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THE UK ABATEMENT

Report presented by the Commission in accordance with

Article 10 of the Decision on Own Resources

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1. THE UK ABATEMENT

This Report is submitted in accordance with Article 10 of the 1988 Decision on Own Resources which states that "the Commission shall submit, by the end of 1991, a report on the operation of the system (which has already been submitted as COM(92) 81), including a re-examination of the correction of budgetary imbalances granted to the United Kingdom, established by this Decision".

1. General characteristics

The UK abatement is calculated as 66% of the difference between the UK's share in allocated expenditure and its share in uncapped VAT revenue to cover total allocated expenditure. The advantage which accrues to the UK after the introduction of the new system of own resources in 1988 as a result of the capping of VAT and the introduction of the GNP resource (instead of the uncapped VAT prior to 1988) is deducted from the abatement. The abatement due for a particular budget year is paid in the following year.

The exact calculation of the abatement, which is the responsibility of the Commission according to Article 5/3 of the 1988 Own Resources Decision, is extremely complex. This is partly because the calculation method, first decided at the Fontainebleau European Council, was altered to insulate it from the changes to the own resources system made in 1988. The result is a mechanism that is extremely lacking in transparency.

With the UK's GNP amounting to approximately 16% of total EC GNP in 1992, the UK budgetary imbalance can be characterized as resulting for the major part from the imbalance in allocated expenditure (UK share of about 8.4%) and to a lesser degree from the imbalance in VAT revenue (UK share in capped VAT contributions of around 17.1%).

Other things being equal, the UK abatement increases in size if:

- the level of allocated expenditure of the Community increases;
- the UK percentage share of uncapped VAT contributions rises;
- the UK share in allocated expenditure falls;
- the advantage accruing to the UK from the system of own resources introduced in 1988 declines (i.e. principally if the size of the budget and hence the use of the GNP resource falls).

Table 1: UK Abatement - Reference compensation (Art 4, par 2) and additional amount

BUDGET (CORRECTION)	1988 (1987)	1989 (1988)	1990 (1989)	1991 (1990)	1992 (1991)	1993 (1992)
(IN MILLIONS ECUS)	(1)	(2)	(3)	(4)	(5)	(6)
1. UK's share of notional uncapped VAT payments	21.0%	19.5%	20.2%	23.9%	15.3%	13.1%
2. UK's share of allocated expenditure	11.1%	9.6%	9.4%	9.4%	8.2%	8.4%
3. (1) - (2)	10.0%	9.9%	10.8%	14.5%	7.0%	9.7%
4. Total allocated expenditure	33214.9	39818.8	39223.9	42130.4	50344.7	56528.7
5= (3) x (4)	3310.1	3943.0	4245.0	6126.9	3541.9	5462.1
6. 0.66 x (5)	2184.7	2602.4	2801.7	4043.7	2337.7	3605.0
7. Benefit to the United Kingdom under the new own resources system		457.8	498.5	518.2	61.5	423.6
8. Reference compensation = (6) - (7)		2144.6	2303.2	3525.5	2276.2	3181.4
9. Additional amount	10.0	6.0	4.0	2.0	1.0	0.0
10. Total compensation (8) + (9)	2194.7	2150.6	2307.2	3527.5	2277.2	3181.4

GROSS NATIONAL PRODUCT AT CURRENT MARKET PRICES PER HEAD OF POPULATION

(ECU, EUR12 = 100)

	B	DK	D	GR	K	F	IRL	I	L	NL	P	UK	EUR12+
1980	120.9	128.2	134.1	43.5	57.8	125.8	55.2	81.7	153.5	121.4	26.7	96.9	100.0
1981	112.6	125.7	128.2	45.4	56.5	125.3	58.9	83.5	152.6	114.9	29.0	105.6	100.0
1982	103.2	127.1	129.0	48.9	56.8	123.0	61.7	85.8	159.1	117.0	28.2	104.9	100.0
1983	100.9	132.3	133.8	45.0	50.7	120.0	60.4	91.3	165.5	116.6	25.9	102.7	100.0
1984	100.8	134.3	133.1	44.9	53.3	118.7	59.6	94.6	168.0	113.5	24.6	100.9	100.0
1985	101.6	138.6	130.3	42.1	54.1	120.3	60.3	93.9	169.2	111.1	25.6	103.1	100.0
1986	103.8	143.2	135.7	36.2	55.0	122.2	59.3	97.2	172.5	111.4	27.3	91.6	100.0
1987	105.0	144.1	137.2	34.4	56.4	119.7	57.8	98.8	165.7	108.7	27.6	90.7	100.0
1988	102.2	138.5	132.7	35.7	59.7	116.5	56.3	98.5	165.1	104.1	28.4	98.4	100.0
1989	102.5	132.5	129.4	35.9	65.2	115.0	57.7	100.8	169.5	101.7	30.6	97.7	100.0
1990	104.2	131.8	129.7	35.4	68.3	115.0	59.1	102.1	170.0	102.2	33.0	92.7	100.0
1991	106.4	132.0	115.0	36.1	72.8	115.0	60.0	106.5	170.8	103.8	38.0	95.1	100.0
1992	105.2	129.5	115.6	36.5	74.7	114.0	59.5	106.2	173.2	101.2	42.0	94.5	100.0
1993	104.4	128.6	115.6	36.2	76.1	112.8	59.7	106.7	178.8	100.0	44.6	94.2	100.0

EUR+: incl. D

4/6/1992

GROSS NATIONAL PRODUCT AT CURRENT MARKET PRICES PER HEAD OF POPULATION

(PPS EUR12, EUR12 = 100)

	B	DK	D	GR	K	F	IRL	I	L	NL	P	UK	EUR12+
1980	105.4	102.2	119.4	53.5	71.1	114.5	58.4	102.5	139.6	107.8	51.3	96.7	100.0
1981	104.7	101.3	119.9	53.1	70.2	115.6	59.5	102.8	144.0	106.8	51.2	96.1	100.0
1982	105.3	103.4	118.3	52.5	70.4	117.0	58.5	102.2	160.9	104.7	50.9	97.5	100.0
1983	104.2	104.9	119.3	51.0	70.2	115.3	56.5	101.4	164.7	104.5	49.9	99.8	100.0
1984	104.4	106.6	121.0	50.6	69.7	114.0	56.1	101.8	165.8	105.0	47.1	99.7	100.0
1985	102.8	108.7	120.8	50.5	69.8	113.1	55.8	102.0	169.4	105.2	47.5	100.7	100.0
1986	101.9	109.9	120.2	49.7	70.2	112.7	54.5	102.0	170.7	103.7	49.0	101.8	100.0
1987	101.7	107.5	118.9	48.1	72.1	111.9	56.0	102.5	159.8	101.2	50.6	103.2	100.0
1988	102.6	105.1	118.3	48.4	73.0	111.7	55.3	102.8	164.1	99.3	50.8	103.4	100.0
1989	103.2	102.6	118.1	48.4	74.2	111.9	57.0	102.5	171.0	100.4	52.0	102.3	100.0
1990	104.2	102.1	118.6	47.1	75.1	111.8	61.1	101.8	169.0	101.5	53.7	100.8	100.0
1991	108.5	105.5	106.1	49.0	78.6	115.4	63.9	105.3	172.2	105.4	56.1	100.4	100.0
1992	108.7	106.7	106.0	49.1	79.4	115.5	64.0	105.2	178.6	104.6	56.7	99.8	100.0
1993	108.6	108.0	105.6	49.1	79.9	115.6	64.1	105.0	186.7	103.8	57.3	99.9	100.0

EUR+: incl. D

The UK abatement has fluctuated considerably over the years due mainly to the effect of VAT and GNP balances carried over from previous years. On average, it has risen in nominal terms⁽¹⁾ while changing little relative to the size of the budget. It increased from 2195m ecus in the 1988 budget (5.2% of the budget) to 3525m ecus in 1991 budget (6.7% of the 1991 budget), which was exceptionally high due to the carryover of large positive VAT and GNP balances from previous years. It then fell back to 2277m ecus in the 1992 budget (4.1% of the 1992 budget) due to the opposite effect of negative balances from previous years. In the preliminary draft budget (PDB) 1993, the abatement is 3181m ecus or 5.0% of the budget. The effect of the abatement for 1992 is to reduce the UK share of VAT contributions in 1993 to 8.5% from what would have been 17.4% before abatement. Table 1 shows the UK abatements as calculated in the last six budgets.

The increase in the size of the abatement has taken place with the relative prosperity of the UK lower now than it was in 1988. Using the latest, revised estimates for GNP per head in ecus, the UK in 1993 is expected to be at 94.2% of the Community average compared to 98.4% in 1988. The UK's relative prosperity in terms of GNP per head in purchasing power standard (PPS), has also fallen, from 103.4% in 1988 to 99.9% in 1993 (see Tables 2 and 3).

2. Development compared to 1988 expectations

The size of the UK abatement has on average exceeded what was expected when the new system was put in place in 1988. Instead of decreasing as percentage of UK GNP, as had been forecast in 1988, the abatement has remained on average at around 0.33% of UK GNP, as shown in Table 4 (no forecasts were made beyond the 1992 budget).

Table 4: UK abatement in millions of ecus

Budget	Year	88-forecast	outcome	in % of UK GNP	in % of Budget
1988	1987	2387	2195	0.31%	5.2%
1989	1988	2009	2151	0.28%	5.0%
1990	1989	2149	2307	0.29%	5.6%
1991	1990	2362	3528	0.43%	6.7%
1992	1991	2584	2277	0.26%	4.1%
1993	1992	-	3181	0.35%	5.0%

(1) The definitive calculation of the UK abatement has been made only up to 1988 (i.e. the abatement in the 1989 budget). Later figures are estimates based on the budget of the year of the correction, which may be different from the definitive calculation made in the year n+3.

The increased size of the abatement is basically due to the lower-than-expected share of the UK in allocated expenditure since the 1989 budget (see Table 5).

Table 5 : UK share in allocated expenditure:

Budget	Year	88-forecast	*) outcome
1988	1987	11%	11.01%
1989	1988	10.73%	9.62%
1990	1989	10.77%	9.42%
1991	1990	10.68%	9.37%
1992	1991	10.54%	8.23%
1993	1992	-	8.40%

*) Revenue and expenditure account figs. for 1987 and 1988, budget figs. thereafter.

The main elements which have caused the UK's share in allocated expenditure to decline are:

- the fall in the UK share in expenditure in the EAGGF from 9.2% in 1987 to 7.0% in 1992.
- the decline of the UK share in the structural Funds (payment appropriations) from 19.8% in 1987 to 10.2% in 1992. This reflects the Community's policy of improving the economic development of less prosperous Member States by way of the increase of their receipts from the EC structural Funds. This implies that a relatively prosperous country such as the UK receives a smaller share.

The second factor affecting abatement has been the UK's share in uncapped VAT contributions (before abatement), which was higher than the 1988 forecast for the years 1989 and 1990. It should nevertheless be noted that the exceptionally high contribution in 1990 was partly due to the effect of large positive VAT and GNP balances carried over from 1989 and 1988. For 1991, the UK share in uncapped VAT was substantially below that forecast in 1988 due mostly to the effect of large negative balances carried over from 1990. The UK share in uncapped VAT in 1992 is expected to be well below 20%.

Table 6 : UK share in uncapped VAT:

Budget	Year	88-forecast	outcome
1988	1987	20%	21.03%
1989	1988	20%	19.53%
1990	1989	20%	20.24%
1991	1990	20%	23.91%
1992	1991	20%	15.26%
1993	1992	-	18.06%

Allocated expenditure as a whole increased substantially in the 1989 budget, stabilized in 1990, increased again in 1991, and is expected to continue to increase in 1992 and 1993.

The advantage accruing to the UK from the use of capped VAT and the GNP resource after the introduction of the 1988 system of own resources (instead of the uncapped VAT) has shown a slight tendency to decline. After its first appearance at 458m ecus in 1989, it rose to 518m ecus in the 1991 budget. In the 1992 budget it has fallen to 61m ecus, affected by VAT balances. In the 1993 PDB, it rises back to 424m ecus.

Table 7 : Allocated expenditure of the Community and the advantage to the UK due to capped VAT and GNP (millions of ecus):

Budget	Year	Allocated EC Expenditure	Advantage to the UK
1988	1987	33215	
1989	1988	39819	458
1990	1989	39224	499
1991	1990	43130	518
1992	1991	50345	61
1993	1992	56529	424

In summary, the rise in UK abatement on average since 1988 has been primarily due to the lower UK share in expenditure. The abatement has also been strongly affected by carryovers of VAT and GNP balances from previous years which have caused it to fluctuate widely. Since the UK's budgetary imbalance has worsened, it is logical that the abatement has evolved in this way.

3. Prospects for future evolution

The future evolution of the size of the abatement in the context of the future financing review, if the mechanism is not changed, will depend principally on the size of the budget, on the UK's share of allocated expenditure and on its share of own resource contributions. Also the UK's relative prosperity, which affects the UK's share in resource payments, could change the abatement.

If the UK's share of the different categories of allocated expenditure and of own resources were to remain the same as now, the abatement could be expected to grow quite substantially up to 1997 assuming the budget were at the ceiling of the Financial Perspectives proposed in the context of the future financing review (see Table 8, "No change" scenario). In these circumstances, the abatement would grow in real terms, due principally to the increased size of the budget and to its concentration on cohesion spending in the less prosperous Member States. However, this effect would be attenuated over the years by the gradual shift towards the GNP resource as the size of the budget increased.

There are, however, two particular areas in which the Commission's proposals will cause the abatement to remain steady in real terms and fall relative to the size of the budget (see Table 8, "Package II" scenario).

- The Commission's own resource proposals, in the context of the financing review, to reduce the VAT call rate by 0.4 percentage points and to cap the VAT base at 50% of GNP instead of 55% will reduce the UK abatement substantially (by around 370m ecus in 1997). This is because the advantage to the UK of these measures in terms of lower own resource payments would be taken into account in calculating the abatement, causing it to fall by the same amount.
- Another important element for the future will be the reform of the Common Agricultural Policy (CAP). First indications are that the Commission's proposals would lead to an increased proportion of CAP spending in the UK. Under the present CAP, relatively little budget spending takes place in the UK compared to its levels of agricultural production because it exports only small amounts and does not sell much into intervention. Under the reformed CAP, EAGGF spending would be more closely linked to factors of production (in which the UK has a higher share) than at present. The result would

Table 8: Effect of the Commission's proposals for the UK abatement 1992-1997 in the Report on Own Resources

17/06/92

Correction for	No change (bn ecu)	Package II (bn ecu)	of which: effect of CAP reform (mln ecu)	of which: effect of VAT 1% & 50% cap (mln ecu)
1992	3.20	3.20	0	0
1993	3.55	3.05	-120	-340
1994	3.75	3.15	-250	-340
1995	3.90	3.15	-380	-350
1996	4.05	3.20	-510	-360
1997	4.25	3.25	-650	-370

No change in % of the budget	Package II in % of the budget
5.0%	5.0%
5.2%	4.6%
5.2%	4.5%
5.2%	4.3%
5.2%	4.1%
5.2%	3.8%

be to raise the UK's share in agricultural spending from 7.0% now to 9.4% in 1997 under the reformed CAP. If agricultural spending were at the guideline as proposed by the Commission in COM 2001, this would result in 1.3bn ecus extra spending in the UK. This would be the main factor in raising the UK's share in total allocated expenditure from 8.4% now to 9.1% in 1997, thus reducing its abatement. The gradual implementation of CAP reform would, according to Commission estimates, reduce the size of the abatement progressively, reaching -650m ecus in 1997.

Taking into account the combined effect of these changes which should reduce the abatement by over -1bn ecus in 1997 from the "No change" scenario, the Commission's proposals should thus contribute towards a diminution of the UK abatement relative to the EC budget. The size of the abatement would fall from around 5% to under 4% of the budget by 1997. Nevertheless, in real terms the abatement would still remain above 3bn ecus.

II. OPTIONS CONCERNING THE CALCULATION OF THE UK ABATEMENT

The re-examination of the UK abatement presented above shows that the mechanism for correcting budgetary imbalances should be maintained. In this framework two questions should be posed and at this stage only options can be presented.

1. Should the basis for calculating the abatement be changed?

A. Concerning the calculation of the abatement, two basic options could be envisaged:

- i) A first option would be to continue with the present basis for calculating the abatement, in view of the fall in the UK's relative prosperity since 1988 and because of the beneficial effects on the size of the abatement of CAP reform and of the Commission's own resource proposals.
- ii) A second option would be to envisage a change in the basis for calculating the abatement. One possibility would concern cohesion spending. It represents a contribution of the more prosperous Member States towards the economic and social development of the less advanced members of the Community.

Since the UK's prosperity is near the Community average (above 90%), it could be argued that, as other Member States, the UK should pay its full share of financing cohesion spending.

This reasoning is reinforced by the Maastricht European Council's conclusions which once more emphasize the importance of cohesion as one of the central pillars of Community structure and furthermore provide for the establishment of a special Cohesion Fund designed to help exclusively the four least prosperous Member States.

For these reasons, a possibility could be to exclude the Cohesion Fund in future from the abatement system.

The Commission leaves open whether such a change should be made.

- B. Another possible change could have been considered concerning the allocation of agricultural spending.

The UK's share of EAGGF budget payments has been low compared to its share of production. It is the level of production which determines the overall economic benefit of farmers derived from the Community's common agriculture policy (CAP). This means that the overall financial benefit of the UK due to the CAP has been higher than suggested by budget expenditure.

It could therefore be argued that the method of allocating CAP spending should be changed. However, the reform of the CAP will have as a consequence a closer link between budget spending and production. The Commission for its part therefore takes the view that changing the method of allocation is unnecessary.

2. Should the financing of the UK abatement be adapted?

The burden of financing of the UK abatement is spread according to the GNP resource key (ex-UK) in which the share of Germany is reduced by one-third. The contribution of each Member State comes under the VAT resource until the 1.4% limit is reached and the remainder is financed from the GNP resource.

Some countries have shown themselves to be very sensitive to the principle of the abatement and to its present method of financing. This is the case in particular for Germany, the main contributor to the Community budget, which has seen its relative prosperity fall with reunification bringing down its GNP per capita to 116% of the Community average.

An option concerning the financing could be opened in consequence, particularly in order to take into account the elements described above and thereby to revise the reduction applied to Germany's share in the financing of the UK abatement.

However, this could only be decided at the conclusion of the discussion on the future Financial Perspective, in particular taking account of the general orientation concerning the structure of own resources.

III. A POSSIBLE TECHNICAL ADJUSTMENT TO THE UK ABATEMENT

In 1988, some Member States underlined that the present calculation of the UK abatement includes in allocated expenditure the gross salaries of Community officials, whereas it is only net salaries that the officials actually receive. The difference, in the form of taxes and pensions contributions, flows back into the Community budget as miscellaneous receipts.

The question should be raised whether it is justified to continue with this anomaly. It concerns the following budget lines:

- Article 400 (Proceeds of the tax on salaries etc. of staff of the Institutions and the EIB);
- Article 401 (Staff contribution to the pension scheme);
- Article 402 (Proceeds of special levy on net salaries etc. of staff).

In 1992, these lines total 270m ecus. Deducting them from allocated expenditure would result in a reduction of the UK abatement for the 1993 budget of approximately 32m ecus.

