Commission proposes to substantially reinforce strategic requirements in the planning phase for the structural funds. This requires the preparation of a national or regional smart "research and innovation strategy for smart specialisation in line with the National Reform Program, to leverage private research and innovation expenditure, which complies with the features of [a] well-performing national or regional research and innovation system".[26] This strategy will need to be integrated and coherent with the wider Common Strategic Framework, a strengthened and more comprehensive version of today's NSRF, which member states had to submit for this programming period. Most importantly, the Commission proposes to have the innovation strategies peer-reviewed. This is a very commendable idea. The review should be undertaken by selected external experts, avoiding the present incompatibility of the Directorate-General (DG) for Regional Policy having to evaluate programmes and simultaneously be under pressure to approve them on time before the programming period starts.

Tailored strategies need to be developed, as the barriers to innovation vary across countries and a one-size-fits-all approach is not to be pursued. The analysis by Reinstaller & Unterlass (2011) from the Austrian Institute of Economic Research,[27] which was used as input into the competitiveness report of the European Commission,[28] points out that the barriers to innovation differ substantially by country, related to the stage of economic development and specific structural factors.

The innovation strategy for the structural funds is not to be confused with the Framework Programme (Horizon 2020), which emphasises excellence and research, but should nonetheless be coherent with it. The

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[26] M. Landabaso, "Innovation Strategies for Smart Specialisation and the New Structural Funds Regulations 2013-20", Regional Innovation Monitor project, 27 October, presented at the CEPS Task Force meeting on 6 December 2011.

[27] A. Reinstaller and F. Unterlass, "Comparing business R&D across countries over time: A decomposition exercise using data for the EU 27", *Applied Economics Letters*, Vol. 19, No. 12, 2011, pp. 1143-1148.

[28] European Commission, *Innovation Union Competitiveness Report,* edition 2011, Directorate-General for Research and Innovation, Brussels, 2011(d).

structural funds are aimed at improving local capacity and entrepreneurship through innovative solutions, and a better understanding and integration of technologies by businesses – ultimately for economic growth and job creation. The funds should promote endogenous growth, developing the economy based on investment in the endowments of the region, making use of what the Commission calls competitive (constructed) advantage. The word 'constructed' denotes new activities that can be developed from scratch and not just the maintenance and promotion of existing structures and businesses, as long as the new activities are sustainable in the longer term. The attention given to the development and use of key enabling technologies (KETs) is interesting. KETs are considered the backbone of the future economy, e.g. micro and nanoelectronics, nanotechnology, biotechnology and photonics.[29] This is actually a re-emergence of industrial development policies. The EU's structural policies are seen as an instrument to foster and make industries more competitive through the support of KETs.

The strategy should be linked to the Horizon 2020 programme. The smart specialisation strategy should aim where appropriate at bringing the RDI capacity of regions to a standard that enables them to participate in Horizon 2020.

Furthermore, actions supported by the structural funds are to be bolstered by a strategy to expand the use of ICT and such instruments as JEREMIE,[30] which uses revolving funds to provide loans for businesses and other financial instruments leveraging private sector funding.

The proposals of the European Commission are commendable and in comparison with the present policy represent substantial advances in the right direction. The policy, at least formally, does seem to reduce the

[29] The Commission, in its Communication on Preparing for our Future: Developing a common strategy for key enabling technologies in the EU, COM(2009) 512 final, Brussels, 30 September 2009, presented these technologies and a high-level expert group proposed policy measures to promote the industrial take-up of KETs (see European Commission, *High-Level Expert Group on Key Enabling Technologies*, *Final Report*, Brussels, 28 June 2011(e)).

[30] Joint European Resources for Micro to Medium Enterprises: A European Union programme to support micro and medium enterprises through equity, loans or guarantees, through a revolving Holding Fund funded by the EU budget acting as an umbrella fund.

discretion of member states in the use of the funds by requiring better justification for actions with a more concrete list of priorities. There will be some resistance to these changes, with a risk that the list is expanded and thereby the focus is diluted and the meaningfulness of strategies is weakened. *It is crucial that the strategic orientation of the policy is preserved, as well as the primary emphasis on innovation. This approach will challenge regions to improve policy coherence and coordination, as well as promote investments with positive, long-term growth implications.* A new culture of strategic planning and delivery based on sound economic analysis and implementation needs to be introduced with the checks and balances. As guardian of the Treaty, the Commission should monitor the fulfilment by member states of the established conditionality and ensure that the use of EU funds is not affected by non-compliance with the requirements. Nevertheless, the improvement in *ex ante* requirements needs to be accompanied by simplification.

2.2.1 Funding level and distribution of funds

The calculation of the funding levels for the regions is a weak element in the proposals, which does not challenge the idea that all regions need to benefit from EU funds (Table 1). While there is some rationale for maintaining some support to regions with a GDP per capita of between 75% and 90% of the EU average and which is correctly digressive, the need for EU funding at the level proposed for other regions beyond 90% is questionable. The latter regions already have access to policies like the R&D Framework Programmes, INTERREG, rural development funds, the Connecting Europe Facility and the European Globalisation Adjustment Fund for crisis situations.

The proposals also require a substantial minimal share of the funds to be invested in the European social fund (ESF), from 25% in less developed regions to 50.2% in more developed regions.

Taking the subsidiarity principle in its strict sense, the justification for using European structural funds in more developed regions is debatable, particularly when these programmes do not have a European dimension and can be handled better at the local level. This criticism does not prejudge whether the actual interventions have positive results in the beneficiary region, but the fact that the EU tackles problems that member states can finance themselves and whose European dimension is questionable.

Table 1. European Commission's proposals for cohesion funds

Proposed budget for 2014–20	**€ billion**	**Minimum ESF share (%)**	**Resulting minimum ESF amount (€ billion)**
Less developed regions	162.6	25	40.7
Transition regions	38.9	40	15.6
More developed regions	53.1	52	27.6
Territorial cooperation	11.7	–	–
Cohesion fund	68.7	–	–
Extra allocation for the outermost and sparsely populated regions	0.926	–	–
Connecting Europe Facility for transport, energy and ICT	€40 billion (with an additional €10 billion ring-fenced under the cohesion fund)	–	–

Source: European Commission (2011k), p. 5.

In the case of ESF interventions, for example, action undoubtedly has to be taken to reduce social exclusion in wealthier regions. The question is rather one of whether the EU budget should be involved or if that is the competence and obligation of the member state governments. For poorer member states, there is a strong rationale for support, as in relative terms they face higher fiscal constraints. Moreover, many cohesion countries do not have the appropriate policies, capacity or infrastructure in place.

In the wealthiest regions, the ESF or INTERREG[31] could still finance programmes for the exchange of practices and collaboration in this field.

These questions should be posed for a number of actions with a local dimension. The EU budget should ensure that the programmes supported by the EU complement and do not substitute for national actions. The present EU additionality rules[32] unfortunately look only at total public expenditure and not at its distribution.

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[31] INTERREG is an EU programme funding programme in which regions cooperate across borders on common projects (see section 2.2.2).

[32] Additionality is one of the official principles of the structural funds introduced in 1988. It requires that EU funds must be additional and not substitute member state funds. However, it does not look into the specific policy area, thus national funds can be shifted to another area of expenditure without affecting additionality.

2.2.2 *INTERREG – Underfunded and neglected*

More surprising in the proposal is the large financial envelope for the developed regions compared with the territorial cooperation programme (INTERREG), an area that is quintessentially a matter for the EU and central for European integration and the development of the single market. In financial terms, however, the budgetary priorities of the cohesion policy seem centred on local benefits, something that can only be defended to support regions catching up and becoming more competitive and to finance EU objectives.

The INTERREG programme is probably one of the most understated programmes in the European budget, weakly financed and generally unknown to many. It nonetheless carries out one of the fundamental roles of the EU budget, which is to increase cross-border collaboration and eliminate barriers in the single market. The funding in regions with a GDP per capita of over 90% of the EU average should be reduced, while the INTERREG resources should be augmented to promote cross-border cooperation programmes.

2.2.3 *Earmarking*

Since the earmarking exercise began in the present budget to increase investment in areas in line with the Lisbon strategy, new various areas for earmarking have been proposed. Earmarking minimum levels of funding for specific EU expenditures can be useful, but should be used based on a solid analysis and rationale. In the case of the minimum shares of ESF expenditure for the structural funds, there does not seem to be such a solid analysis. Earlier, this report questioned the European added value of ESF expenditures in areas that should be the responsibility of the member states and regions, particularly in the more developed parts of the EU. The ESF policy is wide open to numerous interventions, which often reflect a local rather than a European dimension. It also does not focus on excellence and cross-border collaboration, as is the case for the Horizon 2020 programme.

The shares of ESF expenditure across regions and countries vary substantially and the minimum shares proposed by the Commission will entail a large increase in some. Is this increase justifiable based on the needs of the specific regions? An inappropriate use of earmarking can thus be counterproductive. If *ex ante* strategic planning supported by appropriate review is seriously undertaken, earmarking for the ESF should not be necessary.

In a nutshell:

- The proposals to make research and innovation the main priorities of the EU's structural operations must be defended and promoted.
- Strategic planning is a cornerstone for the effectiveness of EU funds and needs to be reinforced. The proposals for the peer review of smart specialisation strategies should be preserved. The monitoring of progress and the shift to *ex ante* conditionality rather than *ex post* auditing needs to be ensured.
- Regional funding should not be offered to regions with an income per capita of over 90% of the EU average, except for those programmes with a strong European dimension. Cohesion policy is excessively centred on local benefits, particularly in the case of more developed regions, which have the ability to cover such costs nationally.
- INTERREG, a quintessentially European instrument that ticks most boxes pertaining to what the EU budget should support, is underfunded.
- Earmarking exercises should be based on a solid rationale, as the balance of expenditure priorities should be based on local needs and potential, not on prescribed figures.

2.3 Investing through the Connecting Europe Facility

In the area of large cross-border infrastructure in transport and energy, it is important that the EU invests through the EU budget and other financial instruments to support the development of an integrated transport and energy grid and the transition to a sustainable energy system. Until today, this has been the role of programmes for trans-European networks for transport and energy (TEN-T and TEN-E, respectively), which emerged from a commitment in the Treaty of Maastricht. This led to the first 14 transport priority projects agreed at the Essen European Council in 1994.

It is not the purpose of this report to evaluate the performance of the programmes; it suffices to mention that funding was scarce and the collaboration among member states weak. In 2001 only three of the projects were completed. The expansion of the TEN-T network did not accelerate much despite the request of the High-Level Group report in 2003 headed by Transport Commissioner Karel Van Miert[33] to strengthen the policy and speed up implementation.

Developing the trans-European networks has since increased in importance and the single market is no longer the only reason. Energy security and climate change policies have added urgency to the development of the transport and energy corridors and given the trans-European networks a new lease of life, putting them back in the centre of EU policy and in the minds of the political decision-makers. Of course the new policy objectives require a rethink of the network we are seeking to build, and the European Commission has produced a new strategy with 40 priority transport projects,[34] integrating the need for a low-carbon transport sector.

With respect to energy, progress in grid integration has been even more sluggish than in transport. Energy security and provision has long been seen as a national priority. Interconnectors have generally not been promoted by member states except where required for energy security. The interest in integrating the energy network across Europe has increased, as member states struggle to reduce emissions in the energy sector and no longer see the European grid as a threat, but an opportunity to develop new markets and enhance energy security. Of course the position of member states on this issue is strongly influenced by the national potential to generate energy from renewable sources. A change in the way energy is produced and distributed can create new markets that offer economic and employment opportunities that member states need. The European

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[33] High-Level Group on the Trans-European Networks, *High-Level Group on the Trans-European Networks*, Report, 23 June 2003.

[34] European Commission, *Roadmap to a Single European Transport Area – Towards a competitive and resource efficient transport system*, White Paper, COM(2011) 0144 final, Brussels, 28 March 2011(f).

Commission has also released new important regulations in this area, on the guidelines governing trans-European energy networks.[35]

On the financial side, the investment requirements in the area of transport and energy are very large and will call for assistance from the public sector[36] and the elaboration of an appropriate regulatory framework. The nature and level of support required varies depending on the infrastructure and the market. The European Commission estimates that to complete the priority European power and gas networks, the investment needed is in the range of €200 billion until 2020, half of which will have to be supported by the public sector. For transport the Commission estimates that €500 billion will be needed for the trans-European networks, of which €250 billion is required to complete the missing links of the core network. Here it does not present any figures on the share of public investment relative to private investment. For ICT networks, the Commission estimates that without any public intervention there will be an investment gap until 2020 of €220 billion, a figure necessary to fulfil the objective of having all businesses and households covered by broadband.

The European Commission has thus proposed a considerable increase in investment for the trans-European networks for energy, transport and ICT through the EU budget and also through potentially new financial instruments supported by the EIB. The proposal of the Commission is to create a €40 billion facility in the European budget for the next MFF, boosted by €10 billion earmarked from the cohesion funds.[37] Compared with the total size of the investment, this budget line seems to fall short, but it is important to highlight that the EU budget is conceived to be a co-financing instrument and a substantial funds multiplier, for example in its role as a guarantee instrument.

The Task Force recommends that the Connecting Europe Facility be kept at the level proposed, although modest in view of the challenges, emphasising that the Facility should operate as a facilitator rather than a

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[35] European Commission, *Proposal for a regulation on guidelines for trans-European energy infrastructure and repealing Decision No. 1364/2006/E*, COM(2011) 658 final, Brussels, 19 October 2011(g).

[36] This includes national public funds, the EU budget and public investment banks.

[37] European Commission, Communication on a Growth Package for Integrated European Infrastructures, COM(2011) 676, Brussels, 19 October 2011(h).

financier of projects. The lion's share of the investment needed must come from the market itself. Means provided by the EU budget should not be perceived as reducing the need for a rigorous economic evaluation of projects, regulatory development, risk-compensation incentives, cross-border cost allocations or public acceptance. Energy and transport are central pillars of the internal market and indirect drivers of Europe's economy. Combined with the climate and energy objectives, the transport and energy networks are the pillars to support the objectives on energy security, low-carbon energy (renewable energy) and low-carbon transport. The investments should be understood as opportunities and foundations for future growth prospects.

One way of making this explicit while at the same time supporting the long-term objectives of the energy sector to reach decarbonisation is to actively allocate financial aid from the EU to pilot projects for new infrastructure technology. One example could be the installation of AC/DC[38] conversion with a capacity increase in existing overhead lines.

If *well deployed*, the returns on investment by the Connecting Europe Facility through the economic development of Europe will be high. Marginal savings to the public purse from a cut to this budget line would be overshadowed by the welfare losses from a weaker internal market, a lower degree of energy security and higher dependency on energy inputs, notably on increasingly costly fossil fuels.

2.3.1 Funding level and distribution of funds

Nevertheless, the distribution of funding for infrastructure proposed by the European Commission (Table 2) is questionable. While it is true that transport is financed more heavily by the public sector, it is debatable whether energy funding should be put on a par with ICT and digital investments. One of the particularities of the ICT and digital sector is that private sector investment is high, demand is strong and cross-border operations have emerged naturally. It is clear that the figures have been selected based on a pro rata calculation of the estimated public share of the investments. Yet there is no apparent attempt to estimate the variation in

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[38] Convertors from alternating current to direct current. Direct current can be transferred with lower losses over larger distances, while Europea energy system is based on alternating current.

the leverage effect or the demand-side characteristics of the energy compared with the ICT sector.

Another surprising factor is that the amounts earmarked from the cohesion fund for infrastructure related to the Connecting Europe Facility are *only for transport infrastructure*, while the energy and ICT needs are considerable in the new member states. This restrictive focus needs to be justified, as cross-border energy transmission is also of central importance in the new member states.

Table 2. Amounts allocated to the Connecting Europe Facility

Areas covered	**Amount (€ billion)**
Connecting Europe Facility, of which	**40**
• Energy	9.1
• Transport	21.7
• ICT/digital	9.2
Amounts earmarked in the cohesion fund for transport infrastructure	**10**
Total	**50**

Source: European Commission (2011a), p. 57.

2.3.2 *Using project bonds to develop core infrastructure*

The European Commission, in a recent publication, has proposed a pilot phase for project bonds.[39] It is limited to investment in the Connecting Europe Facility for the period 2012–13.

The project bonds, which in no way are to be confused with 'Eurobonds', are an expansion of the existing LGTT (Loan Guarantee Instrument for TEN-T projects), which until now has not been very effective in attracting private equity, and as the name indicates, has been limited to transport. Moreover, the infrastructure required to build the trans-European energy, transport and ICT networks calls for levels of private funding well beyond the leverage capacity of the LGTT.

[39] European Commission, *Proposal for a Regulation of the European Parliament and the Council amending Decision No. 1639/2006/EC establishing a Competitiveness and Innovation Programme (2007-2013) and Regulation (EC) No. 680/2007 laying down general rules for the granting of Community financial aid in the field of the trans-European transport and energy networks*, COM(2011) 659, Brussels, 19 October 2011(i).

The project bonds tackle the difficulties of attracting finance from traditional financiers (banks and monoline insurance companies offering debt service guarantees). The project bonds correctly seek to attract funding from more conservative long-term investors, in particular the pension funds. To do so this initiative proposes that the EU budget offers a first-loss debt guarantee of 10% and the EIB a second loss of 10%, which would increase the credit rating of projects. An increase in the credit rating would make the project bonds attractive to private equity investors.

The project bonds are a necessary tool to develop the infrastructure, but policy-makers need to understand that project bonds are another debt instrument, which ultimately needs to be repaid and is thus only to be used for projects with a high degree of added value and a sound Economic Rate of return (ERR). Additional grant support for specific projects could also be envisaged when the high-value social returns cannot be captured by private investors. But it is important that projects are not 'excessively' subsidised, transferring unnecessary risks to the taxpayer. Subsidies should not be used to attract institutional investors for projects with unsound ERRs by raising their credit rating. Project bonds are to be used to make projects of high added value feasible, not bad projects attractive to investors.

In a nutshell:

- The cross-border infrastructure is an essential element of the internal market and the Connecting Europe Facility needs to be appropriately funded.
- The support from the EU budget for infrastructure should not reduce the need for strict economic criteria for project selection. EU funding should mainly have the function of incentivising the private sector and not replacing it.
- A core function of the funds should be to assist pilot projects for new grid technologies.
- The 'project bond' initiative should be supported, but the selection criteria for projects and the rate of total public support should be based on strict economic criteria. Project bonds are to be used to make projects of high added value feasible, not bad projects attractive to investors.

2.4 Investing in Europe's human and social capital, and in employability

Growth depends on the skills of citizens and it is imperative that EU funding promotes human capital formation through its different funding programmes. This has to occur, however, based on the subsidiarity principle, which means that targeting has to be sharpened. The bulk of investments in education and training are made at the national level. The EU budget should concentrate mainly on collaborative projects, from RDI initiatives through its excellence-driven Framework Programmes (the future Horizon 2020) down to student exchanges through the ERASMUS[40] Programme.

For poorer regions, the European Commission's emphasis on building the capacity for innovation is to be commended. The EU budget can assist countries to develop their infrastructure for education, training and research. But even here, its contribution is marginal relative to national efforts and must therefore aim at particularly strategic interventions, with a cross-national dimension.

Funding in the area of lifelong learning and rejoining the labour force should be targeted at the poorer regions and digressively at transition regions. Regions with a GDP per capita over 90% of the EU average should be required to provide these services under the national/regional budgets. The EU budget can still finance common projects in these areas and promote European best practices, but it should not replace national efforts.

Innovative finance initiatives at the EU level, such as microfinance schemes for the self-employed and for small and medium-sized enterprises (SMEs) can be continued, as the leverage factor is important and the results seem to be encouraging. There is a case to be made for promoting similar schemes to firms wherever they are located in the EU to avoid single market distortions, focusing on differences in access to finance among member states. EU financial instruments should avoid substituting for existing national schemes and especially avoid unduly subsidising financial institutions. The EU's JEREMIE initiative for providing loans to SMEs has

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[40] ERASMUS assists student to study abroad and finances cooperation between institutions, for example by supporting professors and business staff to teach abroad or by financing training programmes.

run into difficulties, as it has not always been possible to ascertain that the subsidised interest rates are de facto transferred to the beneficiaries.

On social capital investments, these should be supported in poorer regions and to a digressive level in transition countries. The EU budget should not serve as a substitute for the obligations of the national budgets in wealthier regions.

In a nutshell:

- Key support for human capital development is provided by the European RDI programmes through Horizon 2020 and by cross-border education programmes such as Erasmus, and these programmes should be promoted.
- The EU should assist in developing the infrastructure for education and research in poorer regions to enhance competitiveness and long-term growth potential. This should be primarily for strategic investments with a cross-national dimension and to strengthen the ability of the poorer member states to join Horizon 2020 programmes.
- Financial instruments for micro-enterprises and SMEs seem to bring positive results and could be explored further, but it should be ensured that they do not substitute for national schemes and that the benefits are de facto transmitted to the final beneficiaries and not appropriated by financial institutions.
- The EU budget can assist in developing the social infrastructure in poorer regions, especially in cohesion countries.
- In wealthier regions the EU budget should refrain from financing social programmes that do not have a European dimension.

3. THE EUROPEAN ADDED VALUE OF PUBLIC GOODS AND THE EFFICIENCY OF EXPENDITURES

This chapter is devoted to the expenditures related to public goods with limited relevance for economic growth. A case in point is the Common Agricultural Policy (CAP) and thus it deserves special mention. Yet the EU also has a role to play in the environment and has recently launched a roadmap on resource efficiency, which is briefly analysed.

3.1 A focus on European public goods in agriculture and rural development

An important area in which the EU budget intervenes is agriculture, because full competence in this sector has been transferred to the EU, and therefore it is in fact the only fully common policy. This full financing of agriculture has large repercussions, as it absorbs a substantial share of resources available in the EU budget. This has a bearing on the ability to intervene effectively in other areas.

While the agricultural policy has undergone a number of reforms, which to a large extent have successfully reduced the market and trade distortions it generated, its size in terms of cost is substantial. The agricultural and rural policies of the EU take up nearly 40% of the EU budget, 70% of which is in the form of direct payments[41]. Direct payments

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[41] The main tool to support the farm sector in the European Union (approximately 75% of the CAP for the MFF 2014-2020) is based on direct payments. These are mainly payments granted to farmers per ha of land under cultivation or

are a very inefficient and distortive policy, suffering large deadweight costs. Unfortunately, rather than continue their phasing-out, the proposals for the next MFF are primarily geared towards redistributing the agricultural pie of direct payments, even bolstering such payments while neglecting the second pillar of the CAP, namely rural development. The proposals actually weaken the rural development policy, which should be the first and main pillar of the CAP with income support limited to specific and justified cases.

The proposals for the CAP seem once again to concentrate on the wrong things. Rather than redirecting funding based on needs on the ground and directly tackling the considerable waste of resources, the reforms are chiefly concerned with redistributing the funding among member states. In terms of added value, European and even local, the policy paints an unconvincing picture (Núñez Ferrer & Kaditi, 2007).

The proposed greening of the direct payments loses much of its meaning owing to the impossibility of transferring the funds among member states or even regions. Also, monitoring compliance on green practices will require extensive and costly monitoring. Failing such efforts, even a reformed CAP will end up being a very weakly enforced policy not meeting its objectives.

That is unfortunate, because the agricultural sector is confronting real challenges stemming from climate change. The policy does not allocate funding based on the expected impact of climate change, nor is the policy flexible on issues of market price variability. A constant level of subsidy cannot be justified by market fluctuations.

The agricultural policy is continuing its operations rather impervious to the realities on the ground, based on ill-defined 'income' or 'environmental' justifications, badly targeted and subservient to net balance considerations.

It is clear that politically it will be hard to reform the policy satisfactorily. Even the limited steps in the right direction proposed by the

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maintained in good agricultural condition. Payments are mainly calculated based on tons per ha produced over a reference period, mainly 1989-1991 for the EU 15 and 2000-2002. A system of support that slows down structural adjustment, are weakly related to problems in the sector and suffers from low farm income targeting (Boulanger, 2011; OECD, 2003).

Commission may not be adopted. Some proposals are encouraging, such as those for innovation. The proposed increase in funding for research in agriculture, an area where investment has been deficient worldwide, is welcome, but overall the emphasis given to innovation and restructuring in the sector is still not strong enough.

As more radical reform is difficult to achieve at this time, what matters is that this state of affairs does not negatively affect the changes required in other budgetary headings, and does not undermine those expenditures that are central to the single market and the future economic strength of the EU.

If the member states are seeking to reduce the level of expenditures of the EU budget, it is in the area of direct payments (which in large part are badly distributed and consist of substantial deadweight costs) that savings could still be made. If direct payments are primarily income support, then based on the realities of the sector farms in real difficulties could be targeted and helped better for less money.

Global agricultural markets have changed substantially since the payments were first introduced in the early 1990s. World commodity prices are rising and expected to continue doing so. Farms are also producing non-food products, such as biofuels. These changes do not seem to be reflected in the distribution of the support, which is rather blind to the very large income differences and their causes across farms. The political barriers are clearly significant, but the economic implications for the EU of well-targeted cuts in areas with the highest welfare losses, such as the CAP, would be minimal, even positive if one considers the opportunity costs.

It is also unfortunate that while in other areas there has been an obvious attempt to promote public–private partnerships, this is still foreign to the CAP proposals. A larger fund for sudden crises in the sector has been specified without considering the potential of using private insurance schemes to deal with some aspects of extreme events. The CAP needs a better distribution of risks between the public and private sectors, which also promotes precautionary actions. The role of the insurance sector needs to be explored further.

3.2 Sustainable investment: Environmental and resource efficiency

The EU has an important influence on the environment, for example due to the substantial impact on the environment of the agricultural and fisheries policies. But the budget has major implications beyond these two policies. The cohesion funds and regional development funds finance diverse facets of the environmental infrastructure and are essential to help new member states comply with the EU's environmental requirements.

There is still a striking mismatch between ambitions and policies. Unnoticed by many, the Commission unveiled a resource efficiency roadmap for 2050.[42] This document presents an interesting strategy for resource efficiency, including a considerable number of objectives to be completed already by 2020. While the objectives are valuable, the EU budget proposals do not reflect the roadmap sufficiently. There is a need to bring more coherence to the different objectives and the EU budget. How will the objectives of the roadmap be taken into account in structural funding? Why is the LIFE+[43] programme so small if the environment is so central to the 2020 strategy, if one is to follow the logic of the roadmap? There is undoubtedly much to commend the promotion of an efficient, lifecycle approach to resources.

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[42] European Commission, Communication on a Roadmap to a Resource Efficient Europe, COM(2011) 571 final, Brussels, 20 September 2011(j).

[43] LIFE is the EU's financial instrument supporting environmental and nature conservation projects throughout the EU, as well as in some candidate, acceding and neighbouring countries. The 2014-2020 proposed funding of the programme is of €450 million a year..

In a nutshell:

- The CAP proposals still retain a large degree of financially unjustified spending. Cuts in the EU budget should be sought in this policy unless the policy is further reformed.
- As far as possible the Council should press to improve the targeting of the policy.
- Rather than continue to protect the sector from extreme events primarily through budgetary transfers, which encourage moral hazard in the sector, what is needed is a better distribution of responsibilities and risks with public–private partnerships with the insurance sector.
- The EU has outlined important objectives for resource efficiency, but the budget proposals hardly touch on the issue. The funding and EU objectives for the environment should be reviewed, notably those of the LIFE+ programme.

4. KNOWLEDGE-BASED GOVERNANCE AND INSTITUTIONAL SUPPORT

Europe´s future must be built on a knowledge-based economy. This was set out clearly in the Lisbon agenda and is once again confirmed in the Europe 2020 strategy and the Communication on the Innovation Union. In an ever more competitive world economy, continually evolving cutting-edge technologies and supreme skills in a variety of services are needed to secure high levels of employment and living standards on our continent.

An important precondition for this is excellence in policy formulation and policy implementation. A knowledge-based economy requires knowledge-based governance, at both the national and regional levels and within the European Union. With the progressively increasing impact of our regulatory sphere, the quality of the EU machinery will achieve ever-greater importance. European legislation is already decisive for our economic development and is bound to become even more so in the future.

Growth is more dependent on EU rules than on EU expenditures. But some EU expenditures are instrumental in the formulation and implementation of EU rules. These deserve particular attention in the elaboration of the new MFF.

The cognitive inputs required to provide momentum and sound directions for EU policy-making reach the EU institutions from many different sources. Research institutes, think tanks, interest groups, businesses, NGOs, national governments and regional bodies all make important contributions. It is vital that the EU institutions are well equipped to assemble, systematise and digest all these insights, proposals and criticisms. Much has been done in recent years to improve this process, particularly since the 2001 governance report. New methods for impact assessment are evolving and the practice of consultations has reached impressive proportions. But the link between consultation responses and Commission proposals remains opaque. The new opportunities for better governance are hardly reflected in the Commission's financial proposal. Its discussion on 'administration' boasts about cuts already undertaken and promises a further 5% reduction in the next period.[44] The administrative programme put forward is based on such concepts as simplification, rationalisation and the introduction of single frameworks. An 'equal pains' approach suggests that EU institutions should be reduced in response to similar cuts in the member states.

This is simplistic and at odds with other elements in the budget proposal. The idea of increased conditionality, for instance, is bound to fail unless the Commission can deploy sufficient resources to conduct its dialogue with national and regional governments and perform its own analysis of their initiatives. Today, several DGs and parts of DGs are already clearly under-equipped for this task. With the new proposals this capacity deficit will inevitably expand.

EU legislation plays an increasing role in setting the framework conditions for European enterprises and private individuals. External policy analysis and diplomacy are vital to formulating European lines of action and to asserting European interests in the world. Cramming all these high-brow, highly qualified activities into the grey category of 'administration' is to misrepresent and underestimate the crucial intellectual infrastructure of the EU.

The traditional label of 'administration' is actually singularly ill chosen for the multitude of critical tasks carried out by the various segments and sections of the EU institutions. In common parlance this term conjures up the image of traditional paper-shoving bureaucrats, the tribe so well described by Balzac, Dickens, Gogol and other masters of European fiction. Under present conditions, however, it serves as a conceptual umbrella for a whole batch of indispensable functions: analysis, forecasting, statistics, implementation, auditing, monitoring, evaluation, impact assessment, deliberation, adjudication, stakeholder communication and the ramified activities of some 40 independent agencies.

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[44] European Commission (2011a), op. cit.

A particular reason for the importance of these functions lies in the inevitable uncertainty inherent in much governance. Policy decisions are often made without full knowledge of the relevant causes and effects. This makes it all the more necessary to provide for adequate follow-up procedures and mechanisms for policy learning. Omissions in this sphere can be very costly, as evident from the current euro crisis.

A further mistake is to make 'simplification' the principal avenue for the development of EU governance. Pushes in this direction may play some role but must always be balanced against conflicting interests. Accountability to the taxpayers requires regulatory safeguards. Sophisticated policy-making often relies on differentiation and avoidance of the one-size-fits-all recipe. 'Red tape' has a bad name but the formal requirements linked to obtaining EU funds also have many positive effects in administrative cultures traditionally characterised by favouritism, clientelism and cosy informality.

It is also important to note that reducing the size of the EU's administration may actually create more costs than cut them. For example, the European External Action Service has been left underdeveloped, but by pooling resources member states can actually save more than the costs of running all the external policy services independently.

Strategies need to be evaluated in detail and reviewed not only by the Commission. The idea of having a peer review of the smart innovation strategies is positive, but this should also apply to other strategies for the structural funds.

The quality of strategies depends on the quality of the people drafting them. In some areas there is a need for a more proactive relationship between the European Commission and national administrations, to increase the capacity of the regions and countries to better utilise the budget with a long-term growth perspective.

This reinforced role of the Commission clashes with the financial cuts to administration. In countries where appropriate structures are missing, the European Commission should be able to participate at local level in solving the problems of the member states that seem unable to use the funding correctly.

In conclusion, both the name and the size of the fifth heading of the Commission's proposed budget (administration) deserve reconsideration. EU decision-making must be embedded in a continual pursuit of better knowledge about policy costs, outputs and outcomes. High-quality governance mechanisms and strong support for the institutional infrastructure of the EU are indispensable to strengthening the quality and impact of EU rules, not least those connected with the internal market.

In a nutshell:

- The EU's deepening integration and the number of responsibilities entrusted to the European Commission and its agencies require a knowledge-based, high quality administration. Presently this requires more investment – not cuts.
- In several areas, pooling the resources and having a central administration rather than 27 separate national ones is a savings measure. Cutting funding may result in more costs than benefits.
- The 'administration' heading in the budget does not reflect the work of the European Commission and the other institutions. The Commission should be an effective strategic and monitoring body. Weakening it will not have a positive net effect on the size and quality of the expenditures.
- The European Commission should be more active on the ground in countries unable to use the EU budget correctly.

5. CONCLUSIONS

This report has emphasised that the EU budget is an important investment tool for long-term growth and fundamental for the functioning of the internal market. It is the principal financial instrument for *joint action* by member states to face common challenges and reach common objectives. The European Commission's proposals reflect the need to approach the budget in this way and it has launched plans that do promote an investment vision for the budget, but they are insufficient to reach the goals identified. This report presents the areas that should be protected and advanced by the Council.

The EU budget should be geared towards *investing in long-term growth, the development of the internal market, financing key EU objectives and European public goods*.

For long-term growth the report argues that the *focus on research and innovation has to be protected and reinforced*. Cuts to the EU budget cannot be undertaken in areas that will undermine Europe's capacity to compete globally and generate growth and jobs. No compromise can be acceptable in these areas. Funding for research and development under the Horizon 2020 programme should be maintained at the level proposed or increased, bolstering the funding to such vital components as the Strategic Energy Technology Plan.

This report *recommends maintaining the proposed level of funding for the Connecting Europe Facility*, but holds that the allocation of the funding should be reviewed.

The future impact of the EU funds will depend on the quality of the strategies and their implementation. The European Commission's proposals on the governance of the cohesion policy should be supported. The requirements sought by the proposals in terms of strategies, which include smart specialisation strategies to be drafted by regional or national authorities (or both) for the structural funds, should be endorsed. Yet better governance needs a stronger EU capacity to analyse, monitor and implement policies. The Commission's proposals for cutting administration come at a time when demands call for the opposite.

Without the so-called 'innovative' financial instruments, the EU will not be able to fulfil its objectives for the single market, innovation, energy or climate change. Thus a strengthening of the instruments is necessary, including the adoption of project bonds, which hold the potential promise of speeding up the completion of crucial infrastructure. However, these instruments should be used to make projects of high economic and European added value feasible, not bad projects attractive to investors.

There is understandable pressure to rein in EU budget expenditures, but cuts should be found in areas where the European added value is low, not in areas that involve investing in the future innovative capacity of the EU.

The EU budget should be an important tool to promote long-term sustainable growth in Europe. It is time that this is recognised and decisions are taken in line with ensuring it operates effectively and efficiently towards this goal.

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APPENDIX 1. GLOSSARY OF TECHNICAL TERMS

Bridge capital: In the case of RDI, this refers to financial support for the development of research results into a commercially viable product.

Debt financing: A form of financial support that will cover the losses of lenders if a debtor defaults; it is similar to a loan guarantee, but debt financing is for 'expected' losses under normal conditions and thus equivalent to a subsidy.

First-loss and second-loss risk: In structured finance, the losses on a transaction or a portfolio are distributed among various parties. Losses up to a defined limit will first be borne (by writing off capital, foregoing interest or otherwise) by a certain class. In the case of the Risk Sharing Financing Facility, the first loss is taken over by a €1 billion guarantee of the EU budget. Subsequent risk may be divided further, in this case second-loss risk beyond the €1 billion and up to €2 billion are taken over by the EIB.

Grant: Non-refundable financial assistance.

Economic rate of return (ERR): The ERR is similar to the internal rate of return, but incorporates the value of the social benefits of the project, which do not accrue to the promoter.

Internal rate of return (IRR): This refers to the private economic returns of a project over its lifetime, minus net costs.

Loan guarantee: Financial backing that protects the lender from losses incurred if the debtor defaults.

Opportunity cost: The value forgone of the best alternative use of resources, i.e. the missed opportunity(ies) from any expenditure.

Project bonds: In the project bond initiative, the project bonds are issued by the project company with the assistance and methodology used by the EIB. Project bonds themselves are not guaranteed by the EU or EIB. The EU budget and EIB only offer a risk guarantee to a maximum of 20% of the project, with the EU taking the first loss up to 10% and the EIB covering the remainder up to 20%.

Risk-sharing: The EU has developed a number of risk-sharing facilities. These cover some of the financial risks of project promoters. Risk-sharing by the public sector reduces the capital costs of loans (or increases the value (reduces costs) of issuing private bonds), making projects viable.

APPENDIX 2. TASK FORCE MEMBERS AND INVITED GUESTS AND SPEAKERS

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