

The budget of the European Union: a guide

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Executive Summary

The EU's budget accounts for about 1% of GNI across the 28 member states. This compares with total public spending in each country which ranges between 35% and 58% of GDP. Figures from the European Commission (EC) show that the UK made gross contributions of £11.3 billion in 2014, equivalent to about 0.6% of UK GDP or 1.5% of UK public spending. However the UK received back over £5.6 billion from the EU in 2014 and hence its net contribution to the EU budget was £5.7 billion in that year, though the contribution was relatively low in 2014: in 2013, the net contribution was £9.1 billion on this measure and in 2012 £7.5 billion. (Figures for 2015 are not yet available). Other figures which suggest a much higher gross contribution don't take account of the UK's rebate while figures suggesting a higher net contribution don't account of spending in the UK, such as European funding for research in UK universities, which does not pass through Whitehall.

These figures are small in the context of overall government spending. Furthermore, it is important to be clear that we are not here looking at the actual fiscal consequences of leaving the EU and one cannot say that leaving the EU would free up either the gross contribution or the net contribution for other uses. First it may be the case that whatever alternative arrangements the UK government agreed with the other EU countries on leaving the EU would require some contribution to the EU budget. Second since any change to net contributions would be small, the overall fiscal consequences of withdrawal would be overwhelmingly driven by the effects of that decision on the wider economy. We will look at the possible fiscal consequences of leaving the EU in a subsequent report. Here we instead focus on describing and explaining the way the EU's budget works, where it derives its revenues from and how it allocates spending. In doing so we hope to shed some light on an issue which is complex and rather poorly documented – and which therefore is less than transparent.

The overall budget is set through the EU's multiannual financial framework (MFF) which typically covers seven year periods and requires unanimous agreement at the European Council as well as agreement by the parliament. Annual budgets are then set within this framework – being initially proposed by the Commission then amended by the Council (by qualified majority rather than unanimity) and agreed by the European Parliament. This rational sounding process has, of course, opened up considerable opportunity for political horse trading. A set of negotiated rules on payments into and out of the EU budget are supplemented by special deals for particular countries on particular budgetary contributions or spending items – most famously, the UK's rebate on its contribution. The negotiated rules themselves are complex, and in a number of areas there would seem to be scope for rationalisation.

Revenues

The EU has three main sources of revenue:

- Nearly three quarters comes from **GNI based contributions** – that is countries contribute according to their Gross National Income. This is a relatively straightforward basis for making contributions. There are two riders to that. First, revisions to earlier estimates of GNI can lead to quite significant retrospective adjustments, as happened to the UK in 2014 when data adjustments led to a demand for an additional £1.7 billion.

Whilst clearly reasonable to adjust payments in the light of new information this can be politically awkward. Second, adjustments are made to payments as a result of negotiation. For example over the current MFF period Denmark, the Netherlands and Sweden have secured significant reductions in their GNI based contributions;

- About 13% of the EU budget comes from so called “**VAT based contributions**”. This is effectively a contribution based on a harmonised measure of consumer spending – it has little or nothing to do with actual VAT payments – and exists as a result of earlier hopes that VAT would become a union wide harmonised tax. This makes little sense as a basis for contributions and is relatively harsh on those countries where consumer spending forms a large fraction of GDP. The share of VAT based contributions has been declining over time and ought to be ended altogether with the slack taken up by GNI based contributions;
- Finally **tariffs** – also known as traditional own resources – make up about 11% of the budget. They are duties levied on goods entering the EU. Since the EU is a customs union with no duties levied on within EU trade this is indeed a natural source of funding for the EU as a whole. It is perhaps odd that the countries where the duties are levied are entitled to keep 25% (falling to 20%) of the duties levied in recognition of “collection costs” when the average collection costs for taxes are a small fraction of this.

Spending

Structural and cohesion funds on the one hand, and agriculture and rural development on the other, each account for about 38% (€54 billion in 2014) of total EU spending (€142 billion in 2014).

The **structural and cohesion funds** are the main means by which the EU redistributes from richer countries and regions to poorer countries and regions, though at less than 0.5% of EU GNI the scale of redistribution involved is very modest by comparison with the sort of redistribution which occurs within countries from richer to poorer regions. The aim of this spending is to provide resources for regions and member states to boost their competitiveness and invest in their physical and human capital.

Cohesion funds are available only to poorer EU countries – those with GNI per capita below 90% of the EU average – and account for around 20% of total structural and cohesion funds. **Structural funds**, on the other hand, are allocated to regions within countries depending on their GDP per capita. Regions with GDP per capita less than 75% of the EU average are designated as ‘less developed regions’ and will receive 52% of total structural and cohesion funds in the current MFF period, while regions whose GDP per capita is between 75% and 90% of the EU average are designated ‘transition regions’ and will receive 12%. Regions with GDP per capita above 90% of the EU average will receive 16%. These rules create big discontinuities: if GDP or GNI per capita increases slightly funding can drop dramatically. There are other elements to the rules for determining entitlement to these funds which depend on employment rates and population density. The interaction between the rules has the effect that the UK – where the employment rate and population density are high – receives rather less in structural funds than do some other rich countries which have fewer less developed and transition regions.

The stated rationale for the **agriculture and rural development** budget (or Common Agriculture Budget, CAP) is threefold. First, is to support viable food production, with a

particular focus on income support for farmers. Second is the promotion of sustainable management of agricultural land, including boosting biodiversity and reducing greenhouse gas emissions. Third is to boost employment and growth and tackle poverty in rural areas.

The two main components of this area of the budget are funding for **direct payments for farmers**, and funding for **rural development** projects. EU rules determine how much each member state receives and place certain restrictions on how those funds are then used.

The EU has moved a long way from the production subsidies and price supports of the 1980s and 1990s which resulted in butter mountains and wine lakes, and dumping of surpluses onto international markets. While countries can link some payments to production, the majority of payments are area-based, and 30% are linked to farmers undertaking “greening” activity. In other respects, countries have a considerable degree of freedom over the structure of payments to individual farmers, and the balance between direct payments and funds for rural development.

While the rules on how much farmers get in each country are generally published by the national governments, the actual rules for determining how much each country receives from the overall EU budget are not published. This is apparently in an effort to prevent the periodic negotiations of the CAP from getting bogged down in horse-trading. But it does mean that the process by which national allocations are determined is far from transparent.

The EU’s budget also provides funding for other areas, where it often shares responsibility with national governments including: **science and technology; market regulation; consumer protection; transnational policing; border control, migration and asylum; and foreign aid**. The last few items have seen substantial growth in recent years but remain a small part of the overall budget. Central **administrative costs** make up around 6% of the budget – a figure which excludes the costs countries themselves bear to administer EU spending and policy (such as the CAP). Unfortunately, lack of comparable data means it is difficult to assess the scale of these costs, although some particular costs.

The UK rebate and net contribution

The UK receives relatively little from either of the two biggest components of the EU budget. That is why it has received a rebate on its contributions since 1984, paid for by additional contributions by the other member states. The rebate is substantial at about £5 billion on gross (pre-rebate) contributions of £17.8 billion in 2015, though it has reduced in size following changes in 2010 that have meant that the rebate does not apply to non-CAP spending in the member states that have joined the EU since 2004. Taking account of the rebate the UK’s net contribution to the EU in 2014 was almost identical to that of France, a country with a roughly similar GNI per capita, and smaller as a share of GNI than any of the richer countries with the exception of Ireland. (Belgium and Luxembourg appear to be net recipients from the budget from the EC figures but this is largely because they house the EU’s headquarters: this position changes if we instead allocate this spending on an equal per capita basis across all member states). However, as mentioned previously, the UK’s position in 2014 was relatively favourable: on average over the last five years, the UK has made a larger net contribution as a share of national income than Austria, France and Finland, a similar net contribution as a share of national income as Denmark, but a smaller net contribution as a share of national income than Germany, The Netherlands and Sweden.

Table ES1: The UK's gross and net contributions to the EU Budget, 2012–2015

	2012	2013	2014	2015
Gross contribution excluding rebate (HMT)	£15.7bn	£18.1bn	£18.8bn	£17.8bn
Gross contribution including rebate (HMT)	£12.6bn	£14.5bn	£14.4bn	£12.9bn
Net government contribution (HMT)	£8.5bn	£10.5bn	£9.8bn	£8.5bn
Net contribution overall (EC)	£7.5bn	£9.1bn	£5.7bn	N/A

Note: 'HMT' figures differ from 'EC' figures in part because they exclude receipts from the EU budget that bypass government and go straight to the private sector and other non-governmental organisations such as Universities. They also differ due to some issues related to the timing of payments and receipts. These timing issues affect 2014 in particular.

Source: 'HMT': HM Treasury (2015), 'European Union Finances 2015',

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483344/EU_finances_2015_final_web_09122015.pdf; 'EC': European Commission, <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>

1. Introduction

On 23 June 2016, voters in the UK will be asked to decide whether they wish to remain in the European Union (EU) or leave. This decision will have profound economic implications, particularly given the importance of EU membership to trade and immigration. Leaving the EU would affect UK GDP and hence the level of tax revenues and the state of the public finances.

Membership of the EU also has a more direct impact on the UK's public finances, since the UK is obliged to make contributions towards the EU's budget, and benefits from spending by the EU in the UK that might otherwise have to be met by tax revenues. As is well known, the UK is a net contributor to the EU budget since the UK's contributions to the EU budget exceed the amount that the EU spends in the UK, even after the rebate on its contribution that the UK has enjoyed since 1984. These impacts of EU membership on the public finances are easiest to calculate, but not the most important: if leaving the EU significantly increased or reduced national income, the impact on the public finances would dwarf the UK's current overall net contribution (around £5.7 billion in 2014).¹

This report is the first of several that the IFS will produce in the run up to the EU referendum that will look at these public finance and budgetary issues. In it we set out the EU's budget process, describe the EU's different sources of revenue and items of expenditure and evaluate the rules underlying these, and compare the contributions and receipts of the 28 EU member states and their overall net positions. By bringing the information together and explaining it in a clear and concise way, we hope this 'guide' helps demystify the EU budget and how it works – although, as we shall see, the workings of some major parts of the budget are less than transparent.

While the EU budget may not be so central to the current debate as it was in the 1970s and 1980s, claims about how the UK fares under the budget, and whether the way the EU raises and spends its money is 'fair', 'efficient' and 'sensible', will likely rear their head in the coming months. This paper looks at some of these issues including:

- What are the EU's main sources of revenue?
- How is the EU budget allocated across different budget areas?
- How much does the UK contribute and receive from the EU, and how does this compare to other countries?

Subsequent papers will look at how the EU's budget may change in the years ahead, and will consider a number of budgetary issues should the UK decide to leave the EU.

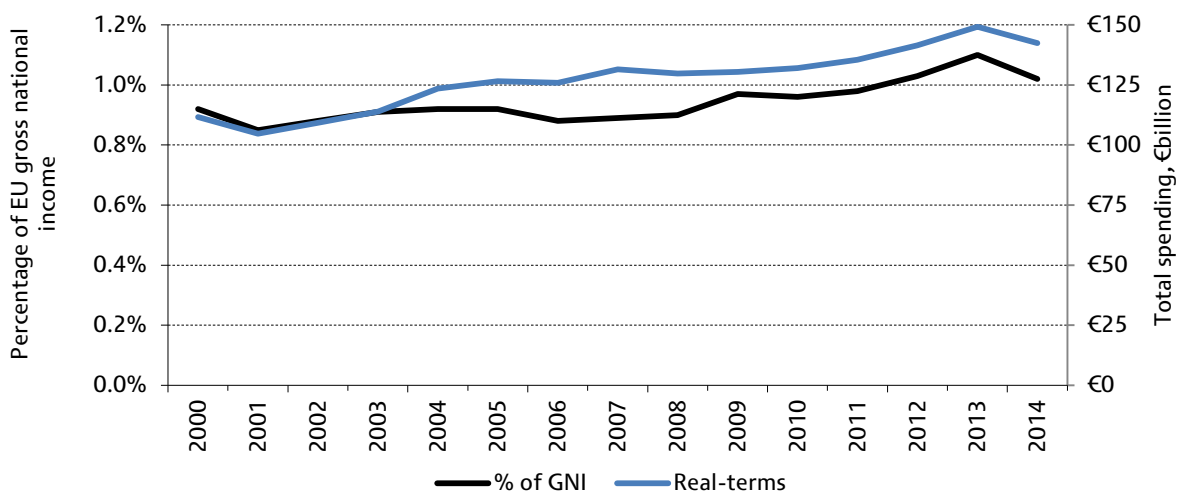
¹ This figure is total payments into the EU budget net of the UK rebate, minus total receipts from the EU budget, including those that go directly to the UK non-governmental sector (including Universities). Source: European Commission. Office for Budget Responsibility/HM Treasury figures exclude receipts that go directly to the UK non-governmental sector.

2. The scale of the EU budget

Total spending by the EU in 2014 across all 28 member states was €142 billion, or just over 1% of the Gross National Income (GNI) of the whole EU. Since, as we shall see, there are mechanisms to ensure that the EU budget balances, total revenues were €144 billion in that year. This is a relatively small component of public spending within the EU: across the whole EU, public spending was 48.2% of GDP in 2014, with a range from 34.8% of GDP in Lithuania to 58.3% in Finland.²

Figure 2.1 shows how total EU spending as a share of total GNI has changed since 2000. We can see that spending by the EU gradually increased as a share of the community's income over the seven years covering the multiannual financial framework (MFF) from 2007 to 2013, but fell in the first year of the new financial framework covering the period 2014 to 2020. The latest MFF involves total 'commitments' of 1% of GNI over the seven year period and actual payments of 0.95% of GNI,³ with total spending increasing in real terms over this period, but falling as a share of community GNI.⁴ Over the longer term, however, the size of the EU budget has certainly increased substantially: when the UK joined the then European Economic Community (EEC) in 1973, total spending was only 0.5% of community GNI. Most of this increase came in the late 1970s and early 1980s as the EEC expanded its structural funds for less developed regions.

Figure 2.1. Total EU spending (payments), 2000 to 2014



Source: European Commission.

Figure 2.2 shows how the breakdown of the EU budget between different budget areas has changed over time. We see that the main change in recent times has been a reduction in the share of the EU budget going towards direct support for farmers through the Common Agricultural Policy (CAP), and a corresponding increase in the share of spending on structural

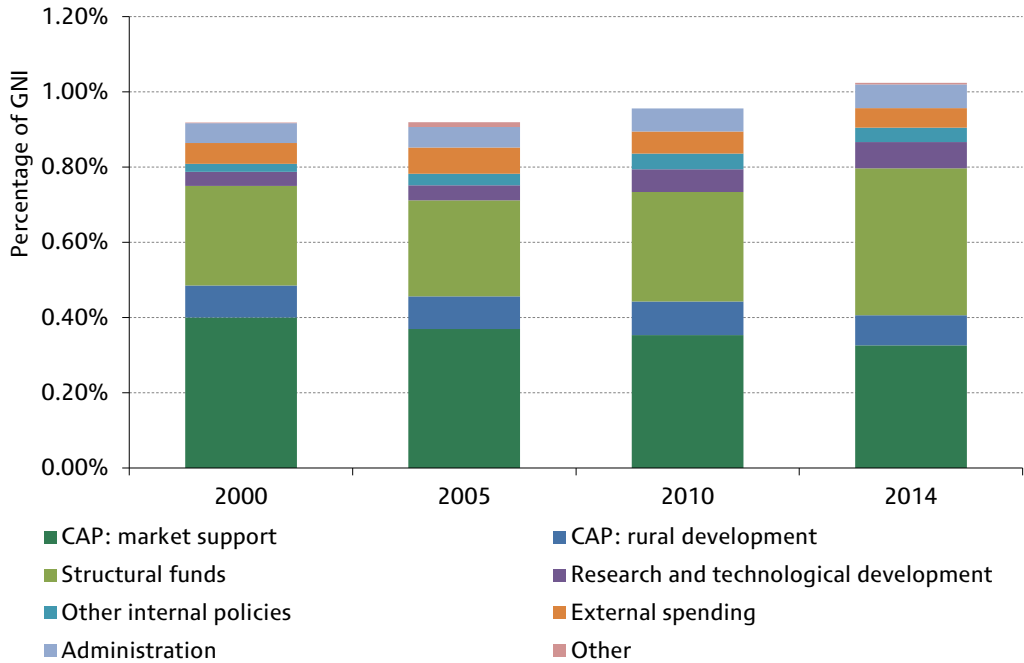
² Source: Eurostat table gov10a_main.

³ The MFF sets out the maximum amount that the EU can 'commit' to different functions in each year of the seven year period, and, acknowledging that not all funds that are committed to certain areas are spent within the year but may be spent in subsequent years, a ceiling on the maximum that can be actually spent each year.

⁴ Source: European Council regulation 1311/2013, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1311&from=EN>.

funds supporting less well-off regions. There have also been increases in the share of the budget spent on research and other internal policies (infrastructure, culture and managing migration flows), though these still represent a relatively small share of the overall budget. This reduction in the share of the EU budget being spent on agricultural support is part of a long term trend: when the UK first joined the EEC in 1973, this made up more than three quarters of the EU’s total budget, whereas in 2014 it was less than a third. Section 4 describes the different areas of EU spending in more detail.

Figure 2.2. Breakdown of EU budget spending headings (payments), various years

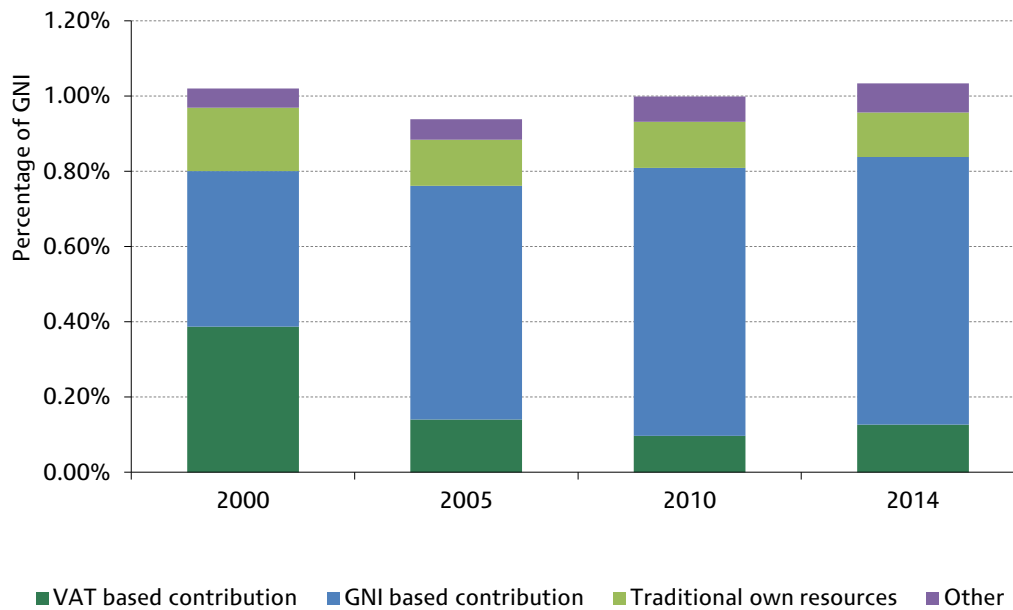


Source: Authors’ calculations using <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>.

Figure 2.3 shows the same analysis for EU revenues. We see that revenues – including any surplus carried forward from the previous year (in the ‘other’ category) – always exceed spending, though by different amounts in different years. The three main sources of revenue for the EU budget are customs duties and levies that are applied at a common rate to imports entering the EU (so-called ‘traditional own resources’), a contribution from member states based on the size of their hypothetical VAT base, and a contribution from member states based on their Gross National Income (GNI). These are discussed in more detail in Section 3.

The main change in the way revenues are raised is that there has been a shift from VAT-based contributions towards GNI-based contributions as the call-up rate (effectively the ‘tax rate’) applied to the harmonised VAT base was reduced during the early 2000s. As we discuss in Section 3, this is probably a sensible change: the VAT-based contribution bears only a passing resemblance to the amount of VAT people actually pay as a result of the adjustments made to the VAT base, and this contribution places an excessive burden on those member states that have a high share of consumption in their national income. The share of revenue coming from traditional own resources has also declined as a result of the decision to increase the share of these levies that member states are allowed to retain to reflect the cost of collection (although this is soon to be partially reversed).

Figure 2.3. Breakdown of EU budget revenue headings, various years



Source: Authors' calculations using <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>.

What is the process by which these spending and revenue allocations are determined?

The MFF sets out the planned level of 'commitments' for each of the EU's functions for each year, and also a (lower) ceiling on the total level of actual payments each year ('commitments' include spending to be undertaken in subsequent years). For some functions (the Common Agricultural Policy and structural funds), ceilings are also set on the level of spending in each member state. Unlike in the UK's Spending Reviews where spending plans are set in nominal terms, the MFF sets these plans in real terms.⁵

The MFF has to be agreed both by the European Council (the governments of the 28 member states) on a unanimous basis and the European Parliament. . The EU is not allowed to run a budget deficit: all disbursements must be met by payments into the EU budget – to ensure that this is the case, the GNI-based contributions of member states are set to ensure that receipts equal disbursements. Underspend on actual payments can be carried forward to subsequent years, however.

Each year, an annual budget is produced in advance of the start of the year that sets out levels of commitments and payments for each budget heading, which cannot exceed those set out in the MFF. The annual budget is initially proposed by the European Commission, and can then be amended by the Council (in contrast to the decision making for the MFF, by qualified majority voting rather than unanimity) and then the European Parliament. If the positions of the council

⁵ The MFF also sets a maximum cap on payments of 1.23% of EU GNI. In practice, this cap is extremely unlikely to be breached as the MFF real-terms limit on payments is forecast to be 0.95% of EU GNI over the seven year period, and no higher than 0.98% of GNI in any year.

and the European Parliament differ, a conciliation committee is set up to attempt to reach a common position⁶.

After a budget has been adopted for a particular year, 'amending budgets' are produced by the Commission to account for changes in circumstances that require more or less spending in a particular area, and to increase spending on areas where there were underspends in the previous year. These amending budgets have to go through the same procedure as those for the original annual budget proposal.

From this description of the budget process, it is unsurprising that the process is characterised by the different member states attempting to improve their overall budget position. As we shall see, in many areas of spending or revenues, different member states get additional spending allocations or reductions in the amount they have to pay that diverge from the amount that they would be allocated under more objective criteria. Furthermore, in some areas, particularly agriculture, spending is allocated in line with historical spending allocations rather than current needs. The process then involves some objective criteria layered on top of historical precedent and with a good dose of compromise and political horse trading. Eventual allocations reflect all these elements of the process.

⁶ This position is then implemented unless it is rejected either by the Council or the European Parliament, in which case the Commission has to produce a new draft budget. If the common position of the conciliation committee is rejected by the Council it can still be implemented if passed by the European Parliament with a sufficient majority (at least half of members voting for it, and 60% of those voting in favour). In the event that a budget is not agreed by the start of the year, the monthly level of payments for each budget heading is set at one-twelfth of the annual level of payments on that area in the previous year.

3. EU revenues

Source	Contributions in 2014			
	UK		EU	
	€s per person	% GNI	€s per person	% GNI
Tariffs (Traditional Own Resource)	42	0.13%	32	0.12%
VAT- based contributions	46	0.13%	35	0.13%
GNI-based contributions	226	0.64%	195	0.71%

Contributions to the EU budget by member states come under three categories: so-called ‘traditional own resources’ (that is to say customs duties and levies), a VAT-based contribution and a contribution set at a fixed percentage of GNI for each member state. In this section, we describe each of these and analyse the sizes of the contributions of each member state.

Tariffs (‘Traditional own resources’)

The EU is a customs union, that is to say there are no tariffs on trade within the EU, and goods and services that come in to the EU face a common external tariff irrespective of where they arrive into the EU, or where the goods and services are actually sold. Tariffs are collected at the point goods enter the EU. This revenue (less 25%, supposedly to cover the costs of collection, though in practice the cost of collection of most taxes is far below this level: HMRC estimated that the average cost of collection of their taxes was 0.58p for every pound collected in 2014–15⁷) is then passed to the EU. In 2014, these tariffs – also known as the EU’s ‘traditional own resources’ – contributed €16.7 billion to the EU budget, 11% of the total. Tariffs collected in the UK amounted to €3.6 billion in that year, with €2.7 billion paid over to the EU (and €900 million retained by the UK as ‘administration’ costs).

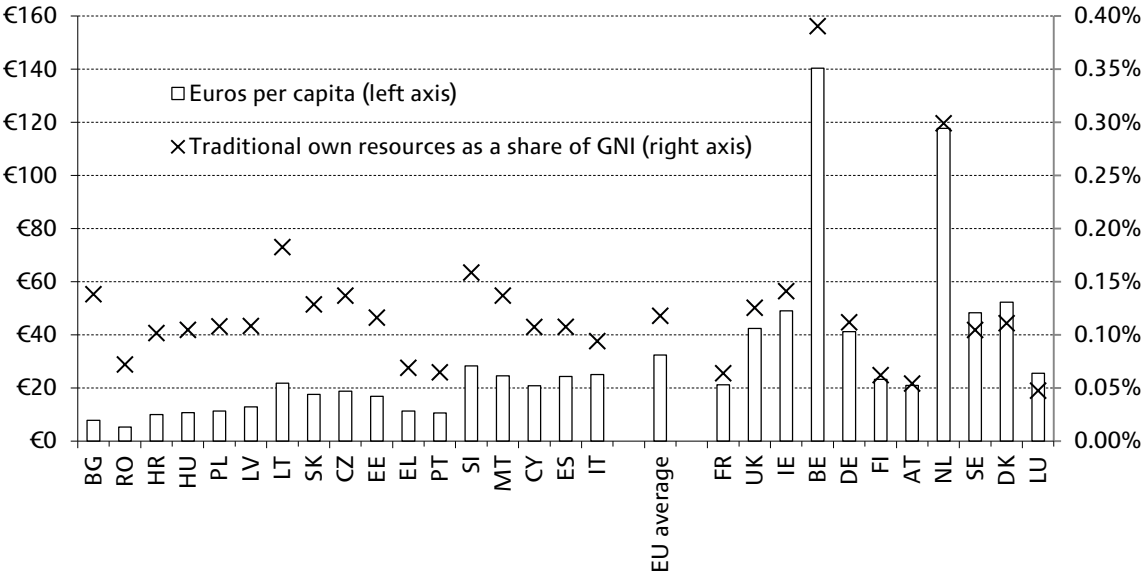
Pooling the revenue from tariffs in this way seems a relatively sensible way to pay for spending at the EU level. As we see in Figure 3.1 below, some countries with large ports (most notably Belgium and The Netherlands) collect large amounts of tariffs and levies, but it would not be correct to say that these taxes are all paid by the citizens of these countries in any meaningful sense, as many of the goods that enter one EU country are then transported on to another. Assuming that these taxes lead to higher prices for the final consumer, the taxes collected by a member state will not necessarily give a good guide to the amount of taxes paid by the citizens of that country. Ideally, we would be able to examine the true amount of taxes paid by the citizens of different member states by using data on the consumption of products from outside the EU by people in each member state, but this is not readily available.

⁷ Source: HMRC Annual Report and Accounts 2014–15, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/449343/HMRC_Annual_Report_and_Accounts_2014-15_Web_accessible_version_.pdf.

Figure 3.1 shows traditional own resources per capita and as a share of GNI for each EU member state (on the basis of where goods enter the EU). As we mentioned above, Belgium and the Netherlands have particularly high recorded contributions, as many of the goods from outside the EU with an origin in continental Europe enter the EU through one of the Belgian or Dutch ports. Similarly, landlocked countries with few borders to non EU countries such as Austria and Luxembourg collect relatively little in customs duties. Looking at variation by national income level, we can see that there is relatively little difference between richer and poorer member states in terms of the amount they contribute as a share of their national income. The UK made a slightly larger than average contribution as a share of national income, but not significantly so.

The agreement by the European Council that set up the 2014–2020 MFF includes a provision to reduce the proportion of traditional own resources that are retained by member states from 25% to 20%, which will increase the amount of revenue the EU receives from these traditional own resources (and reduce the size of GNI-based contributions). However, this needs to be ratified by all member states before it comes into effect, and this has not yet happened. If/when it does so, the rule change will be made retrospective, i.e. member states will have to give the EU the extra 5% of the traditional own resources that are currently retained as costs of collection, and their GNI based contributions will be lowered. Given the numbers shown in Figure 3.1, this is likely to increase the net contribution of Belgium and The Netherlands, but leave other member states’ overall contributions broadly unaffected (increases in the proportion of tariff’s paid over to the EU will be broadly offset by reductions in the GNI-based payments to the EU).

Figure 3.1. Traditional own resource contribution per capita and as a share of GNI by country, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Traditional own resources and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

VAT-based contribution

All EU member states are obliged to have a VAT which has to conform to certain requirements set out in the VAT directive.⁸ For example, the standard rate of VAT must be at least 15%, though member states are allowed to have one or two lower rates on certain goods with a minimum of 5%. In principle, then, allocating a part of each country's VAT revenue to the EU would seem to be a transparent way of showing the EU's citizens how much they were contributing towards the EU Budget, and reflect the EU's role in setting VAT policy.

The way VAT actually works in the different EU member states means that this is not the case in practice, however. Many EU countries have obtained derogations – a sort of 'exemption' from the rules for certain goods and services – from the VAT directive which mean that the breadth of the VAT base varies between member states: for example, the UK's zero rating of a range of goods including most food, prescription drugs, domestic passenger transport and water and sewerage services.⁹ The VAT directive also gives member states a choice of whether to tax certain items, for example rents on properties, leading to further divergences in VAT bases between member states. Thus, simply assigning a certain amount of each country's actual tax base to the EU would lead to an inequitable outcome between different member states: those that applied narrower VAT bases, like the UK, would contribute less, and member states would have an incentive to make their VAT bases narrower in order to reduce their contribution to the EU budget.

Acknowledging these differences in VAT bases across the EU, the VAT-based contribution in practice applies a common rate of 0.3% to a harmonised VAT base across all member states (i.e. what the VAT base in each member state would be if it applied all the rules in the VAT directive without any derogations). To ensure that the burden on member states with a larger harmonised VAT base as a share of national income, the contribution is capped at 0.15% of GNI (i.e. if the harmonised VAT base is more than 50% of GNI, the VAT base for the purposes of the calculation is replaced with 50% of GNI). In 2014, five member states (Croatia, Cyprus, Malta, Luxembourg and Slovenia) had their contributions capped in this way.

For these reasons, the VAT-based contribution is a complicated (since it requires the calculation of the harmonised VAT base), opaque (since it is not the case that of the VAT people pay 0.3% goes towards the EU budget) and inequitable (since, even with the cap, it places a higher burden on member states with a higher consumption share in GNI) way of raising revenue for the EU. There seems little reason for maintaining the VAT-based contribution other than maintaining the facade that VAT is a 'European tax', when in fact VAT bases differ substantially between member states.

VAT-based contributions made up €17.7 billion of the total EU budget in 2014, or 12% of the total. Figure 3.2 shows how large these contributions are for different member states. Figure 3.2 shows the scale of these in each member state. The first thing to notice is that the countries mentioned above as having their contributions capped at 0.15% of GNI do not (other than Croatia) have actual contributions in 2014 at this level. The reason for this is that the VAT-based contributions that member states have to make are based on forecast VAT bases and GNI, meaning that actual payments in the year in question can differ from this level and there have to be corrections in later years. Most obviously, Greece made a particularly large contribution in

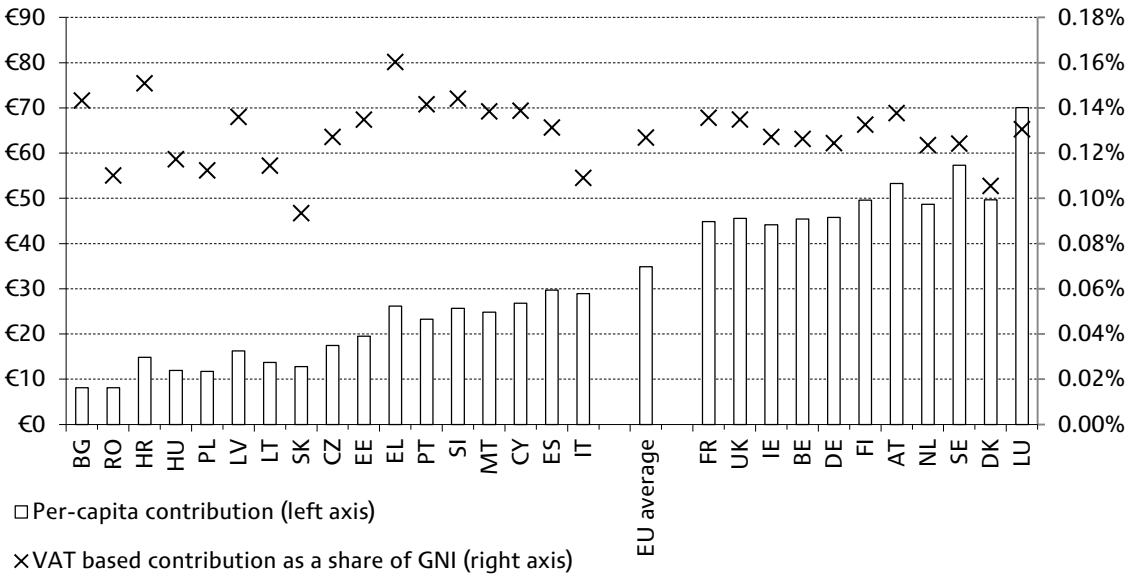
⁸ See Council Directive 2006/112/EC, available from <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32006L0112>.

⁹ For a full list, see HMRC statistics, <https://www.gov.uk/government/collections/tax-expenditures-and-ready-reckoners>.

2014, but this would be revised downwards later as its GNI was lower than forecast. (These corrections are discussed further in Box 3.1 on p.15).

As with traditional own resources, there is little clear pattern in VAT-based contributions as a share of GNI by income level, though there is more variation for lower income countries. Evidently the consumption share of GNI, and the amount spent on VAT-exempt items does not vary significantly by income level. The UK's contribution is slightly larger than average, though unexceptional.

Figure 3.2. VAT-based contribution per capita and as a share of GNI by country, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: VAT-based contribution and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

As part of the 2014–2020 MFF, Germany, The Netherlands and Sweden obtained a reduction in their VAT-based contribution of one half – rather than receiving a rebate as the UK does, these large net contributors to the EU Budget simply receive a discount on their contribution rates. However, as with the change in the percentage of traditional own resources mentioned in the previous sub-section, this cannot come into effect until the agreement is ratified by each of the member states, at which point the change will be made retrospective to 2014. At this point, these member states will receive a rebate on the VAT-based contributions they have made since 2014, paid for by higher GNI-based contributions from the other member states.¹⁰

¹⁰ Austria, Germany, The Netherlands and Sweden received similar reductions under the previous MFF that ran from 2007 to 2013. These expired at the end of 2013, however, meaning that these member states currently have to make the full 0.3% contribution, though they will ultimately receive the discount when the directive is ratified by all member states.

GNI-based contribution

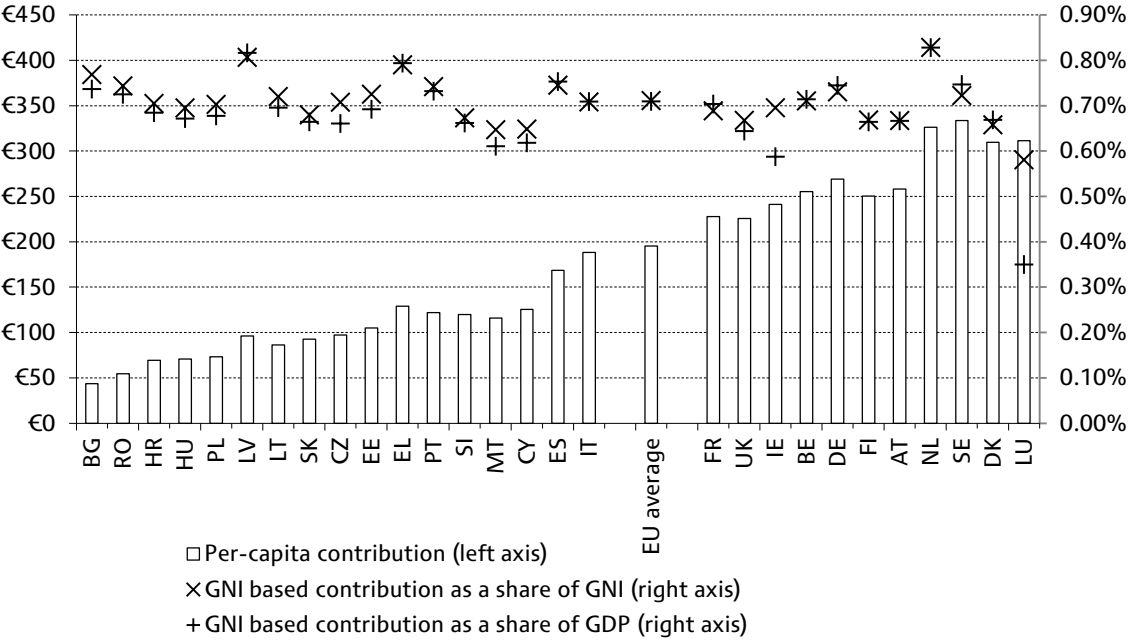
The balancing item in the EU budget is the GNI-based contribution made by member states: the difference between planned spending and forecast receipts from other sources is made up by a contribution from each member state that is proportional to their GNI. This is by far the most important revenue source, contributing €99 billion towards the EU budget in 2014 or 69% of the total.

Obviously, a contribution set proportional to GNI will place a roughly equal burden on each member state. One question that does arise is why the contribution is based on GNI rather GDP (the more commonly-used measure of national income). The difference between the two is that GNI includes returns on overseas investments and deducts returns on domestic investments owned by foreigners. Neither GDP nor GNI seems the ideal measure of a country's tax base: countries are able to tax both returns on overseas investments and returns on domestic investments made by foreigners – for example, the UK taxes foreign dividends received by those who are resident and domiciled in the UK and imposes corporation tax on UK firms owned by foreigners – so there is no strong reason to prefer one over the other. On the whole, this makes little difference to member states' contributions (see Figure 3.3 below) with the exception of those of Ireland and Luxembourg, whose high level of foreign investment means that their GDP is significantly higher than their GNI.¹¹ A shift to a GDP-based contribution would therefore significantly increase Ireland and Luxembourg's contributions to the EU budget and reduce those of other member states very slightly on average.

Figure 3.3 shows the GNI based contributions made by each member state in 2014. Although these contributions are set at a proportion of GNI, since actual payments in a particular year are based on forecasts, the actual proportion of GNI these make up can vary as statistics are revised and corrections are made in the following year. Box 3.1 discusses these corrections.

¹¹ Ireland's GDP is 18% higher than its GNI and Luxembourg's 66% higher.

Figure 3.3. GNI-based contribution per capita and as a share of GNI by country, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: GNI-based contribution and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan, GDP from Eurostat table nama_10_gdp.

Box 3.1. Data revisions

As previously discussed, GNI-based and VAT-based contributions that member states have to make in a particular year are based on forecasts of GNI and the harmonised VAT base. Outturn data often turn out differently to forecasts, and data are frequently revised years after the event. To account for this, EU budget contributions are corrected in light of these revisions up to four years after the year in question, though in some cases where there are doubts about the accuracy of the data in question, revisions can go back further.

A famous example of this revisions process occurred in 2014 when data on GNI in several EU member states was revised going back to 1995. These revised data showed that UK GNI was a larger share of total EU GNI in these years, meaning that the UK should have paid a larger share of the GNI based contributions in previous years. To correct for this, the UK government was told to make a payment of around £1.7 billion by 1 December 2014, though the government ultimately managed to delay making the payment until 2015, and because the UK rebate (described in Section 6) for a particular year can be revised up to four years afterwards, the rebate also increased, reducing the size of the net payment.

Logically, making corrections to contributions in light of data revisions makes sense – it is hard to argue that one member state should have to make a larger or smaller contribution to the EU budget because GNI data for a particular year available at the time proved to be inaccurate. However, this episode makes it clear that governments of EU member states should be aware that their actual contributions to the EU budget may turn out differently to how they expect at the time the MFF is agreed – and that these revisions may lead to them inadvertently agreeing to contribution levels that they would not have considered acceptable had they known about them at the time.

As with the traditional own resource and VAT-based contributions, changes were made in the 2014–2020 MFF that have not yet come into effect. As part of the MFF agreement, Denmark, The Netherlands and Sweden have secured reductions in their contributions of €130 million, €695 million and €185 million a year respectively, and Austria has secured a reduction of €30 million in 2014, €20 million in 2015 and €10 million in 2016. The Netherlands and Sweden had similar reductions in the previous MFF period which ended in 2013. These member states are all significant net contributors to the EU Budget, and these arrangements limit the size of their net contribution: rather than having a rebate like the UK does, these countries simply have a reduction in their contribution levels. Again, when the new own resources directive is ratified by all member states, these countries will receive retrospective refunds paid for by higher GNI-based contributions from the other member states.

Summary

The three contributions member states make to EU revenues are customs duties and levies (known as traditional own resources), a contribution based on a hypothetical harmonised VAT base and a contribution based on a country's GNI. Two of these – traditional own resources and the GNI-based contribution – seem relatively sensible ways of funding the EU budget: it would seem unfair to allow member states that are the point of entry for imports from outside the EU to be allowed to keep all the customs duties and levies they collect, and the GNI-based contribution by definition imposes a relatively equal burden on member states. However, there seems less justification for the VAT-based contribution: it is complicated, does not really correspond to the amount of VAT paid in the different member states and imposes a larger burden on member states with large consumption shares in national income and lower consumption of exempt goods.

4. EU spending

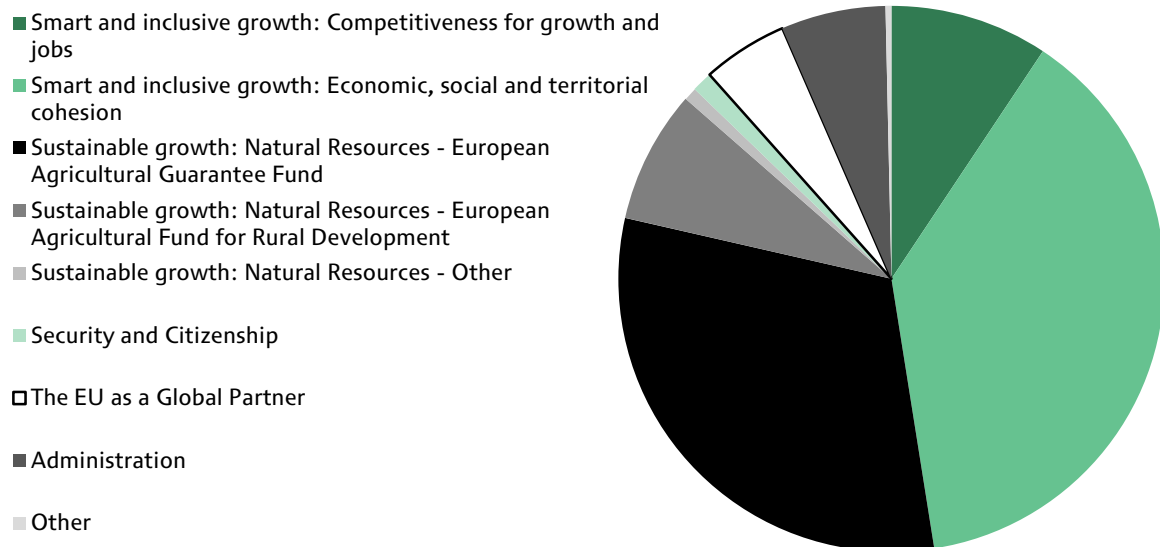
Source	Expenditure in 2014			
	UK		EU	
	€s per person	% GNI	€s per person	% GNI
Competitiveness for growth and jobs	16	0.05%	19	0.07%
Economic, social and territorial cohesion	27	0.08%	107	0.39%
Agricultural Guarantee Fund (CAP)	50	0.15%	85	0.31%
Rural Development	11	0.03%	22	0.08%
Other Natural Resources	1	0.00%	2	0.01%
Security and Citizenship	2	0.01%	3	0.01%
EU as a Global Partner	0	0.00%	0	0.00%
Administration	2	0.01%	15	0.06%
Other	0	0.00%	1	0.00%

Note: In order to aid comparisons between the UK and EU as a whole, the EU figures exclude spending not allocated to a specific EU member state. In 2014 such expenditure amounted to €13.9 billion, or around €27 per person or 0.10% of EU GNI. Around half of this amount is accounted for by spending under the “EU as a Global Partner” heading. Much of the rest is spending within the EU which is not allocable to an individual member state.

Figure 4.1, below, shows how the EU budget was divided between the different budget headings set out in the MFF in 2014 (note that as the budget headings have changed over time, these are not the same as those in Figure 2.2, where we attempted to keep the headings consistent over time). The two largest budget headings are ‘Smart and inclusive growth’ and ‘Sustainable growth: Natural Resources’. The ‘Smart and inclusive growth’ heading has two main components, namely spending on research, infrastructure projects (‘competitiveness for growth and jobs’) and structural and cohesion funds, which principally give funds to the poorer regions of the EU. The ‘Sustainable Growth: Natural Resources’ heading is principally the CAP, which has two ‘pillars’: direct payments to farmers, and funds to support development in rural areas. Together, these two headings make up 87% of the total budget, with the remainder going on measures for internal security and aid to non-EU countries.

In this section, we describe how each of these programmes work, and how much each member state receives. Most structural funds and almost all of the spending under the CAP is ‘preallocated’ to member states at the start of the MFF period, however other forms of spending, in particular research funding, is allocated on the basis of competitive tendering, with the distribution between member states unknown at the time the MFF is agreed.

Figure 4.1. EU spending in 2014



Note: Includes spending that is not allocated to specific EU countries (including spending allocated to non-EU countries).

Source: <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>.

4.1 Structural and cohesion funds

At €54 billion and making up 38% of total EU spending in 2014, structural and cohesion funds are the largest single component of the EU budget. These funds are designed to boost growth, particularly in the poorer member states and regions of the EU (though some funds are available to all parts of the EU).

There are two main categories of funds, structural funds (around 80% of the €54 billion) and cohesion funds (the remaining 20%).

Structural funds

The two structural funds are: the European Regional Development Fund, which is focused on innovation and research, support for SMEs, improving digital infrastructure and decarbonising the economy, and; the European Social Fund, which funds projects to increase labour market mobility, education and skills and enhance member states' institutional capacity. In reality these are not really separate funds; rather, member states must spend a certain proportion of their structural fund allocations on projects that fall under the objectives of each fund.¹²

Structural funds are allocated to regions of the EU depending on their GDP per capita. There are three categories of region:¹³

- Regions whose GDP per capita is less than 75% of the EU average are designated as 'less developed regions' and will receive 52% of total spending in the current MFF period.

¹² The proportion of funds that must be spent on European Social Fund objectives is 25% in less developed regions, 40% in transition regions and 52% in more developed regions.

¹³ Structural funds are allocated between NUTS2 regions based on GDP per capita between 2007 and 2009 adjusted for differences in purchasing power (PPS). There will be a reassessment of these regions in 2016 to investigate whether any regions have changed category based on their GDP per capita between 2012 and 2014.

- Regions whose GDP per capita is between 75% and 90% of the EU average are designated 'transition regions' and will receive 12% of total spending in the current MFF period.
- Regions whose GDP per capita is more than 90% of the EU average are designated 'more developed regions' and will receive 16% of the total in the current MFF period.

There are rules for allocating funds to each region.¹⁴

For less developed regions, the amount received is the difference between their GDP and the EU average multiplied by a percentage which depends on the per-capita GNI of the member state it is in.¹⁵ Regions with an unemployment rate that is higher than the EU average receive an additional payment on top of this. For example, West Wales and the Valleys has been allocated €2,005 million over the current MFF period, and Cornwall and the Isles of Scilly have been allocated €590 million.¹⁶ In both cases, this amounts to around €150 per person per year over the period in question. These are far higher amounts than neighbouring regions that are not poor enough to qualify for this funding: East Wales has only been allocated around €50 per person per year and Devon, Somerset and Dorset have been allocated less than €10 per person per year over the same period.

Funds for more developed regions are allocated on the basis of the characteristics of NUTS2 regions,¹⁷ but member states are allowed to shift funds between regions. Each region is allocated funds based on a combination of their share of:

- population,
- number of unemployed people in regions with an unemployment rate above the EU average,
- the shortfall to the EU's target employment rate of 75% of people aged 20 to 64,
- the shortfall to the EU's target of 40% for the number of people aged 30 to 34 who have completed tertiary education,
- the overshoot of the EU's target of less than 10% of those aged 18 to 24 who left education early,
- the gap between their GDP and that of the most prosperous region in the EU, and
- population living in NUTS3 regions with low population density.

Overall, funding for more developed regions is set at €19.80 per person per year (though the actual allocation between regions will depend on the characteristics listed above).

Transition regions receive a level of funding in between the two: the minimum they can receive is the same as the average of more developed regions in that member state, and the maximum is 40% of what a region would receive if its GDP per capita were exactly 75% of the EU average. There is therefore a big discontinuity in funding for regions whose GDP per capita increases over

¹⁴ What follows is an abbreviated version of the rules in Annex VII of <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1303&from=EN>.

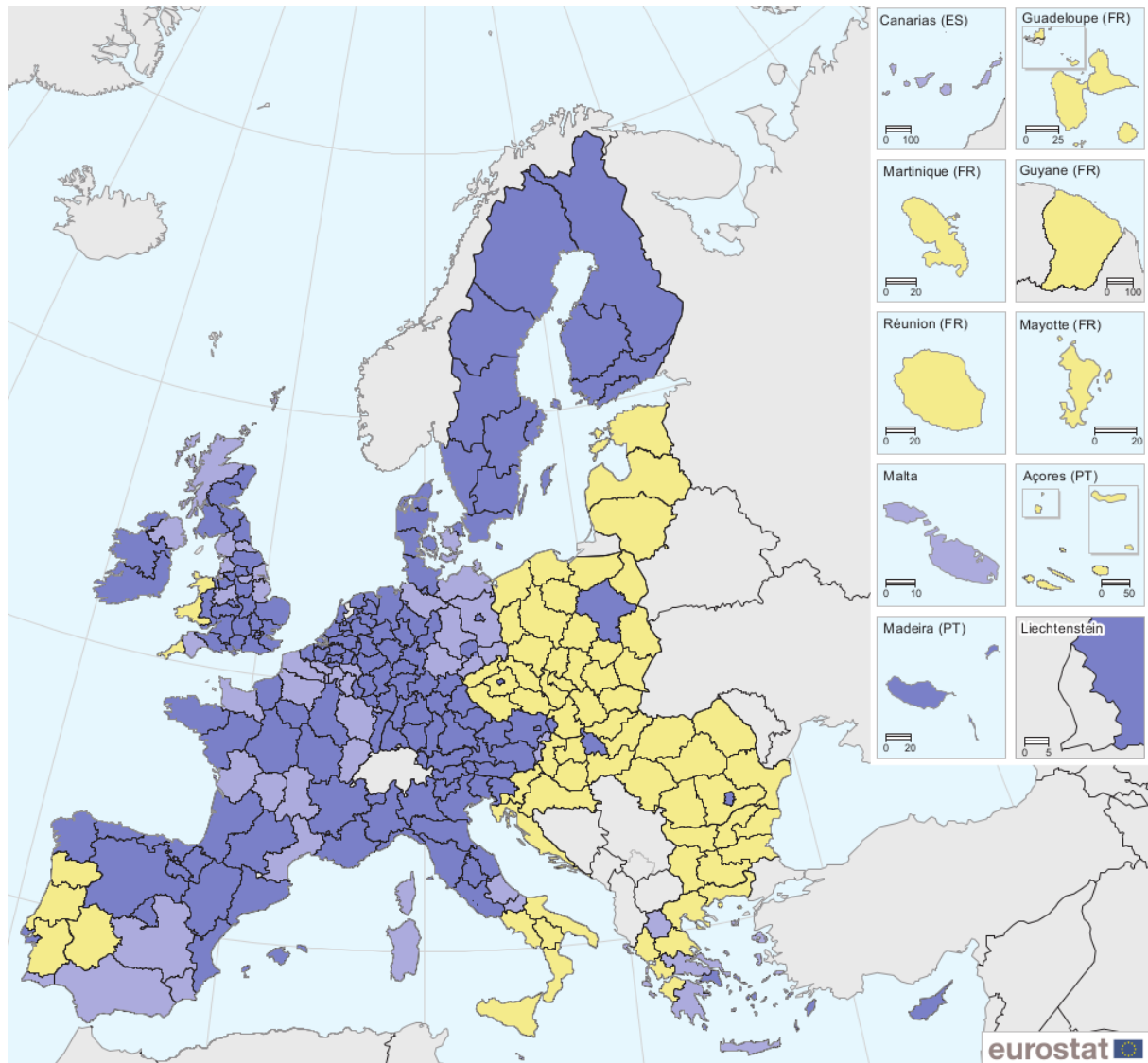
¹⁵ The percentage ranges from 1.65% for member states with a GNI per capita of at least 99% of the EU average to 3.15% for those whose GNI per capita is less than 82% of the EU average.

¹⁶ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/307492/bis-14-772-uk-allocations-eu-structural-funds-2014-2020-letter.pdf.

¹⁷ NUTS2 regions are defined at the European level for statistical purposes, and they are intended to be administrative regions with between 800,000 and 3 million inhabitants.

the 75% threshold, although there are transitional arrangements that ensure that regions receive at least 60% of the amount they received during the previous MFF period, and member states at least 55% of the amount they previously received.

Figure 4.2: Map of less developed, transition and more developed regions in the EU



(% of EU-27 average)

- Less developed regions (GDP per inhabitant, < 75)
- Transition regions (GDP per inhabitant, ≥ 75 – < 90)
- More developed regions (GDP per inhabitant, ≥ 90)

Administrative boundaries: © EuroGeographics © UN-FAO © Turkstat
Cartography: Eurostat — GISCO, 06/2015

0 200 400 600 800 km

Source: http://ec.europa.eu/eurostat/statistics-explained/images/8/84/Regional_eligibility_for_structural_funds%2C_by_NUTS_level_2_region%2C_2014%E2%80%932015_of_EU-27_average%29_RYB15.png.

Figure 4.2 is a map of the EU that shows which regions fall into each category. As we would expect, the 'less developed' regions are concentrated in Eastern Europe, particularly those former communist countries that have joined the EU since 2004, though parts of Greece, Portugal, the south of Italy and Extremadura in Spain, the overseas regions of France and West

Wales and the Valleys and Cornwall and the Isles of Scilly in the UK are also in this list. The UK is therefore unusual among Western European countries in having any 'less developed' regions. The UK also has eleven 'transition' regions: the Tees Valley and Durham, Cumbria, Lancashire, Merseyside, East Yorkshire and Northern Lincolnshire, South Yorkshire, Lincolnshire, Shropshire and Staffordshire, Devon, the Highlands and Islands of Scotland and Northern Ireland. Austria, Belgium, Denmark, and Germany also have some transition regions. Cyprus, Finland, Ireland, Luxembourg, the Netherlands and Sweden are entirely in the 'more developed' category.

Cohesion funds

Separate from the structural funds are 'cohesion funds', which are allocated to member states rather than NUTS2 regions. Only member states whose GNI per capita is less than 90% of the EU average (in purchasing power parity terms, measured in the period 2008–2010) are entitled to cohesion funds. These are focused on transport and environmental projects (broadly defined, so including measures to promote greener energy and public transport). In the current MFF period, the member states benefiting from these funds are the 13 member states that have joined the EU since 2004 plus Portugal and Greece.

Cohesion funds will make up 21% of the total available for structural and cohesion funds in the current MFF period. The starting point of the allocation of cohesion funds is €48 per person per year with some variation depending on population density and how far the country's GNI per capita is below the EU average, though in practice allocations for the member states that have joined the EU since 2004 are determined by a rule that says that one third of their total structural and cohesion fund allocations must come from the cohesion fund. As with the structural funds, member states that benefited from cohesion funds in the previous MFF period (in this case, there is only one: Cyprus) will benefit from some of these funds, which will gradually reduce over the period 2014–2020.

Other fixed allocations

On top of the funds that are allocated according to these rules, certain member states receive additional fixed allocations. These are the Eurozone countries that were particularly badly affected during the financial crisis, and areas of Belgium and the old East Germany that previously received higher structural fund allocations. The UK and Ireland also receive a small additional allocation to assist with the Northern Ireland peace process.

Spending structural and cohesion funds

Although the funds are run by the member states rather than the EU centrally, there are restrictions on what member states can spend the funds on. Member states must submit a 'Partnership Agreement' setting out the proposed projects for each fund and how they fit in to the EU's strategic objectives. They must also commit certain amounts to certain objectives: at least 20% of European Social Fund allocations must be spent on projects to combat poverty (such as training schemes for the unemployed), and 20% of European Regional Development Fund allocations in more developed regions, 15% in transition regions and 12% in less developed regions must be spent on low-carbon economy projects (e.g. funding research into new green energy technologies or building green energy plants).

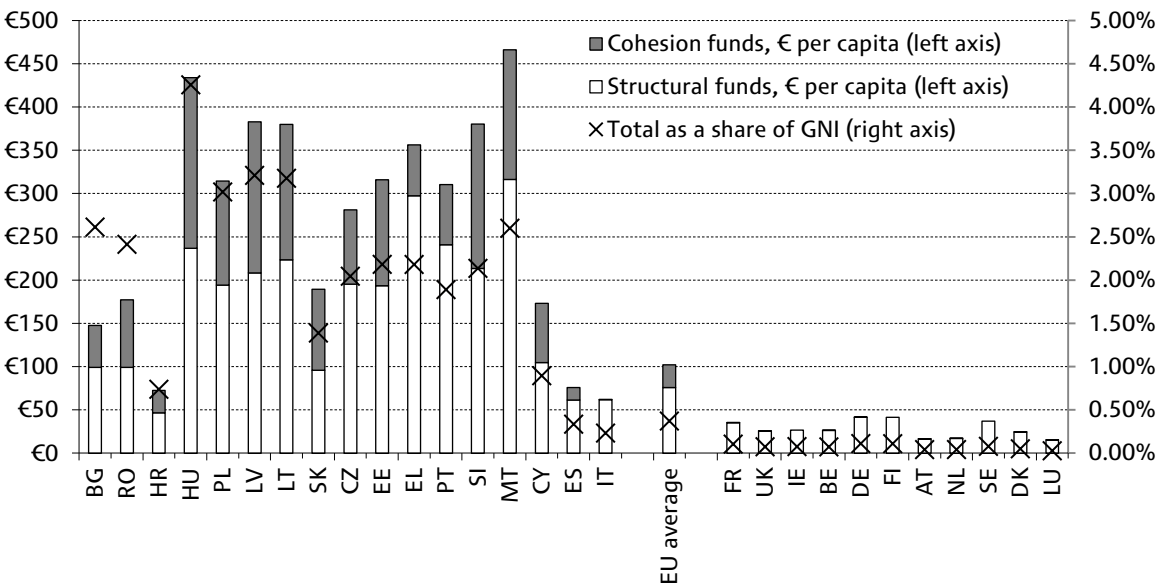
There are also rules around 'additionality' that are meant to ensure that EU funds do not replace funds previously committed by member states, though it is of course impossible to know how

much member states would have spent in these areas if there was no EU funding and hence whether EU funding really is adding to what would otherwise have been spent or not. Projects financed by EU funds must also be co-financed by funds from member states themselves, though the level of the EU contribution is relatively high, ranging from 50% in more developed regions to 85% for the cohesion fund and less developed regions in member states with less than 85% of the EU average GDP per capita.

Figure 4.3 shows how much the different EU member states receive in structural and cohesion funds. We see that these funds are very important for the poorer members of the EU, worth in excess of 2% of GNI for eleven of these countries. However, some member states received less in 2014 than others. This is for different reasons in different cases: Bulgaria, Romania, Slovakia and Poland have been less successful in designing projects that have gained EU approval, meaning that payments out of the funds have been well below total entitlements. Croatia only joined the EU in 2013 and so has had less time to design projects to gain EU approval. By contrast, structural funds are very small (and cohesion funds nonexistent) for countries whose GNI per capita is in excess of the EU average, including the UK. Indeed, it is notable that the UK receives a lower amount per capita from structural funds than other richer countries that do not have any less developed regions and fewer transition regions: this is at least partly due to the UK's relatively high employment rate and population density, but also because the UK has been historically relatively poor at utilising its structural fund allocations.¹⁸

¹⁸ See J. Tosun (2014), 'Absorption of Regional Funds: A Comparative Analysis', *Journal of Common Market Studies*, vol. 55 no.2, pp. 371–387.

Figure 4.3. Structural and cohesion funds by country, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Structural and cohesion funds and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

Are EU Structural Funds successful in their objective of boosting growth in the regions that receive them? Becker et al. (2010)¹⁹ examine this question by comparing the economic performance of those regions that just qualified for the highest level of structural funding by having a GDP per capita just below 75% of the EU average with those that just missed out on that funding, and find that those which qualified for the funding had 2.0% higher GDP growth over the relevant MFF period (they examine the three periods from 1989–93, 1994–99 and 2000–06), which implies that every Euro spent on structural funds yields an additional €1.21 in GDP. They find no impact on employment rates, however: the effect appears to arise as a result of higher levels of investment and higher productivity. A later paper by the same authors²⁰ finds that this effect also varies between different regions, with the effect being larger in regions with higher levels of education and a higher perceived quality of local government institutions. They find no evidence that structural funds have helped boost growth in the regions of France, Italy, Malta and Portugal that benefited from them. Moreover, in many other countries the effect only appears to have come as a result of a boost in consumption, which would be unlikely to be sustained after funds were withdrawn. Only in Austria, Finland, Germany, the Netherlands, Sweden, and the UK was there any significant evidence of structural funds boosting investment.

¹⁹ Becker, S. O., Egger, P. and von Ehrlich, M. (2010), ‘Going NUTS: The Effect of EU Structural Funds on Regional Performance’, *Journal of Public Economics* 94 (9–10): pp.578–90.

²⁰ Becker, S. O., Egger, P. and von Ehrlich, M. (2010), ‘Absorptive Capacity and the Growth and Investment Effects of Regional Transfers: A Regression Discontinuity Design with Heterogeneous Treatment Effects’, *American Economic Review: Economic Policy* 5(4), pp.29–77.

4.2 Agriculture and rural development funds

Rules on direct payments to farmers

The Common Agriculture Policy (CAP) was the first area of spending coordinated across the EEC (as it was at the time) as a whole. The CAP was originally conceived at a time when many basic food items were rationed in many European countries, and its aim was to encourage food production and ensure that farmers were financially viable. Until the 1990s, the CAP achieved these objectives by providing price supports for farmers and purchasing surplus products. The CAP proved rather too successful at encouraging farmers to produce more, as the guaranteed prices for farmers' products resulted in large amounts of surplus products ('butter mountains' and 'wine lakes') which were then dumped on world markets. In response to these developments which proved unpopular with both EU citizens and other countries, there were reforms in the 1990s and 2000s that have meant that the majority of spending takes the form of direct payments to farmers to support their incomes that are not linked to production. The aim of ensuring the financial viability of farms has therefore remained in place, and has been supplemented with the aim of improving farming practices to ensure environmental sustainability: to receive payments, farmers have to conform to certain environmental practices, and a proportion of payments are conditional on adopting practices that go beyond the minimum.

Under the current set of CAP regulations, member states have a fairly wide range of discretion about how they distribute payments to farmers. However, there are a number of fixed rules that apply to all member states:

- Payments can only be made to individuals who are actually involved in agricultural production, and no payments can be made to owners of airports, railway services, waterworks and sports grounds, or to real estate developers. Member states can add other activities to this list that do not receive payments.
- Payments may only be given in respect of land that is used for an agricultural activity.
- 30% of payments must be conditional on farmers engaging in 'greening' activities, including crop rotation, maintaining permanent grassland and having 'ecological focus areas' (e.g. buffer strips, catch crops, cover crops, fallow land, hedges and nitrogen-fixing crops) covering at least 5% of the eligible area.²¹
- Member states must increase payments to young farmers by 25%, though these payments must not exceed 2% of the total spending on direct payments.²² The rationale behind this is that many farmers in the EU are approaching retirement age and there is a desire to ensure that farmland is maintained in the future, and that there are employment opportunities in rural areas.
- Member states must undertake some form of redistribution between those entitled to large and small direct payments. Either farmers who have entitlements of more than €150,000 must have some of their entitlement withdrawn (at a minimum, 5% of the

²¹ There are some exemptions to the rules on ecological focus areas for farmers with holdings of less than 15 hectares. Member states may also, subject to approval from the Commission, give alternative conditions that farmers can comply with to receive these payments.

²² In the case where payments to young farmers would exceed 2% of the total, the size of each payment is reduced by an appropriate percentage. In nine member states (Denmark, Ireland, Greece, Spain, Croatia, The Netherlands, Austria, Portugal and Sweden) this constraint is binding. See http://ec.europa.eu/agriculture/direct-support/direct-payments/docs/implementation-decisions-ms_en.pdf.

amount by which their payments exceed €150,000, though member states have flexibility to withdraw more than this, and over how the threshold is defined)²³, or alternatively member states can introduce a ‘redistributive payment’ to smaller farmers.²⁴

Within these constraints, however, member states (and regions within member states: in the UK these are matters that are devolved to Scotland, Wales and Northern Ireland) have a wide range of discretion about exactly how they design their direct payments to farmers, with the result that the design of the payments varies considerably between member states. However, all of the options involve some degree of convergence towards a flat-rate payment per hectare. Most of the member states that have joined the EU since 2004 (with the exception of Malta, Slovenia and Croatia) have a simple ‘Single Area Payment Scheme’ that gives a flat rate payment per hectare. The remaining member states operate a ‘Basic Payment Scheme’, which is more complicated and has a considerable amount more flexibility about the degree and speed of convergence:

- Some member states have chosen to operate a flat rate payment from 2015. This can either operate at a national or a regional level (where regions can be defined according to historical land use or type of land as well as geographical regions). For example, in England there are separate rates for non-severely disadvantaged areas, upland severely disadvantaged areas other than moorland (which applies to hills and fells), and upland moorland severely disadvantaged areas. Germany has also applied a flat rate since 2015 at a (geographical) regional level, and Malta has applied it at the national level and France has applied a flat rate per hectare in Corsica.
- Other member states have decided to converge to a flat rate payment at either the regional or national level by 2019 or 2020. Under this model, historical payments in 2014 (which were in turn based on farm production between 2000 and 2002) are adjusted each year to converge to the regional or national average value in equal steps. Within the UK, Scotland and Wales have decided to take this approach (Scotland at a regional level, Wales at the national level), and it has also been taken by Sweden, The Netherlands, Finland and Austria (Finland at a regional level, the others at the national level).
- The remaining member states have chosen a so-called ‘tunnel convergence’ approach, whereby there is a degree of convergence in payments over the period 2015–2019, but there will still be some degree of divergence in payment amounts per hectare different farmers receive. Under these rules, farmers with payments per hectare of less than 90% of the national or regional average must see at least one third of the gap to 90% of the national or regional average closed by 2019, and all farmers must receive at least 60% of the national or regions average by this point. These increases for farmers receiving less than the average are matched by reductions for those receiving more than the average, but member states may impose a maximum reduction over the period. The maximum

²³ For example, Wales reduces 15% of the amount between €150,000 and €200,000, 30% of the amount between €200,000 and €250,000, 55% of the amount between €250,000 and €300,000 and an overall cap of €300,000. Member states that wish to limit this reduction have the option of deducting farm salaries from the payment amount for the purposes of defining the €150,000 threshold so that payments only get reduced if payments exceed salaries by at least €150,000.

²⁴ Eight member states or regions have introduced a ‘redistributive payment’ (in Germany, France, Lithuania, Croatia and Romania and Wallonia in Belgium, this is instead of the reduction in payments for those with large entitlements, while Poland and Bulgaria have both a redistributive payment and a reduction for those with large entitlements). The redistributive payment takes the form of a higher rate of payment (which cannot be more than 165% of the national or regional average) for the first 30 hectares.

reduction must be no less than 30%: Belgium, France, Greece, Portugal, Slovenia and Spain have chosen this option.

The other main choice member states can make is whether to introduce 'voluntary coupled support', that is to say support that is linked to production rather than the size and nature of land holdings. There are restrictions on the amount that member states can use in this manner.²⁵ All member states except Germany have some element of voluntary coupled support, but as we will see in Figure 4.4 below, the extent of these varies considerably between member states. Subsidising the production of particular farm products will distort the incentives farmers face and likely lead to overproduction of certain products and the underproduction of others. Payments that are decoupled from production (but linked to the adoption of good environmental practices) will achieve the twin objectives of supporting farmers' incomes and improving the environment without having these adverse effects. The shift away from such coupled payments is therefore a welcome one, and there seems little rationale for retaining support that is coupled to production.

Finally, member states may give additional support to areas with natural constraints, which can be climatic, or due to altitude, soil quality, steepness or water supply. This support cannot make up more than 5% of total direct payments. In practice, only Denmark has taken up this option, and does not spend a significant amount on these payments.

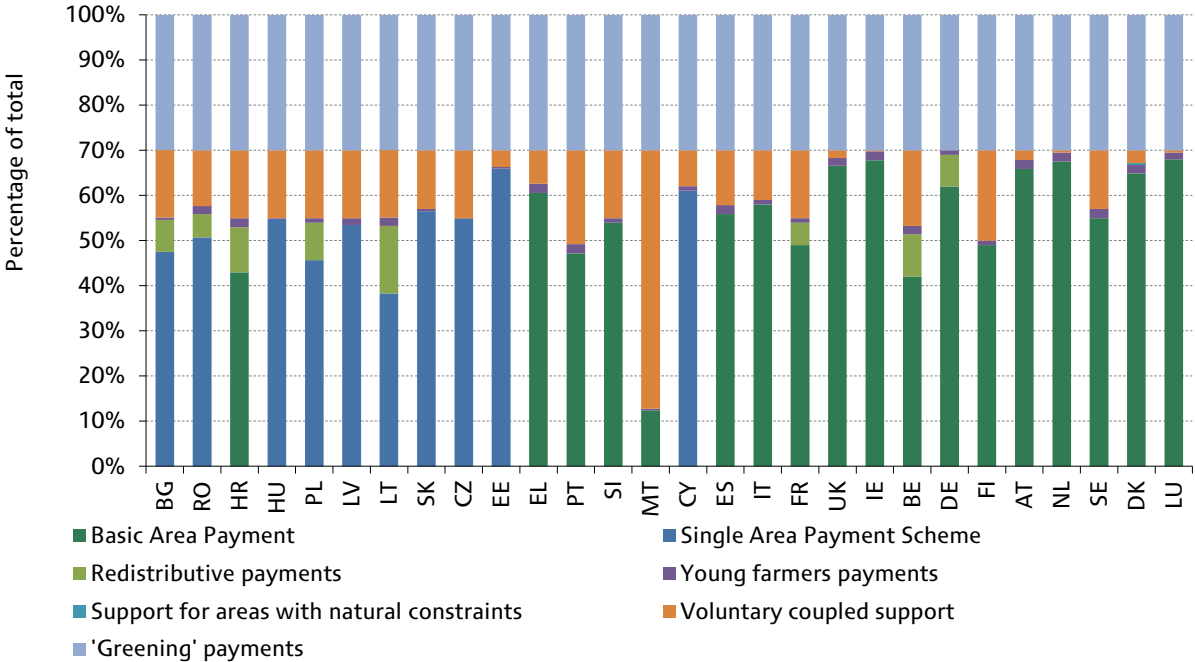
Spending on direct payments to farmers

Figure 4.4 summarises the decisions taken by member states, which shows the level of discretion member states have to design their systems of direct payments to farmers. We see the compulsory 30% spent on 'greening' payments, and that support coupled to production is limited. However, we see that member states have made quite different choices in how much coupled support they give, with many of the richer member states including the UK and Ireland offering much less of this type of support. We also see that some member states, mainly the poorer ones, have taken up the option of redistributive payments to smaller farmers.

Member states are also able to transfer funds between direct payments to farmers and spending on rural development (described in the next sub-section). Member states may transfer up to 15% of their allocated direct payments to rural development, or transfer up to 15% (or for member states who receive less than 90% of the EU average per hectare, 25%) of their rural development allocation to direct payments. 11 member states (France, Latvia, the UK, Belgium, the Czech Republic, Denmark, Germany, Estonia, Greece, The Netherlands and Romania) have chosen to transfer money from direct payments to rural development, and 5 member states (Croatia, Hungary, Malta, Poland and Slovakia) have chosen to transfer money from rural development to direct payments.

²⁵ Specifically, member states are allowed to use 8% of their allocation for direct payments in this way, or 13% if they used the Single Area Payment Scheme or applied a suckler cow premium in 2014. These can both be increased by 2 percentage points if member states spend at least 2% of their national ceiling to support the production of protein crops (e.g. peas, field beans and soya). Malta has a derogation from this obligation, and other member states can apply for approval from the Commission if they wish to spend more than this amount: these have been obtained by Belgium, Finland and Portugal. The most common areas where this support is applied are beef and veal and dairy products, which combined make up 62% of total voluntary coupled support in 2015. See Table A2 of http://ec.europa.eu/agriculture/direct-support/direct-payments/docs/implementation-decisions-ms_en.pdf.

Figure 4.4. Breakdown of direct payments to farmers for each member state



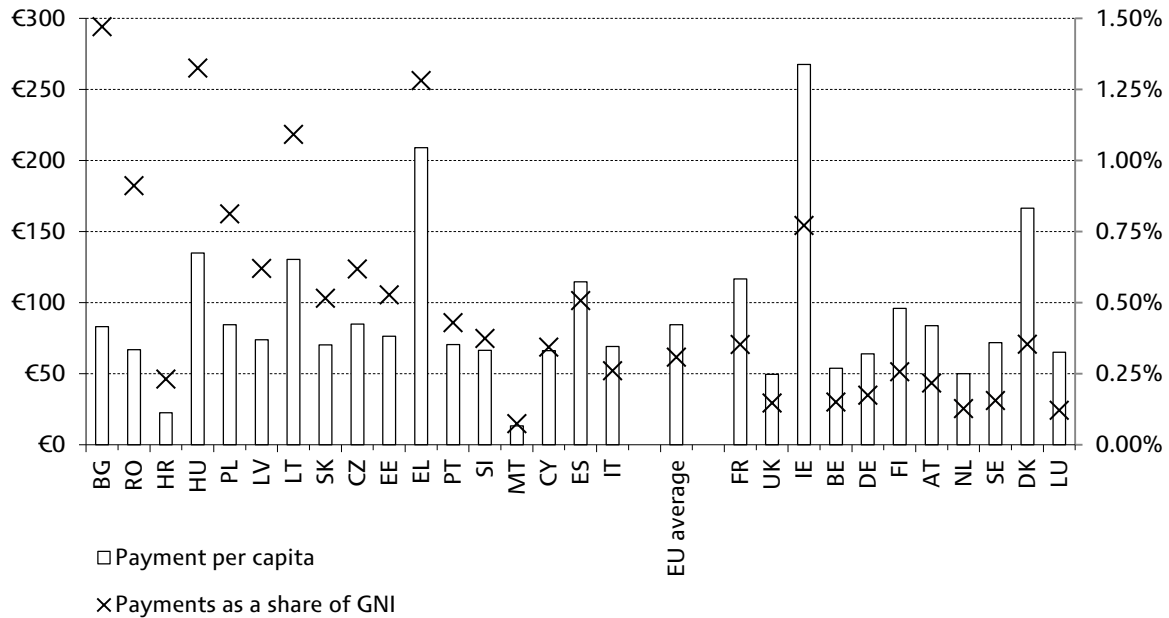
Source: Authors' calculations using <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>.

As with structural and cohesion funds, the amount that is given to each member state each year is set out in the MFF. The precise formula used is not published, but mirroring the convergence in payments per hectare within member states, the distribution is based on historical entitlements but with an adjustment over the current MFF period such that member states who previously received less than 90% of the average payment per hectare make up one third of the gap to 90% of the average by 2020, and all member states receive at least €196 per hectare in the same year. This is offset by a reduction in the per hectare amount for those member states who receive more than the EU average, who see a reduction that is proportional to the amount by which their per-hectare payment exceeds the EU average.

Figure 4.5 shows average direct payments to farmers in cash terms and as a percentage of GNI in 2014. We see that there is a wide variation in the amount different member states receive. This is partly because the size of the agriculture sector varies widely between countries: more densely populated member states such as Malta, the UK, Belgium, The Netherlands and Germany receive less per capita simply because they have less agricultural land (see Figure 4.6). (Croatia is a special case: although it has a low population density, as part of its accession agreement to the EU, it does not receive its full entitlement of CAP payments until 2022. Bulgaria and Romania also have not received their full payment entitlements until 2016, but they were closer towards receiving their full entitlements in 2014). Similarly, less densely populated member states including Ireland and Greece receive larger amounts per capita. But this does not explain all of the difference: as we will see later, there is also still a significant difference in the amount different member states receive per hectare. Looking overall, the UK receives less per capita than any member state other than Croatia (which does not yet receive its full entitlement) and Malta (which is very densely populated and has little agricultural area).

We also see that payments are generally larger as a share of national income in the poorer member states. Since payments are set to broadly the same cash value per hectare in each member state, this is unsurprising.

Figure 4.5. Direct payments to farmers by country, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

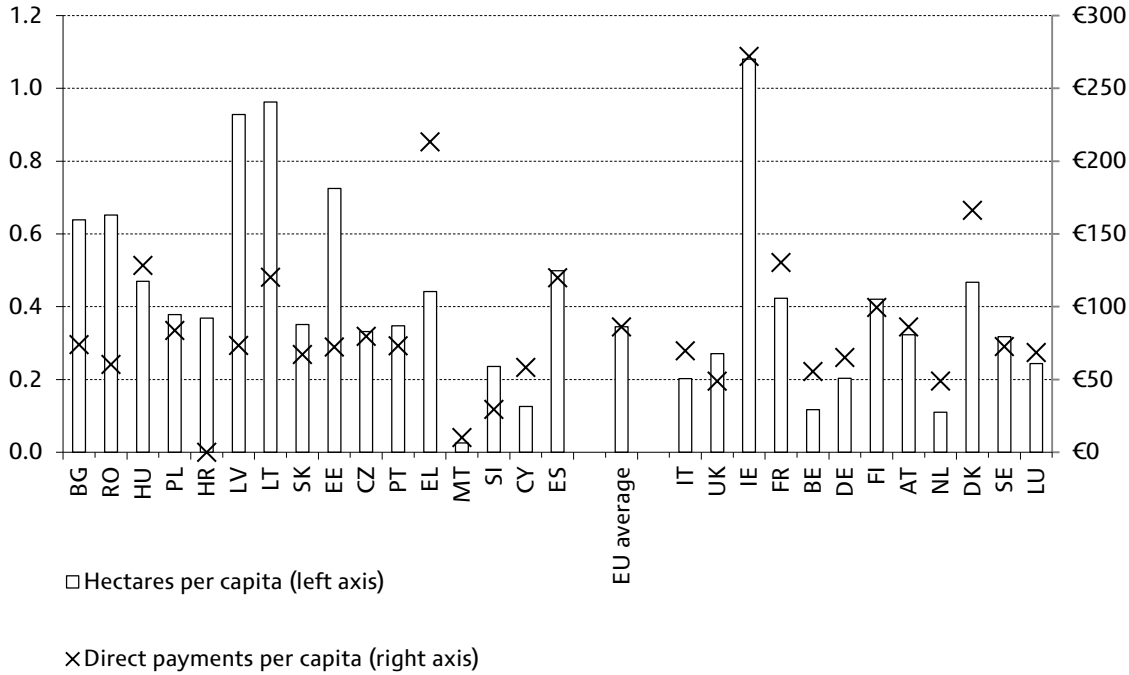
Source: Direct payments to farmers and GNI from

<http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

Figure 4.6 attempts to explain these differences by examining the relative sizes of agricultural sectors in each member state. Since payments are generally set per hectare, we show the number of hectares of land used for agriculture in 2013 (the latest year available) divided by the population in that year, and compare this with the amount of direct payments to farmers per capita in that year. We see that variation in the amount of agricultural land per capita can explain some of the differences in Figure 4.5, in particular the larger per-capita receipts of Ireland, and to a lesser extent Hungary, France, Spain and Greece, and the very low amount received by Malta. But the Figure also shows large disparities in the amount received per hectare: the Baltic states (Latvia, Lithuania and Estonia) receive much less per capita than we would expect given their relatively large agricultural area,²⁶ whereas Greece, Belgium and The Netherlands appear to receive more than we would expect given their agricultural area. The UK is not an outlier in terms of its agricultural area, but nevertheless receives a relatively small amount of agricultural payments per capita.

²⁶ The new entrants – Romania, Bulgaria and Croatia – also fit into this category, but this is chiefly due to their full entitlements not being fully phased in by this point.

Figure 4.6. Hectares of agricultural land and direct payments to farmers per capita, 2013



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.
 Source: Direct payments to farmers and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, agricultural hectares from Eurostat table ef_kvaareg.

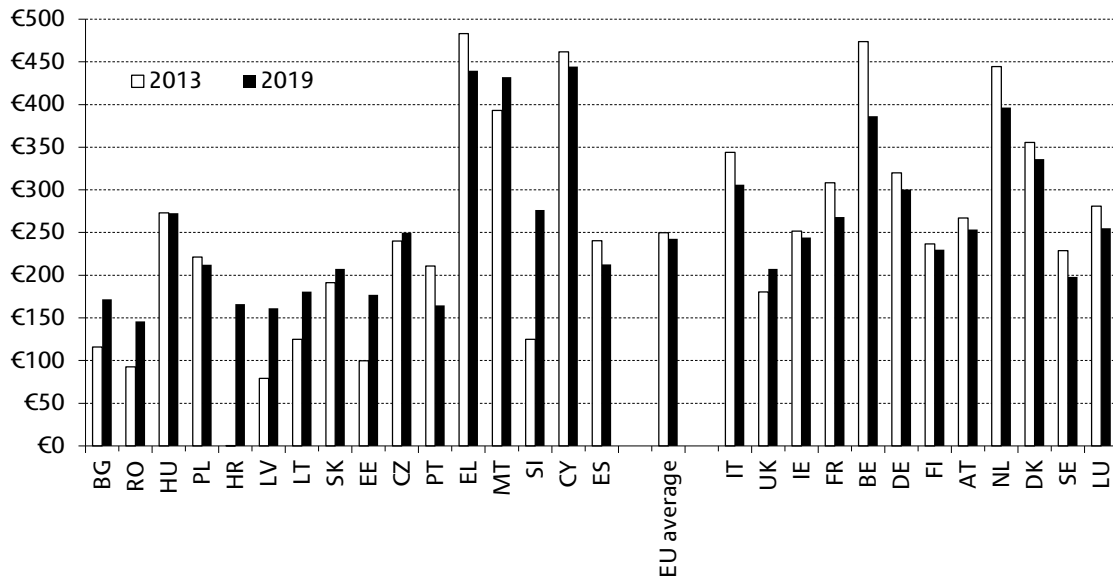
In Figure 4.7, we examine per-hectare payments in each member state in both 2013 and 2019 (assuming that agricultural land use remains the same as in 2013). We see that there was indeed considerable variation in the average payment per hectare between member states in 2013, and this will persist, though narrow slightly by 2019. In particular, Belgium and the Netherlands will see reductions in the average amount paid per hectare, while the Baltic states see sizeable increases. Bulgaria, Romania and Croatia also see increases as they gradually obtain their full entitlements to CAP payments. However, the broader picture is that there is expected to be very little convergence over the current MFF period.

The UK will see a small increase in the amount paid per hectare over this MFF period, though it is worth noting that the UK receives a larger amount per hectare than most of the member states that have joined the EU since 2004. Thus, the reason that the UK receives so little in CAP payments is a combination of the relatively small agricultural sector and the relatively small average payment per hectare.²⁷ Other member states either have more agricultural land per

²⁷ The amounts different member states receive today largely date back to the amount they received in the mid 1990s, when there were different amounts of payment per hectare depending on the land use. Unimproved agricultural land, such as the Scottish highlands, received much lower amounts per hectare than other land. This difference continues to this day, with Scotland receiving less per hectare than other parts of the UK; see <http://www.gov.scot/Topics/farmingrural/Agriculture/CAP/CAPEurope10112012/budget-facts31102012>.

person (most of the member states that have joined the EU since 2004) or a higher average payment per hectare (e.g. Malta, Cyprus, Slovenia, Italy, Belgium, the Netherlands and Germany) or both (e.g. Greece, Spain, France, Ireland, Finland, Austria and Denmark).

Figure 4.7. Average direct payments per hectare by member state, 2013 and 2019



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita in 2013 with the poorest on the left and the richest on the right.

Source: Direct payments to farmers and GNI for 2013 from

<http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, direct payments to farmers in 2019 from Annex III of EU Regulation 1307/2013, agricultural hectares from Eurostat table ef_kvaareg.

Rural development payments

As well as the structural and cohesion funds, the EU has funds that are specifically designed to boost economic development in rural areas. These work in a similar way to the structural and cohesion funds in that each member state is given a certain pre-allocation of funds that they are able to spend on projects in particular areas that have been approved by the Commission. Furthermore, as with the structural and cohesion funds, projects funded from rural development funds must be co-financed by member states at a rate of between 15% (for regions designated less developed regions in the structural fund rules) and 47% (for regions designated more developed regions in the structural fund rules). The three key priorities for rural development funds in the current MFF period are improving the competitiveness of agriculture, sustainable management of the natural environment and action on climate change and ensuring that rural areas keep up with other areas in terms of economic development. In practice, these funds are used to help farmers develop their business and in particular to help new farm businesses, restore and manage farmland, improve the efficiency of water and energy use by farmers, fund research into new agricultural techniques and transfer this knowledge to farmers and support other businesses in rural areas.

Unlike the other development funds, however, the rules for allocating rural development funding to member states are not published. Allocations to the different member states appear to be largely based on historical receipt of these funds – in the 15 member states that were already EU members in 2004, this allocation dates back to the allocation of these funds in the 1994–99 MFF period, which allocated funds to regions with high levels of agricultural employment, low levels of agricultural income and low population density or significant depopulation at that time; for those who have joined since then it is based on their farming population, agricultural area, gross domestic product (GDP) per capita in purchasing power at that time and other geographical characteristics at the time they joined the EU – though other (unspecified) ‘objective criteria’²⁸ are also taken into account. Even then, many of the member states that lost out from the application of ‘objective criteria’ or the convergence per hectare amounts of direct payments to farmers (see previous sub-section) have managed to obtain additional ad-hoc amounts of rural development funding to make up for some of these losses.

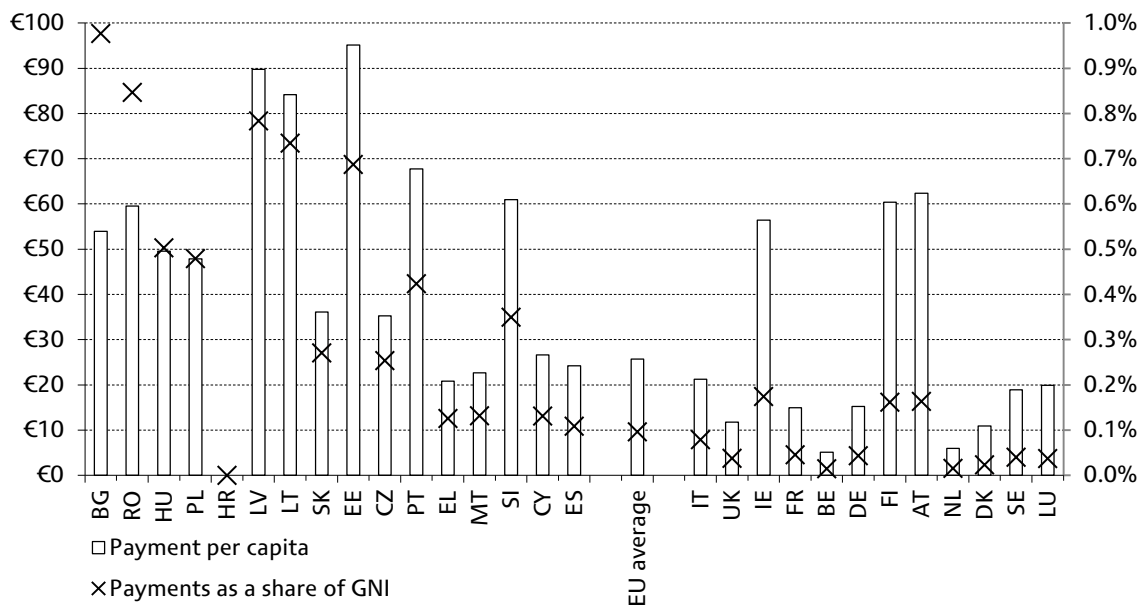
Figure 4.8 shows rural development payments per capita and as a share of GNI in the 28 EU member states in 2013 (note that although 2014 data is available, this is atypical as this was the first year of the new MFF period and there were delays in passing the relevant legislation and approving plans submitted by member states). We again see that there is substantial variation in the amounts received by different member states. In some cases, this can be explained by differences in the size of the agricultural sector in each country: Ireland and the Baltic states have the largest amount of farmland per capita in the EU, and likewise have some of the highest rural development spending, whereas Belgium and The Netherlands which have relatively little agricultural land receive relatively little. Similarly, Finland has both a higher than average amount of farmland per capita and some very sparsely populated areas. We can also see that poorer countries receive more of this funding than richer ones on the whole, in line with the focus of these funds on poorer areas: for example, Poland and Hungary receive relatively large amounts of rural development funding despite their agricultural area per person being not significantly higher than the EU average. But there are many other member states where neither of these explanations hold: Austria, Slovenia and Portugal receive larger amounts of rural development funding than other countries with a similar level of GNI per capita despite having no more than the EU average amount of farmland per capita, whereas Greece, Denmark and France do not receive more than other countries with similar income levels despite having a relatively large amount of farmland per person.

As a relatively rich country with relatively little agricultural land per capita, it is unsurprising that the UK receives relatively little rural development spending. It receives less on a per-capita basis than Germany, despite Germany being richer and having less agricultural land per person, but more than Denmark, despite Denmark having a larger amount of farmland per person.²⁹ The lack of clear criteria for allocating this spending means that it is difficult to argue one way or the other whether these funds are being allocated in the most efficient way.

²⁸ Probably the best source for the ‘objective criteria’ used is an impact assessment published by the Commission in 2011, which proposed various options for reforming rural development payments with allocations depending on criteria including agricultural area, agricultural labour force, agricultural labour productivity, size of forest and pasture areas, rural population and the GDP of rural areas.

²⁹ As we saw previously though, Denmark does receive a larger amount of direct payments to farmers per capita, and per hectare of farmland.

Figure 4.8. Rural development spending per capita and as a share of GNI by country, 2013



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Direct payments to farmers and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

4.3 Other areas of spending

Competitiveness for growth and jobs

The areas of spending that fall under what the EU budget terms funding for ‘Smart and inclusive growth: Competitiveness for growth and jobs’ includes:

- Education, training and youth
- Provision of information and finance support for small and medium enterprises
- ‘Decentralised agencies’ regulating transport, labour and financial markets
- Large technical infrastructure projects such as the European satellite navigation system
- Support for transnational energy, transport and ICT networks, and
- Research and Innovation funding, including Horizon 2020.

The total allocation in 2014 was €13.3 billion, of which just over half (€7.6 billion) was for research and innovation. The UK received an above-average share of funding for research and innovation (€12.40 per person, compared to €10.40 per person, on average, in other EU countries) but a less-than-average share of other funding under this heading.

Large parts of this funding – most notably for research and innovation, but also for education, training and youth work – are allocated on the basis of the merit of applications for funding. Researchers, for instance, can apply for funding from the European Research Council and their

applications are subject to peer-review in much the same way as if they were applying to one of the UK's research councils.

One of the main rationales for the public funding of research and technical infrastructure (whether by the EU or national governments) is that the resulting knowledge and scientific progress is a 'public good' that generates benefits to wider society. If this is the case, the allocations of spending to specific European countries may not represent the extent to which different countries benefit from the end-outcomes of this funding. Furthermore, if the benefits of research transcend borders then it may be beneficial to pool at least some research funding across countries as happens in the EU (where spending on research and many of the areas above is undertaken both by the EU and by national governments). In that way at least some funding can be allocated to the best researchers in the EU as a whole, rather than the best in any individual country. The flip side is that if research activity generates local spillovers – for instance, businesses may be attracted to a specific area due to the research undertaken by a particular university – then allocating funds at the EU rather than at the national level may lead to greater concentrations of research activity and greater concentrations of economic activity (EU structural and cohesion funds can, in part, be seen as measures to counteract this tendency).

Security and Citizenship

The 'Security and Citizenship' heading of the EU budget includes a wide-range of areas including:

- Support for law enforcement cooperation
- Support for management of the EU's external borders
- Support for costs associated with migration and asylum seekers
- Food and Feed safety, and other consumer protection
- Justice and human rights
- Culture, arts and sport, and
- 'Decentralised agencies' with responsibilities over health, food safety, law enforcement and justice.³⁰

This is a relatively small area of the EU budget, with spending of around €1.7 billion overall in 2014. As with the other relatively small budget heading, this reflects the fact that national governments are responsible for far larger amounts of spending in these areas.

The largest areas of spending within this heading are spending on health and food safety, spending on support for law enforcement, and spending on the management of the EU's external borders, migration and asylum.³¹ The rationale for EU involvement in law enforcement is the transnational nature of some key risks – including organised crime and international terrorism. The UK opts out of this area of EU spending. The UK also opts out from spending on the management of the EU's external borders, which is largely associated with managing the external borders and the Visa system of the Schengen area (the group of European countries throughout which it is possible to travel without passports).

³⁰ This includes agencies such as the European Centre for Disease Prevention and Control, the European Food Safety Authority, the European Police Office and Police College, and the European Institute for Gender Equality.

³¹ The following text largely draws upon information available at http://ec.europa.eu/dgs/home-affairs/financing/fundings/migration-asylum-borders/index_en.htm, and http://ec.europa.eu/dgs/home-affairs/financing/fundings/security-and-safeguarding-liberties/index_en.htm.

The UK does participate in the 'Asylum, Migration and Integration Fund'. This provides funding to participating countries to help them manage their asylum systems in accordance with EU legislation, return those who are not granted asylum to their countries of origin, and integrate those granted asylum and other migrants. Funding is allocated on the basis of historical migrant flows (during the period 2011-2013). The UK's basic allocation for funding from this Fund between 2014 and 2020 is €370 million, the most of any individual EU member state (France's basic allocation is €266 million for instance, and Germany's €208 million, with a total of €2.4 billion being allocated to specific states). The UK is far from the largest recipient per capita though: Greece, with a population of little more than a sixth of the UK's is set to receive around two-thirds as much funding in its basic allocation (€255 million). A further €750 million Euros is available during the period 2014 to 2020 to, among other things; provide emergency support to member states facing particular migration issues; and fund payments to countries that accept the resettlement of asylum seekers and refugees from other EU or non-EU countries when requested to do so by the UN. The UK is resettling some Syrian refugees who are in neighbouring countries such as Turkey, Lebanon or Jordan, but not those who are already in another EU country, for instance.

Spending on 'Security and Citizenship' is a growing part of the EU's budget: it will increase to €3.0 billion this year (2016). Most of these increases are for law enforcement, management of the EU's external borders and support for costs associated with migration.

EU as a Global Partner

This heading is, in effect, the EU's foreign aid and foreign policy budget. It includes support for pre-accession countries – that is those countries that have started the process of moving towards EU membership – and for developing countries around the world.

In 2014, €7.2 billion was spent on this area, with around €1.3 billion going to pre-accession countries and €5.8 billion going to other areas of the EU's foreign aid and foreign policy budget, mostly to developing nations. This latter figure is about 10% of the amount EU nations spent on foreign aid in that year.³² Like Security and Citizenship, this is a spending heading experiencing significant growth: payments are budgeted at €10.2 billion in 2016.

Planned allocations for pre-accession countries in 2016 are³³:

- Turkey – €631 million
- Serbia – €208 million
- The Former Yugoslav Republic of Macedonia – €92 million
- Albania – €90 million
- Kosovo – €89 million
- Bosnia and Herzegovina – €43 million
- Montenegro – €37 million

In per capita terms this funding is greatest for Montenegro (around €60 per capita) and lowest for Turkey (around €8 per capita). Funding can support public administration reform, improvements to the rule of law, economic development, environmental sustainability, anti-

³² Data on Overseas Assistance spending available from the Development Assistance Committee of the OECD: <http://www.oecd.org/dac/stats/data.htm>.

³³ European Commission: http://ec.europa.eu/enlargement/instruments/overview/index_en.htm.

poverty strategies, education, and rural and agricultural development. Specific plans and programmes need to be agreed between the EU and the recipient country.

The most recent year for which data on payments to non-accession countries is available is 2014. In that year around €5.3 billion was paid out and the biggest recipients of funding were:

- Occupied Palestinian Territories – €364 million
- Ukraine – €360 million
- Afghanistan – €271 million
- Tunisia – €182 million
- Lebanon – €162 million

The EU also helps coordinate the provision of development aid from its member states via the European Development Fund (EDF). This is not funded from the EU budget but by direct contributions from EU Member States. Beneficiary nations must be in Africa, the Caribbean or the Pacific Islands, and the total allocated between 2014 and 2020 is €30.5 billion.

In 2014 total payments from this fund amounted to €3.2 billion Euros, with the largest portion going to Sub-Saharan Africa. The biggest recipients of funding coordinated by the EU through the EDF in that year were:

- Mali – €180 million (total including contributions from EU budget: €233 million)
- Ethiopia – €152 million (€213 million)
- Niger – €131 million (€197 million)
- Burkina Faso – €121 million (€150 million)
- Madagascar – €102 million (€112 million)

In addition to overseas aid, this budget heading covers funding for sending election monitors to monitor the democratic quality of elections in certain non-member states, help with nuclear decommissioning in certain non-member states, and EU special representatives to particular countries or regions such as the Horn of Africa, Kosovo and Central Asia.

Funding spent under this heading is, in general, not allocated to any specific EU state in EU financial statistics. However, it does count towards countries' contributions to overseas development aid as recorded by the Development Assistance Committee of the OECD. For instance, EU aid spending counts towards the UK government's target of providing 0.7% of UK GNI each year in developmental assistance.

Administration

This heading covers the administrative expenditure of all the EU institutions – such as the Commission, the Parliament and the European Courts of Justice – as well as schools for staff at EU institutions and the pension costs of former EU staff. Total administrative spending was €8.8 billion in 2014, 1.8% of total expenditure by the EU.

Is this level of spending on administration high or low compared to other governments or organisations? This is actually a more difficult question to answer than it sounds: it is important to recognise that administrative spending by the EU's central organs does not represent the total amount it costs to administer EU programmes as national governments bear the cost of administering EU spending and policies in their territories, including the CAP and structural and

cohesion funds. This two-tier system likely adds to the overall administrative burden of the scheme, though of course, member states' governments would also bear the costs of administering any locally-determined spending they undertook in the absence of the EU too. However, as we do not know how much it costs national governments to administer EU programmes, we cannot say by how much. Furthermore, there are no other comparable international organisations that operate in this way (i.e. mainly receiving revenue from its members and then returning it to members to run particular programmes) that one could say were more or less bureaucratic than the EU. That said, there are certain items of spending such as the costs involved in moving the European Parliament back and forth between Brussels and Strasbourg that appear to have little economic rationale.

In EU budget statistics, administration expenses are allocated according to where the expenses take place. This means that the bulk of such expenses are allocated to Belgium and Luxembourg, where most main EU institutions are based. As we discuss in Section 6, this may not capture the extent to which each country benefits from this expenditure.

4.4 Summary

The two main areas of EU spending are structural and cohesion funds and the Common Agricultural Policy. Over time, agricultural support payments have become a smaller share of the overall budget, though it remains an important one. At the same time, the size of structural funds has increased. More recently, the EU has started spending more on internal security and on aid to third countries, most notably to assist with resettling refugees, however this remains a small part of the overall budget.

The UK benefits relatively little from the two largest budget items. It is too rich to benefit significantly from structural and cohesion funds. Despite having some regions that are eligible for the highest level of structural funding, high employment rates and a poor record on using allocated structural funds mean that the UK often receives less than other richer member states that do not have any regions that get the highest level of structural funding. The UK's relatively small agricultural sector and large amount of unimproved agricultural land that has historically attracted little subsidy mean that it receives less per person than most other EU member states from the CAP too.

5. The UK's rebate and other 'corrections'

	Contributions/receipts in 2014			
	UK		Rest of EU	
	€s per person	% GNI	€s per person	% GNI
UK rebate	-94	-0.28%	13	0.05%

We saw in the previous section that the UK benefits less than other EU member states from the main areas of EU spending, namely direct payments to farmers and the structural and rural development funds. This has been the case ever since the UK joined the EU in 1973. As a result of this perceived unfairness, since 1984 the UK has secured a 'correction' or rebate to limit the size of its net contribution to the EU Budget.

The UK's rebate was originally set at 66% of the difference between the UK's share of the harmonised VAT base (which at that time was the main basis for contributions to the EU Budget) and the UK's share of receipts from the EU Budget. The precise design of the UK rebate has changed more recently, with the most important change being that the UK does not receive a rebate on non-CAP spending in the member states that have joined the EU since 2004. The effect of this has been to limit the size of the rebate and increase the UK's net contribution to the EU Budget, though it is important to note that without this change, the UK would have borne only a small share of expanding the EU to poorer countries.³⁴ This change was phased in between 2008 and 2010. Other smaller changes have included accounting for the introduction of the GNI-based contribution and the cap on the VAT based contribution at 0.15% of GNI (i.e. ensuring that the rebate is calculated on the basis of actual payments to the EU budget rather than just the share of the VAT base), and a reduction by the amount the UK has gained on balance (i.e. taking into account the impact on GNI-based contribution) from the decision to increase the share of traditional own resources that are retained by member states from 10% to 25%. The rebate is paid a year in arrears (i.e. the rebate for 2015 is deducted from the UK's budget contribution for 2016), and can be amended up to three years later in light of data revisions (see Box 2.1).

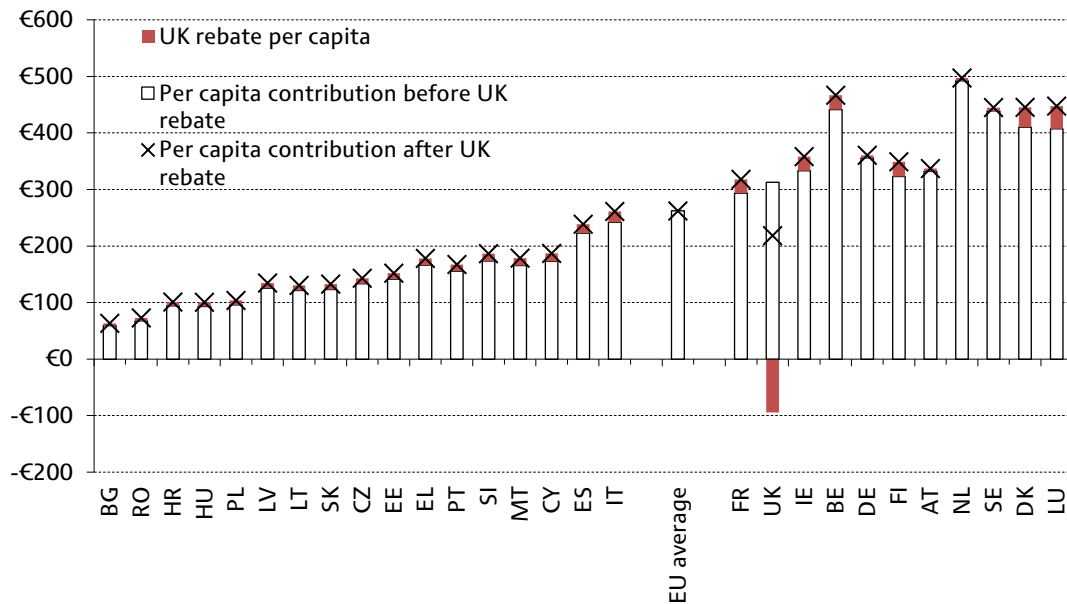
This reduction in the UK's contribution of course has to be made up by additional contributions for other member states. These are allocated according to the GNI shares of the other member states, though Germany, The Netherlands, Austria and Sweden only pay a quarter of their GNI-share contribution to the rebate, with the remaining three quarters reallocated to the other member states, again based on their shares of total GNI excluding these member states. The purpose of this is to reduce the net contributions of these other member states, who are also significant net contributors to the EU Budget.

Figure 5.1 shows each member states' gross contribution to the EU Budget before and after the UK rebate is applied. We see that the rebate significantly reduces the UK's contribution to the

³⁴ This is because the UK's share of revenue fell when the new, poorer member states joined, but the UK's share of total expenditure fell by more, which would have otherwise increased the size of the rebate.

budget to a much lower per-capita level than that of member states with similar levels of GNI per capita. This highlights that the rationale behind the UK rebate is that the UK benefits relatively little from EU spending, not that its gross contribution without the rebate would be higher than that of other member states. We can also see the lower contributions to this rebate for Germany, The Netherlands, Austria and Sweden towards the UK's rebate: the biggest per-capita contributors to the rebate are the other richer EU member states, that is to say France, Ireland, Belgium, Finland, Denmark and Luxembourg.

Figure 5.1. Gross contributions to the EU budget by member state, before and after UK rebate, 2014



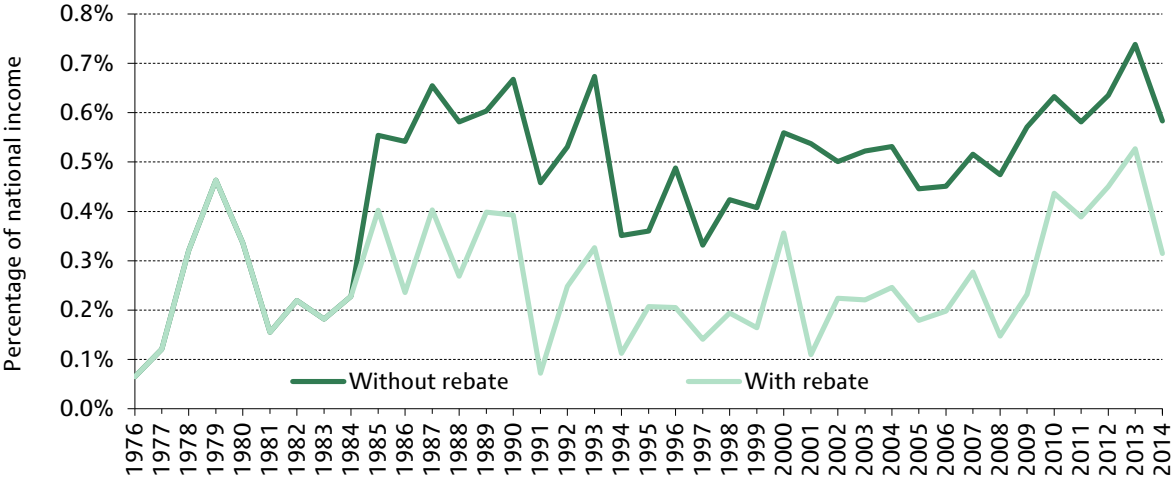
Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Direct payments to farmers and GNI from

<http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

Figure 5.2 shows the difference between the UK's contributions to the EU Budget and the amount spent by the EU in the UK since 1976 both with and without the rebate. For these purposes we ignore spending on administration (which are in any case very small in the UK) and examine all UK receipts from the EU budget, not just those that go through the UK government (so, for example, we include all research funds received by UK universities), which is why these figures are lower than those recorded by the UK government. We can see that the introduction of the rebate in 1985 prevented the UK's net position deteriorating during the mid 1980s. The UK's position then improved during the 1994–1999 MFF period, but has deteriorated again since 2000. In particular, we can see the impact of the reduction in the rebate that took effect between 2008 and 2010 (and hence appears in the figures between 2009 and 2011 because the rebate is paid a year in arrears), which has returned the UK's net position to roughly where it was during the 1980s as a share of national income.

Figure 5.2. UK's net contribution to the EU budget as a share of GDP, 1976 to 2014



Source: Net contributions: 1976 to 1999 from EU Budget 2008 Financial Report, available from http://ec.europa.eu/budget/library/biblio/publications/2008/fin_report/fin_report_08_en.pdf, 2000 to 2014 from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, GDP from Eurostat table nama_10_gdp.

As well as the main rebate, the UK, Ireland and Denmark also receive a smaller adjustment in recognition of the fact that they opt out of participation in certain EU policies in the area of justice and home affairs. These three member states receive a small rebate set equal to total spending in this area multiplied by their share of EU GNI. This is financed by the remaining EU member states in proportion to their GNI.

We noted in section 3 that Germany, the Netherlands, Denmark, Sweden and Austria, all of whom are net contributors to the EU Budget also have ‘corrections’. However, unlike the UK’s rebate, which is essentially a refund on its net contribution to the budget, these countries’ corrections take the form of discounts on either their VAT-based or GNI-based contributions.³⁵ We also noted that these reductions were not yet in place because the new own resources decision (the council agreement that determines how revenue for the EU budget is raised) that includes these corrections has not yet been ratified by all member states. This does not apply to the UK’s rebate, however. This is because the UK rebate is different in that it was part of the previous own resources decision and, unlike similar discounts that these other member states received during the previous MFF period, did not expire at the end of that period in 2013. The UK is therefore in a much stronger negotiating position to continue receiving its correction than these other member states: the UK government is able to veto any new own resources decision that tried to abolish the rebate, and in the absence of an agreement, the UK would continue to receive the rebate on the current basis.

³⁵ Specifically, Austria, Germany, The Netherlands and Sweden have a reduced rate of VAT-based contribution and The Netherlands and Sweden also receive a lump-sum reduction on their GNI-based contribution.

6. Net contributions to the EU budget

In Sections 3 and 4, we examined how much each member state contributes to the EU budget in various ways, and how much each receives from the main areas of EU spending. In this section, we bring this all together to examine each country's net contribution to the EU budget. We do this using figures from the European Commission on the amount remitted by each member state and the amount spent by each member state, which are different from the figures produced by the UK government as these do not include EU spending that does not flow through the UK government (so, for example, research spending in the UK that flows directly from the EU to UK universities is not counted). Box 6.1 discusses the various figures on the UK's gross and net contributions to the EU's budget in further detail.

Box 6.1: How much does the UK contribute to the EU Budget?

There are several different ways of calculating how much the UK contributes to the EU Budget. The first main difference in the figures that are frequently quoted is whether the figure for the contribution is gross or net of the funds the UK receives from the EU budget, in other words whether the amounts received by the UK from the EU budget are deducted. HM Treasury (HMT) says that the gross amount paid by the UK into the EU budget was £12.9 billion in 2015, £14.4 billion in 2014 (the year we focus on in much of this report) or £14.5 billion in 2013. This is a potentially meaningful figure, as this is the additional amount the UK government might have available to spend if the UK left the EU *if* two conditions were to hold. First, if the UK did not then have to continue making budget contributions as part of any future relationship with the other EU countries, as for example Norway does as part of the European Economic Area (EEA). And second, if leaving the EU did not reduce UK growth and hence tax revenues. In practice it is unlikely that either of these conditions would be satisfied. Nevertheless it is useful to know what this gross contribution is. Sometimes this figure is quoted without the UK's rebate having been deducted, which is less sensible as if the UK left the EU as the UK would not continue to receive the rebate if it left the EU and stopped making contributions to the EU Budget. This figure without the rebate was estimated by HMT to be £17.8 billion in 2015, £18.8 billion in 2014 and £18.1 billion in 2013.

One can also examine the net contribution after receipts from the EU budget are taken into account. The HMT figures for this measure only capture those receipts that are received by the UK government, which includes structural and rural development funds and direct payments to farmers that are administered by government departments, but ignores items such as EU funding of research carried out at UK universities. Netting off these receipts by the UK government reduces the overall contribution to £8.5 billion in 2015, £9.8 billion in 2014 and £10.5 billion in 2013. The European Commission produces figures that include these receipts and account for the timing of payments in a different way to the HMT figures (their figures show a gross contribution of £11.3 billion in 2014 rather than £14.4 billion because of these timing differences, for example). These figures show a smaller net contribution of £5.7 billion in 2014 and £9.1 billion in 2013 (figures for 2015 for this measure have not yet been published by the Commission). This is probably the other most meaningful figure, as it shows how much additional money the UK government would have if it left the EU and continued to fund those

payments and services that are currently paid for by the EU (again, assuming that whatever relationship that the UK government subsequently negotiated with the remaining EU member states did not involve any budgetary contributions).

Finally, the Commission also produces data on the ‘operating budget balance’, which leads to lower levels of net contributions for the UK. This is because of two differences in the way revenues and expenditures are allocated. First, administrative expenditure is effectively allocated to each member state based on its share of contributions – this is probably more sensible than assuming that the citizens of the countries where the EU institutions are based gain all the benefit of this expenditure. Secondly, ‘traditional own resources’ are not counted as a national contribution as they result from EU decisions on customs duty rates. Although it is not sensible to think of these contributions as being paid by the citizens of the countries that collect the duties in all cases (see Section 3), neither is it true to say that these taxes are not paid by any EU citizen as this approach implies. If the EU did not exist, member states could still impose customs duties on imports from outside the EU (and indeed from other EU countries). In the case of the UK as an island, the customs duties collected by the UK are probably a good approximation to the amount of customs duties that could be raised outside the EU.

These estimates are summarised in the table below:

	2012	2013	2014	2015
Gross contribution excluding rebate (HMT)	£15.7bn	£18.1bn	£18.8bn	£17.8bn
Gross contribution including rebate (HMT)	£12.6bn	£14.5bn	£14.4bn	£12.9bn
Net government contribution (HMT)	£8.5bn	£10.5bn	£9.8bn	£8.5bn
Net contribution overall (EC)	£7.5bn	£9.1bn	£5.7bn	N/A
‘Operating budget balance’ (EC)	£6.0bn	£7.3bn	£4.0bn	N/A

Source: ‘HMT’: HM Treasury (2015), ‘European Union Finances 2015’, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483344/EU_finances_2015_final_web_09122015.pdf; ‘EC’: European Commission, <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>

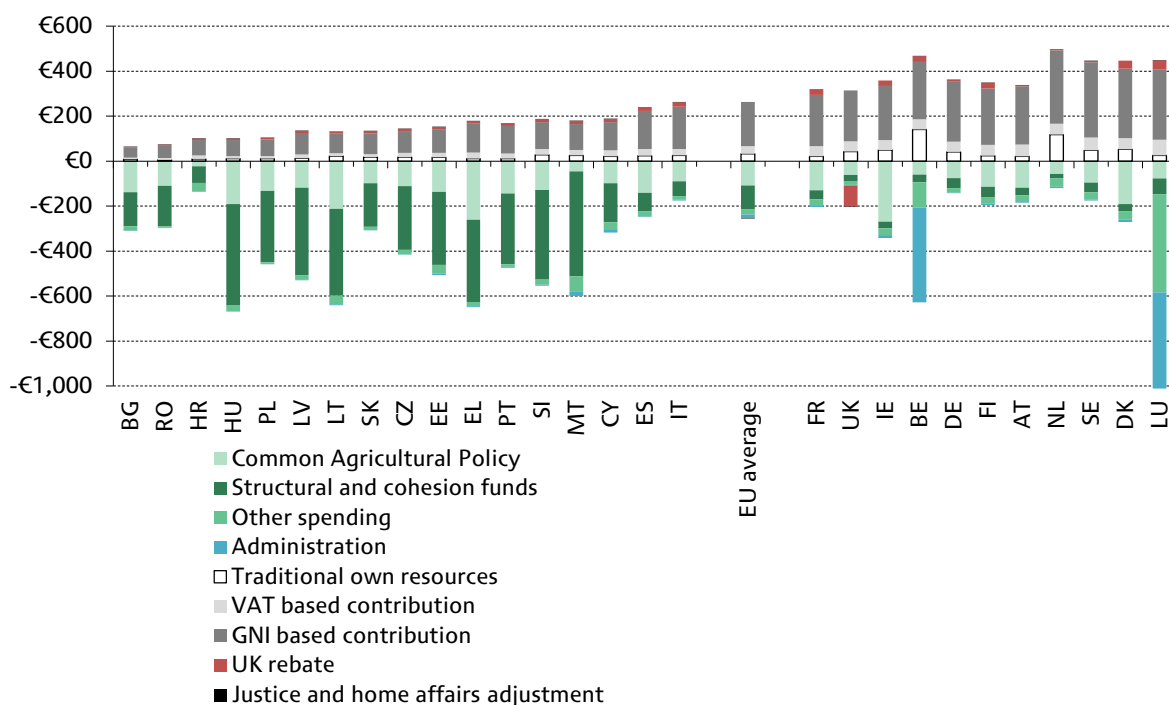
The OBR forecasts the net government contribution to the EU Budget for the next five years.^a The contribution is likely to continue to fluctuate from year to year – it is expected to be particularly large in 2016 and particularly small in 2017 as the new own resources decision is expected to be ratified in 2016, triggering back payments to those countries that have received discounts on their contributions in the new MFF period in 2016, which will then lead to a larger UK rebate in 2017 – but is expected to average £9.6 billion a year over the next five years. As receipts from the EU by non-government bodies in the UK are typically £1-£1.5 billion a year, the UK’s overall net contribution to the EU budget is likely to average just over £8 billion a year over this period.

^a Source: Table 2.26 of OBR March 2016 Economic and Fiscal Outlook: Supplementary Fiscal Tables, <http://budgetresponsibility.org.uk/download/economic-and-fiscal-outlook-supplementary-fiscal-tables-march-2016/>.

Figure 6.1 brings together all sources of receipts and payments for 2014, the latest year of data available. We see that the poorer member states (Greece, Portugal and the member states that have joined since 2004) are significant net beneficiaries from the EU Budget overall. Structural and cohesion funds are the most important source of receipts for these member states. We also

see that most of the other member states are net contributors to the budget. Two important exceptions to this are Belgium and Luxembourg, mainly because they receive large amounts of money from administration, unsurprisingly since the EU's headquarters are based in those two countries. However, it would be wrong to say that citizens of these two countries benefit disproportionately from this expenditure.³⁶ Similarly, as we discussed in Section 3, Belgium and the Netherlands collect a large share of customs duties, but these taxes are not paid by the citizens of those countries in any economically meaningful sense, since many of the goods on which these duties are charged are ultimately consumed by residents of other European countries. The UK receives the lowest amount of expenditure per head of any EU country despite paying a roughly similar amount in per person as other countries with a similar level of income, demonstrating the rationale behind giving the UK a rebate on its contribution.

Figure 6.1. Contributions to and receipts from the EU budget for each member state, 2014



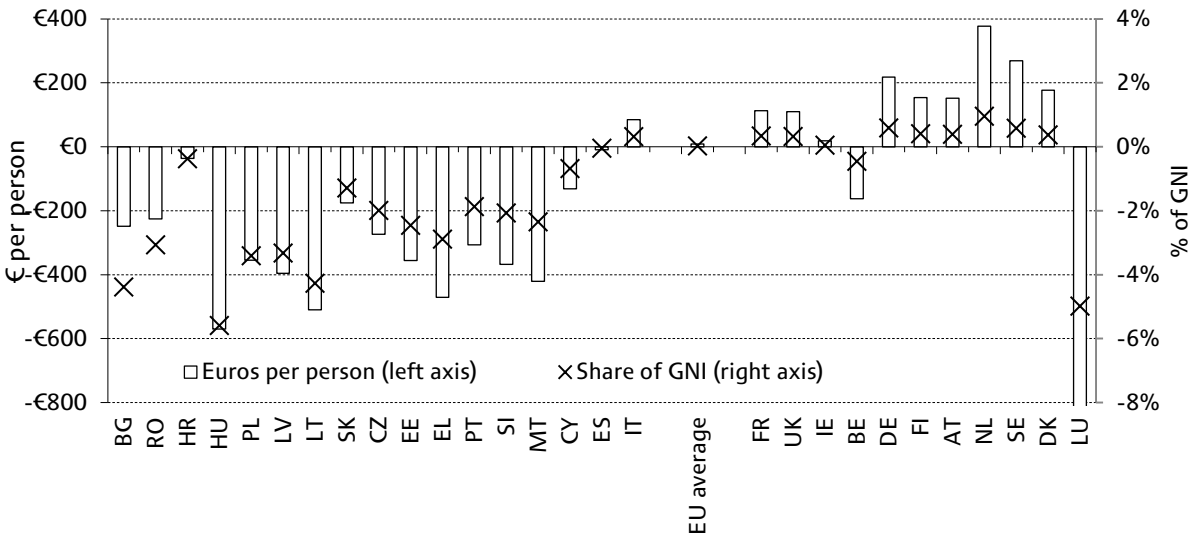
Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right. Luxembourg's net position is off the scale of this Figure: its overall gross receipts per person are €3,118, of which €2,534 comes from administration. Source: Contributions, receipts and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

Figure 6.2 nets off receipts against contributions to arrive at a net position for each member state. We see that the net receipts for the poorer member states are quite significant as a share

³⁶ Belgium and Luxembourg do not even benefit from the taxes paid by EU officials on their employment income: this money is returned to the EU budget.

of GNI, often in excess of 2%. By contrast, no contributing country has a net contribution of more than 1% of GNI: the largest net contributor is The Netherlands, though as we discussed in Section 3, this is likely inflated by it collecting customs duties on goods that are sold elsewhere in continental Europe which are counted as a Dutch contribution to the budget under this methodology. Examining the UK's position, we can see that in 2014 it was almost identical to that of France, a country with a roughly similar GNI per capita, and smaller as a share of GNI than any of the richer countries with the exception of Ireland, whose very large agricultural sector means that it benefits significantly from the CAP, and Belgium and Luxembourg, for whom the treatment of administrative spending makes this comparison unreliable. However, we have also seen that 2014 was a relatively favourable year for the UK: if we take an average over the five years from 2010 to 2014, the UK's net contribution as a share of national income was larger than that of France, Ireland, Austria and Finland, almost identical to that of Denmark, but still less than that of Germany, The Netherlands and Sweden.

Figure 6.2. Net contribution to the EU budget for each member state, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right. Luxembourg's net position is off the scale of this Figure: its overall net receipt per person is €2,624.

Source: Contributions, receipts and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

In Figure 6.3 we make the following adjustments to deal (in a somewhat ad-hoc way) with the issues that make the previous chart misleading in some cases. In particular, we:

- Allocate administrative spending on an equal per-capita basis to each member state. Assuming that each EU citizen benefits equally from this spending seems a closer approximation to reality than assuming that the benefit goes to those member states that house the EU's headquarters. This is the approach taken by the Government Expenditure and Revenue Scotland publication to allocate administrative spending within the UK that cannot be directly linked to a specific nation or region.

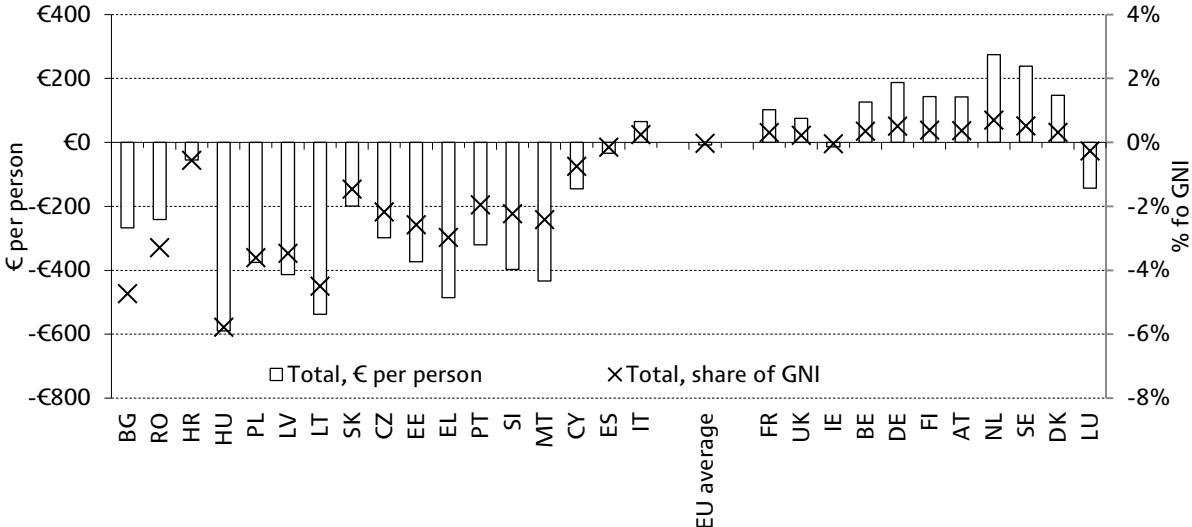
- Allocate 'traditional own resources' in proportion to each country's GNI. We do this because, as we discussed in section 3, certain member states on the borders of the EU collect customs duties on goods that enter the EU through their territory but are ultimately sold elsewhere. Ideally, we would like to allocate these taxes on the basis of consumption of goods and services produced outside the EU, but as an approximation to this we assume it is proportional to GNI.³⁷
- Allocate aid given to non-EU countries in proportion to each country's GNI. The UK counts this as counting towards its target of spending 0.7% of GNI on foreign aid, and since GNI-based contributions make up the majority of the EU's revenue, we can think of this money being given by countries in proportion to their GNI.

A new tool on the IFS website – http://www.ifs.org.uk/tools_and_resources/budget-european-union – allows users to see the impact of each of these changes on these figures.

The overall impact of these corrections is relatively small for most member states, though it makes a big difference to the position of Belgium and Luxembourg who now no longer appear to be benefiting greatly from administrative spending. Luxembourg however is still a net recipient of EU funds, largely as a result of some of the development of European satellite navigation systems taking place in Luxembourg. The Netherlands and Sweden remain the largest net contributors per capita, though this is partly because the reductions in contributions that have been agreed for these two member states have not yet come into effect, which would bring their contribution more into line with others. The UK's net contribution falls slightly as administrative spending is reallocated and it is credited for some of the EU's aid spending which it contributes towards.

³⁷ Effectively, this is assuming that the percentage of income that is spent on goods and services from outside the EU is the same in all member states.

Figure 6.3. Net contribution to the EU budget for each member state, 2014, after ‘adjustments’

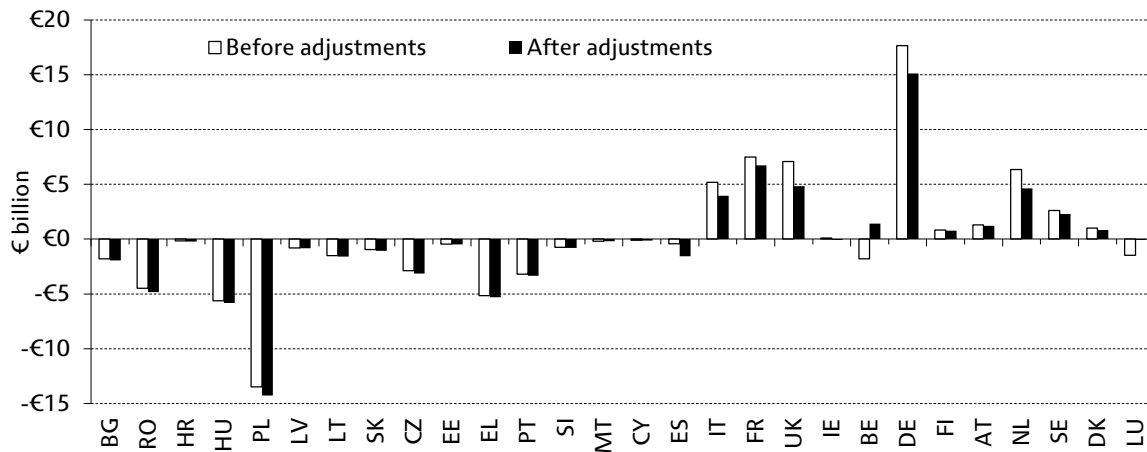


Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Contributions, receipts and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan, authors’ calculations.

We can also examine the cash contributions for each member state rather than expressing them in per capita terms. This makes the contributions of the smaller member states insignificant, and makes it clear that the largest overall recipient from the EU budget is Poland, and the largest overall net contributor is Germany. The UK’s overall net contribution in 2014 was €7.8 billion before we make our corrections, or £5.7 billion (as we saw above), which falls to €4.8 billion or £3.9 billion after we reallocate administrative spending on a per-capita basis and credit the UK for the aid spending it finances.

Figure 6.4. Net contribution to the EU budget for each member state, 2014



Note: Country codes are BG – Bulgaria, RO – Romania, HR – Croatia, HU – Hungary, PL – Poland, LV – Latvia, LT – Lithuania, SK – Slovakia, CZ – Czech Republic, EE – Estonia, EL – Greece, PT – Portugal, SI – Slovenia, MT – Malta, CY – Cyprus, ES – Spain, IT – Italy, FR – France, UK – United Kingdom, IE – Ireland, BE – Belgium, DE – Germany, FI – Finland, AT – Austria, NL – The Netherlands, SE – Sweden, DK – Denmark, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

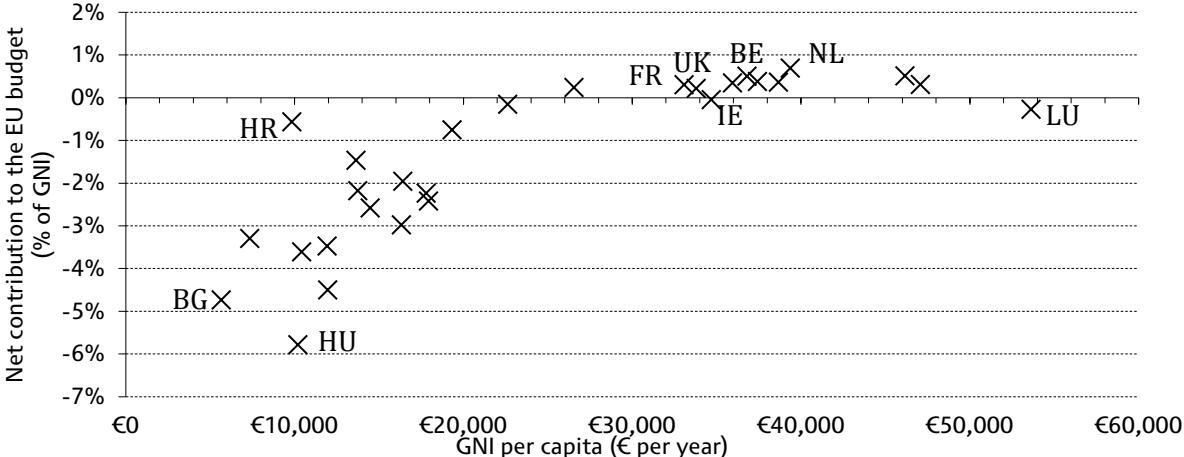
Source: Contributions, receipts and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan, authors' calculations.

In broad terms there is a redistribution of resource from richer to poorer member states. That is part of the purpose of the EU budget. There is by no means a one for one correlation, though, between GNI per capita and net contributions to, or receipts from, the EU. A combination of historical accident, the focus on the EU budget on agricultural subsidies, and other specific features of the way in which contributions are determined and (especially) spending priorities, means that some relatively rich countries such as Ireland make rather small net contributions while some poor countries such as Slovakia do less well than one might expect.

It is important to put the within EU redistribution into perspective. The UK's net contribution in 2014 (following our adjustments) was just 0.22% of GNI made up of a gross contribution of 0.64% of GNI and gross receipt of 0.42% of GNI. No country contributes more than 1% of GNI net. Some of the poorest countries receive up to 6% of their GNI, net (see Figure 6.5 below, which plots each country's net contribution as a share of GNI against its GNI per capita). These net transfers across countries within the EU are very much smaller in magnitude than net transfers between richer and poorer regions of individual countries: experimental statistics from the Scottish Government suggest that in 2014–15, London's total tax revenue exceeded public spending at a time when the UK's overall budget deficit was 5.9% of GDP, suggesting that London's 'net contribution' to the UK public finances was more than 6% of its GDP.³⁸

³⁸ Source: Government Expenditure and Revenue Scotland, 2014–15, <http://www.gov.scot/Topics/Statistics/Browse/Economy/GERS/RelatedAreas/NUTS12016>; Office for Budget Responsibility Public Finances Databank, <http://budgetresponsibility.org.uk/download/public-finances-databank/>.

Figure 6.5. Net contribution to the EU budget by GNI per capita, 2014



Note: Country codes are BG – Bulgaria, HR – Croatia, HU – Hungary, UK – United Kingdom, IE – Ireland, FR – France, BE – Belgium, NL – The Netherlands, LU – Luxembourg. Member states are ranked by GNI per capita with the poorest on the left and the richest on the right.

Source: Contributions, receipts and GNI from <http://ec.europa.eu/budget/library/biblio/documents/2014/Internet%20tables%202000-2014.xls>, population from Eurostat table demo_pjan.

8. Summary and concluding remarks

In this report, we have seen that the EU Budget is rather complex and opaque. While there is a rational process in place to determine its size and allocation it is, perhaps inevitably, subject to considerable political horse trading. There are numerous special deals, allowances, rebates and the like negotiated within it. It is also difficult to reform, as shown by the fact that in many areas funds are allocated in line with previous allocations. This means that it is unlikely that revenues are spent on only the projects that will add the most value. That said, there are some attractive features to the budget process, in particular the efforts to plan for the long term through seven-year MFF periods while retaining the flexibility to respond to events through annual budgets. There may also be benefits of pooling certain spending where there are economies of scale or comparative advantages in different member states.

The revenue side of the EU Budget is relatively straightforward. Nearly three quarters comes from GNI based contributions – that is countries contribute according to their Gross National Income. This is a pretty straightforward and sensible basis for funding. Similarly, using tariffs that are applied to goods and services entering the EU as a source of revenue for EU spending seems sensible: it would be unfair for those countries that are the point of entry for most goods to keep all this revenue when in many cases the final destination for these goods is elsewhere in the EU. However, the fact that countries which collect the tariffs get to keep 25% (falling to 20%) as costs of collection, seems less reasonable: the average cost of collecting taxes is, thankfully, a tiny fraction of this. Finally, about 13% of the EU budget comes from so called “VAT based contributions”. These seem a less sensible basis for dividing the cost of EU spending between member states: the contributions bear only a passing relation to actual VAT revenues collected by member states as they are based on a hypothetical harmonised VAT base that no member state actually applies, and disadvantage countries where spending on items that form part of this hypothetical construct forms a large fraction of GDP.

The spending side of the EU budget is dominated by two spending programmes that between them account for over three quarters of the budget. Structural and cohesion funds on the one hand, and agriculture and rural development on the other, each account for about 38%, (or €54 billion in 2014), of total EU spending.

Cohesion funds go to the poorer EU nations – those with GNI per capita below 90% of the EU average. Structural funds go to regions within countries according to how poor they are relative to the EU average, but also according to levels of employment and population density. These funds ensure that the EU Budget redistributes from richer to poorer member states, though the extent of such redistribution is limited by their size: there is much more redistribution within member states between richer and poorer regions than occurs between EU member states.

The agriculture and rural development budgets remain large, though they have been shrinking as a fraction of the total budget whilst being reformed so that most payments to farmers are not linked to production levels. The exact basis for their allocation is obscure, but depends largely on historical allocations. This leads to significant differences in the amount of support received per hectare of farmland across the different member states in ways that does not necessarily relate to current need. These differences will continue despite moves towards equalisation in the amount of support per hectare in the current MFF period.

The UK does not significantly benefit from either of these areas of spending. Although the UK has two regions (West Wales and the Valleys and Cornwall and the Isles of Scilly) that qualify for the highest level of structural funding, the UK's high employment rates and population density and poor record at spending allocated funds mean that the UK receives no more than most of the other richer member states. And the UK's small agricultural sector, large amount of unimproved agricultural land (such as the Scottish Highlands) and mix of produce that has historically attracted relatively little CAP funding means that it also receives relatively little from the CAP.

This low level of receipts from the EU Budget is the rationale behind the UK receiving a rebate on its contribution to the budget. Once this is taken to account, the UK's net contribution to the EU Budget appears no larger than that of most of the other richer EU member states. There are several different figures that one can use to measure the UK's net contribution (that is to say, contributions minus receipts), which is a source for some confusion. The figures produced by HM Treasury do not account for receipts from the EU Budget by non-government bodies in the UK, for example. The best source is probably figures produced by the European Commission that show a net contribution of £5.7 billion in 2014 (though the contribution was relatively small in that year; in 2013, the figure was £9.1 billion). Going forward, we can expect the UK's net contribution to be just over £8 billion a year on average on this basis.

Although a sizeable cash amount, it is important to bear in mind the UK's net contribution, and indeed the EU Budget as a whole, is relatively small compared to total government spending. Total EU spending is around 1% of EU GNI, compared to total government spending of between 35% and 58% of GNI in the different member states. The UK's gross contribution to the EU Budget represents about 2% of total public spending, and the net contribution about 1%. Thus, even if it were possible to improve the EU Budget process and outcomes substantially, the benefit to the UK would not be so great. Furthermore, the effect of leaving the EU on the public finances would depend much more on the economic impact of leaving the EU than the amount that could be saved by no longer having to contribute to the EU Budget. Future IFS research to be published before the referendum on 23 June will examine these issues in more detail.