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CABINET

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY
SUB-COMMITTEE ON ECONOMIC AFFAIRS

European Community Expenditure Programmes
and the Control of UK Public Expenditure

Memorandum by the Chief Secretary, Treasury

1. The attached note sets out my proposals for controlling the impact of Community expenditure on our own domestic public expenditure plans. With increasing pressure for more Community spending it is most important that we should have agreed procedures for firm control.
2. Our agreed policy is that Community spending in the UK should not normally result in increases in our planned domestic public expenditure programmes. For most existing Community programmes our present arrangements, based on non-additionality and, in the case the Aid programme, attribution, achieve this objective. Subject to some minor improvements, they need not be changed.
3. But we face new Community spending plans, especially in the field of R&D, on which the Commission want to spend some £3 billion over the next 4 years. Even if we are successful in reducing this figure, our share will be

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substantial. We must therefore ensure that these proposals do not simply add to UK public expenditure and that wasteful duplication with UK domestic R&D is avoided. My proposals are designed to achieve this.

4. The present arrangements are not adequate to deal with this new spending. The automatic apportionment of the cost of such spending to the common Programme 2.7 in the Public Expenditure White Papers (the "UK net contribution to the Community Budget") results often in Departments' being less strict in appraising these programmes and less determined to block poor proposals emanating from the Commission and elsewhere because they will not be charged against the Departments' own domestic programme. We must therefore devise a scheme which gives Departments a clear incentive to process such programmes rigorously. Financial responsibility must, I suggest, rest for this purpose with the sponsoring Department.

5. It has been suggested that the proposals which I advance are fundamentally incompatible with our position as a member of the Community. While we recognise that there are some things that are better done at a Community level than at a national level, Member States retain responsibility for their own economic management, of which public expenditure control is an integral and crucial part. All Member States therefore have to find ways of reconciling Community competence in certain areas with national responsibility for expenditure control. Not to do so would leave an intolerable gap in that control.

6. Our budget safety net proposal is not an alternative to proper control of the size of the programmes themselves. First, the outcome of negotiations is not yet assured. We may, for example, end up with a risk-sharing formula requiring us to bear a share of Community Budget increases above a certain level. Second, even if we obtain a bullet-proof safety net, we cannot ignore the overall size of the Community budget. We must seek value for money in respect of all spending, whether financed domestically or by the

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Community. The resources that Community programmes use up are not free: they have real opportunity costs and we must ensure that they are used to best advantage.

7. If we are to keep expenditure on Community R&D and other programmes under control and get the best value for money, Departments must from now on accept responsibility for the costs. This is the basis of the proposals in paragraph 9-12 of my attached note. As is stated in that note, I accept that the rules should be administered flexibly and reasonably. But the present arrangements, which separate responsibility for policies and responsibility for finance, undermine public expenditure control and concern for value for money and need urgently to be changed.

P.R.

HM Treasury
28 November 1983

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Annex to E(A)(83)17

European Community Expenditure Programmes and The Control of UK Public Expenditure

A number of problems have arisen or are likely to arise in connection with the impact of new Community Budget expenditure on the control of both our aggregate expenditure totals and individual programme ceiling. This paper describes these problems and proposes some changes designed to secure more effective control.

Present Arrangements

2 We recognise, as a Government, that it is essential to contain the public expenditure effects of Community spending. We need to keep a close grip on Community spending itself: it would be indefensible to let it race ahead, when our domestic policies are aimed at reducing the growth of public expenditure and minimising Government intervention; and it would be inconsistent with our proviso that an increase in Community resources can only be considered if there is effective control over all types of Community expenditure. This means a discriminating approach to new Community spending proposals. But we also require means of containing the effects of spending which is agreed.

3 We have hitherto followed three main routes for containing the public expenditure burden imposed by the Community Budget. First, we have obtained, and are now seeking to negotiate for the future, arrangements for the refund of a substantial proportion of our net contributions, thus reducing what has to be paid under Programme 2.7.

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4 Second, we have agreed that our receipts from the Community Budget should be used to offset our net contribution and should not fuel additional public expenditure over and above the agreed totals for domestic expenditure programmes. This is the policy of non-additionality, which applies in cases where the Community contributes towards the financing of existing UK programmes (e.g. the ERDF and the Social Fund). The principle of non-additionality was reaffirmed by Ministers collectively last year and the rules are attached at Annex A.

5 Third, in the case of Community expenditure on aid we apply the alternative of "attribution". In this case the full cost of the UK's contribution to EC aid expenditure is charged to the ODA's aid programme. This follows the treatment of our contributions to other multilateral aid institutions (such as IDA), since the aid programme is intended to cover all forms of UK financed aid whether bilateral or multilateral. The arrangement is described at Annex B.

Problems

A: Application of non-additionality rules to existing policies

6 First, a disagreement has arisen over the treatment of certain receipts from the non-quota section of the European Regional Development Fund (ERDF). The facts are summarised in Annex C. Departments agree that savings should be found to offset the receipts, but they do not agree that the burden - small as it is in this case - should be carried only by those Departments whose programmes benefit from the new Community expenditure. Their point is that the Community programme does not correspond with their own priorities; and it is therefore argued that the burden of offsetting should be shared among all Departments. I cannot accept this: the fact that the expenditure may not correspond with Departmental priorities is a natural reflection of Community competence in this field. There are no doubt many other examples particularly in the international field where Departments may from time to time be obliged to finance or contribute to expenditure which do not rank high in their priorities. If public expenditure totals are to remain under control the normal principle must be that such expenditures have to be met from within the budgets of the Departments with policy responsibility. There can be no justification for exempting ERDF non-quota receipts from this principle. So the non-additionality rules must apply.

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7 There is also some uncertainty as to whether the non-additionality rule is being fully respected by all Departmental research establishments. Under the European Communities Act 1972 all Community receipts are required to be surrendered to the Consolidated Fund unless there is specific Parliamentary authority to the contrary. I am asking my officials to check that this is being done.

B: New Community expenditures

8 A second and more significant problem is that the Commission has recently put forward a large number of new proposals for increases in Community spending on research and development, new technology, energy, transport and general industrial support. The amounts of money involved in those proposals are very substantial: for example, £3 billion for the R & D Framework over the next four years. We shall, of course, still need to adopt a restrictive attitude in Brussels to the level of Community support generally. But we also need to consider whether any new arrangements are needed to ensure that the UK's receipts from the programmes help to offset the UK contribution to the Community and that (as the Commission has itself recognised) Community expenditure in these sectors should replace and not duplicate national efforts.

9 We need to distinguish, essentially, between:

- (a) Community financing for common research programmes, broadly in the public sector, where the results and benefits are available to some or all Member States, irrespective of where the work is carried out; and
- (b) Community financial support for R & D, new technology etc in the private sector, where the payments go direct to the companies concerned without passing through the Exchequer (ESPRIT is an example).

In all other cases where there are Community receipts to the public sector the normal rule of non-additionality should continue to apply. We can leave on one side in this context those Community payments which are simply Budget refunds.

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10 In the former case I propose that the net cost of such expenditure (i.e. our gross contribution to the Community Budget less any public sector receipts) should normally be charged or "attributed" to the research budget of the Department in question. This would be in accordance with the treatment of inter-governmental R & D projects more generally. Where there is an existing Community R & D programme, the necessary provision to cover the net cost of the programme to the UK would be transferred from programme 2.7 to the departmental R & D budgets. Future increases in the cost to the UK of the Community programmes would fall, like any other expenditure, to be considered in the annual Public Expenditure Survey. The detailed arrangements for allocating this expenditure between departmental programmes and charging it during the year should be worked out by officials.

11 A different problem arises where the Commission's new proposals provide for Community money to pass directly to private sector firms. In this event UK public expenditure is increased by the cost of the Government's gross contribution towards the programme, but there is no offsetting relief in the form of public sector receipts from the Community, so that our net public expenditure increases. Moreover the Community expenditure in question may in some degree overlap with or duplicate equivalent UK domestic industrial support programmes. I would hope that we could look to the Chief Scientific Adviser at the Cabinet Office, Dr Nicholson, for advice in this field. Even where there is no direct overlap, the Community support may be additional to existing Government support given to the same industrial sector.

12 Where there is such a degree of overlap or duplication we shall want to ensure that so far as possible the Community expenditure replaces the national expenditure, and does not simply add to it. Attribution would be a simple and systematic way of achieving this effect. But where attribution is not thought to be feasible the normal rule should be that the corresponding national programmes should be reduced to produce offsetting savings broadly equivalent to the expected level of UK receipts from the Community programme. (The cost of the UK gross contribution towards the programme would continue to fall on programme 2.7). I recognise that this rule will need to be applied with some flexibility depending on the circumstances of the particular case. The essential point is that, where the Community is supporting a particular project or sector, we should need to spend less to achieve our own policy objectives.

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13 I also have it in mind to propose new interdepartmental arrangements at official level to improve the forecasting of the Community element of UK public expenditure. But these will not be a substitute for the policies of non-additionality and attribution described in this paper.

Conclusion

14 We need to tighten up the application of the non-additionality rules to some existing Community expenditure. We also need to decide how to ensure that the UK contribution to the range of new and expensive Community proposals for R & D and industrial support is, so far as possible, contained within existing public expenditure ceilings and replaces, rather than adds to, national expenditure.

15 I propose that:

- (i) the principle of non-additionality should be applied to the disputed receipts from the non-quota section of the ERDF;
- (ii) Departments should check that Community receipts are being surrendered to the Consolidated Fund except where there is a specific authority to retain them;
- (iii) (a) where the Community establishes a common research programme, the benefits of which are available to some or all member States, the net cost of the UK contribution to its financing should be charged to the R & D budget of the responsible department or departments. Officials should be instructed to work out the detailed arrangements
- (b) where Commission programmes in direct support of industry overlap with or duplicate UK national programmes, the latter should be trimmed so as to eliminate the overlap. Where there is no overlapping or equivalent UK programme, there should nevertheless be a presumption that offsetting savings should be sought in order to ensure that total public expenditure in the field of industrial support remains at the planned level.

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16 Officials should be guided by these rules in considering the proposals for new Community programmes currently under discussion in Brussels. The precise application of the rules will be to be decided case-by-case with some degree of flexibility.

H M Treasury
28 November 1983

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PRESENT NON-ADDITIONALITY ARRANGEMENTS

In successive Public Expenditure White Papers (see Cmnd 8789 - II) the UK's net contributions to the Community are brought together in programme 2.7 - overseas aid and other overseas services.

2. Contributions in respect of overseas aid are identified separately in this programme because they are "attributed" to the UK's total aid programme. This programme constitutes a block budget so that increases or reductions occurring on any individual part of the programme do not affect the total. No other part of our contribution is attributed in this way.

3. In many cases Community policies give rise to use of resources in the UK: some activities are carried out directly by the public sector, more often expenditure takes the form of grants or loans to the private sector. When a Community grant is paid in respect of projects carried out in the private sector there is usually an accompanying, nationally financed, grant. This is because assistance by national authorities is frequently a pre-condition for Community assistance.

4. This public sector cost associated with Community policies is then included in the relevant functional programme eg. the agricultural programme includes price guarantees and support under the Common Agricultural Policy; some of the Government's training and employment schemes are partly financed from the Community's Social Fund.

5. Under the system of non-attribution (except for aid) the gross cost of the UK's contribution to the Community budget (except for the aid portion) falls on programme 2.7. The UK's marginal contribution in the 1983 budget is 23%. The receipts which accrue to the UK following adoption of a proposal are normally used to offset the gross cost in programme 2.7. This is consistent with section 2 of

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the European Communities Act 1972. Under this Act any receipts from the Community (subject to specified exceptions) must be paid into the Consolidated Fund. Since the Commission often pay receipted departments direct there is a risk that some payments go to finance additional expenditure. But without Treasury approval this is contrary to the statutory provisions.

Maximising receipts

6. Some changes in presentation and implementation of the policy of non-additionality were agreed last year. These were set out in a letter from the then Chief Secretary to the Foreign Secretary dated 17 August 1982. The changes were made to improve the implementation of the basic policy that receipts from the Community should not increase public expenditure programmes. As a consequence:

- (a) The public Expenditure White Paper continues to show the UK's net financial contribution to the Community in programme 2.7. It was important presentationally in Brussels to preserve the net contribution concept. But it was agreed that the White Paper would say specifically that the Government's decisions on the relevant programmes had been influenced by the expected levels of Community receipts. Again this was designed to help UK representatives negotiating these receipts in Brussels with the Commission and with other member states.
- (b) The "gross receipts" table in Chapter 2.2 of the White Paper was extended to show expected receipts for future years. The Chief Secretary's memorandum on the supply estimates was for the first time to include a table drawing together expected receipts from the Regional Development and Social Funds which were made through Estimates.

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- (c) Limited arrangements for maximising receipts from the ERDF and Social Fund to avoid increasing public expenditure were explored. Individual cases have since been dealt with on merits without breaching the non-additionality rule.
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- (d) It was agreed not to press for savings to offset ERDF receipts for private sector ports and similar bodies subject to the amounts concerned remaining small.

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ANNEX B

ATTRIBUTION OF COMMUNITY AID EXPENDITURE

General

The aid programme is treated as a block budget for public expenditure purposes. This is because Ministerial decision-making is addressed to the total of expenditure on overseas aid; it is a secondary consideration through which institutions aid is channelled. Since we joined the Community the UK share of EC aid (whether financed through the EC Budget or by direct contributions to the various European Development Funds) has been included in the aid programme total. In the Treasury view there is no reason to change this. The broad objectives of UK aid and Community aid are identical. We take credit for our share of Community aid like our other multilateral aid contributions in the aid statistics reported to the Development Assistance Committee of OECD. Moreover, any change in the system of attribution would seriously weaken control over the total resources devoted to overseas aid. It would probably lead to a substantial and continuing increase in public expenditure.

Growth in EC aid

2. ODA argue that the growth in EC aid expenditure which they are unable to control tends to be at the expense of UK bilateral aid and thus contrary to the Government's objective of giving more weight to bilateral aid in the UK aid programme. This may be so but it does not follow that therefore it would be preferable to offset the increase in EC aid by reductions in the generality of UK domestic expenditure, still less to give up the attempt to secure offsetting reductions and allow a net increase in planned public expenditure totals.

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In-year financial management

3. ODA also claim that last minute decisions (eg by the European Parliament) to increase EC aid can give them severe financial management problems in any one financial year. These problems can be exaggerated: ODA are no worse off than many other departments in having to meet some unexpected payments during the course of the year from within their total programme. The amount of the fluctuations on EC aid is relatively small in relation to the total gross aid programme of over £1,100 million some parts of which tend to underspend and thus provide flexibility for meeting new claims. Moreover it should normally be possible to deal with unpredicted increases by using the existing mechanisms of the aid programme's substantial unallocated reserve and the unique carry-over facility enjoyed by ODA (whereby they can offset any overspend or underspend up to £15 million in any one year by an adjustment to the programme for the next year but one). If any unusually large item occurs very late in the year, it is open to ODA to make a claim on the Contingency Reserve, but the previous Chief Secretary turned down ODA's proposal for an automatic right of access to the Reserve in certain circumstances.

Political difficulty of opposing Community aid proposals

4. It is also claimed that the UK incurs unnecessary political odium in the Community because attribution forces ODA to oppose proposals for additional expenditure supported by our partners largely for political reasons. The Government recognises that political factors are a relevant consideration in allocating UK aid and it is one of the prices of Community membership that we have to take account of our partners' views in EC aid allocations. The problem can of course largely be avoided simply by deciding not to oppose proposals on which we shall be defeated in the end anyway.

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Annex C

ERDF NON-QUOTA SECTION: RECEIPTS FOR ASSISTANCE TO SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)

Note by DTI and Treasury officials

Background

The great bulk of UK receipts from the ERDF are available through the UK's allocated share (the "quota section") which accounts for 95 per cent of Fund expenditure. In 1983, UK receipts from the quota section are expected to be about £300m. This money can only be obtained by making applications for ERDF contributions to projects involving UK public expenditure in regionally-aided areas - either public expenditure on infrastructure or public expenditure on regional aids for industrial projects. Eligible infrastructure includes roads, telecommunications, gas, electricity and water supplies. DTI acts as the channel for applications and receipts.

2. The established policy governing all receipts from the Community Budget is that they should contribute to reducing UK domestic public expenditure by helping to offset the cost of the UK's contribution to the Community Budget. This policy of non-additionality was confirmed in an agreed minute of 17 June 1980 from the Chancellor of the Exchequer to the Prime Minister. Non-additionality is achieved for ERDF infrastructure payments by passing the money to the public authorities but not allowing it to be used for any increase in their overall expenditure; for industry projects, the ERDF quota section money is not passed on but is retained by the Exchequer in partial reimbursement of UK regional assistance.

The Non-Quota Section

3. The present question concerns the 5 per cent of the Fund which is allocated to a "non-quota" section used for specific regional development programmes. The Commission has determined that some of this must be aimed specifically at small and medium-sized enterprises (SMEs) and - if we are to collect it at all - the money must be passed on to the SMEs and cannot be retained by the Exchequer. The UK is already benefitting from about £38m of non-quota aid for a 5 year programme to assist shipbuilding and steel closure areas. Most of this can be used for infrastructure, with non-additionality arranged on the same lines as for the quota section. But £6m was allocated for passing on for aid to SMEs. In

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support of the non-additionality objective, Departments agreed to make offsetting savings for this from within their own programmes.

4. Last year, the Commission made proposals for a second 5 year programme of non-quota aid for UK steel and shipbuilding areas, plus new aid for textile closure areas. At that time, about £62m more was on offer to the UK; DTI estimated that about £37m of this would be allocated for aid to SMEs. To trigger the SME money, a domestic contribution of about £12½m would be required. At ODE on 27 July 1982 DTI said that at that time they were unable to identify specific offsetting savings to cover the ERDF money for SMEs then envisaged. It was agreed that the ERDF receipts would be accepted; and that exceptionally no offsetting savings would be required in respect of the ERDF contributions; but DTI and Regional Departments would seek offsetting savings from their own programmes for the £12½m or so of the domestic contribution (the "trigger expenditure").

5. Towards the end of 1982, Mr Lamont notified colleagues that the likely non-quota receipts for the UK were now about £86m rather than £62m; about £50m rather than £37m would be allocated for SMEs although no increase was expected in the domestic contribution required.

The Problem

6. The source of disagreement is that DTI (and the Territorial Departments) want these additional receipts, and any future ones under the "SME" heading, to be passed on without offset. The Treasury has pressed for the normal rule of full offsetting by the recipient department to apply.

7. All are agreed on the importance of securing the receipts from the EC. If the money were not taken up there would be a severe loss of credibility to the UK in its present attempts to argue for a large share of the main quota section fund, and damage to our wider prospects on the non-quota side. Furthermore our present delicate attempts to convince the Commission that ERDF receipts are genuinely additional to UK domestic expenditure could be brought into disrepute (if the reasons for turning down these receipts became known).

8. DTI contend that the July 1982 ODE agreement covered the passing on without offset of all ERDF contributions for SMEs; and that the indication which was given last July of the sums likely to be available was, of necessity, a broad estimate, subject to fluctuation in the light of exchange rates and other factors of more substance.

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9. The Treasury holds that the need to preserve the principle of non-additionality makes such an interpretation of ODE's decision unacceptably loose; that the concession granted by ODE related only to the sums then on the table (there having been no indication that the figure could be subject to substantial change); and that no further concession could be justified. The Treasury's agreement was to an amount, not to a principle.

10. It is perhaps more helpful however, to concentrate not on the literal interpretation of the earlier ODE decision (which was made before its full implications were apparent, and when questions of definition such as those being posed now could not have been envisaged) but on the position as it now stands. The DTT's case for straightforward 'passing on' of aid to SMEs is broadly that:

- a) The Department does not directly benefit from the receipts, and there is no benefit to its actual regional policy programmes. (Hence DTT's fallback position, that they would be prepared to accept an offsetting arrangement which spread the burden offset "across the board" of departments generally).
- b) DTI have already lost out unfairly by having twice cut their own programmes to facilitate ERDF SME receipts.
- c) The offsetting will cut into the domestic regional assistance programme.
- d) Any such cuts in domestic regional assistance will reduce the base of eligible expenditure with which we can attract ERDF money.

11. The Treasury case against this is:

- a) As an overriding matter of policy, receipts from the EC Budget must not be allowed to swell UK public expenditure programmes.
- b) The receipts in question here are to aid small firms in declining industrial areas. Aid already allocated under the small firms measures covers the provision of consultancy and common services, help on technical innovation and in facilitating access to risk capital. It cannot be argued that such purposes fall entirely outside DTT's domain.
- c) There is an accepted degree of community competence in the matter of regional assistance. It is not reasonable to expect that the objectives of ERDF aid will

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always tally exactly with particular spending programmes in the recipient member state. But that is not a reason for increasing total expenditure.

Conclusion

Ministers are asked to decide, whether, if offsetting is required, receipts under the ERDF Non-Quota Section for SMEs should be offset by corresponding savings on the Programmes of the recipient Departments (DTI and the regional Departments); or whether the burden should be applied to Departments across the board.

H M Treasury
28 November 1983

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