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NBPM

Treasury Chambers, Parliament Street, SW1P 3AG
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20th September, 1979

Dear Paul,

OUR EEC CONTRIBUTION:
POSSIBLE PUBLICATIONS

The Chancellor's letter of 18th September to the Foreign and Commonwealth Secretary should have contained a copy of the Treasury paper referred to in the third paragraph. I now attach a copy.

I am copying this letter to Michael Alexander, to the Private Secretaries to members of ODE, and to Martin Vile.

Yours ever,

MH

(M.A. HALL)
Private Secretary

P. Lever, Esq.,
Private Secretary,
Foreign & Commonwealth Office

BUDGETARY AND OTHER RESOURCE TRANSFERS WITHIN THE EEC

1. In his Budget Speech the Chancellor of the Exchequer said:

> "The European Community can, and should, be a source of stability and strength for its members. In one important area, however, present EEC policies are seriously hindering our efforts to help ourselves. At present the United Kingdom and Italy, which are among the poorer members of the Community, are transferring substantial resources, chiefly through the Community Budget, to richer member states. We have already made it very clear to our partners that this situation cannot be allowed to continue. It is plainly unfair. And it is against the interests of the Community itself, which cannot expect to progress on such an insecure foundation."

2. This paper explains how the present pattern of resource transfers within the Community has arisen, and why the Government considers the results for our budgetary contributions to be inequitable.

Introduction

3. Discussion of the economic impact of the European Community naturally tends to concentrate on particular policies and measures which have been adopted as the Community has developed. But it has become increasingly clear that it is also necessary to consider the impact of all these policies taken together. This is now sufficiently important to have a significant effect on economic development in some countries. The United Kingdom is one of these countries.

4. The range of policies pursued by the European Community causes resources to be transferred between Member States. As the pattern which emerges is a reflection of the individual policies, resources are not redistributed according to relative prosperity of the various Member States. The UK and Italy transfer resources on a significant scale to countries which have a substantially higher level of GNP per head.

5. In the British case, the quantity of resources which we transfer to other EEC countries can to a large extent be measured by our net

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contribution to the Community Budget. Figures published by the European Commission for the first time early this year show that in terms of hard cash paid across the exchanges the United Kingdom is already the largest net contributor. Moreover, the situation is deteriorating. If nothing is done to correct it, the UK will in 1980 be paying well over £1,000 million a year net to the rest of the Community. We will be far and away the largest contributor through the budget to European policies.

6. Any community, if it is to be successful, must in its economic relations as elsewhere have regard to the principles of mutual concern and of equity. The original six members of the Community recognised this in 1971, when they acknowledged that if unacceptable situations should arise in relation to the budget "the very survival of the Community would demand that the institutions find equitable solutions."

7. A number of arguments are advanced against action to redress the UK budgetary situation: that it is wrong to consider the total resource impact of Community policies; that total transfers through the budget are too small to affect significantly individual economies; and that the published figures for budgetary transfers do not provide an accurate guide to the resource flows in the Community.

Budgetary Transfers

8. It is natural to begin an analysis of resource transfers in the Community with an examination of the budgetary flows. The revenues that Member States contribute to the budget are the most obvious and most readily quantified economic costs of Community membership. Expenditure by the Community in any particular country is likewise the clearest pointer to the economic benefit that that country receives from the Community. The pattern of net contributions (contributions less receipts) summarizes the gains and losses to individual Member States through the Community budget. This year the European Commission has for the first time issued figures which make it possible to compare the position of member countries.

TABLE 1: Net budgetary transfers in 1978, £ million (1)

	Absolute figure(3)	As % of GDP	GDP per head
Belgium/Luxembourg	+ 252.6	+ 0.50	129
Denmark	+ 411.9	+ 1.44	145
Germany	- 281.4	- 0.09	139
France	- 55.0	- 0.02	117
Ireland	+ 356.0	+ 5.63	50
Italy	- 499.5	- 0.40	56
Netherlands	+ 146.4	+ 0.25	124
United Kingdom	- 625.8	- 0.44	73
TOTAL(2)	- 294.8		

NOTES: (1) Converted from European Units of Account (EUA) at the average exchange rate for the year.

(2) The net transfers do not sum to zero because all Member States maintain accounts in the name of the Commission; the balances on these accounts changed during the year.

(3) After full refunds under the transitional arrangements (Article 131 of the Treaty of Rome). The fourth quarterly refund for 1978 was paid in the first quarter of 1979, and does not appear in the figures for 1978 issued by the Commision.

9. Table 1 reproduces the Commissions' figures showing the net budgetary transfers that arose out of the 1978 budget. These figures are expressed both in absolute terms and as a proportion of Gross Domestic Product (GDP) for each country concerned. The first column provides an indication of relative prosperity, as measured by GDP per head at market exchange rates (see paragraphs 32-35 below).

TABLE 2: Net budgetary transfers in 1978 excluding the effect of the transitional arrangments

		£s million
Belguim/Luxembourg	+ 275.8	
Denmark	+ 411.9	
Germany	- 141.8	
France	+ 31.5	
Ireland	+ 343.8	
Italy	- 446.7	
Netherlands	+ 176.2	
UK	- 945.3	

10. The figures for 1978 are not however a reliable guide to the situation in future years. In 1978 the UK was still benefitting from the transitional arrangements negotiated at the time of its entry into the Community. These were designed to limit its gross contributio to the Community budget in the early years of membership and they expire at the end of 1979. To get a better idea of the likely pattern of net budgetary transfer in 1980, it is necessary to look at the 1978 figures as they would have been in the absence of the transitional arrangements. These figures are reproduced in Table 2, which shows even more clearly than Table 1 the inequitable effects of redistribution through the budget.

TABLE 3: UK contributions to the Community Budget (gross and net) since accession (1) £ million

	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	368.4	368.4
1978	1348.3	544.5	682.2

NOTE: (1) These figures incorporate Public Sector receipts only and the 1978 figure therefore differs from that shown in Table 1.

11. Table 3 shows that the UK's gross and net contributions have risen rapidly since entry. There are three reasons for the increase in its gross contribution. The first is the growth in the size of the Community budget: this has increased from £2.3 billion in 1973 to an estimated £10.8 billion in 1980. The second is the phasing-out of the transitional arrangements. The third is the nature of the Community's revenue-raising system. The Community receives the yield of the levies on agricultural produce entering the EEC and of customs dues paid on other goods under the Common External Tariff. This system bears more heavily on economies which have a large share of GNP in external trade and which, for reasons of geography and history, have extensive trade outside the EEC. The yield of tariffs and duties levied in the UK in fact exceeds by over 25% its share in the Community's Gross National Product.

12. Britain's unfavourable net position results also from the dominant part played in Community expenditure by the price support mechanisms of the Common Agricultural Policy (CAP). The CAP regularly absorbs 70-75% of the Community's total expenditure. As a major food importer, contributing only marginally to the Community's agricultural surpluses, the UK can only recoup a small proportion of its contribution to the CAP. The more than proportionate share of expenditure it secures from the Regional and Social Funds at present does little to offset this burden; the two combined make up less than 10% of total Community expenditure (see Table 4).

TABLE 4: Breakdown of Community Budget by spending area

EUA

	1978	As % of total	1979	As % of total
Research and Investment	194.0	1.6	196.4	1.4
Social Fund	538.8	4.4	502.5	3.7
Regional Development Fund	525.0	4.2	499.0	3.6
CAP Expenditure				
Guarantee Section	8695.0	70.3	9582.1	69.9
Guidance Section	423.5	3.4	396.3	2.9
Other expenditure	1996.1	16.1	2539.5	18.5
TOTAL	12372.6	100.0	13715.7	100.0

NOTE: Expenditure totals do not sum due to rounding.

The Trade Costs of the CAP

13. The figures for net transfers through the Community budget do not provide a complete picture of the resource transfers caused by Community policies; especially those generated by the CAP. The objectives and operation of the CAP are discussed in a companion paper and are therefore not set out in detail here. It is enough to note here that the CAP pursues its objectives by establishing guaranteed prices for the main Community crops. In order to raise farm incomes and to stimulate production, these guaranteed prices have generally been fixed at levels higher than those prevailing on world markets - hence the need for levies on agricultural produce entering the Community to bring its price up the CAP level.

14. This system means that the main burden of supporting farm incomes in the Community falls directly on the consumer rather than on the budget. The budgetary costs of the CAP arise only to the extent that the prices it maintains stimulate additional production and discourage consumption to the point where it generates surpluses in the Community. Through the price guarantee provisions of the CAP, the Community subsidises the sale of this surplus production on the world markets and compensates Member States for any storage costs they may incur before disposal. These subsidies and the storage costs together make up the budgetary cost of the policy.

15. The budget therefore bears the cost only of that addition to farmers' incomes which stems from production they cannot sell within the Community at guaranteed prices. The bulk of their production is sold within the Community at guaranteed prices.

16. Under this system countries which consume more foodstuffs than they produce (the net importers) transfer income to those which produce more than they consume (the net exporters). The pattern of gains and losses between social groups is everywhere the same as it is bound to be in a system of agricultural support; consumers transfer income to farmers. But the total gain exceeds the total loss for the countries which are net exporters; the reverse is true for the net importers.

The non-budgetary transfers that result from the CAP have been discussed in the companion paper mentioned above. Table 5, which is taken from that paper sets out the estimated non-budgetary transfers in 1977 and 1978. The Netherlands, Denmark and Ireland emerge as major beneficiaries. France, whose budgetary position was approximately neutral, also gains. The principal losers are Italy (which is a heavy importer of the northern agricultural products covered by the price guarantee mechanism), Germany and the UK. The effect is to transfer income from two of the less prosperous countries - Italy and the UK - to others which have a higher GNP per head.

TABLE 5: Summary of the food trade effects of the CAP

£million

	Higher cost of imports from rest of EEC		Higher value of exports to rest of EEC		Net food trade: cost (-) or benefit (+)	
	1977	1978	1977	1978	1977	1978
Belgium/Luxembourg	375	460	365	440	+ 10	- 50
Denmark	15	10	225	285	+210	+275
France	360	420	820	995	+460	+575
Germany	760	890	405	460	-355	-430
Ireland	55	55	220	240	+165	+185
Italy	530	640	45	55	-485	-585
Netherlands	265	320	815	925	+550	+605
United Kingdom	290	400	120	275	-165	-110

Note: for a detailed account of the derivation of these figures see [the companion Green Paper].

The Treatment of Monetary Compensatory Amounts (MCAs)

18. It is frequently argued that the figures for net budgetary contributions reproduced in Table 1 do not provide a good indication of the direction and extent of resource transfers through the Community budget. One argument concerns the attribution of Monetary Compensatory Amounts (MCAs) in the budgetary figures.

19. MCAs have their origins in the exchange rate events of the late 1960s. It is a key feature of the CAP that Community Agriculture Ministers agree annually on a common price level for the principal

crops grown in the Community. These prices are expressed not in any single national currency, but in a neutral accounting unit, the Unit of Account (now the ECU). In the first decade of the Community's existence, these prices were converted into national currencies at the fixed market exchange rates prevailing at the time.

20. This system worked satisfactorily as long as exchange rates remained broadly stable. But when the franc was devalued and the D-mark revalued in 1969, it was regarded as undesirable that these events, which largely reflected the relative performance of the two economies in sectors other than agriculture, should affect the agreed level of common prices as expressed in francs or D-marks. It was therefore agreed that for a limited period conversions from Units of Account into these currencies should be made at the old conversion rates. As the exchange rate movements continued, this system of "green rates" became more pervasive. It permitted agricultural prices in the different states to drift apart so that at one point during 1978 German prices (the highest) were more than 40% above UK prices (the lowest).

21. To allow the CAP to function in these circumstances, measures were needed to keep the markets in different countries separate and thus to prevent produce from low-price countries from travelling around the Community in search of the highest support prices. The mechanism invented took the form of levies and subsidies on agricultural produce traded within the Community; the levies raise the price of low-price produce entering a higher price country; the subsidies lower the price of produce moving in the opposite direction. These levies and subsidies are known as MCAs.

22. In discussing the pattern of budgetary transfers arising from CAP policies, it is sometimes argued that the MCA subsidies paid to cover the difference between the price level operated in a relatively low price country and the common price are in effect a subsidy to consumers in that country. This argument leads to the conclusion that these MCAs should be counted as receipts to the importing country when calculating its net contribution to the Community budget.

23. The two net importing countries whose prices are below the Community average, though still above world prices, are the UK and Italy. If MCAs were attributed in this way the net contributions they make to the Community budget as a whole would be reduced.

24. As the MCAs on UK and Italian imports have since 1976 been paid in the exporting Member States this attribution would not conform to the Community's general accounting convention, which is to treat as receipts to a country all Community expenditure which arises there.

25. However, the real arguments against attribution to the importing country are economic. The first of these is that the effect of the MCAs is merely to allow exporters in higher cost countries to compete with indigenous producers on the lower price markets in Italy and the UK. They are an export subsidy. The consumer is still paying above the world price.

26. Secondly, the two forms of attribution make no difference to the transfers between the countries. For the importing country the difference is simply that fewer transfers are scored through the budget and more outside it. As the previous section has shown, the economic effect of the CAP is to transfer resources from countries which are net importers of products covered by its price support mechanisms to those which are net exporters. The balance of payments loss to the net importers is the same irrespective of the treatment of MCAs. The increase to their import bill remains the same regardless of whether they import at the higher Community price and then receive an inflow of Community funds which partly offset the cost of the imports, or whether alternatively, they buy initially at the lower, MCA-inclusive, price and do not receive the budgetary inflow. In the first case, the accounts show a higher non-budgetary cost and a lower net contribution to the Community budget, in the second, the reverse, but the total is the same in either case.

27. In any full analysis of resource transfers in the Community, therefore, the presentation of MCAs adopted effects only the breakdown of the total resource cost of the CAP to the net importer between the budgetary and non-budgetary elements. The "exporter pays" presentation now used in the Community accounts for MCAs paid on

UK and Italian imports means that the figures for budgetary transfers capture a larger proportion of the overall resource effects.

28. With the recent rise in sterling the question of the treatment of MCAs has become less important for the UK in the discussion about the budget. It is however still the view of the UK Government that MCAs should not be treated as budgetary receipts of the importing countries and that the presentation now used in the Community accounts for MCAs paid on UK and Italian imports is therefore right.

Other Non-budgetary Transfers

29. A highly industrialised country like the UK might expect to recoup some of the resource losses resulting from the operation of the CAP in its trade in manufactures. The years since the UK joined the EEC have indeed witnessed a rapid reorientation of its pattern of trade towards Western Europe, a process that had already begun before membership. As a result the proportion of UK exports going to the original EEC 6 increased by 50% between 1967 and 1977. In the same period UK imports from the EEC 6 as a proportion of its total imports have risen from 28% to 41%. This is the most dramatic change in trade pattern towards the Community of any of the present nine members in this period.

30. There are problems in trying to establish the pattern of resource gains that has resulted from the growth of trade between the UK and the rest of the Community. In general it is likely that the promotion of trade by the average reduction in tariff and non-tariff barriers has raised efficiency. That there has been a gain for Europe as a whole seems highly probable, though very hard to establish conclusively. But there is no evidence that the UK has gained a marked advantage in this field, beyond that derived by other Community partners, which ought to be set against the transfers it makes through the Budget. The benefits of increased trade have been mutual. British manufacturers have benefitted from the UK's membership of the EEC, but so have their counterparts elsewhere in the Community.

Other Areas

31. It is sometimes argued that the UK secures other unquantifiable

t significant benefits from Community membership. It is suggested, for example, that in relation to international trade negotiations, the UK enjoys the advantage of belonging to one of the largest economic blocs in the world. It may well be that there are resource gains of this broad kind associated with Community membership. But these gains are in principle common to all members. They are not something which justifies a disproportionate net budget contribition from the UK.

Relative Prosperity

32. This paper shows that the UK is a substantial net contributor of resources to the rest of the EEC, both through the Community budget and more widely. It has also been suggested that these resources tend to go to countries which/are more prosperous than Britain.

33. No measurement of relative prosperity can be absolutely precise. But it is generally accepted that GDP per head provides the best available yardstick. It is a yardstick widely used by international organisations, among other things, for the determination of national contributions to the United Nations and its agencies. It is also used as a yardstick in the Community's special financial mechanism agreed in Dublin in 1975 under which, in certain very restricted circumstances, the UK can obtain a refund of part of its gross contribution to the budget.

34. The normal approach for making international comparisons of GDP per head is to use market rates of exchange to convert domestic GDP per head to a common international base. It is sometimes argued that a closer approximation to relative standard of living is obtained by using "purchasing power parities", on the ground that these take more account of the prices of goods and services which do not enter into international trade.

35. On either bases the UK emerges as less prosperous than most other members of the Community which are receiving net transfers through the budget. Using data from the EEC Statistical Office, Table 6 ranks Member States in order of relation of prosperity on both bases.

TABLE 6. GDP per head as a percentage of the EEC 9 average, using market exchange rates and purchasing power parities in 1978.

Market Exchange Rates		Purchasing Power Parities	
Denmark:	145	Germany:	120
Germany:	139	France:	113
Belgium/Luxembourg:	129	Denmark:	111
Netherlands:	124	Belgium/Luxembourg:	108
France:	117	Netherlands:	106
UK:	73	UK:	94
Italy:	56	Italy:	72
Ireland:	50	Ireland:	62

The Nature of the Community Budget

36. It is sometimes argued that it is wrong to look at net contributions to the Community budget and ask how these relate to Member States' relative prosperity. Those who put this case maintain that the Community budget is simply the means of financing, through the Community's own agreed sources of revenue, the policies adopted from time to time by the Community's leaders. They hold that it is wrong to consider the overall economic impact of the budget, when each policy must be justified on its own merits and when Community competence is so much more extensive in some areas, especially in agriculture, than in others. In their view, a budget as narrowly-focussed as that of the Community cannot rightly be compared with national budgets and should not be judged by its redistributive effects.

37. It is true that the present pattern of Community expenditure is very lop-sided and that this lop-sidedness in part reflects the varying degree of Community involvement in different fields. But the preamble to the Treaty of Rome lists amongst the Community's primary objectives the strengthening of "the unity of their /Member States'/ economies" and ensuring "their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions". It is hard to see how the present pattern of transfers in the Community can be squared with this wider objective of the Treaty, however successful the Community's individual policies. Indeed, it must impede the efforts of many national governments to achieve through their policies the improvement in their economic performance that both

ey and the founders of the Community regarded as necessary.

38. Some who acknowledge that the present position of transfers in the Community is inequitable see the solution in an extension of Community activity and an expansion of the Community budget, so as to increase expenditure on the Community's non-agricultural policies.

39. There may be scope for the UK to secure higher net benefits from the Regional and Social Funds, or from Community involvement in fields of activity such as urban renewal and transport infrastructure where it has not previously operated.

40. But plans to increase Community expenditure have to be seen also in relation to the objective of national governments in containing public expenditure. The "own resources" available to the Community are not limitless. There is a strong case for the Community to consider stringently the appropriateness of all its policies and to redistribute expenditure. But this would at best be a gradual process. It could not meet the UK's need for an early amelioration of the net budgetary position.

The UK and the Community Budget

41. The United Kingdom wishes to participate fully in the task of making the Community a success in the 1980's. The inequitable position in which the United Kingdom finds itself on the budget is an obstacle to that and is indeed an unintended impediment to the well-being of the Community. The United Kingdom is confident that this situation can be remedied in the near future with the understanding and cooperation of its partners.