Payments backlog in recent EU budgets

Lessons learnt and outlook

IN-DEPTH ANALYSIS

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The backlog of unpaid claims at year-end has been one of the most debated issues during the negotiations of annual EU budgets since 2011. This analysis covers the nature, origin, evolution and consequences of the problem, and gives an overview of what has been done, and what other measures could be taken in the immediate future, to remedy the situation.

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EXECUTIVE SUMMARY

Since 2011, the EU has experienced increasing levels of payments backlogs at year-end. The problem has turned out to be a recurring one, especially pressing during negotiations of the annual budgets, and difficult to resolve with an ad hoc preventive action. Whilst the issue has many technical aspects, it has also developed a political dimension. At the end of 2014, the payment backlog was estimated at some €26 billion, the bulk of which was under heading 1b: 'Cohesion for growth and jobs'. Other policy areas were also affected – for example under the Erasmus and research programmes, the European Neighbourhood Instrument and humanitarian aid.

According to the European Commission, the total year-end backlog consists of both 'normal' and 'abnormal' backlog. The former is an inevitable result of claims received during the last days of December (i.e. too late to be processed before the year-end) and claims pending checks under interruption or suspension procedures. The latter, however, is made up of the claims that cannot be paid because the relevant budget line does not have a sufficient level of payment appropriations authorised by the EU’s budgetary authority (the European Parliament and Council). Analysis demonstrates that these factors, in connection with the rigidity of the EU’s Multiannual Financial Framework and possible disagreements in the use of flexibility instruments, set in motion a 'snowball effect' which led to the growth of an abnormal backlog. The concentration of the backlog in the cohesion policy area is explained by specific features of the policy's multi-annual cycle, as well as by recent changes to its financial rules. Predicting and meeting the financial needs in a given year has become more difficult since spending was accelerated to mitigate the consequences of the economic crisis – when the authorised payment appropriations were insufficient.

The implications of the abnormal backlog are multiple and concern both beneficiaries of the funds and EU credibility. Any delay of transfers from the EU budget may lead to financial and organisational problems for the individual beneficiaries such as local and regional authorities, small and medium-sized enterprises, non-governmental organisations, research institutes or students. Disruptions in project and programme implementation hamper the achievement of EU goals in different policies. Moreover, in most policy areas the EU is obliged to pay interest on late payments.

The damage to date should not be overestimated and the situation should improve by the end of 2016 thanks to a series of interinstitutional initiatives, strongly supported by the European Parliament. Measures include active budget management by the Commission and detailed monitoring and forecasting of payments. To increase payment appropriations, the budgetary authority adopted several amending budgets, mobilised the Contingency Margin and agreed on close cooperation. In addition, when needed, the Commission introduced mitigating measures that in many cases, however, only had temporary positive effects and sometimes led to the creation of a 'hidden backlog'.

The outlook from 2017 onwards still requires assessment. To this end, the finalisation of the adoption of operational programmes under shared management for 2014-20 is one of the upcoming developments that should help understanding of how the situation could evolve after 2016. The EP has always stressed, including most recently within the 2016 budgetary procedure, that EU objectives should be matched with appropriate resources to achieve them.
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1. Introduction

Although representing only around 1% of the total gross national income (GNI) of the Member States, the European Union's budget remains the subject of tough negotiations. Since 2011, a problem of a growing backlog of unpaid claims at year-end has become significant. After years of sluggish absorption of the amounts committed to EU programmes, especially in the field of cohesion policy, the flow of payment claims submitted by the Member States and other recipients of EU funds has accelerated. The problem is a recurring one, especially pressing during negotiations of the annual budgets, and difficult to resolve with an ad hoc preventive action.

The situation has continued to deteriorate, and in 2014 the payment backlog at year-end was estimated at approximately €26 billion (corresponding to roughly 19% of the payment appropriations authorised in the annual budget). The issue has proven complex and contentious, both as an element of the financial management system and as a topic of political debate. Whilst on the one hand, it seems a simple technical aspect of accounting operations, on the other, it can be linked directly to the EU's system of 'own resources' and the flexibility of the Multiannual Financial Framework. Moreover, the issue may have negative and far-reaching consequences for beneficiaries of EU funding, as well as for the implementation and effectiveness of EU policies, nor is the potential for harm to the EU's reputation at home and abroad without significance.

It should be noted that the phenomenon is relatively new in EU budget implementation, therefore relevant documents and literature are scarce and data are incomplete.

2. Context and some key features of the EU financial provisions

Many different elements may play a role in the issue of the increasing level of unpaid claims at year-end confronting the EU in recent years. A brief overview of some of the key features of the EU financial provisions is needed to put the payment backlog at year-end into context.
2.1. Roles of the EU institutions and Member States

The European Parliament (EP) and the Council constitute the two arms of EU budgetary authority, but their respective powers in this domain vary depending on the matter at hand. The EP and the Council have de facto co-decision powers for adopting the annual budget, whereas in the field of multi-year financial planning the Council unanimously adopts the Multiannual Financial Framework (MFF), after obtaining the consent of the EP.1 As for financing the EU budget,2 the 'own resources' system is established by the Council, whereas the EP is only consulted on the relevant provisions (except on its implementing measures, to which consent applies). Some analysts argue3 that this asymmetry between the expenditure and revenue sides of the budget may sharpen the differences in perspective of the two arms of the budgetary authority.

As far as implementation is concerned, the European Commission is ultimately responsible for executing the EU budget. However, this involves a range of actors, to which the Commission delegates implementing tasks. In particular, Member States are responsible for implementing around 80% of the EU budget under shared management with the Commission (including cohesion and agricultural spending).4 In terms of forecasting the timing of payment needs stemming from the implementation of EU programmes and activities – whilst the European Commission is responsible for drawing up overall estimates – their quality also depends on the accuracy of Member State forecasts in key spending areas.

2.2. The principle of equilibrium and its application

In the annual EU budget, expenditure must equal revenue, on the basis of the principle of equilibrium detailed in Article 310(1) of the Treaty on the Functioning of the European Union (TFEU). The EU is unable to borrow money to finance its budget,5 contrary to the custom for Member State national budgets.

At the authorisation stage, when the European Parliament and the Council adopt the annual budget, the principle of equilibrium is fully met with estimated revenue equaling expenditure that, according to the planned activities, needs to be paid out during the course of the year on the basis of the applicable rules. However, at the implementation stage, it is technically impossible for the estimated and authorised amounts to coincide with actual outturn.6 This means that the EU budget will have a balance which is positive (surplus) in case revenue is higher than payments; or negative (deficit) in the opposite case.

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1 EU multi-year financial planning was first introduced in 1988 with a view to overcoming crises in the annual budgetary procedure due to frequent disagreements between Parliament and Council.
2 For an overview of the system, see How the EU budget is financed: The 'own resources' system and the debate on its reform, D’Alfonso A., European Parliament, EPRS, 2014, 36 p.
3 See for example: Understanding the EU budget, Patterson B., 2011, x-127 p.
4 The other implementing methods are: direct management (by Commission departments or through executive agencies); and indirect management (e.g. by third countries, international organisations, the European Investment Bank or the European Investment Fund).
5 The only exception concerns building acquisition projects, for which the EU can draw on loans.
6 Revenue may be higher or lower than estimated. Since the authorised amounts for expenditure represent upper limits that may not be exceeded under any circumstances, spending outturn is always lower than the budgeted amount (or could exceptionally coincide with it).
While entering a year-end balance into the following year’s budget is practically inevitable, the EU must do all it can to ensure that this balance complies with the principle of equilibrium. To this end, the Commission monitors and forecasts budget implementation progress, informing the budgetary authority accordingly. Budget management measures such as transfers between budget lines are a tool to address deviations from estimates (see Section 6.2 below). If other management measures are insufficient and the total authorised amounts need to be modified, the Commission puts forward a draft amending budget for examination, amendment and possible adoption by Parliament and Council, by way of the budgetary procedure.

In practice, the EU budget normally registers a surplus at the end of the year, which is entered as revenue in the following year’s budget. Hence, the surplus correspondingly reduces the contributions paid into the EU budget by the Member States the following year (see Section 2.6 below). The most recent case of a deficit, which conversely is entered as a payment appropriation on the expenditure side in the following year’s budget, dates back to 1986. Figure 1 illustrates that over the past 12 years the surplus has been significantly lower than at the beginning of the 2000s, which indicates an increased and high level of budget implementation.

However, it should be noted that the existence of a surplus at year-end does not necessarily mean that all payable claims were paid, since it may well be the case that the surplus could not be used to cover some claims on the basis of the applicable rules of the Financial Regulation (for example, due to the principle of specification, amounts carried over from the previous financial year cannot be used for any purpose other than that initially agreed, while 'assigned revenue', as its name indicates, can be used only for the purpose for which it was assigned).  

**2.3. Differentiated appropriations: commitments and payments**

A peculiar feature of the EU budget adds to the complexity of the task of monitoring and forecasting budget implementation. Most categories of EU expenditure are entered in the annual budget in the form of differentiated appropriations, since two different figures are detailed for each of them: commitment appropriations and payments.

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payments backlog in recent EU budgets

8 The former is the maximum amount that the EU can commit on new projects or activities during the year, while the latter is the amount that the EU is expected to actually pay to beneficiaries over the same time period. As legal pledges to provide finance once given conditions are met, commitments may lead to payments not only in the same financial year, but also in subsequent ones.

This feature is typically due to the fact that some activities (e.g. large infrastructure projects) may require multiannual implementation. Hence, in the budget of a given year, total payment appropriations cover payments stemming both from commitments made during the year (such as for initial and partial financing of new activities) and from others made in previous years (such as for settling the bill for activities begun, but not completed, the previous year). Thus, in year N, total payment appropriations do not tally with total commitment appropriations.

2.4. Outstanding commitments, or RAL

In EU budgetary management, differentiated appropriations and the existence of a delay between the establishment of a commitment and the execution of the corresponding payment(s) gives rise to the concept of outstanding commitments. Also known by its French acronym RAL,9 this is the total amount of appropriations that the EU has committed but not yet paid at a certain point in time, and represents an EU budget liability in the short and medium term, with an impact on the level of payment appropriations needed for current and future years.

The lifecycle of the commitments that make up RAL may differ significantly depending on the category of expenditure and the rules underpinning its implementation: commitments in cohesion policy, for example, usually take much longer to reach completion than those related to humanitarian aid.

The ratio between RAL and the commitments of the current year is often a useful indicator of the lifecycle of commitments for individual programmes and EU funds: in principle, a ratio significantly above one should show that the implementation of the commitments is mainly multiannual, while a ratio below one (e.g. for Erasmus) suggests that most payments are carried out within one year.

For each category of expenditure, regular forecasting, monitoring and management of RAL are necessary tools to ensure that the EU budget is endowed with sufficient payment appropriations to honour legal commitments in a timely fashion once they fall due.

When submitting its proposal for the following year’s EU budget to the EP and the Council, the European Commission includes an overview, by budget line, of the payment schedule expected in subsequent years for new and outstanding commitments.10 This is a legal requirement, based on Article 38(3)(f) of the Financial Regulation.11

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8 This distinction does not apply to a few categories of expenditure, such as administrative expenditure and most spending under the European Agricultural Guarantee Fund, for which commitment and payment appropriations coincide (non-differentiated appropriations).

9 RAL stands for reste à liquider (remains to be spent).


Similarly, the Commission reports on RAL developments, which the EP closely monitors. Another regular exercise carried out by the Commission in the management of outstanding commitments is the analysis of potentially 'abnormal' RAL. The objective is to identify old commitments that are still open in the accounts but lack a justification for further payments and can therefore be de-committed according to the applicable rules. Abnormal RAL, representing a tiny share of total RAL, is not to be confused with the abnormal payments backlog (see Section 2.5 below).

2.5. Outstanding payable claims at year-end: the payments backlog

Payable claims that beneficiaries of EU funding have sent but are still outstanding on 31 December are a subset of RAL. Within this payments backlog at year-end (see Figure 2), the European Commission identifies two possible components:

- the normal backlog: claims sent by beneficiaries in the last days of December (too late to be processed by year-end), as well as those suspended by the European Commission pending checks or the provision of missing information; and
- the abnormal backlog: claims that cannot be paid by the European Commission because the relevant budget line does not have a sufficient level of payment appropriations authorised by the EU’s budgetary authority (European Parliament and Council).

2.6. Where the cash comes from

The EU budget is financed by a system of 'own resources'. Most of the revenue (more than 80% of the total in 2014) is provided by two own resources based on gross national income (GNI) and value added tax (VAT), which are perceived as national contributions rather than as genuine EU own resources. In practice, Member States generally credit these two resources to the European Commission’s accounts in equal monthly instalments, based on the payment appropriations authorised by the EU’s budgetary authority for that year. The flow of own resources determines the monthly treasury available to the Commission.

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12 See: Working document on outstanding commitments (RAL) and the payments issue, EP Committee on Budgets, Rapporteurs: Francesca Balzani, Giovanni La Via, Jan Mulder.

13 At the end of 2014, the total RAL amounted to €189.58 billion, while abnormal RAL was estimated at approximately €0.67 billion.

14 Exceptions may apply in the first quarter of the year when part of the annual own resources may be called up in advance to cover major expenses. For example, the European Agricultural Guarantee Fund (EAGF) may require significant payments in the initial part of the year.
In its first assessment report, the high-level group currently tasked with reviewing this system drew a link between this perception of resources as national contributions and the recent increase in year-end payments backlog afflicting the EU budget, noting that in many national budgets the contribution to the EU budget appears as an item of expenditure.\textsuperscript{15}

### 2.7. Maximum level of EU spending allowed in relevant legal texts

The Council Decision on the own resources system sets the maximum annual level of own resources ('own resources ceiling') available to cover payments under the EU budget at 1.23\% of the Union's GNI. The annual commitment appropriations must remain below 1.30\% of EU GNI. Respect of the own resources ceiling in subsequent years, as well as the compatibility of commitments and payments, must be guaranteed through an orderly ratio between the two categories of appropriations.

The Decision on own resources is complemented by the MFF Regulation, a multi-year financial planning tool which is meant to ensure the orderly development of expenditure in line with EU priorities and within the limits to own resources stipulated in the Decision. For a certain number of years, the MFF sets the maximum commitment appropriations for each major category of EU spending as well as the overall ceiling for payments. For 2014-20, the overall ceilings for commitments and payments are set, respectively, at 1\% and 0.95\% of the Union's GNI (down from 1.12\% and 1.06\% for 2007-2013). This means that the margin available between the payment ceiling for 2014-2020 and the own resources ceiling corresponds to 0.28\% of the Union's GNI (up from 0.17\% for 2007-2013).

### 3. Recent abnormal payments backlog at year-end

According to the European Commission definition, the abnormal payments backlog at year-end is the amount of payable claims that the EU is unable to honour on 31 December because the budgetary authority has not authorised a sufficient level of payment appropriations for the year in question (see Section 2.5 above). Since the reference date for the abnormal backlog is 31 December, the phenomenon is not related to possible cash flow constraints that the EU may experience in the first months of the year due to the timing of own resources payments from Member States and the prohibition on borrowing money. However, as the following year's budget will be partially used to cover these unpaid claims, a snowball effect in the abnormal backlog may create or worsen cash flow constraints in the first months of the new financial year.

In past decades, the European Community experienced financial difficulties (see box), but these were different in nature from the year-end abnormal payments backlog. The development of a significant and increasing level of unpaid payment claims at year-end due to insufficient payment appropriations appears to be a relatively recent phenomenon in the implementation of the EU budget, so much so that data on it are somewhat incomplete. However, a short overview of some relevant events, including a number of budgetary negotiations and decisions from 2010 onwards, may help to understand how the phenomenon has developed.

\textsuperscript{15} For more details, see: Monti Group's first assessment of EU own resources, D'Alfonso A., European Parliament, EPRS, 2014.
Examples of financial difficulties in previous decades

The financial difficulties experienced by the European Community in the 1970s and 1980s were substantially different, since they resulted from a combination of increasing expenditure and insufficient own resources. The problem was addressed through a wide-ranging reform, including measures such as capping of expenditure and of own resources, the introduction of multiannual financial perspectives (now the MFF) and of an own resource with a budget balancing role (the current GNI-based resource). The key principles of the own resources system remain in place and ensure that payment appropriations authorised by the budgetary authority are fully financed.

In the 1990s, delayed payments occurred in the field of external assistance programmes. Since these appeared to be related to implementation issues, efforts to tackle the situation were focused on management improvements, such as simplification of procedures and the introduction of a standard contract for grants. In 1999, improvements in implementation and the record of timely payments led to shortages in payment appropriations, which were addressed through additional appropriations authorised by the budgetary authority. In subsequent years, broader measures to improve budget implementation included a recast Financial Regulation (2003), the introduction of activity based budgeting (2004) and accrual based accounting (2005). A closer monitoring of outstanding commitments (see Section 2.4) was also promoted.

3.1. Reaching a turning point with the 2011 budget

The 2010 EU budget did not experience any significant problems of insufficient payment appropriations and thus of abnormal backlog. On the contrary, in autumn 2010 the European Commission tabled Draft Amending Budget (DAB) No 10/2010, which contained a proposal to reduce payment appropriations on several budget lines for a total amount of some €760 million, further to a revision of payment needs. The Council approved DAB No 10/2010 on 10 December 2010. However, the EP did not agree a position in time for approval in 2010. The year-end surplus doubled from €2.25 billion in 2009 to €4.56 billion in 2010.

Autumn 2010 was also the moment when the following year's EU budget was negotiated for the first time under the new budgetary procedure with a single reading introduced by the Treaty of Lisbon. The EP no longer had the final say over certain parts of the budget (what used to be called 'non-compulsory expenditure'), but on the other hand gained equal status with the Council on the entire budget. Some analysts deem this development to reduce, in practice, Parliament's strength in this area.

Under the old provisions in their respective readings, the Council cut the payment appropriations put forward by the Commission, while the EP significantly increased them, already expressing a growing concern about the level of payments and the increasing gap between commitments and payments. Table 1 shows that the final agreements for the 2007-2010 budgets set payment appropriations at a level between the Council's positions and the Commission's proposals (in one case slightly above the latter).

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19 EP resolution of 18 December 2008 on the draft general budget of the European Union for the financial year 2009 as modified by the Council (all sections).
The conciliation procedure for the 2011 budget failed, a pattern which was to occur repeatedly in subsequent annual budgetary procedures under the new rules. The two arms of the budgetary authority eventually agreed on the basis of a new draft budget put forward by the European Commission. The adopted 2011 budget set payment appropriations at €126.5 billion, in line with the Council's reading that, in times of fiscal consolidation at national level, had cut the initial Commission proposal by more than €3.6 billion. With implementation of ongoing programmes reaching full speed, the Commission had estimated that payment needs would require a 5.9% increase in payment appropriations in comparison with the 2010 budget. Along similar lines, the EP's reading included a 6% increase in payment appropriations. The Council's reading for payment appropriations, which eventually prevailed, raised them by only 2.9% from 2010. In a joint declaration, the two arms of the budgetary authority committed to tackle payment shortages swiftly should these arise.

At the implementation stage of the 2011 budget, the issue of the abnormal payments backlog at year-end became significant. Figure 3 shows this negative development in cohesion spending – the area where, due to its features (see Section 4.2), the bulk of the abnormal backlog in absolute terms is to be found. While there was a €6 billion backlog in cohesion spending at the end of 2010, this was related to late arrival of claims, interruptions and suspensions and, hence, could be classified as normal backlog. At the end of 2011, the backlog increased to €10.7 billion, with almost half of this amount (some €5 billion) due to a lack of payment appropriations.

Figure 3 – Payment claims and backlog in Heading 1b (Economic, Social and Territorial Cohesion)

Source: Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.

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The European Commission’s Financial Report on the 2011 budget\(^{21}\) drew attention to the €5 billion abnormal backlog, noting that a very high level of payment claims sent by Member States towards the end of the year could not be met because authorised payment appropriations were not sufficient. In the foreword to the report, Janusz Lewandowski, Commissioner for Financial Programming and Budget at the time, expressed his concern over the growing gap between authorised commitments and payments, warning of the risk of a repeat in 2012, since the authorised payment appropriations for 2012 were below the level estimated necessary by the Commission. Figure 3 confirms that the situation worsened in subsequent years.

### 3.2. Recurrent pressure on payment appropriations in 2012-2014

The budgetary procedure for the adoption of the 2012 budget indeed produced a similar result, although an agreement was reached in the conciliation phase. The agreed budget set the payment appropriations at €129.1 billion (+1.86% on 2011); exactly the amount called for by the Council in its reading. Against a backdrop of fiscal consolidation in Member States, the Council’s position again cut the payment needs estimated by the Commission in its initial proposal. Agreed commitment appropriations were set at €147.2 billion (+3.54% on 2011), close to the level in the EP’s reading. In addition, negotiations on the following year’s budget involved discussions on amending budget No 6/2011, with a view to addressing payment shortages in the current year’s budget. This became another recurrent feature in the annual budgetary procedure, with draft amending budgets meant to fix shortfalls in payments for the current budget gaining an increasingly significant role in the negotiations for the following budget. In the agreement on the 2012 budget, the EP and the Council committed to examine promptly any draft amending budgets put forward by the Commission in 2012 in the event of payment shortages.

In October 2012, the European Commission tabled draft amending budget No 6/2012,\(^{22}\) calling for an additional €9 billion in payment appropriations to honour existing legal obligations on time and to ensure the smooth implementation of new projects. Whilst the bulk of payment shortages (€8.3 billion) was in cohesion and rural development spending related to European regions, the Commission noted that expenditure in other policy areas was affected as well, for example under the Erasmus and the research programmes involving beneficiaries such as students, researchers, non-governmental organisations (NGOs) and businesses. In the framework of the budgetary negotiations, the EP and the Council agreed to increase 2012 payment appropriations by €6.1 billion and to cover the remaining €2.9 billion through another amending budget in early 2013. Once again, the agreed level of payment appropriations for the following year was lower (by €5 billion) than the amount estimated necessary by the European Commission in the draft budget.

In 2013, the ‘snowball effect’ of outstanding payment claims from the previous year’s budget soon became apparent. The European Commission tabled DAB No 2/2013\(^{23}\) as early as 27 March 2013, requesting an €11.2 billion increase in payment appropriations for the 2013 budget. Additional payments were requested in all spending areas except administration, with cohesion spending again accounting for the highest amount in absolute terms (€9 billion).

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Furthermore, the abnormal payments backlog and DAB No 2/2013 figured in the intense negotiations on the 2014-2020 MFF. In its July 2013 resolution on the political agreement on the new MFF, the EP set a number of conditions to be fulfilled before giving its final consent to the MFF agreed by the European Council. These conditions included the approval by the Council of amending budgets to cover the €11.2 billion payment shortfall identified by the Commission in full. It is worth noting that the EP stressed that it would not adopt the 2014 budget until the same condition was fulfilled. The increase in 2013 payment appropriations took place in two steps, with amending budget No 2/2013 adopted in September for a total amount of €7.3 billion and the remaining €3.9 billion agreed through amending budget No 8/2013 in November. The agreement on these two amending budgets helped to counter a further worsening of the situation at the end of 2013. However, the year-end backlog in cohesion spending reached €23.4 billion, with more than half of this amount belonging to the category of abnormal backlog.

The 2014 budget again experienced pressure on payment appropriations early on. In addition, being the first budget under the new MFF, it was also confronted with new challenges as regards payments. In particular, the 2014-2020 MFF, which was negotiated against the backdrop of the economic crisis and fiscal consolidation in Member States, reduced the payment ceilings. The maximum payment appropriations allowed for 2014 in the MFF amounted to some €135.86 billion, which was €8.4 billion lower than the final payments for 2013, and thus created a potential conflict with outstanding legal obligations already subscribed to by the EU. In May 2014, the European Commission warned that payment shortages were already visible across all budget headings and put forward a draft amending budget, requesting a €4.7 billion increase in payment appropriations and the mobilisation of the Contingency Margin, a last-resort tool outside the MFF ceilings that can be used under certain conditions to react to unforeseen circumstances. The issue was again addressed in the context of the procedure for the following year's budget, becoming a major stumbling block in the difficult negotiations between the two arms of the budgetary authority. The relevant amending budget for 2014 was eventually approved with a €3.5 billion increase in payment appropriations on 17 December 2014, enabling the Commission to carry out a high number of payments in the last four working days of the year and to keep the level of the total year-end backlog at approximately €26 billion. In this framework, the Contingency Margin was mobilised although the EP and the Council maintained different interpretations of the rules governing this tool.

3.3. State of play in 2015

In its September reading of the 2015 draft budget, the Council again adopted a position to reduce payment appropriations (by €2.1 billion) in comparison with European Commission estimates. The EP, which has repeatedly condemned the Council’s approach towards payment appropriations, tried to tackle the growing backlog both for the 2014 and the 2015 budget, by promoting the utilisation of higher revenue from fines against companies breaching competition law, as well as supporting maximum use of the flexibility instruments provided for in the 2014-2020 MFF.

In December 2014, the two arms of the budgetary authority reached an agreement on the 2015 budget and the amendments to the 2014 budget. The compromise set 2015 payment appropriations at €141.21 billion, an amount closer to the initial Commission proposal than to the Council’s position of September (for the first time since the entry into force of the new procedure). The deal included measures to address the payment backlog such as: extra payment appropriations for 2014; the establishment of a payment plan to reduce the backlog, with particular focus on that related to cohesion policy; and close inter-institutional monitoring of payment implementation and forecasts with at least three joint meetings on the topic at key times of the annual budgetary procedure (Spring, July and October).

In March 2015, the European Commission submitted to the EP and to the Council 'Elements for a payment plan to bring the EU budget back onto a sustainable track'. In the document, the year-end backlog for 2007-2013 cohesion spending was estimated to decrease from €24.7 billion in 2014 to €20 billion in 2015, at least half of which (or some €10 billion in 2015) would remain abnormal backlog, as for the preceding three years. The European Commission expected to be able to phase out the abnormal backlog of cohesion spending the following year and to reduce the backlog to a normal level of €2 billion at the end of 2016, by setting payment appropriations for these programmes at some €21.5 billion in the 2016 draft budget.

As regards spending areas other than cohesion, the total backlog is much smaller in size, totalling some €1.8 billion at the end of 2014. However, the European Commission said that the reduction in payment ceilings under the 2014-2020 MFF had also contributed to problems with outstanding payment claims across the other headings of the budget. The Commission's forecast for the end of 2015 provided a mixed picture, with improvements in some areas (e.g. European Fisheries Fund), persistent financial constraints for a number of programmes (e.g. Erasmus) and a trend towards backlog stabilisation for others (e.g. long-term external policy instruments such as the European Neighbourhood Instrument and the Development Cooperation Instrument). Section 5.4 gives an overview of possible implications of the payments backlog in spending areas other than cohesion.

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27 Procedure files No 2014/2040(BUD) and 2014/2224(BUD) provide an overview of the steps of the 2015 budgetary procedure, respectively for the initial Commission proposal and the new proposal following failure of conciliation.
4. Main drivers of the abnormal payments backlog at year-end

Figure 4 – The main drivers contributing to the year-end payments backlog

4.1. General drivers

Since the entry into force of the new budgetary procedure for the adoption of the 2011 budget, each year payment appropriations have been budgeted at a level lower than that estimated necessary by the European Commission on the basis of legal obligations subscribed to by the EU.\(^{28}\) This appears to be linked to the Council's approach in budgetary negotiations, with Member States often facing fiscal consolidation at national level in times of crisis and aiming to minimise their contributions to the EU budget.

In addition, the 2014-2020 MFF was also negotiated against the backdrop of the economic crisis and the resources available for the EU budget have shrunk in comparison to the 2007-2013 period. In constant prices, the total ceiling for commitments and payments respectively decreased by €34.2 billion (-3.4\%) and by €34.4 billion (-3.7\%).\(^{29}\) Figure 5 demonstrates that the payment ceilings for 2014-2020 are consistently lower than those set for each financial year of the preceding programming period except 2009. However, payment appropriations for 2014-2020 need to cover part of the commitments from the previous programming period due to the multiannual implementation of programmes and projects, as well as to the abnormal end-year backlog since 2011.

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\(^{28}\) On the contrary, the 2010 budget, the last to be adopted under the old procedure, included payment appropriations in line with the Commission’s forecasts.

These lower payment ceilings appear to have introduced an additional pressure on payment appropriations, which proved to be particularly significant in 2014, when the payment ceiling was €8.4 billion lower than the final payments for 2013.

At the time of the negotiations on the 2014-2020 MFF, one of the conditions set by the Parliament to give its consent to the reduced ceilings established by the European Council was the strengthening of the flexibility provisions in the MFF, with a view to ensuring full use of the agreed resources. However, the use of flexibility tools (as well as the adoption of amending budgets) may prove difficult and require time. For example, the European Commission called for the mobilisation of the Contingency Margin in May 2014, but the Council agreed to the proposal only at the end of the year.

In September 2014, the then-Commissioner for Financial Programming and Budget, Jacek Dominik, recalled that, according to the MFF agreement, lower payment ceilings would be 'compensated by the use of maximum possible budgetary flexibility'. Along similar lines, a Parliament statement of December 2014 stressed that 'the MFF Regulation is based on the principle of "specific and maximum possible flexibility" in order to allow the Union to fulfil its legal obligations'.

Another element potentially contributing to the increase of the backlog is the need for the Commission to forecast payment needs for complex programmes and projects,

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30 Commitment ceilings reflect the 2015 revision of the MFF. Due to the late adoption of the MFF and of many related operational programmes, commitment appropriations of €21.1 billion initially available for 2014 were moved to 2015 (€16.5 billion), 2016 (€4.5 billion) and 2017 (€107 million) to allow their re-programming.

31 EU budget: (Not) enough is (not) enough!, Highlights of Commissioner Jacek Dominik's statement at the interinstitutional meeting on the payments situation in the EU budget, 24 September 2014.

which are implemented by Member States over several years. This is particularly the case for cohesion spending, where the European Commission is responsible for the production of overall estimates, but needs to rely on Member State forecasts of progress in budget implementation.

4.2. Specific drivers in the area of cohesion policy

Roughly 95% of the payment backlog is related to spending in the area of cohesion policy. It is important, therefore, to examine the specific features of the policy and the reasons for the concentration of the backlog in this area of EU expenditure, such as its role as an investment policy, multi-annual implementation cycle and the financial management rules.

Firstly, cohesion policy in the EU plays an important role as an investment policy. Its main goal is to strengthen economic, social and territorial cohesion and in practice this is achieved by investing in the development of the EU regions, especially those with the lowest GDP per capita and with the most serious economic and social problems. The policy is implemented through different funds, currently referred to as the European Structural and Investment Funds (ESI Funds), which represent roughly one third of the EU budget. As cohesion policy is a shared competence of the EU and the Member States (Article 4 TFEU), the funds are subject to shared management, i.e. they are managed jointly by the Commission and the Member States.

The ESI Funds are an important contribution to public investment in the Member States. In the poorest EU countries (the biggest beneficiaries of the funds) as much as over 50% of total public investment is financed from the cohesion funds (on average up to 21.5% of total fixed public investment in the EU-28 in 2013). Cohesion policy resources are also increasingly used as a measure to mitigate the consequences of the economic crisis. When the rules of fiscal consolidation do not allow for the expansion of government expenditure, EU funds appear to be the main source of public investments. This is particularly the case for regional and local authorities, whose finances are affected by national consolidation plans and where investment possibilities are significantly reduced.

Secondly, cohesion policy is based on multiannual strategic documents, the operational programmes (OPs), which are implemented through thousands of individual projects at national, regional and local level. Many of these, especially large infrastructural investments, are implemented over several years. Thus, in financial terms, the ESI Funds are an example of differentiated appropriations (see Section 2.3). The funds for the OPs are committed in the year they are decided and paid gradually over the following years as the implementation progresses. In other words, there is a delay between decisions on commitments and the moment when corresponding payments are made (RAL).

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33 In the financial perspective 2007-2013 the policy covered three funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund, see Council Regulation (EC) No 1083/2006. In the MFF 2014-2020 cohesion policy is implemented through five funds: ERDF, ESF, the Cohesion Fund, the European Maritime and Fisheries Fund (EMFF), the European Agricultural Fund for Rural Development (EAFRD), see Council Regulation (EU) No 1303/2013.

34 For more see: Sapala M., The European Structural and Investment Funds. How the EU budget is spent?, European Parliament, EPRS, 2015.

35 Sixth report on economic, social and territorial cohesion, European Commission, July 2014.
This phenomenon is characteristic of the cohesion policy cycle and, to some extent, expected and 'normal'. However, prolonging the conclusion of legal commitments and stretching the delay between commitments and payments indicates implementation delays, and may lead to serious disturbance in the payments plan.

In order to minimise the RAL, provisions applicable to the cohesion funds provide for an **automatic de-commitment rule**, under which the funds committed in a given year (N) have to be covered by payment claims within a certain number of years or else are lost to the programme and de-committed. The rule was first introduced for the period 2000-2006 and provided for automatic de-commitment after two years (N+2).\(^{36}\) The rule also applies to 2007-2013 funding, with an exception for Member States with less developed regions, which may prolong the implementation deadline for one further year (N+3).\(^{37}\) In 2014-2020 the N+3 rule was extended to all Member States.\(^{38}\)

The automatic de-commitment rule aims to strengthen financial discipline and smooth implementation of the projects and programmes. The rule should motivate Member States and the beneficiaries of the funds in dynamic and timely management of the individual projects and thereby the OPs. According to some studies, the rule improved financial absorption in 2000-2006 and encouraged timely programme implementation.\(^{39}\) However, in some Member States after 2007, the consequences of the financial crisis began to translate into serious problems with absorption of the cohesion funds. National, regional and local authorities faced a challenge to meet the fiscal consolidation rules on the one hand and the requirements of the additionality principle on the other. Increasing financial constraints and limited borrowing possibilities did not leave the financial room for co-financing cohesion policy projects. However, in these difficult circumstances, the cohesion funds turned out to be a useful tool in efforts to weather the crisis. In the following years, in the framework of the European Recovery Plan, the rule was relaxed and the de-commitment deadlines were lengthened. As a consequence, the first de-commitments for the 2007-2013 programming period were made in 2011 instead of 2009.\(^{40}\)

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39 The automatic de-commitment rule was assessed highly for its credibility, high level of enforcement, transparency and predictability. See: Bachtler J., Ferry M., Conditionalities and Performance of European Structural Funds: A Principal-Agent Analysis of control mechanisms in European Union Cohesion Policy, Regional Studies, vol 49, number 8.
Cohesion policy payment cycle (Articles 77 and 78 of Council Regulation 1303/2013)

The dynamics of the financial flows between the Commission and the Member States depend on the stage of the implementation cycle, and payments are executed in the following way:

- **Initial pre-financing** is paid following the Commission decision adopting the Member State's operational programme(s); **interim payments** are executed as the implementation of the projects in the framework of the OPs is ongoing, and the Member State (certifying authorities, on the basis of invoices from the beneficiaries) sends claims; **payment of the final balance** is a remaining payment claim for the Member State, settled only after programme closure. This usually takes one to three years, as the closure declaration, final implementation report and final payment claim have to be examined and approved by the Commission.

Other cohesion policy rules, such as co-financing rates and pre-financing levels, have also been adjusted due to the financial crisis. To alleviate the pressure on national financial resources in the countries most affected by the crisis, it was decided in 2009 and in 2010, that during the first three years of the 2007-2013 programming period, the level of pre-financing to OPs should be increased. For the same reason, the co-financing rates were increased temporarily in 2011 and 2013. Although these decisions were well-founded and aimed at improving the Member States' absorption capacity, they inevitably hampered financial planning from the perspective of financial predictability. It should be emphasised that the smooth implementation of these changes required considerable budgetary flexibility and the availability of relevant financial resources in terms of payment appropriations in a given year. This is difficult to achieve with a rigid MFF and low annual payment ceilings.

An additional factor conducive to the growth of a payment backlog in cohesion policy is a high concentration of payment claims submitted at the end of year. Although the Member States are asked to send their payment claims regularly, three times per year, the natural tendency is to concentrate them (as much as 35% of the annual

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41 The reimbursement ends when the total pre-financing and interim payments reach 95% of the allocation for the operational programmes in 2007-2013 and 90% for the operational programmes in 2014-20.
43 For Romania, Latvia and Hungary, Portugal, Greece and Ireland (Regulation (EU) No 1311/2011).
44 For Cyprus, Greece, Ireland and Portugal (Regulation (EU) No 1297/2013).
total) and submit them at the end of the financial year (the end of December). This phenomenon increases with the growing pressure of the automatic de-commitment rule. For this reason, many claims cannot be processed and reimbursed before year-end. Commission data shows that the year-end payment backlog multiplied by four between 2010 and 2014 (from €6.1 billion to €24.7 billion). This has an adverse effect on the implementation of the following year's budget.

Payments can also be delayed by interruption or suspension procedures in cases of serious irregularities or deficiencies in implementation. An interruption period may last up to six months for 2007-2013 funds, and this period may be extended to nine months for funds in 2014-2020. Recent data illustrate that this element has an increasing, but still limited effect on accumulation of the backlog.

Delayed start of the implementation of financial periods is another important disruption of the payments cycle leading to problems with cash flow. The problem recurs with each financial period and is a repercussion of difficult and prolonged negotiations on financial envelopes between the Member States. Although most of the details of the sector-specific legislation laying down the rules for spending the funds have usually been negotiated in advance, the regulations can be finalised and adopted only once a decision on the financial framework is taken. A delay in financial decisions triggers a series of delays in the policy cycle, including adoption of strategic documents, organisation of first competitions for projects and disbursement of pre-payments. This scenario proved to be the case in the 2007-2013 financial period, when a slow start to programme implementation resulted in a low level of payments in the first three years. In the case of the 2014-2020 MFF, due to a late start in implementation, budget allocations for 2014 were not used for new programmes, meaning a significant amount had to be transferred to subsequent years by means of a revision of the MFF.

Initial delays inevitably increase the overall delay between commitments and payments and prolong the payments cycle for years beyond the duration of one financial programming period. As a result programme implementation based on different, consecutive financial periods overlaps. At the end of 2014, almost 1% of the total allocation for 2000-2006 remained to be executed (figure 6).

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46 Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015; Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014, European Commission, May 2015.

47 Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014, European Commission, May 2015.

Yet another factor adding to the difficulties of financial management of cohesion funds is the limitations of medium and long-term forecasts of the amount of payment claims. Commission estimates are essentially based on Member State forecasts; it is therefore important that the data are reliable. Forecasts help to assess the speed of implementation of projects and may be a basis for a request to increase the payment appropriations in a draft amending budget. Forecasts are also taken into account when the Commission proposes the following year’s budget. Since the Member States’ estimations are usually overvalued, the Commission reduces them according to an error rate based on the previous year. As experience shows, the Commission’s prudent figures are cut further in the Council’s position during interinstitutional negotiations on the annual budget. Thus, the discrepancy between the level of payment appropriations adopted in the annual budget and the actual needs increases.

49 While comparing the absolute numbers for historical trends in commitments and payments one should bear changes to the cohesion policy regulatory framework in mind, i.e. the rural development fund was excluded from the framework in 2007-2013 and the Cohesion Fund was included in the data only as of 2007, see: Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014, European Commission, May 2015.

50 In 2007-2013 based on Article 76(3) of Council Regulation (EC) No 1083/2006, the Member States submitted their estimations for the current and following year by 30 April. Recently, on a voluntary basis and in order to facilitate estimation of the backlog at year-end, additional, updated information was provided in September. As of 2015, based on Article 112 of Regulation (EU) No 1303/2013, Member States should send their estimations by 31 January and update them by 31 July.

51 The situation varies across the Member States. In 2014 the average level of error amounted to 11% (2007-2013 programmes forecast and effective payment claims compared), but the difference between the forecast and the payment request (error) ranged from -58.7% for Ireland to 127.7% for Slovakia. In September 2014, for the first time ever, the estimation was understated. The forecasts for 2015 and 2016 could also be underestimated due to the delayed start of 2014-2020 programming. See: Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014, European Commission, May 2015; Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.
To summarise, many reasons contribute to the complexity of financial management of EU cohesion policy and interfere in the payments cycle. Nevertheless, as the European Commission emphasises, for many years the level of outstanding commitments was efficiently controlled and managed and the payments backlog was considered 'normal'. In recent years however, apart from the regular, cohesion policy-related risks and cash flow constraints, the additional, crucial causative agent of a low and decreasing level of payment appropriations authorised in the budget has come into play.

5. Implications of the abnormal payments backlog

The implications of the budget payment shortages are both short- and long-term. Some are only potential and may become hazardous if the payment backlog increases and recurs, while others are already visible and quantifiable. They impede to a greater or lesser extent on achievement of EU goals and may contribute to the deterioration of the EU's reputation among European citizens, as well as abroad (Figure 7).

It is worth emphasising that the problem of payment backlog is relatively new and its implications are not yet been documented. The Commission has only recently presented data on the issue, in the framework of the interinstitutional debate.

Figure 7 – The main implications of the year-end payment backlog

Source: EPRS

5.1. EU reputation and credibility

When running a business, liquidity and cash flow are important indicators of a company's financial standing, competitiveness and efficiency. Even a profitable company with poor cash management can fail. The same can be said of public organisations and government. If no resources are available to pay obligations, an organisation loses credibility. A government's trustworthiness and reputation is to a

52 Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.
great extent based on citizens' and stakeholders' perception that it will do what it has promised to do. Trust and reputation should not be taken for granted.\(^{53}\)

Whilst the damage should not be overestimated, the fact that the EU found itself in a situation where it could not pay for its obligations, even if only temporarily, is certainly not without significance for the EU’s reputation. Some beneficiaries had to wait longer than expected for transfers from the EU budget, contracts were signed later than expected, and calls for projects were cancelled or postponed. On a more general level, the problem of payments backlog may serve as yet another argument in the criticism of the EU for inconsistency in its decisions. The same EU that imposes strict budgetary rules on Member State public finances, is not capable of the smooth management of its own budget. Therefore, as ex-Commission President Barroso remarked, the lack of relevant resources to cover commitments, 'is not just a technical or purely budgetary exercise: it is a question of the credibility of the political decisions taken by the European Council.'\(^{54}\)

The payments crisis has significantly impeded the already difficult interinstitutional negotiations on annual budgets in recent years.\(^{55}\) The unprecedented size of the payment backlog, and related proposals for budget amendments, are crucial aspects of the negotiations between the Council and the EP. In 2011 and 2013, due to prolonged disputes over the lack of resources for payments, agreement within the prescribed deadlines proved impossible, and the Commission was forced to prepare a new draft budget. Similarly, the problem interfered with a compromise during negotiations on the 2015 budget. In fact, since 2011 annual negotiations between budgetary authorities increasingly focus on remedies for the payment backlog, rather than on the following year’s budget itself.

Member States' budgetary negotiations may attract media interest, but they do not improve the EU’s reputation. Communication with citizens is focused on who gets what and who is the winner or loser, rather than on a common concern for priorities and successful functioning of the EU.\(^{56}\) The payments backlog was thus presented in the media in sensational fashion: 'Union's coffers will run dry',\(^{57}\) 'the pile of unpaid bills'\(^{58}\) and 'there is no cash in the EU budget'.\(^{59}\) The impression given is that EU finances are mismanaged and that the European Commission asks for more money than was agreed.

Other stakeholders may also add to the reputational issue, including national parliaments. For example, in July 2014, the Chair of the European Union Committee of the UK House of Lords asked the Financial Secretary of the UK Treasury, whether the

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54 *Letter from President Barroso to the Italian Presidency* of the EU Council on the EU budget payment shortages, Brussels, 2 October 2014.


57 EU budget: Union's coffers will run dry by the end November, Europolitics, 21 October 2013.


problem of payment shortages in the 2014 budget had not been anticipated by any institutions and, if so, whether this represented an indictment of the Commission, the Council, the EP and the budgetary process as a whole.\(^{60}\)

### 5.2. Interest paid on late payments

The consequence of late payments most easily quantified is the interest incurred to be paid in accordance with Article 92 of the Financial Regulation. However, the interest is applicable only to the programmes directly managed by the European Commission, thus excluding most of the payments from the cohesion and structural funds. Under heading 1b, interest applies only to the expenditure on technical assistance on the initiative of the Commission.\(^{61}\) Thus, the bulk of the backlog is not reflected in the figures presented in table 2.

#### Table 2 – Interest paid on late payments 2008-2014 (in €).

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>Sum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heading 1a</td>
<td>294 855</td>
<td>157 950</td>
<td>173 748</td>
<td>329 615</td>
<td>137 906</td>
<td>243 748</td>
<td>1 047 488</td>
<td>2 385 310</td>
</tr>
<tr>
<td>Heading 1b</td>
<td>1 440</td>
<td>5 324</td>
<td>6 220</td>
<td>11 255</td>
<td>31 726</td>
<td>71 620</td>
<td>103 960</td>
<td>231 545</td>
</tr>
<tr>
<td>Heading 2</td>
<td>27 819</td>
<td>1 807</td>
<td>9 576</td>
<td>15 713</td>
<td>61 879</td>
<td>30 991</td>
<td>61 985</td>
<td>209 770</td>
</tr>
<tr>
<td>Heading 3</td>
<td>13 417</td>
<td>59 852</td>
<td>48 673</td>
<td>50 397</td>
<td>29 375</td>
<td>13 060</td>
<td>7 252</td>
<td>222 026</td>
</tr>
<tr>
<td>Heading 4</td>
<td>27 819</td>
<td>1 807</td>
<td>9 576</td>
<td>15 713</td>
<td>61 879</td>
<td>30 991</td>
<td>61 985</td>
<td>209 770</td>
</tr>
<tr>
<td>Heading 5</td>
<td>27 819</td>
<td>1 807</td>
<td>9 576</td>
<td>15 713</td>
<td>61 879</td>
<td>30 991</td>
<td>61 985</td>
<td>209 770</td>
</tr>
<tr>
<td>Total</td>
<td>631 650</td>
<td>846 079</td>
<td>733 402</td>
<td>1 734 230</td>
<td>738 960</td>
<td>653 392</td>
<td>3 027 124</td>
<td>8 364 837</td>
</tr>
</tbody>
</table>

Source: EPRS, (based on: Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015).

Despite the measures taken by the Commission to alleviate the negative effects of payment shortages, the amount of interest paid as a penalty for delayed payments increased five times between 2013 and 2014.\(^{62}\) Total value of the interest paid from 2008 to 2014 amounts to approximately €8.36 million.

The highest interest paid came under the heading 1a 'Competitiveness for growth and jobs' (including the Horizon 2020, the Energy Projects and European Economic Recovery Plan, Erasmus+), and heading 4 'Global Europe' (including humanitarian aid, the European Instrument for Democracy and Human Rights, the European Neighbourhood Instrument, Development Cooperation Instrument, Instrument Contributing to Stability and Peace).

### 5.3. Implications for cohesion policy

The 'snowball effect' described above, led to the creation of unprecedented growth in the payments backlog, which reached €24.7 billion in 2014. Half of this amount was linked to the lack of payment appropriations authorised. In practice it means that part of the duly submitted payment claims from the Member States could not be paid because authorised payment appropriations on the relevant budget line were exhausted.

As the backlog of unpaid bills increases, the question of the impact on project implementation and individual beneficiaries arises. Since the payment backlog mainly exists under heading 1b 'Economic, Social and Territorial Cohesion', it might be

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\(^{60}\) The draft EU budget 2015 and draft amending budget 3 (DAB 3) for 2014, Lord Boswell, Chairman of the European Union Committee, 9 July 2014.

\(^{61}\) Except for expenditure in the framework of technical assistance (Article 14 of Regulation (EU) 1083/2006.

\(^{62}\) Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.
expected that the negative consequences would be evident to the beneficiaries of the ESI Funds. The Commission states that, in terms of EU credibility, payment delay highly prejudicial, yet, to date official documents give little quantified evidence of a detrimental impact on the programmes on the ground. In addition, contrary to directly managed spending, the cohesion policy legal framework does not provide for interest on late payments. Although the relevant articles of the ESI Funds regulation for 2014-2020 oblige the Commission to make an interim payment no later than 60 days after registering a payment claim, and establish the principle that beneficiaries should be paid by the responsible national authorities within a time limit of maximum 90 days, these provisions remain explicitly conditioned to the availability of funding. Therefore, the consequences of delays cannot be measured by the amount of interest paid by the Commission to the ESI Funds' recipients.

Another difficulty in detecting the impact on cohesion policy, results from the fact that the structural and cohesion funds are subject to shared management between the Commission and the Member States. In this type of expenditure, payment transfers flow from the Commission to the national accounts and not directly to the beneficiaries. Some Member States encourage the implementation of the projects and pay the pre-financing from their national budgets even before they receive the transfer from the Commission. Thus, the detrimental impact of the delays may be to a large extent absorbed by the national treasuries.

In countries where pre-financing from the national treasury is not applied, the beneficiaries are responsible for financing their projects without any preliminary support and are reimbursed only after submission of the relevant documents. In this situation, for individual beneficiaries such as local and regional authorities, SMEs, NGOs and research institutes, any delay in transfers from the EU budget increases their risk of losing investment on co-financed projects and incurring higher cost financing. Consequences may include a reduction in activities, withdrawal from the projects, or short-term loans. Beneficiaries may request extra support from their local authorities, who in turn have to take loans to bridge the financial gap. This may lead to serious financial and organisational problems. On a bigger scale, implementation of operational programmes and delivery of expected results may be delayed. In the long term, effectiveness of the cohesion policy programmes may decrease. Thus, on the one hand, cohesion policy rules and instruments are increasingly reworked to remedy the consequences of the crisis, whilst on the other, their initial goals are side tracked and policy effectiveness is limited.

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63 Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.
64 Based on Articles 77, 132 and 135, Regulation (EU) No 1303/2013.
65 This problem is particularly observed in the case of transnational cooperation programmes, for example the INTERREG Northern Periphery Programme 2007-2013 (cooperation between Finland, Ireland, Sweden, United Kingdom), where some project partners, including SMEs in the fishing sector, suffered financially due to late payments. Information based on a note from the European Commission (DG REGIO) presented to the European Parliament’s monitoring group on payments (BUDG Committee). Similar problems were flagged in: Execution of the annual budget 2007-2013: relevant recommendations for local and regional authorities, Committee of the Regions, Brussels, July 2013.
5.4. Implications for other EU policies

Shortage of payment appropriations affects not only cohesion spending under heading 1b, but also other areas of expenditure, in particular under heading 1a 'Competitiveness for Growth and Jobs'; heading 4 'Global Europe'; and heading 3 'Security and Citizenship'.66 With some exceptions, in these areas the Commission manages the funds directly (through its departments and executive agencies) and indirectly (through entrusted entities, e.g. third countries).67 Contrary to the case of shared management, these methods of financial implementation allow the Commission more independence and control over, for example, the launch and conclusion of grant procedures and disbursement of funds. Therefore, in these areas of spending the Commission has more legal possibilities to adjust the level of executed payments to the level of available appropriations and thereby to avoid abnormal backlogs. In practice, the actions taken by the Commission in order to limit the backlog include:68

- speeding up actions to recover any undue amounts;
- limiting idle amounts on fiduciary accounts;
- reducing pre-financing percentages;
- making best use of maximum payment deadlines allowed;
- postponing calls for proposals or tenders and related contracting;
- giving higher priorities to countries under financial assistance.

The Commission applies the above actions with respect to the following principles, to:69

- minimise the financial impact on the EU budget of interest for late payments and potential liabilities;
- maximise the implementation of programmes;
- minimise the potentially negative impact of decisions on third parties and the economy as a whole.

The mitigating measures taken by the Commission assuredly limited the backlog, however, it should be remembered that, in many cases, the positive effect is only temporary and leads to creation of a 'hidden backlog'. The moment of disbursement was postponed, but the commitments will, eventually, have to be honoured. Thus, over a long perspective, these measures may result in policy implementation delays and adversely impact on policy goal achievement and the overall performance of the EU in a given area.

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66 Heading 2 'Sustainable Growth: natural resources' is so far the least affected by the abnormal backlog. Payments from the Common Agriculture Policy and related payments from the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD) have been made on time and a backlog has been avoided. The situation in the European Fisheries Fund (EFF) differs, where the backlog was especially significant in 2014. This was mainly due to the concentration of two thirds of annual payment claims at the end of year. This backlog, however, was significantly reduced at the end of 2014 thanks to the redeployment of unused appropriations for programmes 2014-2020. European Commission, Elements for a payment plan to bring the EU budget back onto a sustainable track, 2015.

67 Except Asylum, Migration, Borders and Security funds, which are subject to shared management.

68 Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.

69 Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.
Despite the mitigating measures undertaken by the Commission, the backlog in the headings mentioned above is noticeable and the interest paid on the delayed payments is high (see Section 5.2). Implementation of the largest spending programme under heading 1a, Horizon 2020, has slowed significantly. In 2014, the level of pre-financing in the programme was reduced from 60% to 35% and many calls were delayed to 2015.\footnote{In September 2014, the EU Commissioner for budget informed that over 70 projects, amounting to €36 million, were blocked, and incurring interest for late payments. European Commission, press release, 24 September 2014.}

In some instances, the Commission had to give priority to payments addressed to the more vulnerable beneficiaries.\footnote{Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.}

Erasmus+ is another example of a programme under heading 1a that has suffered from the shortage of payment appropriations. In 2013 and 2014 the Commission was not able to pay part of the pre-financing to the national agencies. Similar constraints were predicted for 2015. In this case the EU's financial problems had an impact on the students themselves — the final beneficiaries of this mobility grant.\footnote{Hong Jose, Erasmus grant delays blight students’ years abroad, 11 November 2014.}

The shortfall of payments may lead not only to the reduction of places available for students and the level of grants, but also to the weakening of the programme's reliability and prestige. Similar measures were taken under heading 3, which covers the programmes in the field of asylum, migration, borders and security policy.\footnote{In 2007-2013 the heading was implemented via the General Programme ‘Solidarity and Management of Migration Flows’ (SOLID). The General Programme consisted of four instruments: External Borders Fund (EBF), European Return Fund (RF), European Refugee Fund (ERF) and European Fund for the Integration of third-country nationals (EIF).}

The punctuality and reliability of payments is especially important in the area of humanitarian aid (heading 4). There the consequences of the delayed payments may be especially harmful. Therefore, the project cycle in this area is very short and lasts from 12 to 18 months, and also characterises a high implementation level. Unfortunately, here the abnormal backlog of payments also had an impact on the implementation of the programmes. Due to limited payment appropriations, the payments had to be decided based on their priority, on a case by case basis and the appropriations were transferred to budget lines with the most urgent needs.\footnote{Report on budgetary and financial management, Financial year 2014, European Commission, DG Budget.}

Consequently, some projects were delayed, for example humanitarian aid in the Sahel region, in Haiti and the Horn of Africa, as well as in the European Neighbourhood Instrument for Ukraine, Georgia and Moldova.\footnote{Press release, European Commission, 24 September 2014.}

To summarise, the implications of the payment crisis are multiple, visible in most of the spending areas and affect the beneficiaries on the ground. Moreover, as shown by the interest paid on delays, delays also represent a measurable cost for the EU, slowing implementation of various EU programmes and hampering the achievement of the EU’s goals in certain policies.
6. Institutional positions and measures to tackle the backlog

6.1. The two arms of the budgetary authority: what resources for the EU?

In the case where there are insufficient payment appropriations in the approved annual budget, a way of addressing the issue and containing the abnormal backlog is the adoption of an amending budget by the EP and the Council – if the payment ceiling and/or the flexibility provisions in the MFF are not completely exhausted for that financial year.

The two arms of the budgetary authority have taken a different approach to the problem of the abnormal backlog in the framework of the budgetary procedure. The European Parliament has backed the budgeting of payment appropriations, at least at the level that the European Commission proposed on the basis of its estimates of budget implementation. To the contrary, the Council has regularly cut the Commission’s proposals in the annual budgetary procedure and, when amending budgets to address shortfalls in payments have been tabled, it has often called for proceeding first with redeployments of payment appropriations from other budget lines, even though the Commission has already indicated that all potential redeployments (see Section 6.2) had already been explored and were completely exhausted. Negotiations on amending budgets for the current year have often proven lengthy, becoming an integral part of the negotiations meant to establish the following year’s budget.

In a way, the issue of the abnormal backlog can be seen as another aspect of the intensive debate that has informed the difficult negotiations on the 2014-2020 MFF: how much resources should be available to the EU in order for the Union to effectively carry out the policies it is entrusted with? The Own Resources Decision currently sets the upper limit of payments at 1.23% of the Union's GNI (see Section 2.7) and the annual payment outturn has always been below the own resources ceiling. Despite an EU with one additional Member State, the European Council reduced the payment appropriations available in the 2014-2020 MFF in comparison to 2007-2013, both in real terms (€34.4 billion less in constant prices) and as a percentage of the Union's GNI (from 1.06% to 0.95%). The EP has always stressed, including most recently within the 2016 budgetary procedure, that EU objectives should be matched with the appropriate resources to achieve them.

When endorsing the political agreement on the 2014-2020 MFF, the EP acknowledged fiscal consolidation efforts in the Member States, but expressed its concern about the ceilings set by the European Council, saying that these resources may prove insufficient to achieve the EU’s objectives and to recover from the crisis. The Parliament underlined the importance of the conditions that it had set to give its consent, including augmented flexibility provisions in the MFF to allow full use of the reduced appropriations (e.g. through the creation of a Global Margin in Payments and a Global Margin in Commitments for the automatic carry-over of unused appropriations from one financial year to the next). Along similar lines, in October 2014, the then

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76 EU budget: (Not) enough is (not) enough!, Highlights of Commissioner Jacek Dominik’s statement at the interinstitutional meeting on the payments situation in the EU budget, 24 September 2014.

Commission President, José Manuel Barroso stressed\textsuperscript{78} that at the time of the MFF agreement it was made clear that the level of the 2014-2020 payment appropriations was the minimum necessary to carry out the agreed policies and the full use of these resources was only possible if resorting to the flexibility provisions of the MFF. However, the mobilisation of the Contingency Margin in 2014 required lengthy negotiation.

6.2. European Commission: active management and mitigating measures

The European Commission actively manages the authorised payment appropriations, by monitoring budget implementation. If estimates of payment needs for an expenditure item are revised downwards during the year, part of its payment appropriations may be moved to another item, which conversely experience shortages in payments. These transfers must comply with the rules and conditions set in Articles 24-29 of the Financial Regulation (principle of specification), which vary depending on the expenditure items involved. Some categories of transfers are decided by the Commission under its own authority, others require transmission to the budgetary authority, either for decision or information.

Table 3 illustrates that in recent years the European Commission's implementation rate of authorised payment appropriations has been at constantly high levels. The Commission notes that implementation is practically total (99% in 2014) when extrapolating the data concerning the implementation rate of a particular category of appropriations (‘assigned revenue’), which follows specific rules. In other words, the European Commission uses the authorised payment appropriations almost entirely and does not appear to keep idle cash resources at year-end.

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Source: European Commission, Reports on budgetary and financial management

In 2014, the European Commission used a number of specific mitigating measures to counter the increasing level of the abnormal backlog at year-end in the context of active management of scarce payment appropriations. For many of the programmes directly managed by the Commission (and in some cases as early as 2013), these measures included: reduction of pre-financing, postponement of calls for tenders or proposals and related contracting, and use of maximum payment deadlines allowed. However, the Commission draws attention to the fact that most of these measures are only a short-term fix, since they simply postpone the payment date to following years, thus creating a sort of ‘hidden backlog’. In addition, some measures may trigger a negative side-effect at operational level such as delays in the implementation of agreed programmes (see Section 5.4).\textsuperscript{79}

In its 2014 Annual Activity Report,\textsuperscript{80} the Directorate-General for Budget of the European Commission says that the scarce payment appropriations led to some delays

\textsuperscript{78} Letter from President Barroso to the Italian Presidency of the EU Council on the EU budget payment shortages, European Commission, 2 October 2014.

\textsuperscript{79} Elements for a payment plan to bring the EU budget back onto a sustainable track, European Commission, 2015.

\textsuperscript{80} 2014 Annual Activity Report, DG Budget, European Commission, 2015.
in payments and implementation. It adds that a number of Commission departments were confronted with significant managerial and operational challenges, since their payment appropriations were exhausted several months before the end of the year. However, the text concludes that the active management of payment appropriations enabled the Commission to sufficiently mitigate the financial and the reputational impact of the abnormal backlog.

6.3. European Court of Auditors

In its capacity as the EU's independent external auditor, the European Court of Auditors (ECA) frequently presents its assessments and observations related to the problem of increasing outstanding commitments.\(^8^1\) In its annual report on the 2011 financial year, the ECA observed an acceleration of payment requests and a shortage of the payment appropriations under heading 1b. It underlined that sufficient payment appropriations must be ensured in future years 'to cover the widening gap between outstanding commitments and appropriations for payments'.\(^8^2\) In its report for the following year, the ECA discussed the issue in a special section entitled 'The pressure on the budget for payments'. It insisted that the Commission prepare a medium and long-term plan for payment requirements.\(^8^3\)

In its special reports published in 2014 on spending in agriculture and cohesion 2007-2013 and on the risks to the financial management of the EU budget, the ECA draws attention to the fact that, at the end of 2013, payments had not yet been made on more than one third of commitments for 2007-2013 and that it would be difficult to find sufficient funding for payments. The Court also indicates that the amounts de-committed in accordance with the automatic de-commitment rule are very small.\(^8^4\)

6.4. Interinstitutional initiatives

In December 2014, the agreement on the 2014 and 2015 budgets included the establishment of a payment plan to reduce the backlog to a sustainable level, with particular focus on cohesion policy, and close inter-institutional monitoring of payment implementation and forecasts.

In March 2015, the Commission transmitted 'Elements for a payment plan' to the EP and the Council (see Section 3.3). In the document, the European Commission expected to be able to phase out the abnormal backlog of 2007-13 cohesion spending next year and to reduce the backlog to a normal level of €2 billion at the end of 2016, by setting payment appropriations for these programmes at some €21.5 billion in the 2016 draft budget. The Commission added that its proposal for next year's budget would also include sufficient payment appropriations to ensure proper implementation of 2014-2020 programmes across all headings.

In May 2015, the EP, the Council and the Commission agreed on a joint statement\(^8^5\) on a payment plan 2015-16 as a follow-up to the Commission's document. Among other

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\(^8^1\) The analysis of the outstanding commitments was included in each year's report between 2005 and 2013, except 2009.

\(^8^2\) Annual Report on the implementation of the budget 2011, 2012/C 344/01.

\(^8^3\) Annual Report on the implementation of the budget 2012.

\(^8^4\) ECA, Agriculture and cohesion: overview of EU spending 2007-2013.

\(^8^5\) Joint statement on a payment plan 2015-2016, including in its annex the Commission's elements for a payment plan to bring the EU budget back onto a sustainable track, May 2015.
points, the joint statement includes the EP and Council’s commitment to provide the 2016 budget with sufficient payment appropriations to reduce the payment backlog for 2007-2013 cohesion programmes at the end of 2016 to the €2 billion forecasted by the Commission. In addition, the two arms of the budgetary authority asked for the European Commission to closely monitor the implementation of 2014-2020 programmes and to create an early warning system on payment needs, with a view to avoiding the emergence of similar backlogs in the future. The Commission committed to providing, in the context of the budgetary procedure, rolling forecasts of payments organised by spending category and covering two financial years. In July 2015, in the run-up to the second interinstitutional meeting on payment implementation and forecasts, the Commission provided the two arms of the budgetary authority with an update on the state of play by means of a new report entitled ‘Active Monitoring and Forecast of Budget Implementation’.\(^86\)

Despite these arrangements, interinstitutional friction over the 2016 budget appears to have emerged already, by and large mirroring past years’ positions. In June 2015, the European Commission updated its proposal for the 2016 draft budget, which amounts to €153.8 billion in commitments and €143.5 billion in payments. On 4 September 2015, the Council adopted its official position on the proposal, cutting the Commission’s estimates for payments by €1.4 billion and reducing commitments by €0.56 billion. The Council said that it took into account budget execution figures in recent years and its forecast of absorption capacities for the future to amend the proposal.\(^87\) On 8 September 2015, a first debate on the Council’s official position took place in the EP plenary. José Manuel Fernandes (EPP, Portugal), Parliament’s rapporteur for the bulk of the 2016 budget, responsible for leading the negotiations with the other arm of the budgetary authority, defined the Council’s cuts as ‘unacceptable, incomprehensible and inconsistent’. The European Commission also expressed its concern about the reduced appropriations in the Council’s position.\(^88\) On 28 October 2015, the EP voted on the Council’s position, reversing all the cuts proposed by the latter and further increasing commitment and payment appropriations in areas considered of key concern. As regards payment appropriations in particular, the EP underlined the need to comply fully with the 2015-2016 payment plan agreed in May 2015.\(^89\) Parliament’s vote triggered the start of the 21-day conciliation procedure between the two arms of the budgetary authority.

**6.5. Are additional measures needed from 2017 onwards?**

While the payment plan should bring the backlog for 2007-2013 cohesion programmes back to a normal level of €2 billion at the end of 2016, the outlook for 2017 (the year with the lowest payment ceiling in the current MFF) and following years needs to be further assessed with a view to identifying possible issues. The early warning system that the Commission committed to establishing in the interinstitutional statement of May 2015 should contribute to the objective of avoiding the accumulation of abnormal backlog at year-end for 2014-2020 programmes in the years to come.

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\(^{86}\) The following interinstitutional meeting on payments took place in October 2015.


In November 2014, the European Court of Auditors (ECA) published its annual report for the 2013 financial year. When presenting the documents to the Committee on Budgetary Control (CONT) of the EP, ECA President Vítor Caldeira drew attention to potential issues in the field of EU cash flow management in coming years. In particular, he noted that the level of commitments outstanding could prove problematic, in a framework that is going to have broadly stable payment ceilings in real terms for a number of years (see payment ceilings in figure 5). Accordingly, the ECA annual reports recommended the annual production and update of a long-range cash flow forecast. The European Commission accepted the recommendation, while highlighting that this kind of information is produced in the context of the annual budgetary procedure and of the monitoring of the MFF.

In 2016, useful information should be available to update the long-term forecast of payment needs and to produce a thorough analysis of the topic. The adoption of operational programmes under shared management for 2014-2020 should be completed by the end of 2015, following which the Commission should receive forecasts of budget implementation and payment schedules from Member States. On the basis of these data, the Commission will update its estimates of overall payment needs in the coming years. In turn, the exercise could provide valuable information in the context of next year’s review of the 2014-2020 MFF, that could lead to the revision of the financial framework.

The review/revision of the 2014-2020 MFF by the end of 2016 was one of the conditions set by the Parliament for giving its consent to the relevant regulation. The aim is to reassess the EU’s political priorities and to adapt the MFF to new challenges and needs in an evolving context.

7. Outlook

The analysis shows that the problem of the abnormal payments backlog at year-end experienced in recent years by the EU budget is multidimensional and driven by different factors. Consequences of the abnormal backlog are also multiple both for beneficiaries of EU programmes and the Union itself. While the payment plan 2015-2016 should bring the situation back to a normal level at the end of next year, the outlook for 2017 and the following years remains to be thoroughly assessed.

The issue of the abnormal year-end backlog has not only many technical aspects, but also a political dimension, since it can be seen as a symptom of the diverging views of different stakeholders on the amount of resources that the Union needs to achieve the policy objectives that it is entrusted with.

The EU’s financial provisions strictly cap EU spending. Since the introduction in 1988 of the own resources ceiling (currently at 1.23% of the EU’s GNI) and of the multiannual
financial perspectives (known as MFF), actual spending has always remained below the agreed maximum levels.

On the one hand, the abnormal payments backlog may promote some positive developments, such as further improvements in the forecasts of payments needs from all the relevant stakeholders, including both the Commission and the Member States. On the other hand, shortage of payment appropriations may introduce excessive rigidity in a system that already caps expenditure, leading to operational problems such as those experienced by a number of Commission departments that ran out of resources several months before the end of 2014. In turn, this can to some extent hinder the achievement of agreed policy objectives, for instance with partial and/or delayed implementation of programmes.

Cohesion policy, where the bulk of the abnormal backlog has been concentrated in recent years, gives an example of potential contradictions: the European Council supported its full implementation as an investment tool to counter the economic crisis, but authorised payment appropriations were subsequently insufficient to honour promptly part of the payment claims when these began arriving at a faster pace. Along similar lines, the political agreement on the 2014-2020 MFF included the frontloading of appropriations for the Horizon 2020 framework programme for research and innovation. However, mitigating measures to tackle payments shortages such as the postponement of some calls for proposals (the so-called 'hidden backlog') may have at least partially offset this decision.

In 2016, a number of developments should help to understand how the situation could evolve in subsequent years. The adoption of all the operational programmes for 2014-2020 will enable the European Commission to produce more accurate estimates of payment needs after 2016. The Commission is also due to submit a review of the 2014-2020 MFF that could lead to its revision.

At the same time, the high-level group chaired by Mario Monti will present its analysis on the financing system of the EU budget, which national parliaments are expected to assess. The Commission will examine whether the outcome of the work justifies new initiatives in the field of own resources, with possible reform of the financing of the EU budget for the period covered by the next MFF.

The EP, which has long pushed for an overhaul of the own resources system, has little say on the revenue side of the budget, but was a driver of the creation of the high-level group. The underlying idea is that the introduction of new, real, own resources and the reduction of the role of those currently perceived as national contributions should shift the focus of budgetary discussions from national contributions and geographically pre-allocated funds to expenditure with high EU added value. Accordingly, the EP has repeatedly stressed that the objective of reform is not to increase the level of EU spending, but to improve the way it is financed.

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Since 2011, the EU has experienced an issue of increasing levels of payment backlog at year-end. The problem has turned out to be a recurring one, especially pressing during annual budget negotiations, and difficult to resolve with ad-hoc preventive action.

The situation has deteriorated over the years and at the end of 2014 the payment backlog was estimated at some €26 billion, around half of which was classified by the European Commission as 'abnormal'. While the bulk of the backlog came under the heading 1b 'Cohesion for growth and jobs', other policy areas were also affected, such as the Erasmus and research programmes, the European Neighbourhood Instrument and humanitarian aid.

The problem interlocks both technical aspects of budgetary management and a political dimension, with fundamental questions on the architecture of EU public finances, including the system of own resources and the flexibility of the Multiannual Financial Framework.

The situation should significantly improve by the end of 2016 thanks to a series of interinstitutional initiatives, strongly supported by the EP. However, the future outlook from 2017 remains to be thoroughly assessed.