European Communities
Commission
Background Report

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HOW THE COMMUNITY BUDGET IS FINANCED

Summary

The method of financing for the Community budget is complex and has been made more complicated by the gradual introduction of the 'own resources' system since 1970 and the accession of three new member countries with transitional arrangements to allow them to participate gradually in Community financing. This process should be complete by 1980, but further problems are expected to arise after 1982, when the income of the Community will be inadequate to cope with necessary expenditure and new sources of financing will have to be found.

Our background report ISEC/B72/78 outlined some topical aspects of the present discussions on the U.K. contribution to the budget. This supplementary report summarises the factors which determine the levels of contribution. The figures given on page 4 are U.K. Treasury estimates.

Basis of the Community budget

The Rome Treaty and the Treaty of Accession lay down the basis of member country contributions.

Under Articles 199 - 201 of the Rome Treaty the Six contributed to the budget on an agreed quota but in the Council of Ministers' decision of 21 April, 1970, (1) it was agreed to introduce 'own resources' financing of the budget based on agricultural levies and customs duties from 1 January, 1971, plus in addition revenue accruing from other charges introduced within the framework of a common Community policy, (i.e. Value Added Tax.) The decision allowed for a transition period from the old system to the new to 1 January, 1975. Member states continued to finance the balance of the budget not covered by levies and duties by direct quota contributions.

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(1) O.J. No. L94/19 of 28.4.1970.

The system of own resources should have come fully into effect by 1 January, 1975, but as the VAT assessment basis had not been agreed the decision allowed for a further derogation of two years, until 31 December, 1977.

In the event the Council only adopted the Sixth Directive on VAT (1) on 16 May, 1977, but further reservations and difficulties on the part of member states meant that own resources could not be fully implemented as planned on 1 January, 1978. It is now expected to operate from 1 January, 1979.

Treaty of Accession

The admission of the three new states in 1973 also made it difficult to adhere to the original timetable. Under the Treaty of Accession a new scale of direct contributions was agreed whereby, following a five year transitional period, Britain's share would be 19.2%, Denmark's 2.46% and Ireland's 0.61%. German, French and Italian quotas were fixed, under a complex formula, at 25.5%, 25.3% and 15.7% respectively.(2)

With the implementation of own resources in full the quota system lapses. The Treaty of Accession anticipated, however, that by the end of 1977 (i.e. the end of the transitional period) Britain and the other new members would still be a long way from reaching their full contribution to the budget based on own resources. Under Article 131, therefore, ceilings were placed on these contributions for 1978 and 1979 so that none of the new members would be expected to pay their full share of own resources until 1980. The ceiling for 1978 is calculated as two-fifths of the difference between what was actually paid into the budget in 1977 and what each country would pay in 1978 under the 'own resources' system. The 1979 ceiling would be two-fifths more.

These provisions have been complicated by the fact (i) that own resources is only coming fully into operation at the beginning of 1979 and (ii) that the British government invoked Article 131 over the 1978 budget following the change from the old unit of account (ua) to the European Unit of Account (EUA) for budget calculations. (3) Following negotiations in 1977 it was agreed that for 1978 each member country would pay its budgetary share on the basis of the interpretation of Article 131 which was most favourable to it, and the same formula will apply in 1979.

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(1) See Br. ISEC/B38/77.
(2) The European Community's Financial System, European Documentation, P. 16.
(3) For detailed background see BRs ISEC/B74/77 and ISEC/B62/78.

By 1980, however, the restrictions in force under the Treaty of Accession will no longer apply.

The financial mechanism

In 1974-75 the British government sought to renegotiate parts of the Treaty of Accession which it felt operated to Britain's disadvantage. It was particularly concerned about the Common Agricultural Policy (CAP) and what it considered was an unfairly large contribution to the Community budget in relation to Britain's GDP. As a result, at the Dublin European Council of March 1975 agreement was reached on a 'corrective' or financial mechanism to apply if a member state appeared to bear a disproportionate burden in the financing of the Community budget.

Thus under EEC Regulation 1172 of 17 May, 1976 (1) refunds can be made to member countries in such circumstances subject to intricate calculations and the following governing criteria:

a) The per capita gross national product (GNP) of the member state is less than 85% of the average per capita GNP for the Community;

b) The growth rate of the per capita GNP in real terms of the member state is less than 120% of the Community's average rate;

c) If payments made by the member state, as a result of the system of own resources, exceed by more than 10% the amount it would have had to pay if the budget were financed on the basis of its proportion of GNP to the total GNP of all the member states.

Where, however, the member country shows on average surplus balance of payments over the three years preceding the financial year in progress the refunding under criterion (c) applies only to that portion of the contributions arising from the difference between the share of VAT payments (or financial contributions) and the member state's share of Community GNP.

The total refund for a current financial year must not exceed 3% of the total Community budget.

So far no country has had recourse to the financial mechanism.

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(1) OJ No. L131 of 20 May, 1976.

Green paper on financing after 1982

The problem of relying on own resources for budget financing is a different matter. At present the VAT contribution is limited to 1% on all transactions within the harmonised VAT base, but it is already clear that this will not be sufficient within a year or two to provide an adequate budget (levies and customs duties, on the whole, remain fairly constant but are of declining real value). This will mean either increasing the VAT percentage contribution or reverting to direct financing from member states according to an agreed quota for that part of budget financing not covered by own resources. The recent green paper from the Commission emphasises the need to develop sources of finance which tend to eliminate disparities between member states (1).

Budget contributions

The Community budget for 1978 is expected to total about £8,000m and in 1979 about £9,000m.(2) The total may sound large, but in fact the figures represent under 3% of total national budgets and 0.81 and 0.88% respectively.

The table shows Britain's actual and estimated gross and net contributions to the Community budget from 1973 to 1982. These are U.K. Treasury estimates.

British Contributions to the Community Budget

£m - Out-Turn Prices, Calendar Years

Year	Gross Contribution	Receipts	Net Contribution
1973	181.1	78.7	102.4
1974	180.5	149.9	30.6
1975	341.7	397.7	-56.0
1976	462.8	295.5	167.3
1977	736.8	359.3	377.5
1978 (est.)	1120.0	460.0	660.0
1979 (est.)	1235.0	470.0	765.0
1980 (est.)	1320.0	490.0	830.0
1981 (est.)	1280.0	490.0	790.0
1982 (est.)	1295.0	495.0	800.0

Sources: Hansard PQ 13.3.78 and 12.1.78 and H.M. Treasury

These figures can be put into better perspective if they are related to Britain's share of Community GDP and the proportion the totals bear to UK's own GDP and annual budget expenditure.

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(1) COM(78) 531.

(2) EP Briefing, 11-15 September, 1978. Finalised figures will not be known until after December 1978.

In 1976 Community GDP totalled 1,242,500m EUA compared with the U.K. Gross Domestic Product of 196,200m EUA (1), making Britain's share of the total 15.8%. Even in 1978, when there has been a marked estimated increase in U.K.gross contribution to the Community budget(£1,120m) this represents only 14% of the £8,000m total; the net share (£660m), arrived at after taking into account Community financial help through the Regional and Social funds and the Common Agricultural Policy (CAP), represents about 8.3% of the total.

As a proportion of U.K. GDP, the 1978 budget contribution is less than 1%; as a proportion of budgetary expenditure for 1977-78 (£43,500m) (2) the gross contribution represents about 2.6%, and for 1978-79 the proportion is slightly less, both being below the Community average.

Basis for grievance

There is some justification, however for the argument that because about 70% of the Community budget is spent on agriculture, and because Britain is a large net importer of food and other commodities, she gets less return on her budgetary contributions than other member countries, and is penalised by the own resources system with its reliance on agricultural and customs levies.

It is true that because of her small agriculture sector Britain does less well from budget receipts than countries with large farm populations, but it is often overlooked that had Britain been out of the Community today and was operating the system of deficiency payments that applied before joining the Community in 1973, she would be paying British farmers £1.1 billion out of taxation - considerably more than she actually contributes net towards the CAP.

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(1) Basic Statistics of the Community 1978, P. 26 latest available figures.
(2) The Statesman's Year Book, 1977-78 and 1978-79.