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The *European Communities (Finance) Bill*

Bill 2 2007-08

This Bill would give effect in UK law to the decisions on the financing of the EU Budget taken at the December 2005 European Council meeting.

The Bill adds a new Own Resources Decisions (ORD) to the *European Communities Act 1972*. The new ORD does not change the overall ceiling of revenue available to the EU, but a change is made to the UK abatement mechanism.

Edward Potton

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Summary of main points

The *European Communities (Finance) Bill* would give effect to the latest Own Resources Decision (ORD) in UK law and allows payments to be made to the EU directly out of the Consolidated Fund in line with section 2(3) of the *European Communities Act 1972*. This Bill applies to the whole of the UK and will be a considered as a Money Bill in the House of Lords.

The EU Budget is organised around a seven year Financial Perspective which sets out the limits and categories of expenditure over time. The ORD lays out the limits and sources of revenue. The Financial Perspective is formally agreed though the Inter-Institutional Agreement (IIA). In practice, discussions covering the overall shape of the Budget take place at the same time; at a high level revenue and expenditure need to be negotiated together. An annual budgeting process operates within the constraints set out by these agreements. As a result of the Fontainebleau Agreement in 1984, the ORD contains provision for an abatement, or rebate, in favour of the UK.

A new Financial Perspective for 2007-13 was agreed at the European Council meeting in Brussels in December 2005. This provided the political agreement for a new IIA covering 2007-13 and a new ORD. Expenditure will be a maximum of €864 billion (£609 billion) (in commitments) over the period 2007-13, which is equivalent to 1.05% of EU GNI. In cash terms this is higher than the previous period, but lower as a proportion of EU GNI. Around half of cohesion expenditure is expected to be in the new Member States.

The new ORD, which this bill will enforce in UK law, makes two significant changes to the current ORD: it allows for additional provisions to reduce the net contribution of Germany, Austria, the Netherlands and Sweden, and the calculation of the UK abatement is altered so that non-agricultural expenditure in the Member States which joined the EU from May 2004 onwards is progressively excluded from the abatement calculation. The effect of the change to the abatement calculation in respect of enlargement related expenditure is limited to €10.5 billion (£7.4 billion) over the period 2007-13.

UK net contributions will rise over the period 2007-13. Over the period 2000-06, the annual UK net contribution was an average of £3.3 billion. Annual net contributions in 2007-13 are forecast to rise from around £4.7 billion in 2007-09, to between £6.0 and £6.8 billion in the years 2010-2013.

The UK abatement rises if EU expenditure rises (and EU expenditure in the UK rises by less, or falls). The changes to the ORD which exclude non-agricultural expenditure in the accession states mean that, while the UK rebate will rise, it will not rise by as much as it would have under the current arrangements. Some argue that this adjustment means the UK is contributing more fairly towards enlargement-related costs.

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I Introduction

The *European Communities (Finance) Bill* would give effect to the latest Own Resources Decision (ORD) in UK law and allows payments to be made to the EU directly out of the Consolidated Fund in line with section 2(3) of the *European Communities Act 1972*. This Bill applies to the whole of the UK and will be a considered as a Money Bill in the House of Lords.

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A new Financial Perspective for 2007-13 was agreed at the European Council meeting in Brussels in December 2005. This provided the political agreement for a new IIA covering 2007-13 and a new ORD. Key issues during the Council meeting and the negotiations leading up the agreement were the levels of expenditure in new Member States (enlargement-related expenditure), the continuation of CAP expenditure as a significant part of the EU Budget, the level and operation of the UK abatement and the wider issue of high net contributions in some other Member States.

This paper sets out the organisation and levels of EU expenditure and revenue and considers the background to the new ORD. The paper then looks at the Bill itself, followed by the new ORD in detail and its effect on UK contributions. The paper also contains information on a number of related issues, such as the budgetary process and fraud in the EU Budget. An appendix contains additional statistical information and references to further information including previous debates on the issue.

II The EC Budget

A. The financial perspective

The basis for budgeting in the EU is a multi-annual financial perspective (or framework). This sets out expenditure limits in total and for broad headings over a number of years, normally seven. The current financial perspective runs from 2007 to 2013 and was agreed in 2006. The last perspective ran from 2000 to 2006. In addition, there is a budgeting process which runs each year, mapping out final expenditure for the following year within the limits set by the financial perspective. The current financial perspective is set at 2004 prices and an adjustment has to be made each year to take account of price changes.

The official agreement of the financial perspective is known as the Inter-Institutional Agreement (IIA), an agreement between the Commission, Council and European Parliament. The resources (income) side of the Budget is agreed under the Own Resources Decision (ORD).[1] While the IIA is set for a period of years and requires a further agreement before it expires (although there is provision for non-agreement), there is no time limit on the ORD. However, in practice, an overall agreement on the shape of the IIA and ORD for the period of the next financial perspective is generally agreed at the same time by the European Council; it is after this essentially political agreement that the formal IIA and ORD are drawn up for each period.

It should also be noted that technically the Budget for the EU remains the EC (not EU) Budget. Because this Bill deals with the resources side of the Budget only, the two areas are treated separately in this paper.

The following pages set out the sources of revenue and forms of expenditure that exist in the EC Budget.

B. Resources

Member States' financial contributions to the EU are based on the provisions of the Own Resources Decision (ORD). The ORD originates from the 1957 Treaty of Rome, and the current decision was finalised in September 2000, taking effect from 1 January 2002.[2] The *European Communities (Finance) Bill* will implement the new ORD agreed on 7 June 2007 and will apply retrospectively back to 1 January 2007 once approved by all Member States.

Contributions by Member States to the Budget consist of four elements, called 'own resources':[3]

1 Which is a unanimous Council decision following consultation with the European Parliament.

2 Own Resources Decision of 29 September 2000, 2000/597/EC

3 This information is taken from HM Treasury, *European Community Finances : Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement*, May 2007, Cm 7090, see Glossary p31-35. Note the information on the VAT element has been shortened.

- **Customs duties, including those on agricultural products.** These are paid on a range of commodities imported from non-member countries. Following the agreement on agriculture during the Uruguay GATT Round, most agriculture duties are now fixed. However, for some key commodities, they continue to vary in line with changes in world prices.

- **Sugar levies.** These are charged on the production of sugar to recover part of the cost of subsidising the export of surplus Community sugar onto the world market.

- **Contributions based on VAT.** Essentially, the VAT base is the amount yielded by applying a notional rate of 1% to an identical range of goods and services in each Member State. Each Member State's VAT base is currently subject to a cap of 50% of 1% of its GNI (Gross National Income). A call-up rate (set at a maximum of 0.5%) is then applied to the capped VAT base.

- **GNI-based contributions.** The amount due is calculated by taking the same proportion of each Member State's Gross National Income (GNI). Because the Community is not allowed to borrow, revenue must equal expenditure. The GNI resource is the budget-balancing item; it covers the difference between total expenditure in the Budget and the revenue from the other three resources, subject to the overall own resources ceiling.

The first two resources are known as the 'Traditional Own Resources'. The VAT and GNI-based elements are sometimes referred to as the 'Third' and 'Fourth' Own Resources respectively. Member States retain 25% of the customs and sugar duties as collection costs. It should also be noted that the UK's abatement is based on its VAT-based contribution.

Total contributions from Member States may not exceed the overall annual ceiling on own resources established by the ORD. This ceiling is now 1.24% of Community GNI, which is the equivalent of 1.27% of Community GDP. This cap was fixed from 2002. As the Community cannot borrow, the amount of revenue available is effectively limited by this rule. In 2007, Budget expenditure is equal to 1.01% of EU GNI.

The VAT element used to be the largest source of revenue for the Community. However, by the 2001 budget it accounted for only 37% of Member States' gross contributions,[4] whereas fourth resource contributions (including contributions to Community reserves) accounted for 48%. In the 2007 Budget, VAT accounts for 16% of Community Revenue, while GNI accounts for 69% of Community Revenue. It is expected that fourth resource contributions will continue to form the largest single element of revenue for the Community.

Member States pay their contributions for a given Budget year in twelve monthly instalments. The VAT and GNI based contributions can be adjusted as new information becomes available such as outturn figures for GNI. If outturn expenditure is below the

4 HM Treasury, *European Community Finances*, Cm 5173, July 2001

amount raised from Member States, contributions for the following year are adjusted downwards, or in some years excess contributions are refunded in a subsequent Budget. For example, a surplus in the 2005 Budget reduced the contributions required in the 2006 Budget.[5] A more substantial correction occurred for the UK in 2001.

All the above applies to the UK in the same way as it applies to all other Member States. However, the UK's contributions are also subject to reduction through the UK abatement.

1. The UK's abatement

This is calculated according to a formula set out in the ORD in 1988, revised in 1994, and revised again in 2000. It originated from the Council meeting at Fontainebleau in 1984, which replaced annual negotiations to reduce the UK's net contribution with an automatic reduction.

The abatement (or rebate) is approximately 66 per cent of the UK's net contribution to the Budget;[6] calculated by taking the difference between the UK's percentage share of the VAT contributions and UK's percentage share of expenditure, multiplying this figure by 0.66 and then multiplying it by total expenditure. However, this calculation is subject to the following points and exclusions:

- The abatement applies only in respect of allocated expenditure within the Union. Expenditure outside the Union (mainly EU overseas aid), amounting to around six per cent of total EC budget expenditure in 2007, is excluded;
- the UK's contribution is calculated as if the Budget were entirely financed by VAT;
- windfall gains in the abatement calculation caused by the introduction of VAT capping and the GNI resource and gains made from increased collection costs are excluded;
- An amount equal to pre-accession expenditure in the last year it was in place is excluded from the figure for total EU allocated expenditure;
- the abatement is deducted from the UK's VAT contribution a year in arrears.

The cost of the abatement is borne by all other Member States according to a formula set out in the ORD. The cost of the abatement is based on the GNI resource, but Germany, the Netherlands, Austria and Sweden only pay one quarter of their amount due.

The Commission calculates the abatement on the basis of its estimates of the likely outturn for payments from the Budget in-year, and of its estimates of Member States'

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5 European Commission, *Preliminary Draft Amending Budget No. 2 to the General Budget for 2006*, SEC(2006) 490 final, 12 April 2006

6 i.e. difference between what the UK contributes to the Budget and what the UK receives from the it (in terms of EC grants and expenditure in the UK)

contributions to the Budget. This is then corrected in the light of actual outturn figures - both for payments from the budget and for Member States' contributions. Corrections may be made up to three years after the year in respect of which the abatement relates, after which a final reckoning is made in the fourth year. The precise formula for the calculation of the UK abatement is set out in article 4 of the ORD.[7]

The UK abatement in 2007 (in respect of the 2006 contribution) is expected to be £3.5 billion. By the end of 2007, the total abatement made since Fontainebleau in 1984 is expected to be around £54 billion.

In short, the UK's budgetary imbalance reflects the difference between its share of allocated expenditure (about 6% of the 2007 EU budget) and its VAT contribution (about 18% in 2007). Other things being equal, the UK abatement increases if:

(a) the level of allocated Community spending increases,
(b) the UK percentage of uncapped VAT contributions rises,
(c) the UK's share of allocated spending falls,
(d) the advantage accruing to the UK from the system of own resources introduced in 1988 declines (i.e. principally if the size of the Budget and hence the use of the GNI resource falls).

The UK abatement is not popular with other Member States or the Commission and, formally or informally, it is periodically challenged by them. However, it should be noted that any change to the abatement and the ORD requires unanimity in the European Council.

The new financial framework agreed for 2007-13 will change the calculation of the UK's rebate. This is discussed in part IV of this paper.

C. Expenditure

The EU's expenditure breaks down into several broad categories. These are shown below along with the percentage of the total 2007 Budget (expressed as payment appropriations)[8] represented by that line.

- **Sustainable Growth** covers funding to assist regional growth and development (39%). The majority of this relates to what is commonly known as structural funds. The UK benefits from this funding, but a significant focus of the funds over the period 2007-13 is expected to be the new Member States that joined from 2004 onwards.[9]

[7] This section uses Own Resources Decision of 29 September 2000, 2000/597/EC, and HM Treasury, *European Community Finances : Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement*, May 2007, Cm 7090

[8] Two versions of EC Budget are produced; one relates to payment appropriations and the other to commitment appropriations. Commitment appropriations relate to the total cost of legal obligations entered into during the year; Payment appropriations are the amounts of money actually spent during the year (including on commitments in previous years).

[9] Allocations by Member State available at: http://ec.europa.eu/budget/library/documents/multiannual_framework/2007_2013/tab_cohesion_2007-2013_en.pdf

- **Preservation and Management of Natural Resources *(Agriculture)*** is the largest single item of expenditure. This is the main budget line for funding the common agricultural policy (CAP), rural development and fisheries policy (48%);

- **Citizenship, Freedom, Security and Justice** includes funding for culture, youth and public health (1%);

- **The EU as a global player** includes support to the EU's foreign policies and international development. Pre-accession aid is also included here (6%);

- **Administration** (6%);

- **Compensations** which ensure that no new Member States will be a net contributor at the start of their membership. This covers Bulgaria and Romania only (less than 1%).[10]

D. Net contribution by UK

Table 1 below shows UK contributions and public sector receipts to and from the EC Budget in detail for 2000 – 2007.

Table 1 UK Contributions to and public sector receipts from the EU Budget
£ million

		2000	2001	2002	2003	2004	2005	2006	2007
Agriculture and Sugar Levies		303	293	261	255	279	324	308	275
Customs Duties		1,630	1,637	1,029	1,190	1,288	1,428	1,433	1,277
VAT Own Resources		4,104	3,624	2,720	2,776	1,764	1,980	2,164	2,184
Fourth Resource Payments (GNI)		4,245	3,874	5,265	6,629	7,555	8,681	8,357	8,870
VAT and Fourth Resource Adjustments		236	-49	164	116	9	154	165	..
Gross Contributions		10,518	9,379	9,439	10,966	10,895	12,567	12,427	12,606
UK Abatement		*-2,085*	*-4,560*	*-3,099*	*-3,559*	*-3,593*	*-3,656*	*-3,569*	*-3,526*
Total Contributions		8,433	4,819	6,340	7,407	7,302	8,911	8,857	9,079
EAGGF Guarantee	(Agriculture)	2,502	2,482	2,481	2,663	2,737	2,935	2,947	2,627
EAGGF Guidance		82	25	..	2	50	80	51	40
ERDF	(Structural Funds)	989	543	296	621	1,062	1,403	591	990
ESF		659	370	412	427	433	899	1,331	623
Other Receipts		10	10	13	15	12	13	27	101
Total Public Sector Receipts		4,241	3,430	3,201	3,728	4,294	5,329	4,948	4,380
Net Contribution		**4,192**	**1,389**	**3,138**	**3,679**	**3,008**	**3,581**	**3,909**	**4,699**

Note: 2007 figures are forecast

Source: HM Treasury, *European Community Finances,* latest edition published May 2007, Cm 7090

In 2007, private sector receipts from the EC are expected to be £520 million.[11]

[10] HM Treasury, European Community Finances : Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement, May 2007, Cm 7090, p8-10
[11] Ibid., p16

Table 4 in Appendix 1 of this paper sets out the UK's overall contributions and receipts to and from the EU Budget from 1973 to 2007.

The average net contribution over the period 2000-06 was £3.3 billion.

E. The December 2005 European Council

As the 2000-06 financial perspective came to an end, it was necessary for the European Council to come to an agreement over the shape of the Budget for 2007 onwards.

The Commission produced detailed proposals for the new budget in July 2004, including increasing the total budget to 1.14% of EU GNI (for payment appropriations). Luxembourg, which held the EU Presidency in the first half of 2005, produced revised proposals as part of the negotiating process that included a lower level of expenditure than proposed originally by the Commission. An agreement on the financial framework was made at the European Council meeting in Brussels on 15-16 December 2005 under the UK Presidency.

The abatement was a key issue during the discussions. The original Commission proposals suggested replacing it with a 'generalised rebate mechanism' whereby all significant contributors to the budget would be eligible for a reduction in their contribution. The Luxembourg Presidency suggested 'freezing' the rebate at current levels; at the same time the UK sought to link reform of the abatement to reform of agriculture policy.

A new financial framework for 2007-13 was agreed at the December European Council meeting. The UK Presidency had put forward proposals for lower overall expenditure than in the Luxembourg proposal, and a change to the abatement mechanism relating to expenditure in accession States. The main points of the agreement are set out below (all figures are in 2004 prices): [12]

- Maximum figure for EU27 expenditure of €862,363 million (in commitments) over the period 2007-13, which is equivalent to 1.045% of EU GNI.
- Competitiveness for Growth and Employment (heading 1A) allocated €72,120 million (8.4%).
- Cohesion for Growth and Employment (structural funding, heading 1B) allocated €307,619 million (35.7%).
- Preservation and Management of Natural Resources (including agricultural market related expenditure and direct payments, heading 2) allocated €371,244 million (43.0%).
- Citizenship, freedom, security and justice (heading 3) allocated €10,270 million (1.2%).
- EU as a global player (heading 4) allocated €50,010 million (5.8%).
- Administration (heading 5) allocated €50,300 million (5.8%).
- Compensations (heading 6) €800 million (0.1%).

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[12] Council of the European Union, *Financial Perspective 2007-13*, 19 December 2005, 15915/05 CADREFIN 268

- The Revenue side of the budget, covered by the Own Resources Decision (ORD), to be modified to allow for a lower rate of call on the VAT resource, reductions in GNI contributions for the Netherlands and Sweden and an adjustment to the UK rebate.
- The UK Rebate to remain, but to be reduced over the period to take account of enlargement related expenditure except for CAP related expenditure in these countries. This adjustment to be made by reducing the level of total allocated expenditure used in the calculation of the rebate; the change to be phased in over time and progressing to take full account of enlargement-related expenditure in 2011-13. The total additional contribution from the UK will not be more than €10.5 billion (£7.4 billion).[13]
- A full review of EU spending and resources by the Commission to report in 2008/09.

Press reaction to the agreement was mixed. The *Financial Times* thought that an increased contribution due to enlargement was fair, but criticised the agreement for having achieved no substantial reform of EU spending.[14] *The Economist*, while accepting that the deal achieved may have been the best that could have been done, and that the UK contributions had to increase to pay for enlargement, found that as agricultural policy remained unadjusted, too much of the rebate had been lost for too little reform.[15] *The Guardian* found a number of positive outcomes from the agreement.[16] Other papers, such as *The Daily Telegraph* were more critical of the deal, focusing on the reduction in the rebate.[17]

F. The 2007-13 IIA

The agreed financial perspective was formalised by a new IIA, which was signed by the Council, Commission and Parliament on 17 May 2006.[18]

In a letter to the European Scrutiny Committee, the then Minister for Europe, Douglas Alexander, highlighted the main points of the agreement compared to the December 2005 agreement and subsequent draft by the Commission, and noted the proposed IIA was acceptable to all Member States:

> 4.5 The Minister highlights four elements:
>
> - an overall FP ceiling of €864.30 billion (£601.88 billion), €2.00 billion (£1.39 billion) more than the agreement reached by the European Council ... A further €2.00 billion (£1.39 billion) of expenditure will be possible outside the FP — including €1.50 billion (£1.04 billion) in the Emergency Aid Reserve to be called up from Member States if needed;

13 Using market exchange rates at close on 13 November 2007
14 "Blair's budget gamble", Leader page, *Financial Times*, 19 December 2005
15 "Brussels fudge", Leader page, *The Economist* 24 December 2005
16 "EU budget: A bigger achievement than it seems", Leader page, *The Guardian*, 19 December 2005
17 "Blair will pay for his betrayal in Brussels", Leader page, *The Daily Telegraph*, 19 December 2005
18 See Commission Press Release IP/06/645: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/645&format=HTML&aged=0&language=EN&guiLanguage=fr

> - no change to the existing amounts allocated to flexibility mechanisms, including the European Union Solidarity Fund, the annual flexibility instrument and the Emergency Aid Reserve, to the existing decision making procedures to activate these instruments and to the 5% margin on the reference amounts governing multi-annual programmes. In addition, the Globalisation Adjustment Fund is established;
> - inclusion of a Part III on various issues, including the Financial Regulation governing financial management, the creation of EU agencies, certification of Member State spending and financial programming; and
> - a separate declaration on the 2008/9 review of the budget.
>
> 4.6 The Minister says that the Government joined the consensus in favour of the revised draft IIA as the "text maintains the essential elements of the agreement reached by the European Council". Additionally the Minister tells us that none of the text of Part III changes the fundamental institutional balance between the arms of the Budgetary Authority, that is the Council and the European Parliament, and that some of it, such as that on certification, should lead to an improvement in the Community's financial management.[19]

The purpose of the financial framework is to ensure that 'in the medium term, European Union expenditure, broken down by broad category, develops in an orderly manner and within the limits of own resources.'[20]

The IIA has three parts:

- Provisions for the multi-annual financial framework 2007 to 2013.
- Provisions for Interinstitutional collaboration during the budgetary procedure.
- Provisions relating to the financial management of EU funds.[21]

The IIA includes provisions for a European Globalisation Adjustment Fund of up to €500 million a year to be funded from unspent funds in previous years. The IIA also includes a declaration that the Commission will undertake 'a full, wide ranging review covering all aspects of EU spending, including the Common Agricultural Policy, and of resources, including the United Kingdom rebate, and to report in 2008/2009.'[22]

Table 3 in the appendix sets out the agreed expenditure in the IIA.

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19 European Scrutiny Committee, *Twenty-Sixth Report of Session 2005-06*, HC34-xxvi
20 ibid. paragraph 10
21 *Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management*, OJ 2006/C 139/1, 14 June 2006
22 ibid. declarations annex.

III The Bill

The *European Communities (Finance) Bill* is a short bill which gives effect to the new ORD in UK law.[23]

A. The need for legislation

A formal Council Decision on financing the budget (the ORD) requires approval in each Member State 'in accordance with their respective constitutional requirements' as set out in Article 269 of the EC Treaty, which states:

> Without prejudice to other revenue, the budget shall be financed wholly from own resources.
>
> The Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament, shall lay down provisions relating to the system of own resources of the Community, which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.[24]

The ORD changes EC Treaty rules and resembles a treaty more than an item of EC legislation. It is not strictly speaking a treaty, but in practice the procedure is similar to that used for treaty ratification. The adoption of the ORD initially follows a legislative process at EU level. It is agreed by the Council on the basis of a Commission proposal and after consulting the European Parliament. However, the wording of Article 269 is different from that used to describe the procedure for the ratification of Treaty amendments in Article 48 of the *Treaty on European Union*. Whereas the latter requires 'ratification' by Member States, the ORD Decision is 'recommended' for 'adoption' by Member States. The Article 269 procedure is unusual, comparable in the EC Treaty only to the procedure used for the "Act concerning the election of the members of the European Parliament by direct universal suffrage" (and the annexed Decision). Any Council Decision modifying that Act and the ORD needs to be transposed into national law, and this is often referred to as 'ratification'.

The ORD goes through the EU scrutiny process in both Houses and then requires legislation in the form of a European Communities (Finance) Bill to give it legal effect. The legislation provides for Section 1(2) of the *European Communities Act 1972* (ECA) to be amended to add the ORD to the list of European Community treaties and decisions to be enforced in the UK. This legislative procedure has been followed for successive ORD decisions, with each new Act repealing the previous Act and providing for any financial obligations incurred under it to be met directly from the Consolidated Fund.

23 *European Communities (Finance) Bill*; Explanatory Notes

24 *Treaty Establishing the European Community* (TEC)

B. What the bill does

The Bill itself has two clauses; **Clause 1** adds the new ORD to the list of Treaties in section 1(2) of the European Communities Act 1972 (ECA), which allows payments made by the UK in relation to the ORD to be charged directly on the Consolidated Fund under section 2(3) of the ECA. **Clause 2** repeals the *European Communities (Finance) Act 2001* as the wording in clause 1 of the new act supersedes the wording added to the 1972 ECA by that act.

These are essentially technical measures, giving legal effect to the ORD. The bill does not replicate the Council Decision itself, but merely adds it to the list of Community Treaties for the purpose of its enforcement under the ECA. Neither does the bill refer to European Council agreements on the budget or the financial perspective, which are expressed in Presidency Conclusions and are politically, rather than legally, binding.

The ORD is designed to be legally binding once all the Member States have notified the Council of Ministers that they have carried out their respective constitutional requirements. In the case of the UK this means the passage of legislation. Failure to adopt the ORD by one or more Member States would delay or prevent its implementation.

C. Consequences of non-approval

If any Member State fails to approve the new ORD the current ORD will continue to operate. Unlike the IIA, the ORD has no end date and can run indefinitely. However, in practice, the agreement over the expenditure and revenue sides of the budget going forward are done together, and are therefore part of an overall political deal. Non-approval of the ORD would be expected to have political costs.

The new ORD also has a provision that it is effective from 1 January 2007 (and is backdated). If approval of the ORD is delayed, any Member State who expected their contributions to rise due to the new ORD would have a larger amount to pay when the ORD was finally approved.

IV The new Own Resources Decision (ORD)

This section of the paper explains each part of the new ORD and the changes compared to the ORD currently in force.[25]

The formal ORD was agreed (though a council decision) on 7 June 2007. The main changes to the ORD are:

- A reduction in the call up rate for VAT contributions to 0.3%, thereby increasing contributions based on GNI;
- A further reduction in the call up rate for VAT contributions (applicable rate in brackets) for Germany (0.15%), Austria (0.225%), the Netherlands (0.1%) and Sweden (0.1%) for the period 2007-13 only.
- A reduction in GNI based contributions for the Netherlands and Sweden of €650 million and €150 million per year respectively for the period 2007-13 only.
- Non-agricultural enlargement related expenditure will be progressively removed from the calculation of the UK rebate with the cost to the UK limited to €10.5 billion over the period 2007-13; this change will be phased in from 2009.
- The changes to the ORD will be backdated to 1 January 2007 when approved by all Member States.

Each article in the new ORD is examined in more detail below and any major alterations are indicated.

Article 1 of the ORD sets out the Treaty basis of the ORD, and that EU expenditure shall be wholly financed from own resources.

Article 2 sets out the four areas of revenue which form the Own Resources: Customs duties, sugar levies, VAT based contributions and a GNI based contribution. Collection costs relating to customs duties remain at 25% (Article 2(3)). The call up rate for the VAT resources will be 0.3% for the period; this is a reduction from 0.75% in 2002 and 2003, and 0.5% from 2004 onwards. For the period 2007-13 only, Austria, Germany, the Netherlands and Sweden have reduced call-up rates of 0.225%, 0.15%, 0.1% and 0.1% respectively. Under part 4 of the article there is a simplification of the calculation used for VAT based contributions where the 'uniform rate' has been replaced by a 'constant rate of call'. This is not expected to have a significant effect.

The method of calculating the GNI resources remains the same, however the Netherlands and Sweden will benefit from additional reductions in their annual GNI-based payments of €650 million and €150 million respectively (in 2004 prices).

Article 3 sets out the limit for expenditure funded by Own Resources each year: 1.24% for payment appropriations and 1.31% for commitment appropriations. This indicates the

[25] Current ORD: Own Resources Decision of 29 September 2000 (2000/597/EC) Proposed ORD: Own Resources Decision of 7 June 2007 (2007/436/EC)
This section also uses the explanatory notes published with the Bill and the Explanatory Memorandum submitted to the European Scrutiny Committee on 18 April 2006 on the draft ORD.

total limit for EU expenditure as the EU is unable to borrow. These limits are unchanged from the current ORD. Planned expenditure will continue to be well below these limits.

Article 4 concerns the UK correction or abatement. This article sets out the method to be used in calculating the UK rebate, which is used by the Commission to prepare a working paper on the operation of articles 4 and 5 of the ORD.[26] This article sets out the workings as described in part II.B.1 of this Research Paper. However the following changes are made:

- Equivalent amounts of non-abatable pre-accession expenditure continue to be removed from the calculation of the UK abatement after a country has acceded. However, Article 4.1(f) of the new ORD notes that this will no longer be included in the calculation from 2014 onwards.
- Non-agricultural expenditure in countries which have acceded to the Union after 30 April 2004 will be progressively excluded from the abatement calculation. This expenditure has been defined as 'enlargement related expenditure'. This has the effect of reducing the UK rebate (as any increase in EU expenditure increases the abatement). This change is to be phased in from 2009 onwards, with 20% of enlargement related expenditure excluded from the calculation in 2009, 70% excluded in 2010, and 100% excluded from 2011 onwards (Article 4.1(g)).
- The additional contribution from the UK that will arise from the change to the abatement calculation to include enlargement related expenditure will be limited to €10.5 billion (in 2004 prices) over the period 2007-13 (Article 4.2). If there are any further enlargements over the period this limit will be adjusted upwards accordingly.

Article 5 details how the cost of the UK correction is paid by other Member States. This is paid by Member States based on GNI contributions and is in addition to the calculation of the four own resources. All Member States, including those that have acceded since 2004 will pay a share according to their GNI. The calculation is made before the reductions in GNI payments given to the Netherlands and Austria, but the provision made in the 2001 ORD for Germany, Austria, the Netherlands and Sweden to pay only one quarter of the calculated abatement contribution continues.

Articles 6 and 7 have been shortened and set out that the resources provided by the ORD shall be used 'without distinction' to finance all expenditure within the Union and that any annual surplus shall be carried over to the following year. The reference to the 'Monetary Reserve' has been removed as this no longer exists, while the 'Loan Guarantee Fund' and 'Emergency Aid Reserve' have been moved to a different heading within the Budget and no longer require a provision in the ORD.

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26 Commission Working Document on calculation, financing, payment and entry in the budget of the correction of budgetary imbalances in accordance with articles 4 and 5 of the council decision on the system of the EU's own resources (2000 version) and Commission Working Document on calculation, financing, payment and entry in the budget of the correction of budgetary imbalances in favour of the United Kingdom ("the UK correction") in accordance with Articles 4 and 5 of Council Decision 2006/xxx/EC, Euratom on the system of the European Communities' own resources (2007 version)

Article 8 has been streamlined to take account of the views of the ECA over the way the ORD dealt with Treaty provisions.

Article 9 has been revised and now states that in the framework of a full, wide-ranging review of all aspects of EU spending, including CAP and the UK's abatement, the Commission will undertake a general review of the Own Resources System and report in 2008/09. In the 2001 ORD, the article asked for a review of the Own Resources System by 1 January 2006.[27]

Articles 10 and 11 provide for the new ORD to enter into force. Any references to previous ORDs should also point to this one, while provisions are made for VAT resources and collection costs to be applied at the correct rate according to the ORD in force at the time (in other words revisions relating to previous years will continue to be based on the ORD used at the time). The new ORD, once approved by all Member States, shall enter into force on the first day of the month after the last notification of approval was received by the Council. However, once in force, the ORD will apply from 1 January 2007 onwards. The cost of backdating this agreement, if approved by 1 January 2009 will be small, as it will involve the extra provisions made to Germany, the Netherlands, Austria and Sweden being borne by other Member States.

A. Effect on UK contributions 2007-13

The agreement of a new IIA and ORD means that UK contributions will rise over the period; the IIA increases nominal expenditure levels (although the proportion of GNI is lower than in the previous financial perspective), while the new ORD means the UK rebate is lower than it would have been if the current ORD had continued to apply. The agreement of this ORD attempted to resolve two key issues in the negotiations: dealing with the high net contributions of Germany, Austria, the Netherlands and Sweden; and secondly, addressing the issue of the rising UK rebate. The rebate calculation means that any increase in EU expenditure that does not increase expenditure in the UK will increase the size of the abatement. Because enlargement meant that EU expenditure rose, particularly to meet cohesion spending in accession States, the UK would have contributed less than other Member States to this rise if the existing ORD was used. This was perceived as being unfair by other Member States, and by the UK Government who accepted the need to contribute towards the cost of enlargement.

The forecast contributions to the EU Budget under the December 2005 agreement were set out in a PQ in January 2006:

> **Mr. Ivan Lewis** *[holding answer 9 January 2006]:* Based on the European Commission's forecasts and assumptions, and using the Financial Perspective table agreed on 17 December 2005, Treasury estimates for the UK's gross contribution to the EC budget, the abatement, UK receipts and the UK net contribution to the EC budget are:

[27] European Commission, *Financing the European Union: Commission report on the operation of the own resources system*, 14 July 2004, COM (2004) 505

	Gross contribution before abatement	Abatement	Receipts	Net contribution
				£ billion 2004 prices (payments)
2007	-14.2	3.9	5.6	-4.7
2008	-14.6	4.6 / 4.7	5.2	-4.6 / -4.7
2009	-13.7	4.8 / 4.9	4.2	-4.6 / -4.7
2010	-14.4	3.8 / 3.9	4.6	-6.0 / -6.1
2011-13	-14.1 / -14.5	3.5 / 4.1	4.2	-6.0 / -6.8

As the Prime Minister said in his statement to the House on 19 December, while the UK's net contribution will rise over the next financing period compared to 2000–06, France and Italy's contribution will rise twice as fast. The abatement will also rise, not fall.

The UK's actual financing share, receipts and abatement are all dependent on a number of variables, including the actual rate of spending in each policy area in each member state, and the pound-euro exchange rate.[28]

This PQ answer was based on the December 2005 Council agreement between Member States which set a maximum figure for EU27 expenditure of €862.4 billion (in commitments) over the period 2007-13, which is equivalent to 1.045% of EU GNI.[29] The final IIA provided for expenditure €1.9 billion higher (1.05% of EU GNI).

The cost to the UK of the change in the rebate mechanism is limited to €10.5 billion (£7.4 billion at current exchange rates) over the seven year period; the impact in the first three years is limited, but increases to £1.6 billion - £1.9 billion per year in the financial years 2010-11 to 2012-13.[30]

The net contribution of the UK over the period 2000-06 was £22.9 billion. According to the PQ above (HC Deb 31 January 2006 c399W), and taking the mid-range of the estimates of the net contribution, the net contribution over the period 2007-13 is likely to be around £39.3 billion (in 2004 prices). The difference between the two seven year periods is £16.4 billion, or £2.3 billion per year (although actual levels of contributions are not constant and vary between years; the calculation is also based on 2004 prices).

UK contributions are rising for a number of reasons, including: the overall size of the budget (in cash terms) is higher, UK receipts are falling over the period of this financial perspective and the changes to the ORD (the calculation of the UK abatement). The change to the abatement is accounting for up to £7.4 billion of the increase.[31]

It is also worth noting that receipts from the abatement are likely to be higher in the period 2007-13 compared with 2000-06. Using the mid-point of the ranges in the PQ data again and the table in part II.D of this paper, the rebate in 2000-06 totalled £24.1

[28] HC Deb 31 January 2006 c399W
[29] Council of the European Union, *Financial Perspective 2007-13*, 19 December 2005, 15915/05 CADREFIN 268
[30] HC Deb 20 December 2005 c2796W
[31] At current exchange rates

billion (an average of £3.4 billion a year), while in 2007-13 it is expected to be £28.7 billion (an average of £4.1 billion a year).

Updated figures on future contributions (in financial years rather than calendar years) were published in the recent Pre-Budget Report. The table below shows net contributions up to 2011, along with total Government expenditure and the Budget contributions as a percentage of overall expenditure.

Table 2 - Net contributions in financial years 2006-2011
£ billion

	2006-07	2007-08	2008-09	2009-10	2010-11
Net contribution to EC Budget	3.5	5.0	4.1	5.7	6.5
UK Total Managed Expenditure (TME)	550.1	589.2	617.4	646.6	678.3
Net contribution as % of TME	0.64	0.85	0.66	0.88	0.96

Note 2006-07 are outturn figures, 2007-08 are estimates, 2008-09 are projections

Source: HM Treasury, *2007 Pre-Budget Report and Comprehensive Spending Review*, October 2007, Cm 7227, Table B11

Following a referral to debate by the European Scrutiny Committee,[32] the draft ORD was discussed alongside the new IIA on the floor of the House on 8 May 2006. The then Minister for Europe, Geoffrey Hoon, said:

> […]
>
> The budget agreed in December has four key elements. First and crucially, it supports economic development in central and eastern Europe—a cause that the United Kingdom has consistently championed, and for which we should rightly pay on the same basis as others. The agreement provides an unprecedented transfer of receipts to the poorest member states of central and eastern Europe. Such transfers will provide the basis for economic development in those member states, making them and the EU more prosperous. Secondly, the rebate remains on all expenditure except economic development in the new member states. Thirdly, the total rebate over the next financial perspective will actually be larger than in the current period.
>
> Fourthly, the December agreement is fair. For the first time in the history of our membership of the EU, we have rough parity with France and Italy in terms of net contributions. I repeat: at every stage of the negotiation, this Government made it clear, here and in Brussels, that the UK abatement remains fully justified because of our disproportionately low level of EU receipts. Without the abatement, the UK would have paid, net, 10 times as much as Italy and 13 times as much as France over the last decade. It is therefore absolutely right that under the agreement reached in December, the UK abatement remains and will in fact be worth more than in the current budgetary period.
>
> It is also important, however, that the UK pays its fair share of the costs of enlargement in return for the economic, political and social benefits that

[32] European Scrutiny Committee, Twenty-Sixth Report of Session 2005-06, HC34-xxvi

enlargement brings. That is why we agreed that spending on economic development in the new member states could gradually be disapplied from the abatement calculation from 2009. But we were also clear that the UK would not pay more than its fair share, which is why the UK abatement will be applied in full on all expenditure in the 15 original member states, and on CAP expenditure everywhere in the EU.

Overall, under the December agreement, the UK will go from paying two and a half times more than France and Italy over the last decade to paying roughly the same, net, as those countries as a proportion of national income, for the first time since we joined the EU. That is a good and fair result for the UK and, indeed, for our EU partners. Agreement on the budget deal is only the beginning of a process to ensure that the EU has a more rational and logical budget that more effectively supports the EU's longer-term aims. This Government's arguments in favour of budget discipline have resulted in agreement to an effective and controlled budget that focuses on the EU's priorities. Overall, expenditure as a share of EU income will fall to some 1 per cent. by 2013—the lowest level in 20 years. Yet within this disciplined budget, sufficient funding is guaranteed across the range of the Union's priorities, such as competitiveness, research and development, freedom, security and justice, and development assistance. […] [33]

[33] HC Deb 8 May 2006 c92-3

V Budgetary Procedure and Other Issues

A. Annual Budgetary Procedure

The financial perspective provides the long term basis for the EU Budget. An annual process involving the Commission, Council and European Parliament sets the annual budget. This annual process is detailed below.[34]

Each year a preliminary draft budget (PDB), which reflects the constraints contained in the financial perspective, is prepared by the Commission. The PDB is put together following an internal procedure where spending departments put forward plans for expenditure. There are also three-way discussions between the Parliament, Commission and Council on the likely priorities of each party for the forthcoming budget. The PDB for the forthcoming year is submitted to the Commission by the Budget Directorate-General in April, adopted by the Commission in early May and is sent to the budgetary authority (the Council and European Parliament) in May/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 budgetary procedure, and the steps the Council and Parliament take, are set out in Article 272 of the EC Treaty.

The Council conducts its first reading of the PDB, normally following discussions by the budgetary committee and COREPER (the committee of Permanent Representatives of the Member States). The draft budget is then adopted by the Council by QMV by 31 July. A trialogue meeting between the three institutions also occurs to discuss compulsory expenditure.

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.[35] Proposed modifications to compulsory expenditure (most expenditure on agriculture 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 third 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.

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[34] For further information see: http://ec.europa.eu/budget/budget_detail/deciding_en.htm

[35] 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 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.

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 be implemented on 1 January.

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 or amending budget is then submitted. These are subject to the same rules and procedures described above. A number of amending budgets are issued during the year; these can include amending budgets which return surpluses for previous years to Member States through reduced contributions.

The annual Budget is subject to the European scrutiny process in the UK, and a debate is normally held in a European Standing Committee on the preliminary draft budget.

There are revisions to the Treaty basis of the EU Budgetary Process, financial framework and ORD in the proposed EU Reform Treaty[36]

B. Auditing the Budget

An issue that is regularly raised is the control of expenditure within the EU Budget.

The European Court of Auditors (ECA) is responsible for the external audit of EU institutions. It is required, under the EC Treaty, to submit an annual report to the European Parliament and Council on the implementation of the Community budget. The latest report, covering 2006, was published on 13 November 2007.[37]

The report includes a 'Statement of Assurance' each year covering the reliability of the accounts and the legality of the underlying transactions. The Statement of Assurance was introduced in 1992 and was first used with the 1994 accounts. The statement of assurance was a change introduced in the Maastricht Treaty in 1992. In 1994 the ECA did not provide a full positive statement of assurance.[38] The accounts have not been given a full positive statement of assurance since then. It is important to note that this report highlights errors and problems, which do not necessarily constitute fraud.

The annual European Anti-Fraud Office (OLAF) report, *Protection of the financial interests of the Communities - fight against fraud*,[39] examines the action taken by national authorities and the Commission to prevent and fight against economic and financial crime. OLAF was established in 1999 and aims to protect the interests of the European Union, to fight fraud, corruption and any other financial irregularities, including

36 Draft Treaty amending the Treaty on European Union and the Treaty establishing the European Community, 5 October 2007

37 European Court of Auditors, *Annual Report concerning the year financial year 2006*, 13 November 2007. A summary and press release, as well as previous reports, are available online at: http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/annualreports

38 HM Treasury, *European Community Finances*, Cm 3350, July 1996

39 European Commission, *Protection of the financial interests of the Communities - fight against fraud-Commission's annual report 2006*, 6 July 2007, COM (2007) 390

misconduct within the European Institutions. An activity report covering the operation of OLAF in 2006 and the previous five years is available.[40] Further information is also available on the organisation from their website.[41]

The annual OLAF report, required by the Amsterdam Treaty, considers the Community's legislative and regulatory activity, measures taken by Member States and a statistical analysis of the irregularities identified. The number of irregularities notified to the Commission decreased in 2006 compared to 2005 (by 0.3%) but the total amount affected rose (by 11.5%). It is important to note that an irregularity is not necessarily fraud; most are the result of simple non criminal errors. The report provides the following statistics on fraud and irregularity reported by Member States, including the new Member States from 2004, in areas of revenue and expenditure:

- **Own Resources**, which covers duties collected for the EU; irregularities increased 7% to €353 million; the number of cases fell by 12%. In the UK, the number of cases increased by 28% (to 882 cases) and the amounts affected increased by 5% (to €61 million). In terms of the EU overall, the Commission notes: "The increase in the total number of cases since 2003 can be accounted for by an increase in the number of cases reported by the Member States, the inclusion of transit operations discharged late and the accession of new Member States. The number and proportion of transit operations cleared late has fallen compared with 2005 (by over a third).
  The goods most affected by irregularities in 2006, as in previous years, are tobacco products and TVs. The figures for sugar, fish, glass and glassware and optical instruments were down on 2005, whereas meat, engines and parts, inorganic products and oils and fats were all up. The textile sector remained relatively stable, involving €10.3 million in duties."[42]
- **EAGGF Guarantee** (Agriculture funding) decreased 17% to €87 million in 2006. €87 million represents 0.17% of the EAGGF budget for 2006. 311 of the 3,249 cases reported in 2006 were in the UK, with a value of €3.9 million.
- **Structural Funds** increased 17% to €703 million. The number of cases decreased from 3,750 to 3,216. In the UK, 223 cases were identified, with a value of €60 million.[43]

Across the areas above, and also including pre-accession funding, there were 12,092 cases of irregularities reported in 2006, with a value of €1,155 million. Suspected fraud within that total was estimated to be €323 million.[44]

These EU documents are assessed within Parliament and by the National Audit Office (NAO) each year. The Treasury comment on fraud reports in their annual publication on

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40 *Report of the European Anti-Fraud Office: Seventh Activity Report for the period 1 January 2006 to 31 December 2006*

41 http://www.europa.eu.int/comm/anti_fraud/index_en.html

42 European Commission, *Protection of the financial interests of the Communities - fight against fraud-Commission's annual report 2006*, 6 July 2007, COM (2007) 390, p6

43 Ibid., see 2nd Annex to the report, *Statistical Evaluation of Irregularities - Agricultural, Structural and Cohesion Funds and Own Resources - Year 2006*

44 Ibid., main report, p5-6

the EU Budget. The ECA and OLAF (previous report) documents were debated in European Standing Committee B on 26 February 2007.

The reform of financial management in the EU has been a topic of discussion within the EU in recent years, with concerns raised regarding the continued qualification of the annual accounts. The Commission published an 'action plan' for improving financial control in 2006.[45] One of the key issues within the discussion about reform of the auditing system was a national statement of assurance by Member States covering expenditure in their own country, for which they are partly responsible. ECOFIN was unable to agree on this matter; but following the publication of the 2006 ECA report, the then Economic Secretary to the Treasury, Ed Balls, set out in a written statement the Government's intention to annually lay before Parliament a statement on the UK's use of EU funds. The statement will be audited by the NAO and made available to the Commission and ECA.[46] Further information was given in the latest Treasury publication on the Budget.[47]

C. House of Lords reports

The House of Lords European Union Committee has produced a number of reports of interest relating to the EU Budget and Own Resources. Links to the relevant reports are given below:

- *The 2008 EC Budget*, 33rd Report of Session 2006-07, HL Paper 160, 30 July 2007
- *Funding the European Union*, 12th Report of Session 2006-07, HL Paper 64, 14 March 2007
- *Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals*, 50th Report of Session 2005-06, HL Paper 270, 13 November 2006. Responses to the report are also available.

The Committee also intends to look at the Government Response to the 2008/2009 EU Budget Review.[48]

D. 2008/09 review

As agreed in the December 2005 European Council, officially noted in the 2007-13 IIA and in the new ORD, the Commission has started the process of undertaking a review of EU expenditure and revenue, including the CAP and UK rebate.

This process started with the publication of a public consultation paper by the Commission on 12 September 2007.[49] Further information is also available on the

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45 European Commission, *Communication from the Commission to the Council, the European Parliament and the European Court of Auditors: Commission action plan towards an integrated internal control framework*, COM (2006) 9 final, 17 January 2006

46 HC Deb 20 November 2006 c13-4WS

47 HM Treasury, *European Community Finances : Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement*, May 2007, Cm 7090, p24-5

48 See: http://www.parliament.uk/parliamentary_committees/s_comm_a.cfm

Commission website for the budget review.[50] The deadline for submissions is 15 April 2008.

In the introduction to the review it noted that:[51]

> The budget review is a unique opportunity for a thorough assessment of the EU budget and its financing, free from the constraints of a negotiation on a financial framework. It will take a long time horizon, to see how the budget can already be shaped to serve EU policies and to meet the challenges of the decades ahead. It will therefore not propose a new multi-annual financial framework for the period from 2014 – this task will be for the next Commission – nor the overall size and detailed breakdown of the EU budget. It will rather set out the structure and direction of the Union's future spending priorities, assessing what offers the best added value and most effective results. It will also examine how the budget works, how to get the right balance between continuity and responding to new challenges, and whether it should be managed differently. Finally, the review will take a fresh look at the best way of providing the resources necessary to fund EU policies.

The aim of the paper is to launch a consultation with interested parties at a local, regional, national and European level. Alongside this consultation the Commission will also review each of the major spending areas and use this to inform their work. According to the paper they have also launched a number of studies with the help of academics on policy areas.[52]

In the area of resources, the Commission asks for feedback on the principles that should underpin the revenue side of the budget and how this should translate into the Own Resources system; whether there is any justification for maintaining the current system of corrections and compensations; and how the financing of the budget should relate to citizens and policy priorities.[53]

The Government commented on their likely approach to the review in May:

> […] With 40% of the total EC Budget still being spent on the CAP, and with more than 60% of Structural and Cohesion Fund expenditure still being directed to rich Member States, the UK will continue to argue that this is hardly a Budget designed to meet the challenges of the 21st century. The UK will therefore argue that the following principles should guide the Review:
>
> First, that the EU should act only where there are clear additional benefits from collective efforts compared to action solely by individual Member States, the aim being to advance the UK's and the EU's public interest together. Applying this principle means that there is a strong case for budgetary assistance to less well-off Member States, helping them make the infrastructure and institutional investments needed to support their economic growth, in turn helping to develop the wider European economy.

[49] European Commission, *Reforming the Budget, Changing Europe: A public consultation paper in view of the 2008/2009 Budget Review*, 12 September 2007, SEC (2007) 1188
[50] http://ec.europa.eu/budget/reform/index_en.htm
[51] p.2
[52] p.3
[53] p.13

Second, where EU-level action is appropriate, it should be proportionate and flexible. While there is a clear case for European spending on some objectives, it must be recognised that there are very real limits to the case for European budgetary intervention. Expenditure is only one of a range of policy levers alongside: coordination through peer review and shared best-practice, such as in aspects of social policy; competition policy and liberalisation, such as in the Single Market; and legislation or regulation, such as the setting of environmental emission levels. Where expenditure is appropriate, we will also encourage the consideration of a wide range of other sources of financing. The European Investment Bank, for example, is pioneering the use of loan support to aid the development of climate change financial instruments, such as the Climate Change Finance Facility.

Third, the EU needs the highest standards of financial control and independent audit - alongside continuing budget discipline.[54]

[54] HM Treasury, *European Community Finances : Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement*, May 2007, Cm 7090, Box 2.1

Appendix 1 - Statistical Appendix

Table 3 - Agreed IIA - Financial Framework 2007-2013
Commitment Appropriations (euros million, 2004 prices)

	2007	2008	2009	2010	2011	2012	2013	Total 2007-13
1. Sustainable Growth	51,267	52,415	53,616	54,294	55,368	56,876	58,303	382,139
1a. Competitiveness for Growth and Employment	8,404	9,097	9,754	10,434	11,295	12,153	12,961	74,098
1b. Cohesion for Growth and Employment	42,863	43,318	43,862	43,860	44,073	44,723	45,342	308,041
2. Preservation and Management of Natural Resources	54,985	54,322	53,666	53,035	52,400	51,775	51,161	371,344
of which: market related expenditure and direct payments	43,120	42,697	42,279	41,864	41,453	41,047	40,645	293,105
3. Citizenship, freedom, security and justice	1,199	1,258	1,380	1,503	1,645	1,797	1,988	10,770
3a. Freedom, Security and Justice	600	690	790	910	1,050	1,200	1,390	6,630
3b. Citizenship	599	568	590	593	595	597	598	4,140
4. EU as a global player	6,199	6,469	6,739	7,009	7,339	7,679	8,029	49,463
5. Administation	6,633	6,818	6,973	7,111	7,255	7,400	7,610	49,800
6. Compensations	419	191	190					800
Total Commitment Appropriations	120,702	121,473	122,564	122,952	124,007	125,527	127,091	864,316
as a percentage of GNI	1.10	1.08	1.07	1.04	1.03	1.02	1.01	1.05
Total Payment Appropriations	116,650	119,620	111,990	118,280	115,860	119,410	118,970	820,780
as a percentage of GNI	1.06	1.06	0.97	1.00	0.96	0.97	0.94	1.00
Margin available (%)	0.18	0.18	0.27	0.24	0.28	0.27	0.30	0.24
Own Resources Ceiling as a percentage of GNI	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24

Source: Agreed IIA OJ 2006 C 139/1

Table 4 - UK net contributions to the EC Budget 1973-2007
£ million

	Gross contribution	Negotiated refunds	Abatement	**Total contribution (after abatement and refunds)**	Public sector receipts	**Net Contribution** *(Gross contribution - refunds and abatement - public sector receipts)*
1973	181			**181**	79	**102**
1974	181			**181**	150	**31**
1975	342			**342**	398	**-56**
1976	463			**463**	296	**167**
1977	737			**737**	368	**369**
1978	1,348			**1,348**	526	**822**
1979	1,606			**1,606**	659	**947**
1980	1,767	98		**1,669**	963	**706**
1981	2,174	693		**1,481**	1,084	**397**
1982	2,863	1,019		**1,844**	1,238	**606**
1983	2,976	807		**2,169**	1,522	**647**
1984	3,204	528		**2,676**	2,020	**656**
1985	3,940	61	166	**3,713**	1,905	**1,808**
1986	4,493		1,701	**2,792**	2,220	**572**
1987	5,202		1,153	**4,049**	2,328	**1,721**
1988	5,138		1,594	**3,544**	2,182	**1,362**
1989	5,585		1,154	**4,431**	2,116	**2,315**
1990	6,355		1,697	**4,658**	2,183	**2,475**
1991	5,807		2,497	**3,309**	2,765	**544**
1992	6,738		1,881	**4,857**	2,827	**2,030**
1993	7,985		2,539	**5,446**	3,291	**2,155**
1994	7,189		1,726	**5,463**	3,253	**2,211**
1995	8,889		1,207	**7,682**	3,665	**4,017**
1996	9,133		2,412	**6,721**	4,373	**2,348**
1997	7,991		1,733	**6,258**	4,661	**1,597**
1998	10,090		1,378	**8,712**	4,115	**4,597**
1999	10,287		3,171	**7,117**	3,479	**3,638**
2000	10,517		2,085	**8,433**	4,241	**4,192**
2001	9,379		4,560	**4,819**	3,430	**1,389**
2002	9,439		3,099	**6,340**	3,201	**3,139**
2003	10,966		3,559	**7,407**	3,728	**3,679**
2004	10,895		3,593	**7,302**	4,294	**3,008**
2005	12,567		3,656	**8,911**	5,329	**3,581**
2006	12,426		3,569	**8,857**	4,948	**3,909**
2007	12,605		3,526	**9,079**	4,380	**4,699**
Totals	**211,459**	**3,206**	**53,655**	**154,598**	**88,218**	**66,379**

Note: 2007 are forecasts, all other data based on outturn

Source: HM Treasury
HM Treasury, *European Community Finances* , latest edition published May 2007, Cm 7090

Net contributions by Member State

Table 4 shows EU Budget contributions and expenditure by Member State for the last three years available. New data is expected to be published in autumn 2008. This table is based on data published by the European Commission and shows the budgetary balance excluding non-EU related funding. An example of non-EU related funding is EU overseas development aid. The figures do include administration expenditure which can have a significant effect on the contributions of some Member States, such as Belgium and Luxembourg, where in 2006 the EU spent €3,574 million and €1,017 million respectively. For 2004, the balances of the new Member States are based on eight months of membership (from 1 May).

Table 5 - EU Budgetary Balances by Member State 2004-2006

€ million, includes administrative expenditure

	Expenditure			Contributions			Net Contribution			Net contribution per head (in €) , 2006
	2004	2005	2006	2004	2005	2006	2004	2005	2006	
Belgium	5,164	5,576	5,625	3,849	4,024	4,156	-1,315	-1,552	-1,469	-140
Czech Republic	816	1,075	1,330	565	990	1,035	-251	-85	-295	-29
Denmark	1,591	1,552	1,502	1,940	1,989	2,193	349	437	691	127
Germany	11,745	12,284	12,242	20,230	20,136	20,501	8,484	7,852	8,259	100
Estonia	202	249	300	55	100	130	-147	-149	-170	-126
Greece	5,808	5,596	6,834	1,742	1,802	1,834	-4,066	-3,795	-5,000	-449
Spain	16,357	14,824	12,883	8,384	9,475	9,800	-7,973	-5,349	-3,083	-70
France	12,945	13,620	13,496	16,013	16,854	16,636	3,069	3,234	3,140	50
Ireland	2,815	2,494	2,462	1,250	1,442	1,482	-1,564	-1,051	-980	-233
Italy	10,367	10,696	10,922	13,786	13,547	13,507	3,419	2,850	2,584	44
Cyprus	147	215	240	95	150	153	-53	-65	-86	-113
Latvia	267	385	403	67	130	155	-200	-255	-247	-108
Lithuania	488	666	800	119	207	234	-368	-459	-566	-166
Luxembourg	1,132	1,106	1,195	231	227	217	-901	-879	-978	-2,127
Hungary	713	1,357	1,842	537	833	783	-176	-524	-1,060	-105
Malta	79	135	157	33	50	50	-46	-85	-107	-264
Netherlands	2,116	2,094	2,190	5,269	5,947	6,131	3,153	3,854	3,941	241
Austria	1,621	1,786	1,830	2,047	2,144	2,209	426	358	379	46
Poland	2,720	4,029	5,306	1,311	2,327	2,447	-1,410	-1,702	-2,859	-75
Portugal	4,414	3,881	3,635	1,332	1,527	1,378	-3,082	-2,354	-2,256	-213
Slovenia	282	366	406	170	275	279	-112	-91	-127	-63
Slovakia	388	609	696	220	359	402	-169	-250	-295	-55
Finland	1,375	1,351	1,280	1,443	1,465	1,560	69	114	280	53
Sweden	1,451	1,563	1,573	2,681	2,654	2,698	1,230	1,092	1,124	124
UK	7,130	8,670	8,294	11,683	12,157	12,381	4,552	3,487	4,086	68
Total	92,132	96,178	97,444	95,053	100,811	102,351				

Note: New Member States joined in May 2004
Negative net contribution indicates Member State is a net recipient
Figures include administrative expenditure (significant effect on expenditure in Belgium and Luxembourg)

Source: European Commission, *EU Budget 2006 - Financial Report*, September 2007, available at:
http://ec.europa.eu/budget/publications/fin_reports_en.htm
Eurostat, (population data) downloaded 12 November 2007

The table shows that in the last available year (2006), the UK net contribution was €4,086 million.

Each year the Treasury explains the differences between these figures published by the Commission and those published in *European Community Finances*.[55] This publication covers just the UK, and the latest edition only covers the Commission figures for 2005. The difference between the European Commission figures and Treasury figures amounted to £1,195 million in 2005, a higher figure than in recent years. Private sector receipts are counted in the European Commission figures (£595 million in 2005), while the Treasury considers public sector receipts only. The late adoption of an amending Budget for 2004 meant that implementation of this was not until January 2005 meaning the Government's figures are £60 million higher than the Commission's; a similar issue relating to a late amendment to the 2005 EU Budget means the Treasury figures are a further £456 million higher than the Commission's. The remaining differences relate to the payment of structural funds in different financial years. The Commission tries to match payments to particular Budgets while the Treasury look at the cash-flows in a particular year. The European Commission figures are the best available for Member State comparisons.

Table 5 shows agricultural and structural fund expenditure by Member State in 2006, as well as GDP data for all EU27 countries in 2006.

Further information on expenditure and revenue in Member States is available at: http://ec.europa.eu/budget/publications/fin_reports_en.htm.

Data on the economies of Member States is available from Eurostat: http://epp.eurostat.ec.europa.eu/

[55] Ibid.

Table 6 - Agricultural and Structural Funds Expenditure, GDP data, 2006

	Agriculture Expenditure, 2006		Structural Funds Expenditure, 2006		GDP, 2006		GDP per head, 2006		Budget Net Contribution, 2006 ***(See Table 5)***	
	€ millions	€ per head	€ millions	€ per head	Total, in € millions	% of EU total	€	% of EU average	€ millions	As % of GDP
Belgium	956	91	310	30	316,622	2.7	30,000	128	-1,469	-0.46
Bulgaria	..	..	..	..	25,100	0.2	3,300	14	..	..
Czech Republic	498	49	464	45	114,021	1.0	11,100	47	-295	-0.26
Denmark	1,165	215	125	23	220,163	1.9	40,500	173	691	0.31
Germany	6,567	80	4,388	53	2,322,200	20.0	28,200	120	8,259	0.36
Estonia	76	56	142	106	13,234	0.1	9,800	42	-170	-1.28
Greece	3,071	276	3,591	323	213,985	1.8	19,300	82	-5,000	-2.34
Spain	6,681	153	5,767	132	980,954	8.5	22,300	95	-3,083	-0.31
France	10,092	160	2,235	36	1,791,953	15.5	28,400	121	3,140	0.18
Ireland	1,736	413	475	113	174,705	1.5	41,100	175	-980	-0.56
Italy	5,486	93	4,531	77	1,475,401	12.7	25,100	107	2,584	0.18
Cyprus	51	67	15	19	14,522	0.1	18,900	80	-86	-0.59
Latvia	137	60	141	61	16,180	0.1	7,100	30	-247	-1.53
Lithuania	309	91	192	56	23,721	0.2	7,000	30	-566	-2.39
Luxembourg	46	101	21	45	33,852	0.3	71,600	305	-978	-2.89
Hungary	841	83	691	69	89,901	0.8	8,900	38	-1,060	-1.18
Malta	9	23	16	40	5,025	0.0	12,400	53	-107	-2.12
Netherlands	1,220	75	464	28	534,324	4.6	32,700	139	3,941	0.74
Austria	1,275	154	304	37	257,897	2.2	31,100	133	379	0.15
Poland	2,142	56	1,951	51	271,530	2.3	7,100	30	-2,859	-1.05
Portugal	951	90	2,534	240	155,131	1.3	14,700	62	-2,256	-1.45
Romania	..	..	..	..	97,118	0.8	4,500	19	..	..
Slovenia	160	80	91	45	30,454	0.3	15,200	65	-127	-0.42
Slovakia	277	51	268	50	43,945	0.4	8,200	35	-295	-0.67
Finland	818	156	317	60	167,062	1.4	31,700	135	280	0.17
Sweden	925	102	308	34	305,989	2.6	33,700	144	1,124	0.37
UK	4,308	71	3,021	50	1,909,721	16.5	31,500	134	4,086	0.21
Total	49,799	107	32,399	70	11,583,403	100.0	23,500	100	..	..

Note: Total relates to EU25 for agricultural and structural fund expenditure, EU 27 for GDP data
Negative net contribution indicates Member State is a net recipient
Budget net contribution figure includes administrative expenditure (significant effect on expenditure in Belgium and Luxembourg)

Source: European Commission, *EU Budget 2006 - Financial Report* , September 2007
Eurostat, (population data) downloaded 12 November 2007

Appendix 2 - Prime Minister's Statement, European Council, December 2005

The then Prime Minister, Tony Blair, made a statement on the outcome of the Council meeting on 19 December 2005:

> **The Prime Minister (Mr. Tony Blair):** With permission, Mr. Speaker, I should like to make a statement about the European Council in Brussels on 15–16 December.
>
> The main issue at this European Council was the European Union budget for 2007–13, the first budget ever for the enlarged Europe of 25 member states, soon to become 27 with the accession of Bulgaria and Romania.
>
> This country can be proud of the part that we played in the enlargement of the EU. The countries of central and eastern Europe that for so long suffered under communist dictatorship are now free democracies and vibrant new members of the EU. I say that to have championed the cause of those new states, to have welcomed them into NATO and Europe and then to have refused to agree a budget that protects their future economic development, would have been a betrayal of everything that Britain has rightly stood for in the past 15 years or more since the fall of the Berlin wall. They are our allies. It is our duty to stand by them. But it is also massively in our national interest. These new member states have fast-growing, open economies, new ideas, human capital and a political vision of Europe that is close to ours.
>
> However, although they are catching up economically, they are still much poorer than most of the original European Union 15; their people half as wealthy as in the rest of Europe. The purpose of the budget is rightly to transfer resources from the wealthiest west of Europe to the poorer east of Europe. Over the coming years, within a broadly stable budget, funds for the new member states will increase from €24 billion to €174 billion, a seven-fold increase.
>
> In time, of course, this makes them prosperous and us too. If we look at the example of Ireland and Spain, bilateral trade with those countries in goods alone is now more than €60 billion a year. Investment in the future prosperity and stability of eastern Europe brings big and lasting benefits to this country.
>
> The reason that it was so important to reach agreement at the European Council is as follows: as all central and eastern European leaders made clear to me, it was essential to have a December deal to allow those countries to plan and prepare for using the EU funds when those funds start in 12 months' time. It was clear that the prospects for a deal next year were negligible, and, if there were to be no deal, then in 2007 the European Parliament would take over the budget process. That would mean the Parliament setting annual budgets, on the existing financial agreements, which would have meant that countries such as Poland would have lost around two thirds of their EU funds. That is why they wanted a deal now.
>
> Of course, there is also a need for fundamental reform of the EU budget. As I said in June, what we need is to settle the budget on the basis of everyone paying their fair share of the costs of enlargement now; and then to open up the prospect of a radically reformed budget midway through the next budget period.

The agreement reached on Saturday morning differed from that of the Luxembourg proposal in four key respects. The overall budget is smaller. The proposal in June was that the UK rebate should be reduced in commitment terms by about €22.5 billion; under this deal, the maximum we shall pay is €10.5 billion. In the review clause in June, the common agricultural policy agreement of 2002 was specifically endorsed. Now it is clear that all aspects of the budget can be examined in 2008–09. However, crucially for Britain, this agreement states expressly—unlike that of June—that the British rebate remains in full on all expenditure in the original 15 member states. It remains in full on all common agricultural policy market expenditure everywhere in the Union, including in the new member states. We have, however, agreed to disapply a proportion of the rebate on structural and cohesion spending in the new member states—in effect, on the spending directly designed for economic development. As I have said, the cost of this is up to a maximum of €10.5 billion or about £7 billion over the next seven years of the financing period. Moreover, because the rebate stays on all common agricultural policy and all spending in the original European 15, the rebate will rise, not fall, to an average of €5.8 billion in payments terms annually from 2007. Overall, the rebate will get us about €41 billion back in the next budget period—substantially more than in this period. That is then the crucial leverage for future reform.

As the strongest supporter of enlargement among all member states, I strongly believe that it was right—indeed, essential—that the UK should contribute properly to enlargement. The fact is that if we support and, indeed, drive through a policy of ending the post-war division of Europe, we have to be ready to accept our fair share of the costs of that policy. Enlargement was never, and could never be, a cost-free policy, and this Government are prepared to shoulder their responsibilities in this area, because it is the right thing to do. In this context, I want to dispel one misunderstanding that has arisen—the impression that only the UK is contributing to the costs of enlargement. All wealthier countries are contributing. In terms of net contributions, our contribution will increase by 63 per cent. over the next financing period in comparison with 2000–06. France's contribution will increase by 124 per cent. Italy's contribution will increase by 126 per cent. Spain will lose in the region of €40 billion. Moreover, after some 20 years of our paying, under the original rebate, twice as much as France, UK and French contributions will, from 2007, for the first time, be in rough parity. Because the UK economy is now bigger than the French economy, we will, in fact, on the Commission's figures, be contributing a smaller share of our national wealth.

Alongside this agreement on support for the modernisation of eastern Europe, we also agreed on a fundamental review of all aspects of the EU budget, including the common agricultural policy, to be led by President Barroso, with the recommendation that it begin in 2008. As the language in the European Council conclusions makes absolutely clear, it is then possible for changes to be made to this budget structure in the course of this financing period. This will also allow us to take account of any changes agreed in the World Trade Organisation round, including the decision to phase out all export subsidies for agriculture by 2013. In addition, it was agreed that any CAP spending for Romania and Bulgaria—about €8 billion—should be fitted within existing CAP ceilings, which is a significant budgetary discipline.

So to summarise, when people ask what we got for agreeing to pay our fair share of enlargement, the answer is an agreement that sees us, for the first time since we joined the EU, paying no more than similar countries, such as France and Italy; the rebate staying put on all CAP spending and rising, not falling, in value;

and a process that can, in the years to come, lead to the necessary fundamental reform of both rebate and CAP that we all want to see.

[…]

The Prime Minister: And we have delivered an EU budget deal that is €160 billion cheaper than the original Commission proposals, provides for a huge transfer of spending from the original 15 to the new member states of eastern Europe, and preserves the British rebate in full on the CAP and all spending in the EU 15. I commend all this to the House.[56]

[56] HC Deb 19 December 2005 c1563-5

Appendix 3 - Further Information

Links to further information on the EU Budget and the ORD are given below. Links are provided in the text of the PDF version of the paper.

General Budget Information

European Commission, *Financial Programming and Budget directorate*

European documents and reports on the revenue and expenditure of the EU Budget are available at: http://ec.europa.eu/budget/documents/multiannual_framework_en.htm

Documents relating to the annual Budget are available from: http://ec.europa.eu/budget/documents/annual_budgets_reports_accounts_en.htm

HM Treasury, *European Community Finances: Statement on the 2007 EC Budget and measures to counter fraud and financial mismanagement*, May 2007, Cm 7090

Further information on expenditure and revenue in Member States is available at: http://ec.europa.eu/budget/publications/fin_reports_en.htm

European Council Conclusions and New ORD

December 2005 European Council Conclusions, *Financial Perspective 2007-13*, 19 December 2005, 15915/05 CADREFIN 268

Statement on December 2005 European Council, 19 December 2005

Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management (OJ C 139, 14/06/2006).

Current ORD: Own Resources Decision of 29 September 2000 (2000/597/EC) and Commission Working Document on the method for the calculation of the correction of budgetary imbalances.

Proposed ORD: Own Resources Decision of 7 June 2007 (2007/436/EC) and new Commission Working Document on the method for the calculation of the correction of budgetary imbalances.

European Scrutiny Committee reports on the IIA and ORD:
Twenty-first Report of Session 2005-06, HC34-xxi and Twenty-sixth Report of Session 2005-06, HC34-xxvi

Debate in the House on Future EU Finances, 8 May 2007

Annual Budget Scrutiny

European Scrutiny Committee Report on the Preliminary Draft Budget 2008 – *Twenty-Fifth Report of Session 2006-07*, HC 41-xxv

European Scrutiny Committee Report on the Preliminary Draft Budget 2008 – *Thirty-Seventh Report of Session 2006-07*, HC 41-xxxv

Annual European Standing Committee Debate on the Preliminary Draft Budget, 9 July 2007

Annual Reports from the European Court of Auditors:
http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/annualreports

Annual Reports from the European Anti-Fraud Office (OLAF):
http://ec.europa.eu/anti_fraud/reports/index_en.html

Annual European Standing Committee debate on Financial Management in the EU, 26 February 2007

European Communities (Finance) Bill 2001

Library Research Paper 01/62, *The European Communities (Finance) Bill, Bill 1 2001-02*, 2 July 2001: http://www.parliament.uk/commons/lib/research/rp2001/rp01-062.pdf

2nd reading debate for 2001 Bill (3 July 2001): http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmhansrd/vo010703/debtext/10703-04.htm#10703-04_head1

Committee stage for 2001 Bill (19 July 2001): http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmhansrd/vo010719/debtext/10719-17.htm

3rd reading debate for 2001 Bill (18 October 2001): http://www.parliament.the-stationery-office.co.uk/pa/cm200102/cmhansrd/vo011018/debtext/11018-12.htm#11018-12_head2