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M Alexander

4th February, 1980

Dear Tim,

You will wish to know that the next issue of the Treasury's Economic Progress Report, due out on Wednesday afternoon this week, will contain material on the UK's excessive net contribution to the Community Budget. I attach a copy of the proof version. You will see that the article has been confined to giving background factual information; it has not attempted to make a more "political" presentation of the case. Your Press Secretary already knows about the article from Peter Davies here.

Yours

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Economic Progress Report

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The UK's contribution to the Community Budget

At the time of the negotiations, in 1970, about the United Kingdom's entry to the European Economic Community, there was concern that the Community's way of raising revenue (the 'own resources' system*), together with the predominance of agriculture in Community spending, would result in the UK making a very large net contribution to the Community's Budget once the transitional period ended late in the 1970s. It was then held in the Community that such fears were exaggerated. It was said that calculations for a period 8 or more years ahead were theoretical and it was likely that the Community would adopt new policies which would reduce the proportion of the Budget taken by agriculture to 60 per cent or even 40 per cent. This would reduce the UK's prospective net contribution, because Britain's receipts under the new policies would be higher than those from the Common Agricultural Policy.

However, the original Member States agreed that 'should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the Institutions find equitable solutions' (paragraph 96 of Cmnd 4715, July 1971).

The development of the UK net contribution

Britain joined the Community on 1 January 1973. In the first year of membership it made a net contribution of just over £100 million. There followed 2 years, 1974 and 1975, in which the United Kingdom's accounts with the Community were roughly in balance. But by 1976 the British net contribution had risen again to over £150 million. By 1978 it had reached £800 million and in 1979 £900 million.

Between 1973 and 1979 the UK's payments to the Community were governed by the so-called 'transitional arrangements', which provided for the phased introduction of the full UK gross contribution under the Own Resources system. In 1980, for the first time, the UK net contribution will reflect the unmodified effect of the Community's budgetary arrangements on the UK's transactions with the Community.

Comparison with other Member States

Table 1 is based on the European Commission's latest available estimates of the net positions of Britain and the other Member States in 1980. These estimates were made in the early autumn of 1979. The difference between columns 1 and 2 and 3 and 4 respectively lies in the differing attribution of the benefit of the Monetary Compensatory Amounts (MCAs) paid on agricultural exports from other Member States to the UK and Italy. The UK believes that these payments must be regarded as subsidies to producers in the exporting Member State, since they allow their higher cost produce to compete in lower price markets. On this basis, the presentation in columns 1 and 2 is correct. But on either treatment of MCAs the UK emerges as the largest net contributor by a substantial margin.

The UK as the major net contributor

On present policies, the UK would make about 60 per cent of the total net contributions to the Community Budget in 1980. But as Table 2 shows, the UK's GNP per head is the third lowest in the Community.

Table 1

NET BUDGET POSITIONS IN 1980

	Exporter benefits from MCAs		Importer benefits from MCAs	
	£m	*EUA m*	*£m*	*EUA m*
Net contributors				
UK	1,209	1,814	1,035	1,552
German Federal Republic	699	1,048	738	1,107
France	13	19	80	120
Net beneficiaries				
Luxembourg	195	292	195	292
Denmark	247	370	189	283
Netherlands	281	422	239	359
Ireland	342	513	291	436
Belgium	367	550	359	538
Italy	489	734	581	871

Source: Commission Reference Paper on Budgetary Questions. EUA amounts converted to sterling at an exchange rate of £1 = EUA 1.5

GNP per head is widely accepted as the best available measure of a country's ability to pay. But in 1980 the UK is expected to make a net contribution 40 per cent greater than that of Germany, although German GNP per head is very nearly twice as high.

Causes of the high UK net contribution

The UK's disproportionate net contribution results from the interaction of two factors: a high gross contribution and a low level of receipts from the Community Budget. Table 3, which relates the UK share of gross contributions and of Community expenditure (UK receipts) to its share of Community GNP, shows that rather over 1/3 of the UK's net contribution is attributable to the excess of its gross contributions over its GNP share. The remaining, greater, part of the net contribution arises from the low level of Community spending in the UK

*The Community's Own Resources consist of the duties levied on imports entering the Community from third countries under the Common External Tariff, levies charged on agricultural products from outside the Community to bring their prices up to the fixed levels prevailing under the Common Agricultural Policy price support regime, and the yield of a notional VAT rate of up to 1 per cent on a harmonised Community base.

Table 2

GNP PER HEAD AT MARKET EXCHANGE RATES 1978

	(Community = 100)
Denmark	143.7
German Federal Republic	136.7
Belgium	128.9
Luxembourg	125.8
Netherlands	123.1
France	116.1
UK	72.6
Italy	60.2
Ireland	49.6

Table 3

ANALYSIS OF UK NET CONTRIBUTION IN 1980*

		£m	as % of Community total
1. UK gross contribution		2,075	20.5
2. UK gross contribution if in line with UK share of Community GNP		1,621	16.0
3. UK receipts		866	8.5
4. UK net contribution (1–3)		1,209	
			as % of total net contribution
Of which:	Excess gross contribution (1–2)	454	37.5
	Deficient receipts (2–3)	755	62.5

*Exporter benefits attribution of MCAs

Source: Commission Reference Paper on Budgetary Questions

The level of UK payments to the Community under the Own Resources System reflects its exceptionally open economy, heavily dependent on imported food and with world-wide trading connections. The UK contributes almost a quarter of the Community's total revenue from tariffs and agricultural levies.

On the receipts side, the UK's meagre share in Community spending results from the continued domination of the Community Budget by expenditure on agricultural support. The Common Agricultural Policy absorbs over 70 per cent of the total Budget, most of this being attributable to the cost of storage and disposal of agricultural surpluses. The UK's small farming sector can never attract more than a small share of such expenditure; in 1980 its share of Community spending on price support is forecast to be no more than 5½ per cent. In other areas of Community expenditure, for example the Regional and Social Funds, Britain does better. But since these two funds account for only 7½ per cent of Community expenditure, even the UK's prospective 26 per cent share from them, which is 5½ per cent higher than its contribution share, would yield Britain a net gain of only £45 million. The British net contribution to the cost of agricultural price support measures is 25 times this size.

The 1975 Financial Mechanism

To be effective, any measures to reduce the UK's net contribution must take account of both the factors that have brought it about. So far, the Community has considered only the contributions side. In 1975 arrangements were made which, under certain circumstances, would serve to reduce the UK's gross contribution through the so-called Financial Mechanism. This states that: 'conditions incompatible with the proper functioning of the community could arise when a member state's economy, whilst in a special situation, is forced to bear a disproportionate burden in the financing of the Community Budget'. It provides that a Member State with a GNP per capita less than 85 per cent of the Community average, and a growth rate of per capita GNP less than 120 per cent of the Community average, should, subject to certain further conditions, be entitled to a partial refund of its gross contributions related to the difference between its share in total gross contributions and its share in Community GNP. The UK has met the relevant economic conditions in every year since the mechanism was agreed, but the other conditions have so far prevented it from receiving any benefit.

Own Resources

Despite the existence of this Financial Mechanism, which specifically acknowledges that high Own Resources payments may impose an undue economic burden on a Member State, it is sometimes argued within the Community that the UK's case rests on a misrepresentation of the true nature of these revenues. According to this view the imposts which make up Own Resources are the Community's legal property and cannot properly be regarded as 'a contribution' by the individual Member State in which they happen to be collected.

The legal status of Own Resources is not in dispute. They do belong to the Community. But as the Financial Mechanism recognizes, they can be the Community's property and still represent a burden. They are an economic burden on the UK because they remove resources which could otherwise have been employed in the UK, for the direct benefit of its people. And the fact that they are the Community's own resources does not rule out deploying them in a balanced and equitable way.

Trade patterns

It is also sometimes argued that the UK could solve its problem if it avoided levies and duties by importing less from outside the Community. For its part, the UK scrupulously observes the system of Community preference which the Common External Tariff embodies; this gives exporters in other Member States an advantage in the UK markets over producers elsewhere.

The Treaty of Rome did not set out to make the Community into a closed trading zone. But the UK has already re-oriented its trade towards the Community. The share of total imports coming from the Community rose from 31.6 per cent in 1972 to 38 per cent in 1978. The increase for manufactures, excluding transport and machinery, was even sharper, from 28.3 per cent in 1972 to 39.6 per cent in 1978. Comparable figures for food and drink show a rise from 32.4 per cent to 42.9 per cent. Such a reorientation is not reflected in the experience of other Member States in these years.

In any case, the trade pattern affects only the contributions: the argument is irrelevant to the low level of UK receipts from the Community.

North Sea oil

Another argument often heard is that UK energy resources enable us to sustain without difficulty a net Budget contribution of the size forecast for 1980. There is a second argument that every time the oil price rises, there is a very large additional benefit to the UK. Both arguments ignore the fact that although North Sea oil is of great benefit to our economy, the UK remains primarily a trading and manufacturing nation and a major consumer of oil and other forms of energy. In 1979 total North Sea oil output represented only 2 per cent of UK GNP, or less than half the growth of the German and two-thirds the growth of the French economy in that single year. The UK remains a net importer of oil and is likely to be in that position throughout 1980. So oil price increases continue to harm our economy directly (even if they harm us less than others), and they cause major damage indirectly because they add to inflationary pressures and reduce world growth and trade. As a nation with 30 per cent of GNP in exports, we suffer substantially from reduced world growth.

North Sea oil in no way removes the case for reducing the UK's present inequitable net contribution to the Community. GNP and GNP per head remain the valid tests of ability to pay, and are recognised as such in the present Financial Mechanism. The benefit of North Sea oil is fully reflected in both GNP and GNP per head. Even taking account of North Sea oil, the UK's ranking in the Community GNP per head table is unchanged.

The discussion in Europe

At the meeting of the European Council in Dublin in November 1979 the Council agreed, as regards the contributions element, that the 'adaptation of the Financial Mechanism could constitute a useful basis for a solution'. As for the receipts element, the Council requested the European Commission to put forward proposals for developing 'supplementary Community measures within the United Kingdom which will also lead to greater participation by the UK in Community expenditure'. These aspects will be followed up at the next Council meeting, the date for which is to be suggested by the Italian Presidency.