The EU Budget Structure

Income

Own Resources

As far back as the Treaty of Rome (1957) the architects of what is now the European Union[1] were intent on ensuring that the European Union should be financially independent. What exactly do we mean by that? Clearly, the European Union is not financially independent in the sense that it does not raise its own taxes. Rather, its income is based on a concept of 'own resources' which was written into the original treaty. These resources, though not levied by the European Union directly, are as of right the resources of the European Union, i.e. the Member States must contribute them. However, although this was the intent right from the start, it was implemented only from 1970 onwards. Before that date the funding mechanism resembled that of the Council of Europe, the UN and similar international bodies, leaving the international body dependent on the member states' willingness to pay.

Traditional 'Own Resources'

The first set of resources which were identified as 'own resources' were customs duties and agricultural and sugar levies.

Customs duties are duties paid on goods entering the EU at its external borders. One of the arguments for making these levies an 'own resource' is the argument that the duties are paid at the point of entry and not at the point of destination, and that goods, once they have entered the European Union, can travel freely to their final destination in any Member State. In other words, the country in which the point of entry is and where the duties are paid is not necessarily the country in which the goods are sold. It therefore makes sense to 'communitize' such revenue.

Agricultural levies are charges on agricultural trade with non-member countries; they were introduced in 1962. The argument for making such charges EU 'own resources' is that agriculture has been one of the earliest cornerstones of European integration.

Sugar levies are charged on the production and storage of sugar in the European Union; this is, thus, an own resource that comes from internal, rather than external, sources.

The proportion of the EU budget funded through these resources is 15%.

Value Added Tax

When the traditional own resources were found not to be sufficient to finance the expenditure of the growing European Union, the Member States agreed to add to the traditional own resources another source of funding. This, based on the VAT base of each Member State, is quite complex to calculate because the VAT bases of all Member State needs to be harmonised to arrive at the levy. The technicalities of this are beyond the scope of this briefing. Suffice it to say that a proportion of VAT revenue of Member States is deemed an EU own resource and receivable by the EU from the Member State as of right.

[1] Throughout this paper we refer to the European Union; it should be noted that this term includes its predecessor organisations (the European Economic Communities – EEC- and the European Community – EC) depending on the timeframe to which certain aspects of this discussion refer.

The proportion of the EU budget funded through these resources is also about 15%.

Gross National Income

It is clear from the above that the EU budget cannot be funded from these resources alone. The remaining 70% of the budget is funded through a levy on each Member State based on a percentage of GNI (Gross National Income).

The maximum percentage of GNI which can be taken up by the EU budget is agreed by Member States in what are called 'Financial Perspectives' – multi-year financial frameworks which currently operate on a non-rolling 7 year basis. Multi-year frameworks started in 1988. The current Financial Perspective runs from 2007 to 2013.

The own resources ceiling for the current Financial Perspectives is set at 1.24% of GNI.

New Own Resources

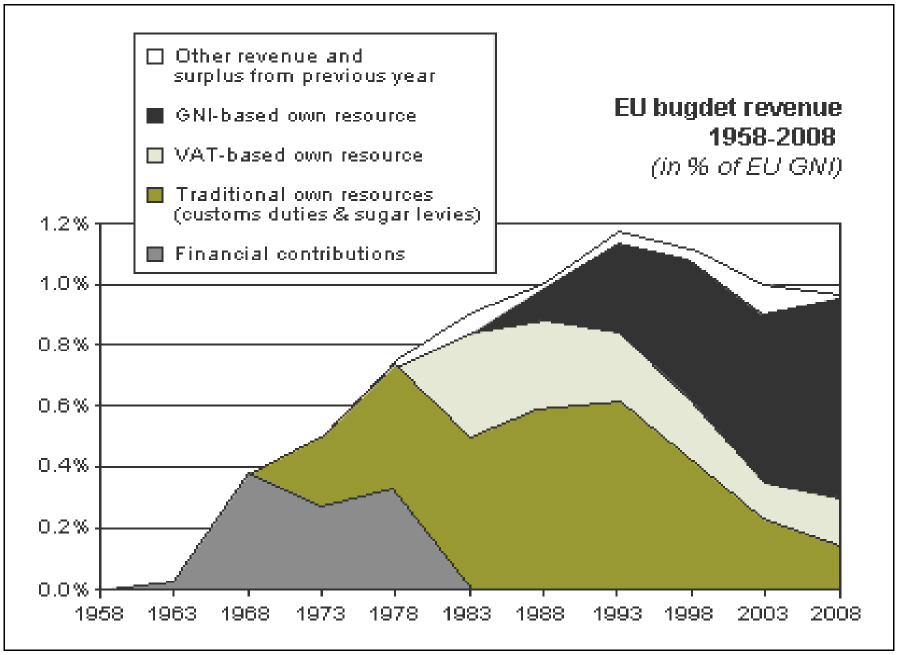
In many ways the description of the sources of income of the EU shows that the 'own resources' approach has been weakened considerably. Member States have full control over the so called 'own resources ceiling' in the development of the Financial Perspectives and much of the last round of these discussions focused on this ceiling and gave impetus to the current budget review. To quote from a recent report to the European Parliament on this subject: 'it is these "membership fees" that have accentuated the short-sighted net-payer debate that does not do justice to the benefits of the European Union in terms of peace, freedom, prosperity and security'[2].

Development of Income Streams

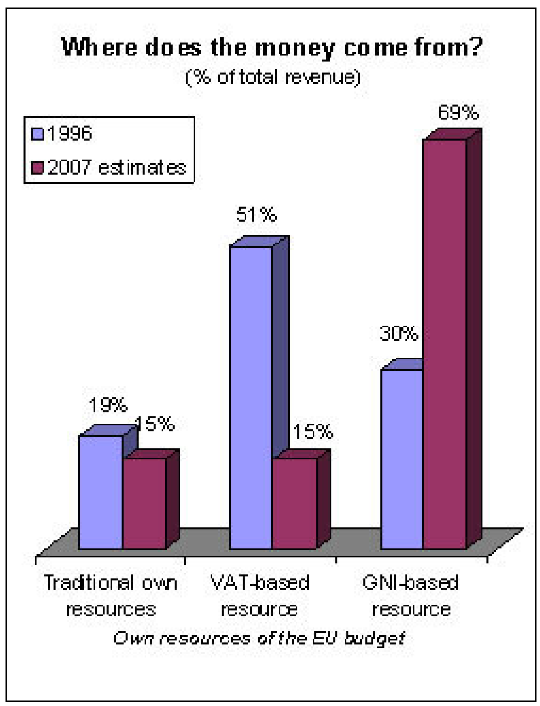
Looked at over the long term, there has been a significant change in the sources of funding of the European Union. The following graph shows this clearly[3].

[2] European Parliament, Report on the future of the European Union's own resources (2006/2205 (INI)), Committee on Budgets, 13.3.2007, Rapporteur: Alain Lamassoure, accessed at: http://www.europarl.europa.eu/oeil/file.jsp?id=5378292 on 20 December 07

[3] Graph from the European Commission website accessed on 20 December 2007 at: http://ec.europa.eu/budget/reform/history/history1957_en.htm



Even more recently, the shift between the different sources is noticeable, as shown in the graph below:[4]



This then opens the debate about alternative approaches to get back to a situation where the European Union has real own resources. This is part of the budget review, too. We will come back to this question in another briefing paper.

[4] Graph from the European Commission website accessed on 20 December 2007 at: http://ec.europa.eu/budget/reform/budget_glance/where_from_en.htm

Expenditure

Broad headings of the budget

The European Union budget (expenditure side) is made up of a great many chapters and lines within the chapters. The purpose of this briefing paper is not to explain all of these in any great detail. We will focus here on some broad headings.

The main headings which feature in the Financial Perspectives (2007 to 2013)[5] are[6]:

- Sustainable Growth – this part of the budget is subdivided into (a) Competitiveness for Growth and Employment and (b) Cohesion for Growth and Employment. Funding under this heading would cover research, transnational networks, support for developing the 'knowledge society', support to countries and regions with below average GDP, support to the peace process in Northern Ireland and specific support to cross border regions.
- Preservation and Management of Natural Resources (this includes the Common Agricultural Policy, Fisheries Policy and related areas). In addition to the subsidies to farmers, expenditure under this heading also includes some funding of sustainability, biodiversity and rural development measures and support to regions affected by changes in fishing patterns to develop economic diversification.
- Citizenship, freedom, security and justice. This heading includes a broad range of expenditure including asylum and migration issues, the Schengen Information System, counter-terrorism measures, EU level law enforcement, cultural exchange programmes, the European Media programme and many more.
- The EU as a global player. This includes all external action instruments including development assistance (other than that funded through the European Development Fund which is not part of the EU budget), conflict prevention work, expenditure on enlargement and on the European neighbourhood policy, humanitarian aid and support in third countries for human rights and democratisation.
- Administration
- Compensations (This is a minor element and only relates to the years up to 2009.)

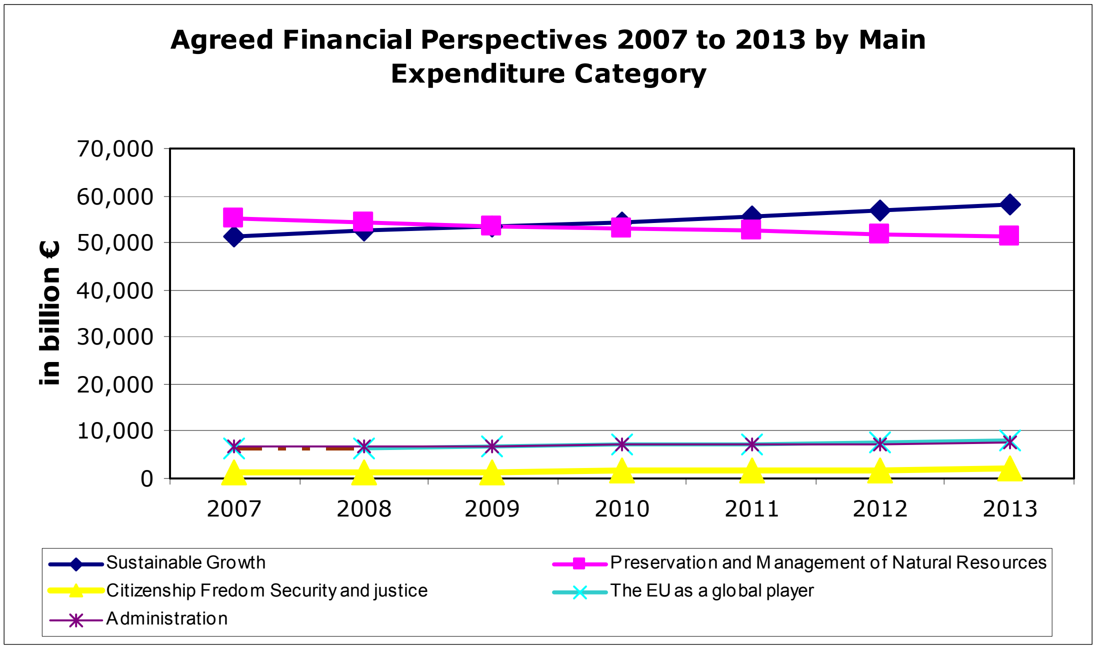
Relative weight of expenditure by policy area

Looking at the actual agreed figures within the Financial Perspectives[7] by main category, it becomes clear where the priorities lie.

[5] See http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_139/c_13920060614en00010017.pdf for detail

[6] For details on all the headings, there are so-called Technical Fiche available which set out exactly what expenditure is covered under which heading and the amounts of money available. They are accessible at: http://ec.europa.eu/budget/reform/issues/article_5961_en.htm

[7] Figures from: Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management published in the Official Journal of the European Union C139 on 14.6.2006, accessed on 21 December 2007 at: http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:2006:139:SOM:EN:HTML



'The Preservation and Management of Natural Resources' (mainly the Common Agricultural Policy but also including Rural Development Funding) starts off as the highest priority but reduces to the second highest priority by 2010.

'Sustainable Growth' starts off as the second highest priority and becomes the highest priority from 2010 onwards.

'The EU as a global player' is relatively steady in terms of the funding available and at a very low level in percentage terms (approx 6%).

'Administration' also runs at around 6% on average and given the bad press the EU has for having a top heavy bureaucracy, this is not a bad level, especially if one bears in mind the cost of running the European Union with over 20 official languages. Because this represents an amount very similar to that expended on EU as a global partner, the two lines almost cover each other completely on the graph.

'Citizenship, Freedom, Security and Justice' similarly occupies only a very marginal level of EU expenditure.

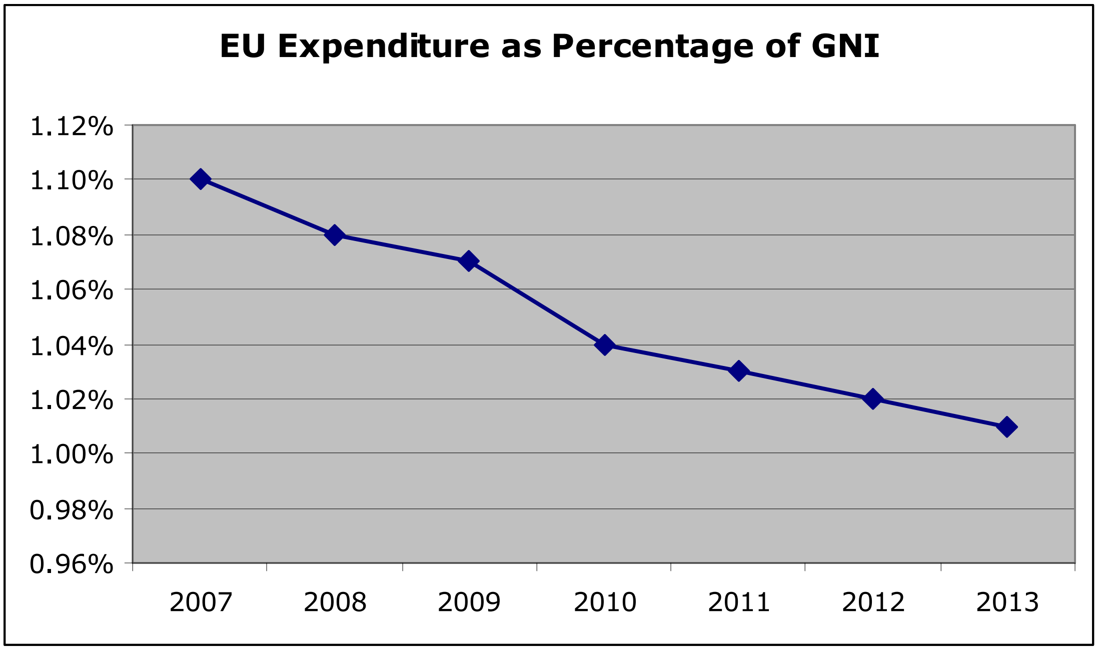
In terms of the distribution it thus becomes clear that policy areas focused inwards (sustainability and growth, agriculture and rural development, citizenship, freedom, security and justice) taken together make up the bulk of the budget and that external action takes a very minor back seat. Given the aspiration of the European Union to be a global actor, this might be surprising, but given that the European Union started out as an Economic Community with the aim to have a single market where everyone inside that market could compete on equal terms, this balance is not surprising. What it says about solidarity with people outside the European Union is another question, however.

It must be remembered that in addition to the EU budget there is also the European Development Fund which is a major source of EU development funding. This amounts to another nearly € 23 billion over the period 2008 to 2013. Member States also fund significant amounts of development assistance on a bilateral basis

Furthermore, as foreign and security policy is a Member State competence and thus expenditure on this is within the Member State budgets rather than at EU level. Indeed, some ESDP missions (certainly all the military ones, but to an extent also some civilian ones) are funded through contributions from EU Member States which are outside the EU budget.

Relative weight of expenditure over time

Looking at this in terms of the European Union budget as a percentage of GNI (and we need to remember that the current ceiling on this is 1.24%) the following picture emerges:



In other words the burden of the European Union budget on the Member States becomes marginally less over time. This is despite the fact that the policy aspirations of the European Union and even the internal needs of some of the newer Member States under the headings of sustainability, growth and agriculture are growing and putting an extra burden on the European Union. This, too, says something about solidarity, however on this occasion it is more about solidarity within.

Who pays and who gains

Clearly this is only a part of the picture. The European Union and its Member States are not completely separate entities – there are financial flows in both directions; i.e. Member States hand over money in terms of the three main sources of European Union funding and Member States (MS) (or institutions, organisations, and individuals in Member States) receive funding from the European Union.

Flows from EU to MS and from MS to EU

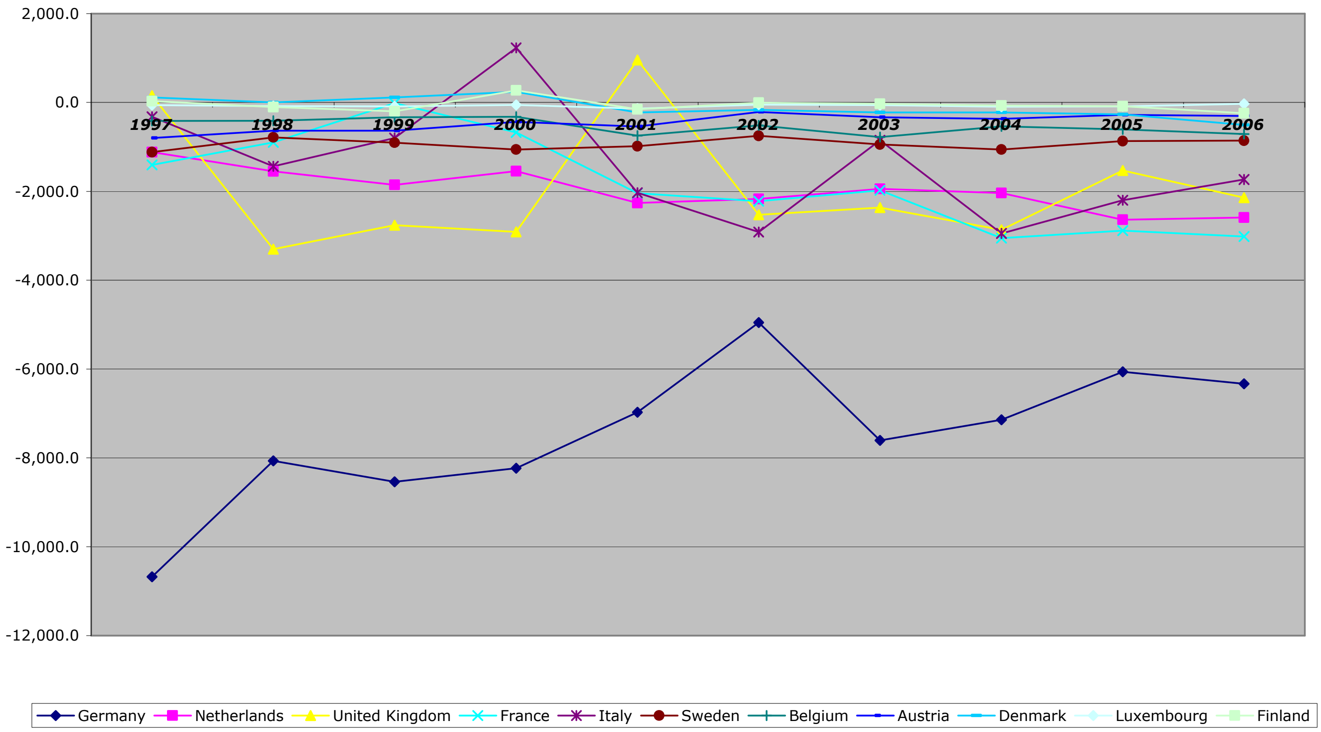
At the end of an accounting period there is therefore a net position which each Member State arrives at which could be neutral (inflows and outflows balance each other out), positive (inflows from the EU outweigh the outflows to the EU) or negative (inflows from the EU are less than the outflows). This leaves some countries as net payers and others as net recipients, while a few countries might find their net position to be neutral. It was quite evident in the discussions which led to the agreement of the current Financial Perspectives that the net payers have a different view on the EU finances from that of the net recipients.

Added to this, as this round of Financial Perspectives was launched the significant recent enlargement led to a situation where previous net recipients were going to be net payers for the first time. That led to strong views from this group of countries.

The calculation of who is a net payer and who is a net recipient is by no means simple. It takes considerable time and the information tends to be available only long after the end of the accounting period.

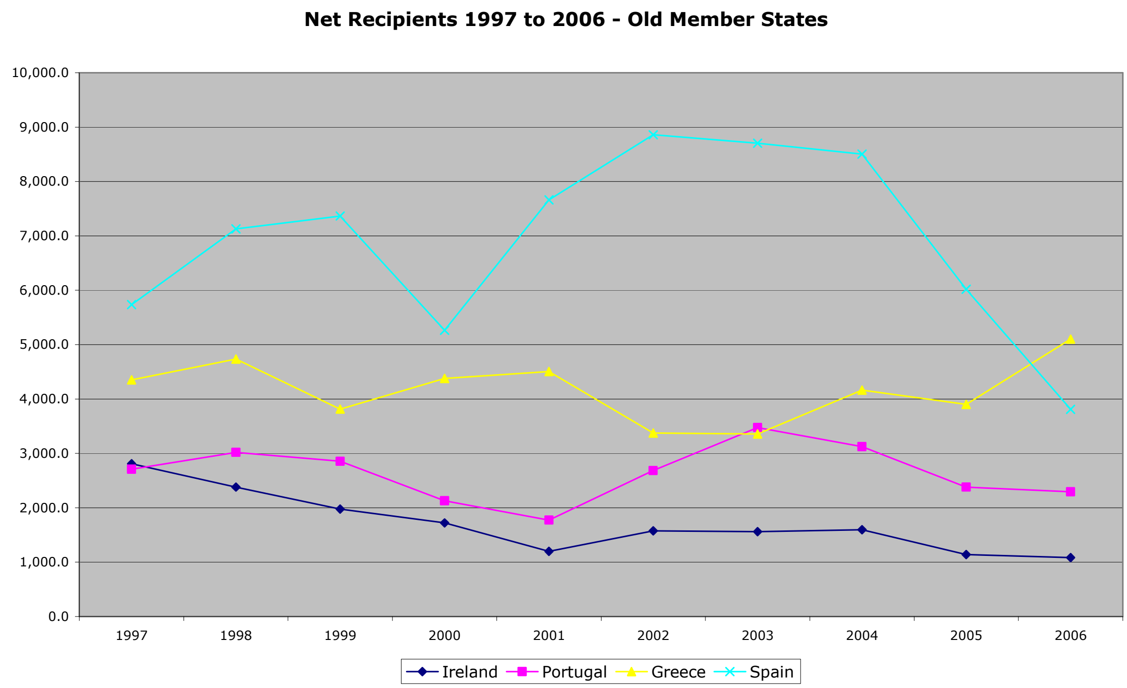
The following three graphs show the picture in terms of net contribution and net gain over the last 10 years. New Member States are shown only since 2004, which was only a part year for them, so that graph only reflects 2.66 years. Bulgaria and Romania are excluded as no figures yet exist for these countries.[8]

Net Contributors 1997 to 2006

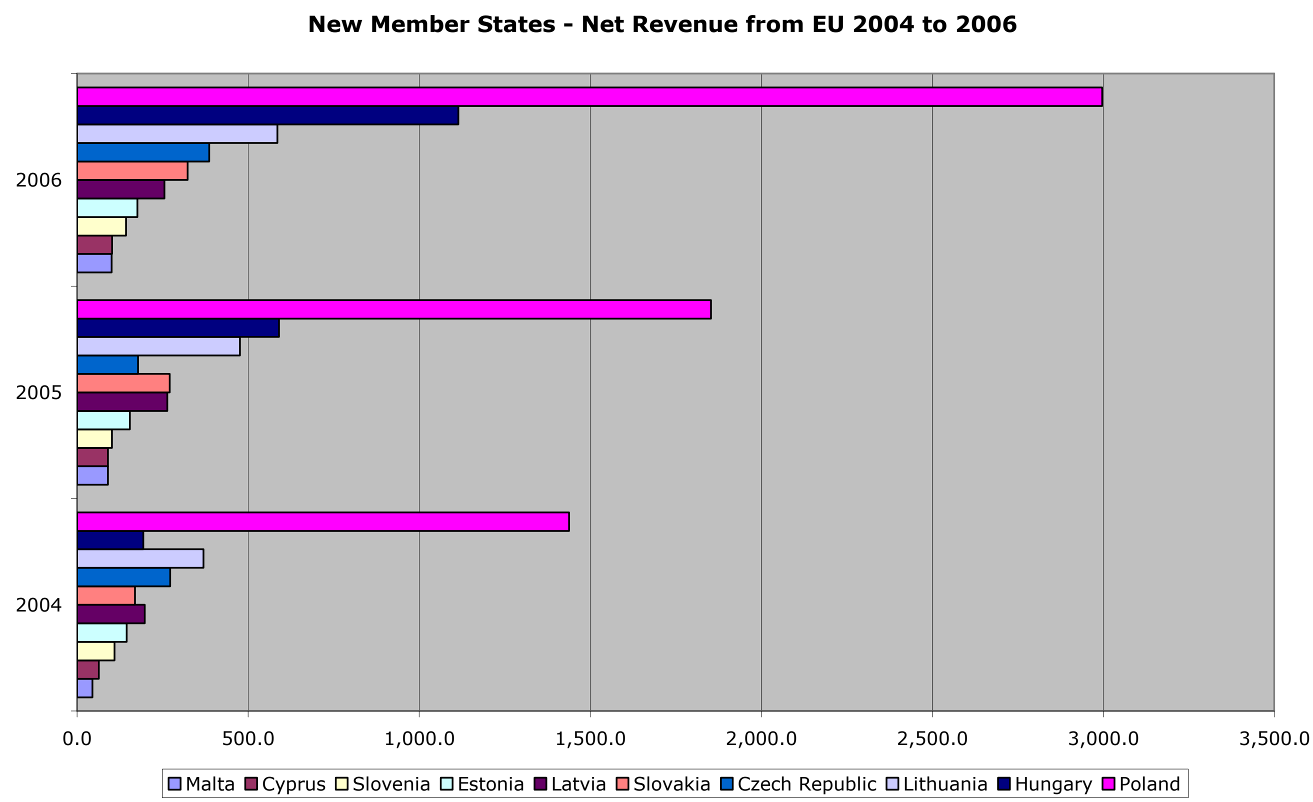


These are the net contributors. It is interesting to note that for the heaviest net contributor, Germany, the contributions have reduced over the last 10 years.

[8] All figures from EU Budget 2006, Final Report, p65 accessed on 21 December 2007 at: http://ec.europa.eu/budget/library/publications/fin_reports/fin_report_06_en.pdf



The 4 old Member States that have been net recipients of the European Union are shown in this graph.



It is clear that even in the very short space of time of membership a clear pattern of direct budgetary benefit emerges which becomes more evident over time. This is an area that will need to be watched.

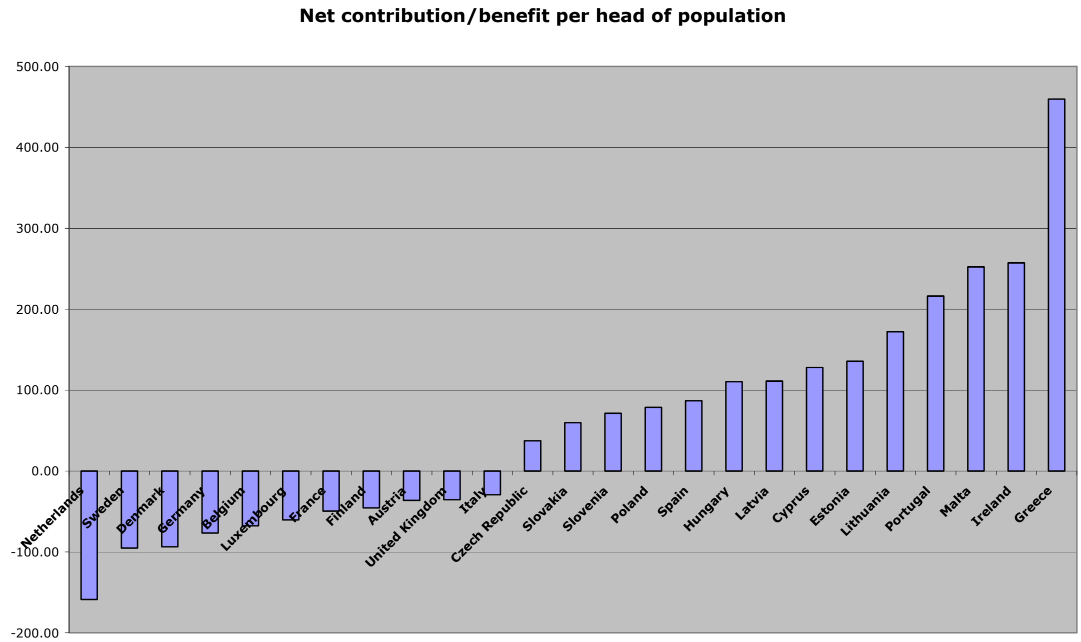
Different ways of measuring

The figures in the graphs are quite crude – they reflect the budget outturn in each year and are calculated with reference to a relatively complex formula as the allocation of receipts from the European Union to Member States is not straightforward. Administrative expenditure is excluded as is revenue from traditional own resources.

They also do not reflect the relative wealth of each country in terms of average purchasing power nor is it based on a per capita basis of the population.

The following graphs then show the position first by comparing the contribution/receipts on the basis of a per capita allocation of the total[9]. The comparisons here are made only for the last of the 10 years shown in the graphs above to simplify the picture a little.

This is, again, a crude measure but does show a slightly different allocation of 'the burden' of the EU budget from that in the graphs above:

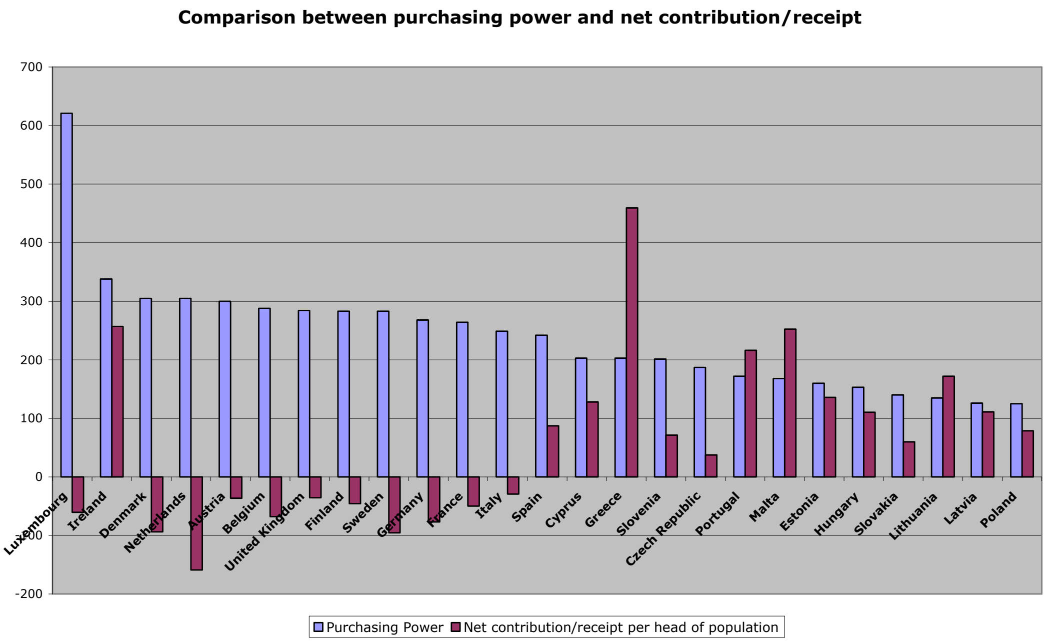


Here, it is clear that net contributors with smaller populations are contributing a little more per person than those with larger populations.

Another aspect is the relative wealth of each country. Again, there are several measures used for this; the European Union uses a measure which is the gross domestic product per head of population and we have applied this measure (based on 2006 figures) to arrive at the following comparison[10]. (Please note that the gross domestic product per head of population has been scaled by a factor of 100 to allow the graph to be drawn.)

[9] Population figures from map published by Travelling in Europe, 2007

[10] Figures from map published by Travelling in Europe, 2007 edition



Corrective measures

Whenever the European Union budget is discussed, the conversation comes round to the question of corrective measures. Essentially, what this means is the UK rebate and the consequences arising from it.

The UK rebate is not a simple issue. To quote again from the Report on the future of the European Union's own resources (2006/2205 (INI)), Committee on Budgets:

> 'The origin of the problem was the special situation of the United Kingdom which was characterised by two factors:
> - A small agricultural sector resulting in very low Community agricultural spending in the UK
> - A large contribution to the financing of the Community budget because of the large proportion of the country's GNP accounted for by the VAT base.' [11]

Without going into significant detail on the calculation method of the amount rebated to the UK (and this rebate has been in place since 1982 and in its current form since 1984) it is worth noting that the amount of the annual rebate has averaged 4.6 billion Euro over the period 1997-2003[12]. Given that over the same period the average annual contribution of the UK to the EU budget (based on the Operating Balances used in the graphs above[13]) amounted to just under € 2 billion, this gives some indication of the importance and magnitude of this rebate. Even with the rebate, the UK is the third highest net contributor in overall financial terms but falls to place 10 on a per capita basis.

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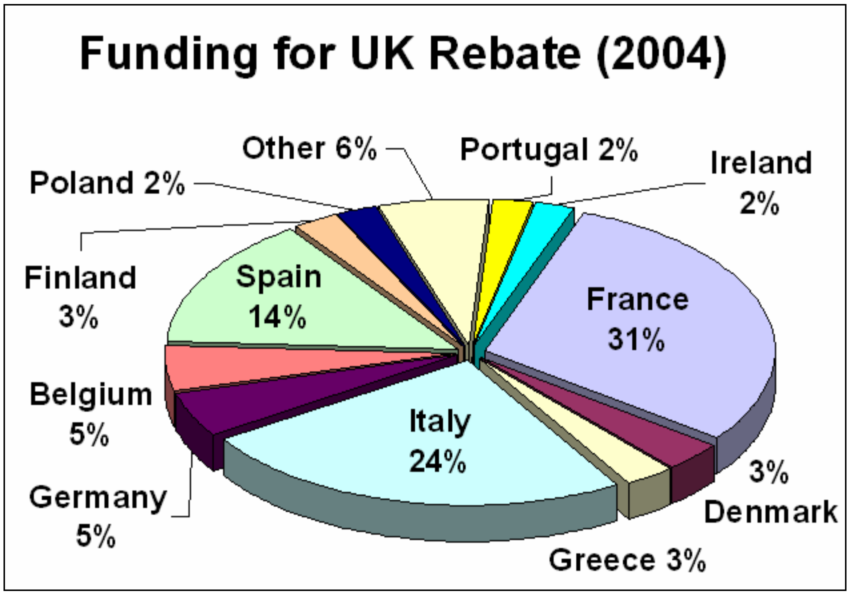
[11] European Parliament, Report on the future of the European Union's own resources (2006/2205 (INI)), Committee on Budgets, 13.3.2007, Rapporteur: Alain Lamassoure, accessed at: http://www.europarl.europa.eu/oeil/file.jsp?id=5378292 on 20 December 07

[12] Figures as quoted in European Parliament, Report on the future of the European Union's own resources (2006/2205 (INI)), Committee on Budgets, 13.3.2007, Rapporteur: Alain Lamassoure, p. 22 accessed at: http://www.europarl.europa.eu/oeil/file.jsp?id=5378292 on 20 December 07

[13] All figures from EU Budget 2006, Final Report, p65 accessed on 21 December 2007 at: http://ec.europa.eu/budget/library/publications/fin_reports/fin_report_06_en.pdf

The question then arises: how is this rebate financed? The rebate does not make the budget of the EU smaller. In other words, other Member States have to pay more in order to fill the gap. In principle, this extra money that the others have to pay is allocated in proportion to the GNI; but the other major net contributors (Germany, the Netherlands, Austria and Sweden) pay only 25% of what they would have to pay towards this on the basis of their GNI. That means the others have to pay more. The resulting distribution of the contributions to making up this gap, i.e. the funding of the UK rebate looks like this[14]:



Clearly, several things have changed since the rebate was agreed in its current form in 1984. The Common Agricultural Policy (then representing some 80% of the expenditure of the European Union) has reduced quite considerably in terms of its proportion of the EU budget; the importance of VAT as a source of EU funding has reduced significantly; and a large number of new Member States have joined the European Union thus changing the balance between the Member States and their relative economic weight.

A further complicating factor is that the allocation of financing of the UK rebate is uneven, in that it is based on the GDP of the Member State but capped for the large net contributors (Germany, Sweden, the Netherlands and Austria) with the result that the other countries have to contribute more to the funding of the rebate.

How big is the budget?

It is invidious to compare the EU budget to budgets of Member States or other governance entities (such as a local authority or regional authority) because the policy objectives, the approach to funding and the division of funding responsibility are very different. But sometimes it helps to have a bit of a picture.

The one picture that might be helpful is to focus on how much the EU costs each citizen per year on average: a grand total of € 255. You might want to compare this with the overall tax burden you bear, in income tax, indirect taxes, local taxes and social security contributions.

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[14] Graph from Wikipedia, the Free Encyclopaedia, accessed on 21 December 2007 at: http://en.wikipedia.org/wiki/UK_rebate