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Analizy i Opinie

Polish position with respect to the British rebate and EU budget reform

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- *Poland ought to draw up a position with respect to the British abatement – compensation paid to the United Kingdom for its over-contribution to the financing of EU policies. Indeed, a reform of the British rebate may turn out to be one of the bargaining chips in negotiations of the EU budget for 2007-2013.*
- *In spite of its seeming insignificance, the British rebate constitutes a pivot in the EU financial and budgetary equilibrium. The unavoidable disassembly of that mechanism and probable fundamental reform of the EU system of member contributions give Poland an opportunity to strengthen its presence in European structures and achieve its own political objectives.*
- *Poland may use the debate over the British rebate to win the goodwill of countries located on the opposite end of economic interests – the net payers, who are vitally interested in the reform of the current EU budget financing and spending system.*
- *The EU practice is to conclude package deals. While formulating its expectations of the EU budget carefully and avoiding self-serving insistence, Poland should combine several aspects of the budget reform and, consequently, support the reform of the rebate mechanism and Common Agricultural Policy while trying to maintain its access to the Structural Funds at the appropriate level.*

The origin of the adjustment of British contributions to the EU budget is directly associated with the persona of Prime Minister Margaret Thatcher. The sentence she has uttered in 1984 at the summit of European Communities in the Parisian suburb of Fontainebleau – “I want my money back!” – is to this day synonymous with the British attitude toward the European Union. The main reason for establishing

the rebate for the UK lied in the excessive deficit that that new member of the European Community (since 1973) was experiencing in the settlement of its accounts with the common budget. The blame for this state of affairs was placed on the system of financing expenditures, which at that time relied mainly on members’ contributions calculated on the basis of proceeds from VAT.

Rebate calculation method and Polish membership contribution

The amount of the rebate is determined by way of examining the UK net turnover in its account settlements with the European Commission in the given accounting year. The formula is so complicated (see Table 1) that anecdotes have been circulating about the fact that nobody in the Commission understands any longer how the ultimate amount of the rebate is arrived at. The basis for estimating the net amount is the percentage of a member's share in contributions to the EU budget out of VAT proceeds. This amount is reduced by the member's percentage share in "internal" expenditures (or, more precisely, in so-

called "allocated expenditures", i.e. expenditures which are transferred directly to members and candidate-members). The resulting amount serves as a basis for calculating the due rebate. It was decided in 1984 that other members would finance 2/3 of the British overpayment. Consequently, the amount is multiplied by 0.66 and the result (reduced further by other small amounts) constitutes the British abatement proper. Its financing is divided proportionally among all remaining members. Therefore, it can be stated that Great Britain is reimbursed roughly 2/3 of its net contribution to the EU budget.

Table 1. Simplified British rebate calculation formula

$$0,66 \times [(VAT_{UK} - EXP_{UK}) \times EXP_{internal\ EU}] - GDP_{UK} - extra_{UK}$$

VAT_{UK} – UK percentage share in the EU budget from VAT proceeds

EXP_{UK} – UK percentage share in internal expenses out of the EU budget (incl. enlargement costs)

$EXP_{internal\ EU}$ – (allocated expenditures) – expenditures out of the EU budget incurred in member-states (incl. enlargement costs)

GDP_{UK} – amount gained by the United Kingdom thanks to the introduction of membership dues based on GDP and reduction of proceeds from VAT

$extra_{UK}$ – additional UK earnings from traditional domestic sources, e.g. customs duty

The ten new EU members are predominantly small (some 80 million citizens in the new member-states constitute approx. 20% of the EU25 population; half of them are Poles) and poor (the EU GDP growth after enlargement will amount to a little over 5%). In accordance with the draft budget for 2004, these countries will contribute those very

5% to the financing of the UK rebate, i.e. approx. 250 million Euro, which, however, will cause a disproportional alleviation of costs for the old members. Table 2 shows an approximate amount of the Polish contribution to the EU budget in the initial years of membership.

Table 2. Approximate PL contribution to the EU budget in 2004-2006

Year	Amount (million €)	Incl. British rebate (million €)
2004	1356 ³	105 ³
2005	2764 ¹	230 ²
2006	2894 ¹	244 ²

Source: ¹Paweł Samecki, *Przepływy finansowe między UE a Polską w latach 2004-2013* (Financial flows between EU and Poland in 2004-2013) published in the report *Korzyści i koszty członkostwa Polski w UE* (Benefits and costs of Poland's membership in the EU) prepared by the European Centre in Natolin, Warsaw 2003, p. 34.
² Conclusion de la présidence, *Cadre financier pour l'élargissement 2004-2006*, Copenhagen 19 décembre 2002;
³ Draft EU budget for 2004.

The draft of the EU budget for 2004 sets the amount of the Polish contribution at 1356 million Euro, of which 105.1 million Euro will finance the UK rebate. This is approx. 8% of the entire amount paid in. Thus the Polish state budget will be burdened to such great extent with financing a mechanism totally futile to our country. This

also shows how important it will be to assume an appropriate position prior to the negotiations of the financial prospects for 2007-2013. Their outcome may have a measurable impact on the amount of the Polish contribution and the total of financial flows between Poland and the EU.

Poorer countries should care about reforming the system

France and Germany have always been the staunchest critics of the British rebate, and representatives of the Scandinavian countries are also expressing their mounting skepticism. What is surprising in the debate on the reform of the system of payments into the common EU budget is the silence of the countries that would be its greatest beneficiaries. To date, attempts of reform have boiled down to adjustments in the financing of the EU budget consisting in reductions of the share contributed by net payers. Germany

stopped to be the main country financing the rebate and in 2003 its 30% contribution was reduced to 7%. The same happened in the case of the other three countries from the so-called Group of Four (that was what the group of the largest net payers was called during the negotiations of the financial prospects for 1999-2006) – Germany, Austria, the Netherlands and Sweden. During the Berlin summit of 1999, they were successful in achieving a reduction of their contribution to the British rebate by 75%.

This means that a portion of the contribution which falls to the affluent countries must be covered by their poorer counterparts. Hence they should be doubly interested in an overall reform of the system. Unfortunately, they speak about this issue rarely and only in the context of holding on to their own benefits, such as large subsidies under the Structural Funds or the Cohesion Fund. Countries of the so-called “cohesion group” (Ireland, Portugal,

Spain and Greece), in other words those countries which greatly benefit from European policies, have never come forward with an unequivocal position. The attitude of their governments shows a fear of losing current privileges. Consequently, the system of financing European policies has found itself in a paradoxical situation where the maintenance of the widely criticized status quo seems more beneficial than an attempt to overhaul the mechanism.

There are no reasons for keeping the rebate

From the economic point of view, the current solution based on a complicated contribution adjustment scheme has ceased to fulfill the role it has been tasked with. VAT proceeds going into the EU budget have plummeted and, therefore, the reasons for maintaining a mechanism that reduces the UK contribution are no longer valid. The economic situation of the United Kingdom has ceased to provide the grounds for its demanding attitude, which has been dominating the European discourse in Great Britain for the past 20 years.

The EU enlargement, which converges in time with the necessity to renegotiate budgetary provisions, should be used to carry out a total reform of the financing system. Attempts to prepare such reform are easily visible not only in European Commission documents. The will to put the budget in order, on the side of expenditures and contributions alike, is discernable in the comments of the leaders of net paying member-states.

However, Great Britain is not making the discussion of reforms any easier. The main negotiating strategy of all successive British governments has been to stay away from the topic. “The rebate is not on the agenda” – warn British politicians before practically every European Council summit dedicated to financial issues. Attempts to focus on the budget reform are à priori exposed to strong criticism. The British usually tell France that it is trying to divert everybody’s attention from excessive expenditures associated with the Common Agricultural Policy and censure Germany for having organized a covert EU enlargement through German reunification. This throwing about of political accusations has been going on in the EU for some time already and does not seem to lead to any specific changes. The European Commission has been trying to raise the substantive level of the debate by publishing extensive studies of possible reforms of the contribution system.

Possible reform scenarios

A comparison of British economic indicators with those of the new members clearly shows the absurdity of a situation where the latter will have to chip in to a rebate granted to a richer member. The outcome of a simulation conducted last year by the Swedish finance ministry demonstrates that by 2013, without a reform of the current financing system, all members of the so-called cohesion group (Italy, Ireland, Spain and Portugal) as well as the 12 new members (including Romania and Bulgaria) will each pay into the EU budget more than Great Britain.

Consequently, the British realize that the defense of the rebate will be extraordinarily difficult during successive budgetary negotiations. Therefore, the task of the British negotiators will rest in developing such EU financing model or reform of Community policies that will compensate for the loss of the privilege won in 1984. Comments found in the British press, both Conservative and supportive of the government, clearly indicate the British intention to attack the Common Agricultural Policy and reduce direct agricultural subsidies.

It is also probable that Great Britain will consent to reforming the Structural Funds in a manner directing a larger portion thereof to financing the development of regions in prosperous countries. This would provide British negotiators with a palpable evidence of the return of British money from Brussels back to the UK. Nor is it surprising that London has joined the coalition of countries which wish to lower Community expenditures to 1% of the GDP of EU25. This will give Great Britain a double advantage. Firstly, it will lower the British

contribution to the EU budget - whose main task will be to finance the development of new member-states and, secondly, it will give the UK an argument in the debate over the rebate, since reduced expenditures and contributions will also lower the burden of its financing.

The British abatement could be given up if the benefits ensuing from the new financing system were greater than the current status quo. However, the British attitude to date seems to indicate that the UK is less concerned with actual financial benefits and a cohesive EU financing system than with maintaining the symbol, regardless of the price (political and economic) which it will have to pay. It may also turn out that bringing the pound sterling into the Euro zone will be a much more significant priority for other member-states than the elimination of a cumbersome but inexpensive British "toy".

Polish negotiating position should be flexible

What position should Poland assume under the circumstances? It is clear that the situation of Poland in budgetary negotiations will not be easy. The strength of a voice in every political debate is measured in the EU by the size of the wallet. Our attitude during the initial contacts at the negotiation table has shown that we are indeed able to hold a decisive stand when fighting for our interests in spite of our weak bargaining position. The discussion of the financial prospects for 2007-2013 will inevitably overlap with the final stage of negotiations of the shape of the European constitution. Voices heard here and there give grounds to believe that both issues will be linked and that Poland, a country which stands firmly by solutions benefiting its interests, may find itself in isolation.

And isolation is what we should fear the most. Despite the fact that on both key issues (constitution and financial prospects) decisions will be made with due regard for the principle of unanimity, political consequences of holding on to an extreme position may turn against Poland. The EU practice is to make package deals. Member-states try to solve as many issues as possible with one decision, so as to ensure that everybody gets the proverbial candy to sweeten some controversial but needed decision. Therefore, the Polish position should anticipate potential moves by our partners in negotiations. We should suggest unconventional solutions and justify them with our unfavorable economic predicament known to all.

Poland should back a radical reform of the EU budget

Poland may use the debate over the British rebate to win the goodwill of countries located on the opposite end of economic interests, the net payers. They are vitally interested in the reform of the current EU budget financing and spending system. Therefore, transparency of the own contribution system and excessive burdening of the budget with obsolete expenses will be very important to them.

In addition to the budget financing reform, which may allow Poland to save almost 10% of its contribution to the EU - used to cover our part of the rebate – it is important to assume an appropriate

attitude on the issue of the Common Agricultural Policy and reform of the Structural Funds. A continuation of the trend to reduce EU expenditures, regardless of the way it is done, will harm Poland the most, since it is potentially the largest beneficiary of Community policies. This is why Poland ought to be very careful in formulating its expectations as concerns the EU budget. Our arguments should be free of self-serving insistence which will expose us to criticism. Instead, we should try to accentuate those compromises which our country is ready to make.

As for expenditures on agriculture, Poland has not achieved much success despite its very tough stand at the end of accession negotiations and during the Copenhagen summit (December 2002). It will take nine years for the new members to reach the full amount of agricultural production subsidies. The agricultural agreement reached by Germany and France in mid-2003 (freezing agricultural production subsidies at the current level) and recent decisions relative to sugar production subsidies seem to indicate that the overall trend will go in the direction of limiting rather than increasing expenses associated with agricultural subsidies.

On the eve of the negotiations Poland should ask itself how much it wants to fight for a larger share in the Common Agricultural Policy – an instrument whose effectiveness has been repeatedly questioned and which will be very difficult to keep in the present form. Backing a reform of the agricultural policy may turn out exceptionally beneficial for Poland. Maintaining some form of assistance to farmers in the so-called “old” Union is inevitable. However, a successive reduction of subsidies in countries which to date have been beneficiaries of a full financial support and a concurrent gradual introduction of such subsidies in Poland would reduce the period needed to equalize assistance levels and would greatly improve the competitiveness of Polish agricultural products on the Common Market. Agreeing to the reform of the agricultural policy would also be an important signal issued by a state universally suspected of being reluctant to reform its own agriculture, which is generally considered (rightly or wrongly) to be outdated and ineffective.

Moreover, it would also make sense to compare the level of agricultural subsidies which Polish farmers will be receiving out of the EU budget against other transfers. According to the Finance

Ministry data, out of the 37.5 billion Euro which Poland may receive from the EU budget in 2004-2006, subsidies to farmers will amount to less than 4.6 billion Euro. At the same time, resources for rural development (under the European Agricultural Guidance and Guarantee Fund) will alone exceed 5 billion Euro, whereas Poland might receive almost 22 billion Euro for the development of all its regions from the Structural Funds and the Cohesion Fund.

Consequently, it seems much more important to be able to guarantee a proper level of utilization of the Structural Funds. Polish negotiators should try to ensure that the current priorities of the structural policy are kept side by side with the introduction of new ones, beneficial to other members. For example, it would be possible to apply the ring fencing principle, whereby funds earmarked for financing structural policies in poor regions of the new member-states could not be used to finance the development of affluent regions (and vice-versa). Another solution that would not include any reduction measures would consist in facilitating access by poorer regions to resources earmarked for financing the new priorities of the Structural Funds, for example investments in new technologies. Another method of increasing the benefits gained from the Structural Funds would consist in bringing down the amount of equity required to access these resources – a problem that all beneficiaries of pre-accession funds, both private and institutional, must struggle with already today.

Independently from the possibilities potentially associated with the elimination of the British rebate and overhaul of the contribution system, one must be aware of a whole gamut of restrictions that we will have to face during the negotiations. Great Britain continues to be a “peculiar” EU member. The British enthusiasm for and involvement in the

European project show a great deal of susceptibility to current events, hence the EU willingness to make concessions to Great Britain. In addition, there is the already discussed issue of Great Britain joining the European Monetary Union. Therefore, the Polish position should be flexible and based on a thorough examination of the possible priorities of other members, so as to enable Polish negotiators to attach the issue of the rebate to other reforms. Poland can start building a wider coalition around a small issue, apparently insignificant, but one that would allow inclusion of the priorities of the Polish policy toward the EU in a comprehensive solution.

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