RESEARCH PAPER 01/62
2 JULY 2001

The *European Communities (Finance) Bill*

Bill 1 2001-02

This short bill gives effect in UK law to the decisions on the financing of the EU Budget taken at the European Council in Berlin on 23rd and 24th March 1999 and at the European Council in Brussels on 20th September 2000.

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ISSN 1368-8456

Summary of main points

The financing of the EU Budget has been under consideration for a number of years. The Commission undertook a number of studies from 1997 under the heading of *Agenda 2000*. This looked at several issues including:

- dissatisfaction at the way funding for the Budget had developed;
- concerns over the equity of contributions and receipts;
- resentment at what was seen as special treatment for the UK that was no longer justified by circumstances;

The *Agenda 2000* process resulted in number of far reaching changes agreed upon at European Council meetings in Berlin and Brussels. These particularly affected the way in which the Community's revenue, its own resources, are calculated.

The reforms shifted the balance of collection towards what is hoped to be a fairer system of contribution more related to ability to pay based upon a Member State's national income.

The UK's abatement of its VAT contributions remains but further adjustments are made to its overall Budget settlement to reflect the other changes.

A change to the Community's Own Resources Decision (ORD) requires ratification in each Member State according to its own constitutional rules. This bill is a technical measure, giving legal effect to the ORD. The bill does not replicate the Decision itself but adds to the list of Community Treaties for the purpose of their enforcement in the UK by Section 2 of the 1972 European CommunitiesAct.

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I Introduction

This short bill will give effect in UK law to the decisions on the financing of the EU Budget taken at two European Council meetings, the first in Berlin on 23rd and 24th March 1999 and the second (more formal) in Brussels on 20th September 2000. The decisions form the new own resources decision. This decision will be added to the list of Community Treaties in Section 1(2) of the European Communities Act 1972. The background to the decisions taken at Berlin was:

- dissatisfaction at the way funding for the Budget had developed;
- concerns over the equity of contributions and receipts;
- resentment at what was seen as special treatment for the UK that was no longer justified by circumstances.

The build up to 'Berlin' began in 1997. In the July of that year the Commission issued a communication entitled *Agenda 2000: For a Stronger and Wider Union*[1]. This is a crucial document to many aspects of the subject. It dealt with the reforms thought necessary to meet the future changes, such as reforming the common agricultural policy, the future of economic and social cohesion policy, the establishment of a pre-accession strategy, the consequences of future enlargement and the financing of the Community. In March 1998 the Commission presented a set of legislative proposals on these topics, a proposal for a new financial perspective (see below) for the period 2000-2006 and a report on the implementation and renewal of the Interinstitutional Agreement of 29 October 1993. In October 1998 the Commission completed the series of *Agenda 2000* documents by presenting a report on the operation of the own resources system (ORD). The main components of the *Agenda 2000* package were agreed by the Berlin European Council on 24 and 25 March 1999 and finalised at the Brussels Council in September 2000.

This Paper will first describe the organisation of Community finances. It will then look at the problems and concerns listed above. It will then describe the changes made and how this Bill gives effect to these. Lastly, statistical information about the levels of expenditure and contributions is presented.

II The European Community Budget

The two crucial elements of the funding arrangements on the revenue and expenditure sides are the **own resources** and the **financial perspective** respectively. Equally important to remember is the principle that the EC Budget cannot run a deficit. The EC cannot borrow to finance excesses of expenditure over income. As a result, decisions on

[1] COM(97) 2000 final

funding impose an immediate constraint upon expenditure, whereas national governments can make up deficiencies by running a public sector deficit.

A. Revenue: the Four Own Resources

The way in which the European Community is financed is laid down in what is the Own Resources Decision (ORD), made by unanimous decision of the Council of Ministers. The previous ORD came into effect on 1 January 1995 and it was this decision which was reviewed in Berlin. There are four own resources described below.

1. Agricultural and sugar levies

Agricultural levies are charges on imports of certain agricultural products from non-Community countries. Following the conclusion of the GATT Uruguay round, most agricultural levies are now fixed. The levy is either a fixed amount or a percentage of the value in euros of the product. It is also possible for a combination of these two types of levies to be used. However, for some commodities, levies continue to vary in line with changes in world prices to offset the difference between world and Community price levels. Charges are also levied on EU sugar producers to ensure that they contribute towards market support expenditure, and also to finance the storage cost equalisation system, which ensures a regular flow of sugar onto the market. In 2001 levies will account for 2.1% of the Community's own resources (down from 2½% in 1997).[2]

2. Customs duties

These derive from the application of the Common Customs Tariff to imports of goods from non-Community countries. In 2001 this resource will account for about 13% of the Community's own resources (15% in 1997).

3. VAT based contributions

These are not a proportion of VAT receipts, as some believe. VAT contributions are payments up to a level equivalent to 1% (call up rate) of a common, harmonised VAT base.[3] This hypothetical base is, in turn, capped so as not to exceed, (since 1999), 50% of any country's GNP. In 2001 VAT-based contributions will account for just over 36% of the Community's own resources (42% in 1997). The UK receives abatement on its VAT-based contribution. This is described in more detail below.

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2 These and other similar statistics are derived from the Commission's publication, *The Community Budget: The Facts in Figures*

3 i.e. National expenditure on a harmonised range of goods and services

4. GNP based contributions

These are based on the application of a common rate to the aggregate GNP of all Member States. They were introduced as a variable resource to ensure that revenue and expenditure balanced in the budget, and were intended to cover the amounts not yielded by other budget revenue. They have grown rapidly in importance for the Budget. In 1997 they accounted for 40% of the Community's own resources but in 2001 are expected to be nearly 48%. But, as they are effectively a top up facility to make sure that income is sufficient to meet expenditure, the proportion can alter considerably from year to year.

The first two resources are together known as the "traditional own resources". The VAT and GNP-based contributions are often referred to as the "third" and "fourth" resources: hence the discussion of whether there should be a new source of revenue is often couched in terms of a "fifth" resource.

VAT and GNP based contributions are calculated on the basis of estimated data for the forthcoming year. Adjustments are made in later years to reflect out-turn data, which may be different from the earlier forecasts because of changes in, say, economic growth or exchange rates.

Almost all of the community's revenue (98.3% in 2001) is obtained through the appropriation of own resources as described above. Other revenue is raised through deductions of taxes and social security contributions from the salaries of Community officials; interest on late payments; fines; and revenue generated from the operations of the Community institutions (such as the sale of publications).

Own resources are usually paid to the Commission within two months of the entitlement being established. In the case of agricultural and sugar levies and customs duties, 10% is retained by Member States to cover their collection costs. VAT and GNP-based resources are paid every month when one-twelfth of the amount given in the budget for the year in question is transferred. An adjustment is then made after the year-end in line with the actual tax bases determined for that year.[4]

The ORD also places a ceiling on the amount that the Community can raise from Member States each year. The ceiling is expressed as a percentage of overall Community Gross National Product (GNP). In 1997 the ceiling was 1.24% of Community GNP but the previous ORD increased it in stages to 1.27 per cent in 1999, to remain at that level subsequently.

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4 *The Community Budget: the facts in figures*, European Commission, 1995 (SEC (95) 1400 - EN)

B. Expenditure: the Financial Perspective

A multi-annual expenditure framework, known as the financial perspective, governs expenditure on the Community's programmes. The financial perspective is simply EC jargon for a table showing expenditure projections and own resource ceilings for the years ahead. It forms part of an inter-institutional agreement between the Commission, the Council and the European Parliament. The current financial perspective, which runs from 2000 until 2006, was adopted on 6 May 1999, after a final round of negotiations following the Berlin European Council.

The financial perspective sets out in money terms annual ceilings for seven categories of expenditure (agriculture, structural operations, internal policies, external action, administrative expenditure, reserves and (a new category) pre-accession aid) which must be respected when the annual budget is set.

The new financial perspective is shown in the table below:

Financial Perspective 2000-2006
2001 Prices, eur millions

Appropriations	2001	2002	2003	2004	2005	2006
Agriculture	44,230	45,379	45,538	44,488	43,624	43,344
Structural operations	32,720	32,106	31,503	30,785	30,785	30,343
Internal policies	6,272	6,386	6,500	6,614	6,729	6,853
External action	5,015	5,019	5,025	5,029	5,035	5,040
Administration	4,776	4,880	4,984	5,088	5,192	5,296
Reserves	916	666	416	416	416	416
Pre-Accession aid	3,260	3,260	3,260	3,260	3,259	3,259
Total	97,189	97,696	97,226	95,680	95,040	94,551
Appropriations for payments as a % of GNP	1.11%	1.20%	1.10%	1.04%	1.00%	0.97%

Source:General Budget of the European Union ,January 2001, EU Commission

In passing, it is worth pointing out how small the EC Budget is in comparison to national budgets. The EC Budget for 2001, £60.5 billion[5], is dwarfed by UK government expenditure of nearly £400 billion for the same period. Put another way the Department of Social Security alone spends about 50% more on benefits, pensions etc, than the EU does on all its programmes combined.

C. The Annual Budget

EC budget expenditure is shown in five separate sections, each relating to one of the five institutions: Parliament (Section I), the Council, including the Economic and Social

[5] As a rough approximation Members wishing to convert figures in euros to sterling should reduce the euro figure by a little more than a third to gain the sterling equivalent.

Committee (Section II), the Commission (Section III), the Court of Justice (Section IV) and the Court of Auditors (Section V). Appropriations under sections I, II, IV and V are exclusively for administrative expenditure, as is Part A of the Commission section. Part B of the Commission section covers the main operating appropriations, and is divided into nine subsections, which are outlined briefly below.

- **Subsection B1** is the largest single item of expenditure, which contains all the guarantee expenditure for the European Agricultural Guidance and Guarantee Fund (EAGGF). This is the main budget line for funding the common agricultural policy.

- **Subsection B2** covers structural operations, including the operations under the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Financial Instrument for Fisheries Guidance (FIFG) and, since 1993, the Cohesion Fund. Expenditure on some other regional and agricultural operations, and transport and fisheries, are also included under this heading.

- **Subsection B3** covers expenditure on youth policy, audio-visual media, information, social dimension, training and culture.

- **Subsection B4** is concerned with the environment, energy and nuclear safeguards.

- **Subsection B5** covers consumer protection, the internal market, trans-European networks, security and justice.

- **Subsection B6** provides for expenditure on research and technological development.

- **Subsection B7** relates to external policies, covering a wide range of activities. These include financial, technical and economic assistance to developing countries and to the former communist states of Eastern Europe; initiatives for democracy and the protection of human rights, and emergency food and humanitarian aid.

- **Subsection B8** relates to common foreign and security policy.

- **Subsection B9** contains the guarantees and reserves. The budget headings in this subsection will be used in the event of a country defaulting on a loan guaranteed by the Union, or to fund appropriations which had no legal basis when the budget was adopted but which are expected to be required during the course of the year.

The final major subhead is for administrative expenditure and this is shown separately. The table below outlines the amounts payable under each of these headings in respect of the 2001 general budget. Spending on the Common Agricultural Policy reached 68% of total spending in 1985, but has since declined to less than half. It should be noted that within this declining share, actual spending on the CAP has increased, in cash terms, over the years. This decline in the share of the EC budget dedicated to agriculture has been accompanied by an increase in the share of the budget devoted to regional and social policies. Currently one third of the EC budget is spent via the Structural Funds, compared to one sixth in 1988. Regional and social spending has thus become the second most important spending category.

EU Budget 2001

		Appropriations for commitments		
		Eur millions	£ millions	% of total
B1	EAGF Guarantee Section	43,797.7	27,544.0	45.5%
B2	Structural operations	32,875.8	20,675.3	34.2%
B3	Training	862.8	542.6	0.9%
B4	Energy	167.7	105.5	0.2%
B5	Consumer protection	1,125.8	708.0	1.2%
B6	Research & technology	3,920.0	2,465.3	4.0%
B7	External action	8,340.7	5,245.4	8.7%
B8	Common foreign & security policy	36.0	22.6	0.0%
B9	Compensation, guarantees	208.0	130.8	0.2%
DA	Administrative expenditure	4,904.3	3,084.3	5.1%
	Total	96,238.8	60,523.7	100%

Source:EU Commission, General Budget of EU 2001

The next section of the Paper looks at the reasons behind the Commission's Agenda 2000 review as they affect the issues covered in the Berlin Council decision and, hence, in the current bill.

III What's the problem?

The House of Lords Select Committee on the European Communities neatly summed up the main reason for the review of the Budget. They said:

> The own resources ceiling sets an overall limit to the amount of revenue which the Community can raise, and thus to total expenditure. Within that ceiling there is at present an agreed framework covering all Community expenditure, known as the "financial perspective", which sets an annual limit on each category of expenditure. The financial perspective thus provides the context for each annual budget. Once the level of expenditure for a given year has been agreed through the budget, the necessary funds are automatically made available through the own resources system. So, given an adequate own resources ceiling, if the financial perspective proposed by the Commission were agreed as proposed and the funding system continued to operate as it does at present, there would not, by definition, be a problem in covering the expenditure foreseen in the Commission's proposals.
>
> The problem arises because some Member States consider that under the present system they are contributing too much to the EU in relation to the benefits that they receive. The most vociferous of these is Germany, where the new Government has argued strongly that it is not prepared to continue financing a disproportionate share of EU expenditure, but Austria, the Netherlands and Sweden have also formally asked for abatements. In the course of our enquiry, we have considered the extent of the existing imbalance, and the proposals which have been put forward to remedy the situation.[6]

Before looking at the specific complaints various general points are worth considering. First, no Member State is arguing that net contributions (contributions less receipts from the Budget) should be entirely fair in a proportional sense. The very existence of the structural funds, to give one example, is to redistribute money from the rich northern core (France, Germany, the UK etc) towards the poorer Member States such as Spain, Portugal, Greece and Ireland. Second, there are arguments over whether the problem lies with the way that the own resources are calculated or whether it is the fault of an unfair distribution of benefits. Lastly, the cause of much concern (and possible resentment) amongst other Member States is the fact that the UK already receives an abatement of its contributions since the Fontainebleau arrangement of 1984. It was hardly surprising, therefore, that the UK's treatment came under intense scrutiny both by the Commission and in the inter governmental fora where the topic was discussed. In one sense, therefore, there were two issues before the Community. First, was the general system fair? Second, is it fair for the UK to have special treatment?

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[6] House of Lords Select Committee on the European Communities, *Future Financing of the EU: Who Pays and How?,* 2 March 1999, HL 36 1998/99, p15

A. The General Situation

'Fairness' is a difficult concept to define, especially when the redistributive element in EC spending is taken into account. It is generally recognised that g*ross* contributions to the EU budget are roughly proportional to the GDPs of the Member States.[7] The table below demonstrates this. It shows gross contributions as percentages of each Member's GDP for each of the last five years. For example, the UK's gross contribution for the five year period as a whole is calculated as 0.9% of the UK's GDP per capita, which is slightly below the EU average of 1.04%. If contributions were absolutely fair all countries would have the same share of GDP figure. A statistical measure of dispersion (standard deviation) applied to these figures suggests that, over time, contribution rates are becoming fairer according to this definition.

Gross contributions (after abatement) as percentage of GDP

	1995	1996	1997	1998	1999	**Average** (1995-99)
Belgium	1.27%	1.30%	1.38%	1.40%	1.37%	1.34%
Denmark	0.94%	0.95%	1.01%	1.09%	1.01%	1.00%
Germany	1.13%	1.10%	1.14%	1.07%	1.06%	1.10%
Greece	1.10%	1.13%	1.10%	1.21%	1.15%	1.14%
Spain	0.82%	0.95%	1.09%	1.10%	1.11%	1.01%
France	1.00%	1.01%	1.06%	1.05%	1.04%	1.03%
Ireland	1.31%	1.19%	0.97%	1.28%	1.21%	1.19%
Italy	0.76%	0.93%	0.84%	0.99%	0.98%	0.90%
Luxembourg	1.20%	1.12%	1.11%	1.32%	1.07%	1.17%
Netherlands	1.37%	1.37%	1.45%	1.45%	1.36%	1.40%
Austria	0.98%	1.03%	1.16%	1.11%	1.04%	1.06%
Portugal	1.04%	0.96%	1.15%	1.11%	1.15%	1.08%
Finland	0.90%	0.96%	0.98%	0.99%	0.99%	0.97%
Sweden	0.90%	0.95%	1.11%	1.12%	1.05%	1.03%
United Kingdom	1.07%	0.88%	0.77%	1.00%	0.82%	0.91%
EU15	1.03%	1.03%	1.03%	1.08%	1.03%	1.04%

Source: The Community Budget: The Facts in Figures, EU Commission

Unfairness is more marked when receipts are taken into account and *net* receipts are measured.

Publications relating to the EC budgetary process provide estimates of Member States' gross contributions, but do not give a breakdown of each Member State's expected receipts from the budget until after the year in question in the annual Court of Auditors' report on the implementation of the budget.[8]

[7] OP cit p 17
[8] HC Deb 13.1.94 c246W

The table below shows Member States' total contributions and receipts from the Budget and net contributions for 1999.[9] Net contributions to or receipts from the EC budget are calculated as the difference between own resources and operating expenditure incurred in each Member State.

EU Budget Receipts and Contributions, 1999
£ millions

	Receipts	Contributions	Net cont's +/(-)
Austria	801.5	1,351.8	550.3
Belgium	1,264.2	2,103.7	839.6
Denmark	995.1	1,090.2	95.2
Finland	592.9	797.0	204.1
France	8,445.0	9,211.5	766.5
Germany	6,391.5	13,868.5	7,477.0
Greece	3,285.7	889.2	-2,396.6
Ireland	1,897.2	697.5	-1,199.7
Italy	5,933.3	7,086.4	1,153.0
Luxembourg	52.7	127.8	75.0
Netherlands	1,141.1	3,351.4	2,210.4
Portugal	2,570.5	808.1	-1,762.4
Spain	8,483.0	4,101.7	-4,381.3
Sweden	738.5	1,546.1	807.6
United Kingdom	3,813.5	7,295.6	3,482.1
Unallocated	3,490.9	*na*	*na*
Total	49,896.5	54,326.4	4,429.9

Source: Court of Auditors Annual Report Concerning the Financial Year 1999

The table is not necessarily an accurate reflection of events. Payments and receipts by Member States vary considerably from year to year, therefore, the figures may not reflect each Member State's overall budgetary stance over the long term. Secondly, although the contributions reflect data in 1999 the receipts relate to payments made under programmes sanctioned in 1999 and earlier. Lastly, a substantial sum (£3.5 billion) of money cannot be attributed to any Member State in particular. Payments not allocated to Member States consist mainly of external actions such as development assistance (spent outside the EU) and also other internal policies, although not administration. This has the effect of artificially increasing the number of States that are net contributors.

In terms of the budgetary positions for 1999, Germany was the largest net contributor in absolute terms, followed by the United Kingdom with the Netherlands in third position. Spain was the largest net recipient in absolute terms, followed by Greece and then Portugal.

[9] The figures have been converted at the 1999 annual average sterling/euro exchange rate of 1.5192 eur/£.

A similar table, but this time showing the data on a per capita basis is shown below. It shows that on this basis Luxembourg makes the highest per capita net contribution followed by the Netherlands with Sweden and Germany joint third. Irish citizens receive the highest individual subsidy followed by Greece, Portugal and Spain.

EU Budget Receipts and Contributions, 1999
£ per head

	Receipts	Contributions	Net cont's +/(-)
Austria	99	167	68
Belgium	124	206	82
Denmark	187	205	18
Finland	115	155	40
France	141	154	13
Germany (c)	78	169	91
Greece	312	84	-228
Ireland	507	186	-320
Italy	103	123	20
Luxembourg	122	296	174
Netherlands	72	212	140
Portugal	259	81	-178
Spain	215	104	-111
Sweden	83	175	91
United Kingdom	64	123	59
Unallocated	*na*	*na*	*na*
Total	132	144	12

Source: Court of Auditors Annual Report Concerning the Financial Year 1999

It might be recalled that the Lords Committee's summary included the following (author's emphasis):

> The problem arises because some Member States consider that under the present system they are contributing too much to the EU in relation to the benefits which they receive. The most vociferous of these is **Germany,** where the new Government has argued strongly that it is not prepared to continue financing a disproportionate share of EU expenditure, but **Austria, the Netherlands and Sweden** have also formally asked for abatements.

The table gives some indication as to why these four countries were the most 'vociferous'. Austria and Sweden are very small countries compared to the UK but both make greater net contributions per head. The Netherlands, though a larger economy than either Austria or Sweden makes a contribution more than double that of the UK's. The German complaint appears to be as much about the sheer size of its contribution.[10]

[10] The position of Belgium and Luxembourg is rather different since, outside the formal Budget arena, they benefit greatly from their position as host to many of the EU's institutions which provide substantial economic benefits to both countries.

Professor Begg summed up the budgetary position of individual Member States in his evidence to the Lords Select Committee. He said:

> Four Member States (Greece, Ireland, Portugal and Spain) are regarded as the targets of cohesion policy, so that their (substantial) net receipts from the EU budget are justifiable. Belgium and Luxembourg are substantial net recipients if administrative expenditure is included; if it is not they are net contributors on a par with the United Kingdom.
>
> Finland, which has a *per capita* GNP marginally below that of the United Kingdom, is a modest net beneficiary from the EU budget, as is Denmark which is the most prosperous Member State after Luxembourg. For [Finland], it is a combination of a relatively low gross contribution and slightly above average receipts from the Structural Funds that explains the balance, whereas Denmark continues to benefit disproportionately from the CAP. Both France and Italy, the two remaining Member States, are modest net contributors: France because it receives much more from the CAP than its GNP 'share', and Italy because its share of gross contributions is well below its GNP share [11]

The broad conclusion, therefore, is that the current situation is unfair and unfairness exists because of the pattern of distribution of benefits from the Budget rather than from the contributions made by Member States.

B. The Special Case of the UK

The June 1984 Fontainebleau European Council decided that any Member State which was bearing excessive budgetary costs in relation to its relative prosperity could benefit from a correction. On this basis, the United Kingdom's VAT contributions are abated according to a formula set out in the ORD. The abatement is calculated through a rather complex formula which, in broad terms, is equivalent to 66% of the difference between, on the one hand, what the UK would have paid if the Community had been financed entirely by VAT and, on the other, UK receipts from the budget, subject to the following points:

- expenditure outside the Community (such as the development aid programme) is excluded;
- the United Kingdom's contribution is calculated as though the budget were entirely financed by VAT-based contributions;
- the abatement is deducted from the United Kingdom's VAT contribution a year in arrears.

[11] Op cit , p17

The Fontainebleau European Council further agreed that the cost of the United Kingdom abatement should fall on the other Member States, with Germany's contribution to it reduced by a third.

Challenges to the UK's privileged position are not new, nor are they unexpected. Successive governments however, have taken a robust view of the issue. For example in 1994 the then Prime Minister said:

> The abatement is an integral part of the own resources decision -ORD. The ORD, including the abatement, continues in force unless or until changed or replaced. Change or replacement requires unanimity in the Council followed by adoption of the new arrangements by member states according to their respective constitutional procedures. In the case of the United Kingdom, this means the passage of an Act of Parliament. This has been made clear on many occasions.[12]

The Commission alone determines the level of the abatement each year. It is calculated on the basis of forecasts of Member States' contributions to the Budget and payments from the Budget to Member States. It is then corrected in the light of out-turn figures, and corrections can be made up to three years in arrears. Agenda 2000 stated:

> The uncertainties surrounding the future relative prosperity situation of the United Kingdom, however, lead the Commission to propose postponing a re-examination of the rebate mechanism until immediately after the first enlargement.
>
> At that moment, it will be possible to proceed to an assessment of the situation on the basis of more reliable data. If the relative prosperity of this country were to be above the Union's average, it would be appropriate to review the current arrangements and to foresee a gradual reduction of the current rebate.

And later

> At the time of the enlargement, it will be necessary to adapt the definition of the expenditure on which the calculation of the rebate is based to avoid an unjustified increase in its amount due to purely statistical changes. This is made necessary by the fact that with enlargement some expenditure flows directed to the new Member States, which are now considered "external expenditure" and therefore do not enter into the calculation, will be replaced by payments under internal policies, which enter into the calculation.[13]

In evidence to the House of Lords Committee the Commission questioned the continued relevance of the rebate and argued:

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[12] HC Deb 4 July 1994, c2W

[13] Agenda 2000, For a Stronger and Wider Union, part III, (COM(97) 2000).

> The Commission has suggested that the United Kingdom abatement is no longer justified because the proportion of spending represented by the CAP (from which the United Kingdom does particularly badly) has decreased, and because the gap in relative prosperity between the United Kingdom and some other large net contributors has narrowed. In addition, it notes that the budgetary imbalance of the United Kingdom is no longer unique.[14]

In response, and after taking evidence from Treasury Ministers the Lords response was even handed. On the one hand it recognised that:

> We accept that without abatement, the United Kingdom would remain one of the largest net contributors, and we agree that some way of remedying that situation would need to be found.[15]

But on the other it noted:

> We agree that there is still a problem for the United Kingdom, but we consider that the rebate itself may no longer be the best way of solving it. We therefore take the view that the rebate should be negotiable as part of an overall settlement delivering the result of fairer net contributions. It would be regrettable if the entire package (including CAP reform and the possibility of funding enlargement) were to be lost because the United Kingdom Government insisted that there was only one way of solving its problem. Equipping the European Union to handle enlargement is a very big prize: we urge the Government not to throw it away. It seems to us that a realistic negotiating result for the United Kingdom would be agreement to forgo the rebate on condition that - and only when - the loss can be made up on a permanent basis through the savings of a reformed CAP and a stabilisation of expenditure overall by 2006, and possibly through increased EU expenditure in the United Kingdom.[16]

IV The Bill

A. Why the Need for Legislation?

A change to the Own Resources Decision (ORD) under Article 201[17] requires ratification in each Member State according to its own constitutional rules. The incorporation of the 1994 ORD into UK law, for example, required legislation to include the new ORD within the scope of the European Communities Act 1972 s1(2)(e) as a "Community Treaty" as defined by the Act. This was achieved by means of the European Communities (Finance) Act 1995. The new Act also repealed the previous Act of 1988. This made the ORD effective within

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[14] House of Lords, p23
[15] Op cit p 24
[16] op cit p 25
[17] Treaty establishing the European Economic Community as amended by the Treaty of Amsterdam

UK law and provided for financial obligations incurred under it to be met from the Consolidated Fund. The current bill extends this sequence by including the latest Council decision (of 29 September 2000) on own resources as a treaty within the meaning of the 1972 Act.

B. The Bill

The bill has only two clauses, the second of which simply repeals the previous European Communities (Finance) 1995 Act. According to the Treasury note on the bill no financial implications can be ascribed solely to the new legislation. It continues:

> No increase in the UK's net contribution is expected to result purely from the introduction of the new Decision since it does not make provision for additional categories of own resources and provides for the continuation of the abatement mechanism.[18]

The bill is a technical measure, giving legal effect to the ORD. The bill does not replicate the Decision itself but adds to the list of Community Treaties for the purpose of their enforcement in the UK by Section 2 of the 1972 Act. The content of the Decision itself can be found in the Conclusions of the Berlin Presidency.[19] The main changes are listed below.

1. VAT contributions

Under the old ORD the VAT call up rate (i.e. the notional VAT rate) was 1%. Under the new agreement it is being reduced to 0.75% in 2002 and 0.5% in 2004. Any shortfall in receipts due to this move is automatically compensated for by a rise in GNP contributions. Hence the real import of this move is to deliberately shift the basis upon which contributions are made away from VAT and towards a GNP basis. This is generally perceived to be a more equitable basis for contributions. At an individual level poor people spend a higher proportion of their income than rich people (who save more). Hence a tax on spending hits the poor proportionately harder than the rich. This analogy can be extended to Member States too.

Another point in favour of moving to away from the VAT base is the impact it has on fraud. The Lords Committee noted:

> Commissioner Liikanen pointed out that if both traditional own resources and the VAT resource were abolished, "there would be no fraud on the revenue side" (Q 104). He explained that "when we have enquired into the really detailed fraud cases, by far the biggest numbers are on the traditional own resources side… Because member countries retain only ten per cent out of the traditional own

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[18] HM Treasury, *Explanatory Notes to European Communities (Finance) Bill,* para12
[19] House of Commons Library Deposited Paper, 99/685

> resources for administration, the incentive is perhaps not sufficient". Moreover, moving to a single GNP based resource would, he said, "do away with a major part of the bureaucracy in member countries and in Brussels". [20]

2. Retention against collection costs

Currently Member States can retain 10% of their own resources against the cost of collection of all EC resources. Under the new ORD the percentage rises to 25%. Again this is a further diminution in the role of 'traditional own resources'. Again shortfalls will be made up with increased contributions from the GNP base which benefits poorer Member States.

3. The UK abatement & the windfall

The UK's abatement procedure remains intact. However, what are called 'windfall' bonuses will be deducted from the UK's overall abatement to ensure that the UK does not benefit twice from the changes made to the ORD. The Berlin Presidency conclusions note that:

> In accordance with the principles reflected in the conclusions of the 1998 Brussels and 1992 Edinburgh European Councils, its amount [of rebate] shall not include windfall gains from changes to the financing system. So technical adjustments in the new ORD will, as before, neutralise windfall gains resulting from the progressive reduction of the VAT reserve and now from the increase in the percentage of traditional own resources retained by Member States to cover their collection costs. Similarly at the time of enlargement, an adjustment will reduce "total allocated expenditure" by an amount equivalent to the annual pre-accession expenditure in the acceding countries, thereby ensuring that expenditure which is unabated now remains unabated.
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> The overall impact of these two effects is estimated at 220 million euros by 2006.[21]

It will be recalled that payments under the heading of development assistance are not currently included in the VAT abatement and the new agreement makes provision for deductions of similar amounts once enlargement takes place.[22]

Underlying this decision therefore is an assumption that the UK will benefit from the shift away from traditional own resources and that it would be unfair to benefit both from this and from the abatement. It is not stated in the documents accompanying the Bill what the scale of these benefits might be.

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[20] Ibid p 20
[21] conclusions of Berlin Presidency, para 72, Deposited Paper 99/685
[22] It will be noted that this was foreshadowed in the Commission's *Agenda 2000,* document, see p 18

V The Budgetary Procedure

A. Draft budgets: Commission/Council/Parliament

Each year a preliminary draft budget, which reflects the constraints contained in the financial perspective is prepared by the Commission. This is essentially a 'statement of estimates' which incorporates the requests of all its spending departments together with those of other institutions (the Parliament, Court of Auditors etc), and forms the overall forecast of revenue and expenditure for the year in question. The preliminary draft for the forthcoming year is adopted by the Commission in early May and is sent to the budgetary authority (the Council and European Parliament) by 15 June. The preliminary draft can subsequently be amended by the Commission by means of a letter of amendment to allow for new information that was not available earlier.

The Council conducts its first reading of the preliminary draft budget, and, on this basis and after a meeting with a delegation from the European Parliament, establishes (before 31 July) the draft budget. The draft budget is then sent to the Parliament in the first half of September.

The European Parliament conducts its first reading of the draft budget in October. Amendments to non-compulsory expenditure require the votes of an absolute majority of members.[23] Proposed modifications to compulsory expenditure (most expenditure on agriculture - around half of the budget - is compulsory) require an absolute majority of the votes cast.

The budget is then passed back to the Council for their second reading of the budget, which usually occurs during the second week in November, after a conciliation meeting with a delegation from the European Parliament. The draft budget is amended to take account of the European Parliament's amendments and proposed modifications. As a rule, the Council's decisions on compulsory expenditure at the time of second reading determine the final amount (unless the whole budget is subsequently rejected by the European Parliament). The amended draft budget is then returned to the European Parliament in late November.

At its December sitting the European Parliament reviews the non-compulsory expenditure, for which it can accept or reject the proposals from the Council. For the European Parliament to pass the budget, the threshold is a majority of its members and three-fifths of the votes cast. The budget is then adopted and can then be implemented on 1 January.

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[23] The distinction between compulsory and non-compulsory expenditure is essentially a political one: the European Parliament has the last say over non-compulsory expenditure, and the Council has the last say over compulsory expenditure. The somewhat vague definition of the two concepts contained in the Treaty was clarified in 1982 stating that compulsory expenditure is that which the budgetary authority is obliged to undertake to meet its obligations (both within and beyond the Community) under the Treaties and acts adopted. All other expenditure is non-compulsory.

In the event of unavoidable, exceptional or unforeseen circumstances the Commission may propose during the year that the budget should be amended. A preliminary draft supplementary and amending budget is then submitted. These are subject to the same rules and procedures described above. In 1997 a supplementary and amending budget was produced. The main purposes of this were to allocate the 1996 cash surplus of around £3.2 billion to Member States and to adjust the calculation of the UK's abatement using new information.

B. The Court of Auditors Report

The European Court of Auditors is responsible for the external audit of the EC Budget each year. It examines the expenses of the Institutions and the Community expenditure undertaken directly by the Commission (e.g. on development assistance) or by Member States (principally agricultural and structural programmes). It is also concerned with ensuring that contributions by Member States have been calculated and paid correctly.

In addition to this role the Court of Auditors looks at whether the accounts drawn up by the Commission are accurate and whether the transactions are legal. It also monitors the soundness of the financial management employed by the Commission in discharging the Budget. The findings of the Court of Auditors are published in a report each year. The reports do not cover every aspect of the Budget in detail each year; they tend to focus on particular spending programmes in turn.

One of the provisions of the Maastricht Treaty was that the Court of Auditors should produce a separate Statement of Assurance as to the reliability and legality of transactions. The latest Statement, relating to the 1999 Budget, found 'material understatement of short term amounts receivable from Member States'. In particular the Court identified unauthorised payments to farmers under the EAGGF programme of over one billion euros.

Appendix

The table below shows the components of the UK's net contributions to the EC Budget for each year since accession in 1973.

UK Net Contributions and Abatement from EU Budgets
£ million at cash prices

Calendar year	Total contributions	Total receipts	Negotiated refunds	Abatement	Net contributions	
					Before Refund and Rebate	After Refund and Rebate
1973	151	63	..	..	88	88
1974	206	128	..	..	78	78
1975	352	362	..	..	-10	-10
1976	476	249	..	..	227	227
1977	767	290	..	..	477	477
1978	956	432	..	..	524	524
1979	1,958	543	..	..	1,415	1,415
1980	1,862	852	98	..	1,010	912
1981	2,174	962	693	..	1,212	519
1982	2,862	1,090	1,019	..	1,772	753
1983	2,976	1,373	807	..	1,603	796
1984	3,201	1,831	528	..	1,370	842
1985	3,925	1,696	61	166	2,229	2,002
1986	4,493	2,059	..	1,701	2,434	733
1987	5,203	2,219	..	1,153	2,984	1,831
1988	5,120	2,097	..	1,595	3,023	1,428
1989	5,587	2,111	..	1,156	3,476	2,320
1990	6,355	2,179	..	1,697	4,176	2,479
1991	5,805	2,758	..	2,497	3,047	550
1992	6,737	2,818	..	1,881	3,919	2,038
1993	7,982	3,288	..	2,540	4,694	2,154
1994	7,188	3,251	..	1,726	3,937	2,211
1995	8,889	3,665	..	1,207	5,224	4,017
1996	9,134	4,373	..	2,412	4,761	2,349
1997	7,991	4,661	..	1,733	3,330	1,597
1998	10,090	4,115		1,378	5,975	4,597
1999	10,288	3,479	..	3,171	6,809	3,638
2000	10,458	4,325		2,085	6,133	4,048
1973-00	122,728	52,944	3,206	26,013	69,784	40,565

Sources: ONS Database
"European Finances: Statement on the 2000 EC Budget and measures to counter fraud and financial mismanagement"; Cm 4771

There are a number of large changes in the gross and/or net contributions paid by the UK in some years. Obviously, when gross contributions increase but receipts remain largely unchanged, the net contribution will grow. The large increase in gross contributions between 1978 and 1979 reflected growth in the size of the budget generally; most of the additional revenue available to the Community was absorbed by agricultural spending. The increase in the contributions during the early 1980s again reflected a step increase in the size of the budget; this time being absorbed mainly by increased structural fund expenditure. Later in the 1980s, the overall size of the budget increased again - by almost 25 per cent between 1985 and 1986. This caused the UK's gross contributions to increase again, although in 1986 the effects of the VAT abatement began to be felt and the net contribution was relatively small. Both of these step increases in the size of the budget coincided with new accessions to the Community: Greece in 1981 and Spain and Portugal in 1986.

More latterly the pattern of gross contributions, VAT abatement and net contributions has followed a somewhat erratic path. A large net contribution in one year causes the abatement in the following year to be larger, reducing the net contribution once more. For instance, a large net contribution in 1998 (£4.6billion) was followed by a much larger abatement in 1999 (£3.2billion as opposed to £1.4billion) resulting in a lower net contribution of £2.5billion.

Changes in the level of gross contributions obviously reflect the size of the budget overall. In more recent years they also reflect the relative economic strengths of the Member States. A country with an economy more buoyant than other Member States will tend to contribute more, since the structure of own resources is now more closely related to economic performance than previously.

The two tables on the following page illustrate the broad pattern of contributions to the EC Budget over a five-year period.

Gross Contributions (After Abatement)*

(eur millions)

	1995	1996	1997	1998	1999	Average (1995-99)
Belgium	2,680.1	2,750.9	2,971.4	3,130.9	3,196.2	2,945.9
Denmark	1,295.4	1,368.7	1,505.8	1,694.7	1,656.2	1,504.2
Germany	21,324.1	20,742.7	21,217.3	20,633.0	21,069.0	20,997.2
Greece	985.2	1,105.9	1,178.4	1,310.3	1,348.8	1,185.7
Spain	3,645.2	4,547.1	5,367.6	5,752.4	6,231.3	5,108.7
France	11,876.8	12,423.2	13,185.9	13,584.3	13,993.8	13,012.8
Ireland	664.8	681.6	687.0	984.7	1,059.7	815.6
Italy	6,413.7	9,003.0	8,667.1	10,581.4	10,765.8	9,086.2
Luxembourg	167.8	160.7	170.7	216.7	194.2	182.0
Netherlands	4,349.6	4,435.5	4,837.6	5,104.5	5,091.4	4,763.7
Austria	1,762.9	1,874.0	2,110.4	2,085.8	2,053.7	1,977.4
Portugal	864.9	851.9	1,077.8	1,104.6	1,227.6	1,025.4
Finland	887.4	964.0	1,061.9	1,145.8	1,210.7	1,054.0
Sweden	1,658.3	1,968.2	2,326.0	2,382.7	2,348.8	2,136.8
United Kingdom	9,251.6	8,218.1	8,928.1	12,537.2	11,083.5	10,003.7
EU15	67,827.8	71,095.5	75,293.0	82,249.0	82,530.7	75,799.2

Note: * Own resources

Source: The Community Budget: The Facts in Figures, EU Commission

Gross Contributions (After Abatement)*

Percentage of total gross contributions

	1995	1996	1997	1998	1999	**Average** (1995-99)
Belgium	4.0%	3.9%	3.9%	3.8%	3.9%	4%
Denmark	1.9%	1.9%	2.0%	2.1%	2.0%	2%
Germany	31.4%	29.2%	28.2%	25.1%	25.5%	28%
Greece	1.5%	1.6%	1.6%	1.6%	1.6%	2%
Spain	5.4%	6.4%	7.1%	7.0%	7.6%	7%
France	17.5%	17.5%	17.5%	16.5%	17.0%	17%
Ireland	1.0%	1.0%	0.9%	1.2%	1.3%	1%
Italy	9.5%	12.6%	11.5%	12.9%	13.0%	12%
Luxembourg	0.2%	0.2%	0.2%	0.3%	0.2%	0%
Netherlands	6.4%	6.2%	6.4%	6.2%	6.2%	6%
Austria	2.6%	2.6%	2.8%	2.5%	2.5%	3%
Portugal	1.3%	1.3%	1.4%	1.3%	1.5%	1%
Finland	1.3%	1.4%	1.4%	1.4%	1.5%	1%
Sweden	2.4%	2.8%	3.1%	2.9%	2.8%	3%
United Kingdom	13.6%	11.6%	11.9%	15.2%	13.4%	13%

Note: * Own resources

Source: The Community Budget: The Facts in Figures, EU Commission

Prime Minister's Statement Berlin European Council Meeting

(Extract connected with Agenda 2000)

I shall now turn to Agenda 2000. On agriculture, the European Council agreed to phased price cuts of 15 per cent. for milk and cereals, and 20 per cent. for beef. It also set limits on agricultural spending, bringing the common agricultural policy under tighter control than before. Agricultural spending by 2006 is planned to be less than 2 per cent. in real terms above its level next year, and falling. Of course, some of us wanted more, but it is worth contrasting this outcome with the increase of 9 per cent. agreed at the Edinburgh European Council in 1992--and UK consumers will, when these reforms have been implemented, benefit by about £1 billion a year, or £65 for a family of four.

On the structural and cohesion funds, the European Council agreed that spending in the existing Union should total 213 billion euros in the period 2000 to 2006, an 11 per cent. reduction in the Commission's proposal. Within that total, full and proper account will be taken of the interests of the UK.

Cornwall, west Wales and the valleys, and South Yorkshire will qualify for the first time for assistance under objective 1 of the structural funds. Merseyside will retain its objective 1 status. A safety net will safeguard the position of regions of the UK qualifying for assistance under objective 2 of the structural funds. This will cover 14 million British people. There will be a special package for Northern Ireland, assuring assistance at a level equivalent to objective 1 status. There will be a special transitional programme of assistance totalling 300 million euros for the highlands and islands of Scotland, which no longer qualify for objective 1 status. That sum is double the amount available for other areas losing objective 1 status, and is comparable to the amount that the highlands and islands would have received as an objective 1 area. That is a tremendous deal for Scotland.

The negotiation also covered the revenue side of the Union's finances. It was agreed that more revenue would be raised from contributions linked to gross national product and less from value added tax receipts and customs payments. There is also to be a change in the way in which payment for the UK abatement is divided among the other member states. But no change was made to the own resources ceiling, the limit on revenue available for the Community budget. That is significant and welcome.

In the past two major negotiations on European finance, in 1988 and 1992, the European Union, when it made changes, agreed an increase in the revenue ceiling: that is an increase in the share of the European Union's wealth which taxpayers can be required to contribute towards EU spending. For the first time there has been a major Community financial settlement without an increase in the potential burden on taxpayers. In 1988, the settlement envisaged spending rising by 17 per cent., and in 1992 it foresaw spending rising by 22 per cent. This time spending within the EU 15 will fall in real terms over the period covered by the agreement.

On the abatement, I am delighted to report that the presidency conclusions say in terms that the UK abatement will remain. In line with the 1988 and 1992

European Council conclusions, the UK accepted that we should not make a windfall gain out of changes to the method of EU financing; that is the gain from a switch from VAT to GNP contributions and from an increase in the collection costs for traditional own resources. On the same principle, I agreed that the abatement will not apply, after enlargement, on an amount of expenditure in the new member states equal to the pre-accession aid in those member states which is itself now unabated. So any expenditure unabated now will remain unabated after enlargement. But the vast bulk of expenditure in the new members after enlargement will qualify for the abatement, because it is abated now. The result is that there will be no reduction in the United Kingdom's rebate. Our objective was secured. I said that the Government would maintain the abatement. We have done so.

HC Deb 29 March 1999 c 733