The budgetary imbalances issue

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Whilst income and expenditure in the budget of the European Union has to be in balance, the same is not true of the contributions paid by and refunds paid to Member States. Some Member States pay more into the Community budget than they actually receive from it under the various Community policies. These are the *net contributors*. Other Member States, however, receive more than they contribute. These are *net beneficiaries*.

Although the spirit of the Community financing system means that these budget transfers are the reflection of solidarity amongst the Member States, some of them are insistent that the principle of the *juste retour*, or fair return, must apply. This idea compares the monetary flows received by the Community from a Member State with the flows received by that Member State from the Community budget. This *budgetary imbalance* — also called the *net balance* — has, over the years, prompted a number of adjustments being made to the Community's budgetary policy in an attempt to limit the negative balance of those Member States which are *net contributors*.

The British rebate

On 1 January 1973, the United Kingdom acceded to the Communities. In 1974, its — newly elected — Labour Government criticised the European system of own resources and called for a 'fair balance of advantage', that is to say a better balance between what a Member State pays into the Community and what it gets out. The United Kingdom felt especially disadvantaged by the Community financing system. Its objections were twofold. Firstly, the United Kingdom pays more in structural terms than the other Member States. As a large importer of agricultural products from non-member countries, it makes a sizeable contribution to the two traditional own resources of agricultural levies and customs duties. Likewise, its contribution from VAT receipts is especially large because consumer spending accounts for a high proportion of its gross national product (GNP). Secondly, it receives less in structural terms than the other Member States. Its farming population is small and its agricultural market well structured, with few production surpluses, so it receives little funding from the common agricultural policy (CAP) which, nevertheless, accounts for the lion's share of Community expenditure.

The United Kingdom's determination led the **European Council, meeting on 9 and 10 December 1974 in Paris**, to acknowledge this as an 'unacceptable situation' and to accept the idea of a '*juste retour*', or fair return. Following the **Dublin Summit held on 10 and 11 March 1975**, the Council therefore adopted **Regulation (EEC) No 1172/76 of 17 May 1976** setting up a corrective *financial mechanism*. This was a general measure, potentially benefiting any Member State which simultaneously meets three conditions — its per capita GNP must be less than 85 % of average per capita GNP for the Community, its growth rate of per capita GNP in real terms must be less than 120 % of the average rate for the Community, and the payments that it makes to the Community budget must exceed by more than 10 % its proportion of Community GNP. Any correction made is capped and is reduced if the balance of payments returns to equilibrium. This mechanism has never been applied to the United Kingdom or to any other Member State, because the requisite criteria have never been met.

In accordance with the instructions given to the Commission by the Council on 30 May 1980, the correction mechanism was amended. The financial mechanism introduced in 1976 was revised by **Council Regulation (EEC) No 2743/80 of 27 October 1980** in such a way as to make its operation effective. But the criteria were still not met, and it was not applied any more than it had been in previous years. However, **Council Regulation (EEC) No 2744/80 of 27 October 1980** establishing *supplementary measures* in favour of the United Kingdom with regard to regional policy enabled the UK to receive its first rebates. These measures provide for a rebate in the form of an additional expenditure charged to the Community budget.

The **Fontainebleau European Council held on 25 and 26 June 1984** went further, considering 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.' The 10 Member States then reached agreement on the rebate to be granted to the United Kingdom so as to reduce its contribution to the Community budget. This agreement came in response to the insistent demands made by the British Prime Minister, Margaret Thatcher, demands which were memorably embodied in the famous statement: ‘I want my money back.’

The second **Decision on own resources of 7 May 1985** implemented the decision of principle taken at Fontainebleau and institutionalised the British rebate. Under an extremely complicated formula, the United Kingdom had its VAT payments cut by two thirds (66 %) of the imbalance. In other words, it was excused from having to pay two thirds of its share of expenditure in excess of the uniform rate (Article 3(3)). The cost of financing this refund was borne by the other Member States in proportion to their share of VAT receipts, except for *Germany*, which had its share cut by a third. Germany, also a net contributor, was not given a rebate, but it had its share of the funding of the British rebate reduced.

The European Council meeting in Brussels from 11 to 13 February 1988 radically reshaped the system of own resources and formalised the principle of correcting budgetary imbalances. Accordingly, in its third **Decision on own resources of 24 June 1988**, the Council retained the existing compensation mechanism, tweaking it in order to take account of the capping of the uniform VAT base and the introduction of a fourth resource assessed on the basis of Member States’ GNP — two innovations which were favourable to the United Kingdom (Article 4). The cost of funding this rebate was still borne by the other Member States, now no longer in proportion to their share of VAT receipts but in proportion to their share of Community GNP. In addition, the 1988 Decision perpetuated the reduction of *Germany’s* contribution towards the funding of the British rebate (Article 5) and reduced the shares of *Spain* and *Portugal* by introducing a temporary reduction which would remain in force until 1991 (Article 9).

The fourth **Decision on own resources of 31 October 1994** called on the Commission to review the question of budgetary imbalances. The Commission set out its findings in ‘**Financing the European Union — Commission report on the operation of the own resources system**’ dated **7 October 1998**, expressing serious conceptual and methodological reservations on the issue of budgetary imbalances. It criticised the pertinence of the idea of budgetary imbalance and held that the calculations of budgetary balances took account only in part and in a simplistic manner of the benefits accruing to the Member States from their membership of the European Union.

The Commission also thought that the circumstances which had led the Fontainebleau European Council to adopt the correction mechanism for the United Kingdom had changed. That mechanism had technical drawbacks, and, because it was so complicated to calculate, it detracted from the transparency and simplicity of the budget.

The Commission went on to analyse the relative budget positions of *Germany, Austria, the Netherlands and Sweden*, all of which were candidates for a budget rebate. In March 1998, in the light of the agreement secured at Fontainebleau, each of those Member States had already taken the view that its negative balance had to be seen as excessive ‘in relation to its relative prosperity’. The Commission showed that, since the Fontainebleau Summit, there had been significant changes in the relative situation of these four Member States, most especially in that of Germany and Sweden.

The Commission also hinted at the possible impact which the reforms envisaged as part of *Agenda 2000* (Commission communication of 16 July 1997) might have on the budgetary imbalances of the Member States.

Lastly, it set out the main possible approaches to tackle the problem of budgetary imbalances. These options, none of them exclusive, followed a certain logic. Firstly, the Commission envisaged structural simplification — *financing approach* — towards a system based more on GNP contributions, which would encompass the reduction and even the phasing out of the British rebate. Secondly, it suggested the introduction of a system of partial rather than total repayment of CAP expenditure on direct aids — *expenditure approach*. Thirdly, it proposed applying a *generalised correction mechanism* to all Member States experiencing major budgetary imbalances — *budgetary balances approach*. The Commission concluded that none of these options provided an ideal solution and that the Decision on own resources would need to be amended.

The **Berlin European Council held on 24 and 25 March 1999** secured a political agreement on the British rebate and adopted the basis for the fifth **decision on own resources of 29 September 2000**. The British rebate continued, but with technical adjustments designed to neutralise the exceptional gains resulting, on the one hand, from a higher percentage of traditional own resources — agricultural levies and customs duties — retained by Member States to cover their collection costs — this had risen from 10 % to 25 % — and, on the other hand, from pre-accession expenditure (Article 4(e) and (f)). In fact, in order to ensure that this expenditure, for which no rebate was given prior to enlargement, was not the subject of a rebate demand afterwards either, the 2000 Decision made provision for the British rebate to be adjusted subsequently. Under pressure from *Germany, Austria, the Netherlands and Sweden*, which all had sizeable budgetary imbalances, too, the Council reduced the amount that they normally paid towards funding the British rebate to one quarter. The remaining three quarters were borne by the 10 other Member States in proportion to their share of the Community's gross national income (GNI). GNI was defined in this Decision as being equal to GNP (Article 5(1)).

The Commission was also asked, by 1 January 2006, to undertake a general review of the own resources system and consider the system of budgetary imbalances.

On **14 July 2004**, the Commission adopted **Financing the European Union — Commission report on the operation of the own resources system**. Given that there were net beneficiaries and net contributors and that the size of these imbalances was at the centre of political discussions, the Commission reviewed the existing correction mechanism in the light of the general Fontainebleau principle whereby 'any Member State paying a share towards the budget which is excessive in relation to its relative prosperity may have that share adjusted at the appropriate time.' It emphasised, moreover, that, whilst the correction had been granted only to the United Kingdom, the principle of a *generalised correction* had already been acknowledged at Fontainebleau ('any Member State'), namely that the correction had to be based on the size of the budgetary imbalance ('excessive') and the wealth of a Member State compared to the EU as a whole ('relative prosperity').

It found that, with the passage of time, enlargement and changes to the structure of the budget, the United Kingdom was no longer in a unique position and that the granting of a correction on an exclusive basis to the UK was no longer justified. It noted, too, that, because of the cost of financing enlargement, any failure to amend the existing system would lead to a significant increase in the British rebate and that this would accentuate the disparities already existing amongst the net contributors. The Commission therefore proposed a *general application of the correction mechanism* so as to bring the system closer to the original objective of avoiding excessive budgetary burdens. The aim of this general application was to reduce net negative balances, narrow the disparities between the net contributors and ease the cost to those Member States which did not benefit from the mechanism. This correction (in the form of a partial refund) would be triggered if net contributions exceeded a *threshold* — representing the acceptable degree of unlimited financial solidarity within the European Union — expressed as a percentage of each Member State's GNI. The maximum available refund volume was to be capped, however. Lastly, the Commission was adamant that the method of financing the corrections had to be simplified, with all the Member States contributing in proportion to their GNI.

The issue of budgetary imbalances continued to be a thorny issue in talks on the financial perspective for the period 2007–2013. However, the European Council, meeting in Brussels on 15 and 16 December 2005, reached a political agreement on the financial framework 2007–2013. It also invited the Commission to draft a new decision on own resources and to amend the accompanying working document on the British rebate. On 8 March 2006, the Commission adopted a proposal for a Council decision on the system of own resources of the European Communities and submitted a working document on the British rebate. Once this decision has been unanimously adopted by the Council and ratified by each Member State, it will enter into force and take effect retroactively from 1 January 2007.