



Briefing #1

The UK rebate issue

Briefing prepared by Ben Patterson

Before the end of this year a decision has to be reached on the Commission's financial perspective for 2007-2013. This has provoked renewed discussion on the "controversial and delicate"¹ issue of Britain's annual £3 billion EU budget rebate, the disruptive potential of which was illustrated at the recent Brussels summit. President Chirac described the rebate as "unjustified", forecasting that unless it was reviewed agreement on future financing would be impossible. A UK government spokesman then declared that "there can be no deal on future financing which does not protect the rebate." Foreign Secretary Jack Straw stated that any proposed reduction would be vetoed.

Adding to the discomfort, the UK will hold the Presidency of the Council during the second half of 2005, and will be expected to facilitate a solution if this has not already been achieved in June by the Luxembourg Presidency.

Background to the rebate

Briefly, the justification for the UK rebate has been that, without it, our net contribution to the EU Budget would be excessive compared to that of other Member States. The term "net contribution" or "net balance", however, is not a legal term within the budgetary system. It is also, as the Commission observes², a term "fraught with significant conceptual and accounting problems". Nevertheless, the funds coming from a particular Member State *can* be compared with those received under various Community programmes. This information is published annually by the Commission.

The possibility of correcting for an adverse net balance was, in fact, already envisaged when the UK joined the Community in 1973³.

Following the 1974-5 renegotiation, a mechanism was actually put in place, based not on net balance but on gross contribution. This did not make the issue go away. A final solution was only reached at Fontainebleau in 1984, and enacted in the own resources decision of May 1985.

The mechanism agreed at Fontainebleau applied exclusively to the UK. However, the Commission has pointed out that the decision was based on the principle that

*'...any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time.'*⁴

In 1984, three factors contributed to the UK's adverse position:

1. On the revenue side, the UK's **higher propensity to import** from outside the Community, resulting in high payments of levies and tariffs into the Budget. This was, however, of only marginal importance.
2. On the expenditure side, the UK's **relatively low receipts under the Common Agricultural Policy**, which at that time accounted for nearly 70% of the Budget.
3. **The UK's per capita income**, which in 1984 stood at only 90.6% of the Community average. This made the UK the least prosperous of the countries then making net contributions.

The UK's net contribution would have been just under 0.5% of GNI in 1985, had the rebate not existed – a marginally larger proportion than that of the only other major contributor, West Germany, whose GNI at that time stood at 109.6% of the average.

The rebate has taken the form of payments to the UK out of the Budget equal to two-thirds of its net adverse balance.

The current dispute

The argument for reviewing the UK rebate mainly rests on two developments since 1984:

1. First, the proportion of the Budget spent on the CAP has fallen to only 47% of the total (in 2003) and is projected to have fallen to 42% in the current year.
2. Secondly, the relative prosperity of the UK has risen. In 2003 its GNI stood at 111.2% of the EU(15) average, now *higher* than that of any other net contributor.

Since the UK rebate is paid out of the general Budget, all Member States theoretically contribute, including the new Member States.

However, under the Fontainebleau agreement itself, West Germany was excused one third of its contribution to the rebate; and since 1999 Germany, the Netherlands and Sweden have paid only a third.

The untidy nature of these arrangements might be considered a further reason for review.

Finally, further complicating the situation, there is the controversy surrounding the size of the Budget itself. The Commission is arguing for an expansion of expenditure to 1.26% of total GNI⁵. The "gang of six" net current contributors – the UK, Germany, France, Sweden, the Netherlands and Austria – is demanding that the Budget be capped at 1%.

According to the figures published by the Commission⁶:

- Were **the UK rebate to end**, net contributions would amount to 0.62% of the UK's GNI over the period 2008-2013. This would compare with 0.55% for the Netherlands and 0.52% for Germany, and make the UK the *largest* net contributor out of ten⁷.
- Were **the UK rebate to continue as a present**, its net contributions (post-rebate) would amount to 0.25% of the UK's GNI over the period 2008-2013. This would compare with 0.5% or more for the Netherlands, Germany and Sweden, and make the UK the *smallest* net contributor out of the ten.

Proposed solutions

Apart from continuing as at present, two solutions are currently under discussion.

1. A Generalised Correction Mechanism

In its Communication of February 2004⁸, the Commission proposed the introduction of a mechanism aimed at correcting all net contributions in excess of a pre-defined threshold. This was later published as a draft Council Decision and draft Regulation⁹. Briefly¹⁰:

- when a Member State had to contribute more than 0.35% of its GNI to the EU budget, it would receive a refund;
- all contributions exceeding 0.35% of GNI would be refunded at a rate of 66%;
- the total refund would be limited to a maximum of €7.5 billion a year;
- the UK would receive additional, but decreasing, top-up payments during a 4-year transitional period.

For the sake of “feasibility, transparency and simplicity”, all Member States, including those receiving a rebate, would participate in funding all the corrections.

Compared to the *status quo*, the effect would be to reduce the net payments of all contributors except Austria and the UK. When fully operational, it would result in UK net contributions equal to 0.51% of GNI (compared to 0.25% under the *status quo*, and 0.62% with no rebate mechanism at all). The UK would become the largest net contributor in GNI percentage terms, followed by the Netherlands and Germany (each at 0.48% of GNI).

2. General Reform of the Budget

The alternative solution – proposed, among others, by the House of Lords European Union Committee¹¹ and by Professor Iain Begg at the LSE¹² – is to tackle the underlying reason for the UK rebate: “the uneven incidence across Member States of EU expenditure”¹³, arising in particular from the disproportionate size of CAP expenditure in the Budget. This could be achieved either by reducing the role – or completely repatriating – the CAP itself; or by increasing expenditure on other items (for example, research, where the UK might benefit disproportionately).

As far as CAP reform is concerned, Prof. Begg observes that “the obvious bid deal is CAP reform in exchange for an end to the British rebate”. There is precedent: the CAP has already been significantly changed over recent years. The process, however, has been difficult and gradual; and it is open to question whether the further major changes necessary to solve the rebate problem would be politically feasible in any short term.

The alternative – a significant expansion of the EU Budget in other fields – is in part a feature of the Commission’s future financing proposals. Yet, as Begg observes, “this is the point at which any discussion immediately grinds to a halt”.

Conclusions

A constructive attitude to this situation should take into account a number of factors.

- As the UK Government has repeatedly emphasized, no change to the *status quo* can be made without its consent, since the Council is required to take decisions on budgetary revenues by unanimity¹⁴.
- A stance of “no surrender” was inevitable during the run-up to a General Election. It may now be possible to soften the position,

given that the UK government still has a working majority. However, the issue of the Constitutional Treaty may make compromise impossible, at least until after the referendum on it has been held.

- Although this is in one sense a statistical illusion, the fact that the relatively poor new Member States contribute to the current UK rebate makes it vulnerable to the charge of being “indefensible”. Whatever else happens, it would be advisable to change this.
- Legally, the only specific proposal on the table is that of the Commission; and agreement on the financial perspective, of which it forms an element, is necessary before the end of the year.
- The mathematics of the Commission proposal are complex, and can be “tweaked” in a number of ways. Amendments which resulted in all the richer countries (including major CAP beneficiaries France, Denmark and Ireland) making net contributions at roughly the same percentage of GDI should not be too difficult to devise.
- The most plausible solution to the problem would seem to be acceptance of an amended mechanism in the short term, combined with reforms on the expenditure side of the Budget within the context of the 2007-2013 financial perspective. For example, targets might be agreed for the steady reduction of CAP expenditure, either in absolute terms or as a proportion of the whole.
- In general terms, it is necessary to reduce the *machismo* associated with the UK rebate issue, in particular by pointing out:
 1. how small the EU Budget is as a proportion of both GNI and public expenditure;
 2. the limitations to the concept of “net balances”: much EU expenditure benefits countries other than those in which the accounts show the sums being spent¹⁵.

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The views expressed in this briefing do not necessarily represent the official position of the European Movement.

¹ To use the words of the recent House of Lords Report (see footnote 11).

² In COM(2004)501 of 3.8.2004

³ See the 1972 White Paper.

⁴ Conclusions of the Presidency following the Fontainebleau European Council, 1984.

⁵ The Budget is currently just under €100 billion. The Commission would raise this to €124.6 billion in 2007 and €143.1 billion by 2013.

⁶ In COM(2004)501

⁷ The others would be Austria, Italy, Cyprus, France, Denmark and Finland. However, the Commission notes that, if administrative expenditure is excluded, both Belgium and Luxembourg would become net contributors. Including the spending on the EU institutions in Brussels and the city of Luxembourg, Belgium would have net receipts under the *status quo* of 1.21% of GNI; and Luxembourg, the richest *per capita* country in the world, would be a net beneficiary to the tune of 5.8% of GNI!

⁸ *Building our common Future: Policy challenges and Budgetary means of the Enlarged Union 2007-2013*, COM(2004)101 of 26.2.2004.

⁹ COM(2004)501 of 3.8.2004.

¹⁰ The (complex) mathematical expression of this mechanism is contained in Annex 1.

¹¹ *Future Financing of the European Union*, HL Paper 62 of 9.3.2005, HMSO £24.50.

¹² *Funding the European Union*, Federal Trust, March 2005.

¹³ Begg *op. cit.*

¹⁴ See Article 269 of the Treaty. Unanimity is retained in the Constitutional Treaty (see Article I 54(3)).

¹⁵ For example, expenditure through the Structural Funds can result in contracts for firms based anywhere in the Union. The Commission also notes that expenditure on such things as border protection immediately benefits the EU as a whole.
