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Thinking ahead for Europe

What Cameron should have known: Q &A

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A surprise revelation that the UK would be paying a surcharge to the EU budget of €2.1 billion sent Prime Minister Cameron into a rampage.[1] How could this misunderstanding happen, as the resources mechanism of the EU budget uses a rather rigid method of calculation agreed by all member states? Although this issue today is still shrouded in some mystery, it is clear that a €2.1 billion seems a rather hefty request. We have adopted a Q&A format in the following technical explanation of how the surcharge came about in an attempt to dispel the Machiavellian phantasies that have so excited journalists and eurosceptics alike.

What is the mechanism behind the surcharge for the UK?

The EU budget contributions, as well as the UK rebate, are strongly related to movements in GNI (gross national income). The GNI key of the own resource makes up the lion's share of the budget resources and was 73% of the contribution in 2013. Member states pay for this resource according to their share of the sum of 28 member states' GNI. Some of the member states benefit from reductions in some of the resources, particularly the UK with the rebate, which is roughly two-thirds of the net contributions to the EU budget. As a result, the UK gross contribution is lower than that of any other member state *as a percentage of GNI* – 0.077% in 2013, compared to around 1% for most countries. The surcharge for the last 10 years represents approximately one-half of the rebate the UK receives annually.

All member states regularly review the GNI levels, and corrections to contributions to the EU are performed and countries will pay or receive a payment every 1st of December.

All member states have been reviewing over the last decade their figures in a global effort to improve the reporting of economic performance by including better data from activities in various economic sectors. The recalculations affect the period 2002 onwards, with only Greece having a review stretching back to 1995. The changes in GNI estimates performed by national statistical offices revealed that GNI has been more often than not underestimated, notably for

[1] See companion Commentary by the author and Daniel Gros, "An appalling way to behave", 4 November 2013 (http://www.ceps.eu/node/9779).

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the UK and the Netherlands.[2] While most countries see their GNI levels increase moderately,[3] the increases of the UK and the Netherlands are striking: 8.1% in 2010, 5.2% in 2011 and 5.3% in 2012 for the Netherlands and 3.3%, 3% and 3.9% for the UK. The latter percentages are equivalent to £49.3, £47.1 and £61.5 billion; before that, the additional yearly changes were between £14 and £40 billion (between 1.3% and 2.6% of GNI). While lower, the upward corrections for the period 2002 to 2010 were nevertheless on average higher for the UK than for other member states adding to the surcharge.

In total, the UK GDP between 2002 and 2012 is estimated to have been £343 billion higher (before adjusting for inflation, which would make the present value even higher).

The UK has thus reported that for the period its share of GNI was higher than initially estimated; therefore, it should have paid a higher share of the EU budget (adjusted for the rebate). Other member states, which now see that their share of EU GNI was lower, have to be compensated for the excessive payments.

Was the recalculation based on the new European system of accounts (ESA) 2010 in development?

No, the 'surcharge' is not based on the new ESA 2010 method; changes in the GNI contributions can only be based on the ESA95 system according to the regulations in place. Legally, the EU can thus automatically amend the contributions of member states without needing to consult member states.

Was the timing wrong? Was the European Commission withholding the information and choosing the date of the meeting of Heads of State on purpose?

The Commission informed the relevant offices in the member states of the new GNI data on 17 October 2014. The statistical changes were performed with national authorities and the UK Treasury is fully aware and involved in the process of calculating the EU budget contributions.

How is it then the Treasury of the UK (and that of other member states) or the Prime Minister's office was unaware? Because from an administrative point of view, there was probably no real need to bring this up to the Prime Minister in the first place. The EU budget contributions are handled by officials in an automatic manner based on standard procedures agreed by all member states.

Is the surcharge unfair and disproportionate?

No, it is not. It is correcting for low contributions to the EU budget that were covered by other member states. €2.1 billion is also less than half the UK rebate. Even adding the whole surcharge, the contribution of the UK to the EU budget still falls below the levels of other net contributors as a share of GNI.

In addition, the surcharge is also benefiting from the UK rebate. Since this is comparable to the size of GNI, the higher the contribution the higher the rebate, which means that €2.1 billion (0.1% of UK GNI) is already a rebated surcharge.

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[2] The statistical changes from the revised ESA95 and ESA 2010 accounts are presented at: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-17102014-BP/EN/2-17102014-BP-EN.PDF; see the GNI impacts for the purposes of the EU budget contributions at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Monitoring_GNI_for_own_resource_purposes

[3] Rarely do the revisions show downward calculations, but they do exist, most notably the Luxembourg case with a negative correction in excess of 3% each year between 2010 and 2012.

The higher UK GNI also means that while the UK contributions will rise with a higher GDP, so will the UK rebate.

What are the lessons to be drawn from this event?

The first lesson is that there is a deep misunderstanding by member states' leaders of how the EU works. It is not the first time that common practices agreed by all member states are attacked as if they were arrived at independently by the EU bureaucracy. It is time for member states to be better informed and not to create a polemic where there is no justification.

The second lesson is that the EU Own resources mechanism needs to be reformed and simplified. The calculations are performed on extremely complex mechanisms for 20% of the contributions, while 80% are linked to member states GNI shares', amended by exceptions and rebates and GNI recalculations. Data issues and the complex rebate calculations are occasionally responsible for strange results. The UK, for example, had an extremely low net budgetary balance in 2009, based on corrections introduced to compensate the UK for lower rebates than due, which reduced the UK contributions considerably. Today we are encountering the opposite effect due to a GNI recalculation. If the EU budget were levied as a real tax, such as a small percentage of real VAT, such disputes would be non-existent. Actual VAT receipts are not changed by statistical adjustments of GNI.