WALES AND THE EU

THE EU BUDGET

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This report is one of a series examining the implications of EU membership for Wales, and the legal and policy considerations presented by the EU referendum vote. The full set can be found at http://sites.cardiff.ac.uk/wgc/eu/

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The referendum on 23rd June 2016 will determine whether the UK remains a member of the European Union. This is one of a series of briefs which outline the UK's, and Wales' relationship with the European Union (EU) across a range of policy areas. This paper looks at the EU budget, explaining how the EU budget is decided, how much the UK and Wales pay into it, and how much they get out. It presents relevant data and evidence in relation to Wales and provides an impartial evidence-based overview of the issues raised by the referendum vote, and its possible consequences, from the perspective of Wales. It forms part of a set of financially focused papers alongside one on Cohesion, or Regional Policy.

IN BRIEF

- The EU Budget is proposed by the European Commission and agreed by Member State governments unanimously in the Council after consultation with the directly elected Members of the European Parliament. Individual Member States are able to veto the decision.

- The European Commission is responsible for the implementation of the EU budget. The EU accounts have been signed off for 19 consecutive years by the European Court of Auditors but without an unqualified approval. Errors in implementation by national authorities are the most significant issue.

- For the current 7-year budgeting period, the EU budget is around 900 billion euro. The EU budget is less than 1% of GDP and has been shrinking in recent years.

- Member States contribute to the EU budget roughly in relation to the size of their economy. The UK is in the top four contributors in amount paid in, however the UK has negotiated a rebate on its contribution and pays the least of all 28 Member States as a share of Gross National Income (GNI).

- Wales is a net beneficiary of the EU: in 2014, the net benefit to Wales of being in the EU was £245 million, or £79 per person. This figure excludes EU centrally funded programmes which were worth more than £12 million to Wales in 2014.

- If the UK leaves the EU, Wales will lose these revenue streams, unless they are replaced by central government.

- If the UK remains in the EU, Wales will remain a net beneficiary until at least the start of the next programming period in 2021.

WHAT DOES THE EU DO IN THIS AREA?

The Financial Provisions in the Treaties are contained in Title II of the Treaty on the Functioning of the European Union (TFEU). EU expenditure is established for at least a period of 5 years within a Multi-Annual Financial Framework (MFF) which sets out ceilings on expenditure and payments under different headings representing the main areas of EU activity. The **2014-2020 MFF has a maximum ceiling of more than EUR 900 billion for the seven-year period** covering six categories of expenditure. These include Smart and Inclusive Growth and Sustainable Growth as the two largest categories of funding (which cover the Cohesion Policy and Common Agricultural Policy respectively). Administration costs make up 6% of the overall figure. The 2014-20 MFF was the first time EU Heads of Government agreed a real-terms reduction in multi-year expenditure ceilings, partly in response to pressure from the UK government to ensure budgetary restraint at a time of deficit reduction.

The EU budget is mostly **(99%) funded by the EU's 'Own Resources' which is revenue collected from the 28 EU Member States**. The 'Own Resources Decision' lays out the provisions for funding the EU budget, where resources will come from and how they will be calculated.[1] The EU budget is proposed by the European Commission and then agreed unanimously by the Council (EU Member State governments) after consultation with the European Parliament (directly elected members, of which 4 MEPS are Welsh). The implementation of the 'Own Resources Decision' requires ratification by all Member State Parliaments and an Act of Parliament in the case of the UK.

Under 'Own Resources' national contributions are, roughly, determined by the size of the Member State's economy relative to those of other EU Member States. Contributions based on tax and levy revenues fall under three categories:

> **Traditional Own Resources** – Customs duties on goods brought into a Member State from outside the European Customs Union and sugar levies; member states contribute 75% of the total collected and retain 25% for administrative costs.[2]

[1] 2007/436/EC: Council Decision of 7 June 2007 on the system of the European Communities' own resources, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32007D0436
[2] Will reduce to 20% once the new Own Resources Decision (Council decision of 26 May 2014 on the system of own resources of the EU (2014/335/EU)) is ratified by all Member State parliaments.

Own Resource from Value Added Tax (VAT) - A standard percentage is levied on the harmonised VAT base of each EU country, capped at 50% of each country's GNI to avoid disproportional contributions.

Own resource based on Gross National Income (GNI) - A standard percentage is levied on the GNI of each EU country.[3] This is the largest share of Own Resources (roughly 75% of the total).[4] The other 1% of the budget comes from taxes on EU staff, unspent money from previous years and income from payment of fines imposed by the European Commission.

The MFF is a framework for financial programming and budgetary discipline within which annual budgets are decided. The MFF is proposed by the Commission and adopted unanimously by the Council (Member State governments) with the consent of the European Parliament (directly elected members). **The Member States have absolute control over the adoption of the decision with each having the right to veto**. Negotiations tend to be lengthy, with each Member State seeking to secure the best possible individual deal (i.e. lowest possible contributions and highest possible receipts), arguably instead of focusing on the budgetary needs of the EU as a whole. As a result, the 2014-2020 MFF took more than two and a half years of negotiation.

The Union's *annual budget* is drafted and proposed by the European Commission based on forecasts from the different institutions and is then approved by the Council by Qualified Majority Voting (QMV) and by the European Parliament. All expenditure in the budget must relate to an adopted legally binding act at EU level allowing for its implementation. The EU's annual budget is subject to the scrutiny of the UK Parliament but does not require an Act of Parliament.

The European Commission is responsible for implementation of the EU budget and for submitting each year the accounts to the European Parliament and Council. The European Parliament, acting on the recommendation of the Council, is responsible for discharging the budget based upon the reports received from the Commission and the annual report from the European Court of Auditors.

The underpinning principles of budgetary implementation include cooperation between the EU and Member States, sound financial management and countering fraud and illegal activities that affect the EU's financial interests.[5] The European Commission has a European Anti-Fraud Office (OLAF) responsible for ensuring EU tax-payers money is correctly spent and EU staff act according to the necessary rules and regulations. It works as an administrative investigative service to combat

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[3] GNI is basically UK value-added (GDP) adjusted to count all income earned by UK residents regardless of where it was earned. The official estimates of the UK economy that feature in the EU budget calculations are produced by the UK Office of National Statistics. See: http://www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/national-accounts/changes-to-national-accounts/blue-book-and-pink-book-2015-changes/gdp--gni-and-the-uk-s-contribution-to-the-eu-budget.pdf

[4] For an explanation of the EU institutions and the law making process see http://ukandeu.ac.uk/explainers/the-european-union-the-institutional-system-explained/

[5] TFEU Title II Chapters 4-6.

corruption, fraud and illegal activity. Member States also have control and audit responsibility in implementing the budget, with **management of more than 80% of the EU budget delegated to Member States**.

Financial rules governing the implementation of the EU budget and control of the European Union's finances are established in secondary legislation. As a percentage of Gross Domestic Product (GDP), the EU budget is small when compared to federal budgets such as that of the United States which spends twenty times more per annum than the EU, and also that of the UK government which is over six times as much.[6] Currently, the EU budget represents less than one per cent of EU GDP and is shrinking in relation to share of GDP.[7]

The UK government, amongst others, has tended to be critical of the financial management of the EU budget and voted against its discharge regularly in the last few years.[8] However, the European Court of Auditors (ECA) has signed off the EU budget for nineteen consecutive years albeit without an unqualified approval. This means that the accounts are considered reliable and accurate but that the estimated error rate under payments is higher than what is considered acceptable. The error rate has been more or less stable over the 2012-2014 accounting years ranging from 4.8 per cent for the EU Budget as a whole in 2012 to 4.4% in 2014, against a 2 per cent acceptable level of error. **The majority of errors occur within the 80% of funding under shared management**, like agricultural and regional funding i.e. where national authorities are responsible for detecting and correcting errors before submitting claims for reimbursement to the Commission. In these areas of funding the ECA noted error rates were significantly higher than areas managed by the European Commission in 2013 and that the only area of EU expenditure not affected by material error was the EU's spending on its own administration.[9] Similarly, in 2014, the error rate under cohesion policy of 5.7% contrasted with the 0.5% error rate under administrative expenditure.[10]

It should be noted that the error rates usually relate to mistakes rather than fraud or waste – for example incorrect procurement processes. The European Commission subsequently reduces the error rate to below 2% with financial corrections, clawing the money back and re-using it for other projects, but this is not taken into account by the ECA. At the House of Lords Select Committee on the European Union in 2006, evidence was given by the UK's Auditor General comparing the ECA single statement of assurance on the whole of the EU budget with the qualification of UK central

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[6]Begg, I Who pays for the EU and how much does it cost the UK? Available at: http://ukandeu.ac.uk/wp-content/uploads/2016/01/Who-pays-for-the-EU-and-how-much-does-it-cost-the-UK-Disentangling-fact-from-fiction-in-the-EU-Budget-Professor-Iain-Begg.pdf [accessed 04.04.2016]
[7]http://www.economist.com/news/britain/21692883-why-britains-eu-budget-burden-no-longer-valid-eurosceptic-gripe-budget-didnt-bark [accessed 16.02.2016]
[8]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332762/2902399_BoC_EU_Budget_acc.pdf [accessed 18.02.2016];
[9] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332762/2902399_BoC_EU_Budget_acc.pdf [accessed 18.02.2016]; http://blogs.ec.europa.eu/ECintheUK/european-auditors-point-to-errors-but-sign-off-eus-accounts/ [accessed 18.02.2016]; https://fullfact.org/economy/did-auditors-sign-eu-budget/ [accessed 18.02.2016]; www.eca.europa.eu/Lists/ECADocuments/ECA1452/ECA1452_EN.pdf [accessed 22.02.2016]
[10] http://www.eca.europa.eu/en/Pages/AR2014.aspx [accessed 05.05.2016]

government 500 separate accounts, of which only 13 had been qualified in the previous year.[11] More recently, a House of Commons Select Committee report on financial management of the EU budget highlighted the £650 million worth of penalties UK government departments have incurred over the last decade as a result of errors in how they spend EU funds. The report criticises departments for adding to the complexity of funding requirements and exhibiting a lack of urgency in tackling issues.[12]

WHAT ARE THE UK AND WALES' POWERS AND RESPONSIBILITIES IN RESPECT TO THE EU BUDGET?

UK AND THE EU BUDGET

UK fiscal policy, the allocation of public expenditure across the UK and EU budgetary contributions are the responsibility of Her Majesty's Treasury (HMT). The UK's contribution to the EU budget is complicated by the **UK rebate or 'abatement'**, a mechanism that has applied to UK Budget contributions since 1985. It was conceded on the basis of the UK's previous relative lack of prosperity in the EU and hence perceived disproportionate financial contribution.[13] It is financed by the other Member States i.e. **the UK contribution is reduced and that of the other 27 Member States is increased**. Some adjustments are made to the contributions of other Member States on the same principle i.e. where a budgetary burden exists which is excessive in relation to its relative prosperity, although none on the scale of the UK rebate. In addition, the UK does not contribute to EU spending in areas where it has an opt-out under the Treaties. This includes law enforcement / justice and home affairs and Schengen-related expenditure on external borders.

UK annual contributions can vary significantly between different years as they are complicated by the different financial year in the UK compared to the rest of the EU, the general volatility of national contributions over time due to the nature of the 'Own Resources' system, variations in receipts from the EU, fluctuations in the UK's rebate, and volatility in the sterling/euro exchange rate.[14]

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[11] http://www.publications.parliament.uk/pa/ld200506/ldselect/ldeucom/270/6060607.htm [accessed 22.02.2016]

[12] http://www.publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/730/730.pdf [accessed 05.05.2016]

[13] The size of the rebate varies from year to year and is equivalent to 66% of the difference between the UK's share in the EU VAT base and its share of total allocated expenditure. It is paid in arrears and since 2004 has not included a rebate on non-CAP funding in new Member States.

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483344/EU_finances_2015_final_web_09122015.pdf [accessed 06.04.2016]

ESRC Senior Fellow Professor Iain Begg (2016) states that in order to accurately measure the UK contribution to the EU, figures showing gross contributions are misleading as they are substantially higher than *actual contributions* due to the subsequent correction applied through the rebate and *net contributions* which take into account the reverse flow of EU spending receipts in the UK. Hence whilst for 2014 the gross contribution was £18.7 billion, the actual contribution taking into account the rebate was £14.7 billion, and the net contribution taking into account the rebate and EU receipts was much lower at £9.8 billion. This figure only takes into account EU funding which goes directly to the public sector or through their accounts i.e. the Common Agricultural Policy, Cohesion Policy and not funding, for example, for universities or companies to undertake research. In 2013 the latter was estimated to be in the region of £1.4 bn.

Based on the *actual payment* outlined above, the amount paid per person in 2014 (a year in which the UK contribution was relatively high), was £228.43 per annum or £4.40 per week, *before taking into account any EU receipts which would reduce this figure.*[15] When the rebate and EU receipts to the UK are taken into account, the UK's *net contribution* is £23 million a day according to Fullfact.org.[16] Bell (2016) suggests the net contribution to the EU would be roughly £2.25 per person per week.[17]

By way of comparison, the CBI says the net cost of EU membership equates to a quarter of what the UK spends on the Department for Business, Innovation and Skills, and less than an eighth of the UK's defence spend.[18] The Institute for Fiscal Studies compares the total EU spending of around 1% of GDP with the between 35% and 58% total government spending across the EU Member States.[19]

Whilst the UK has always remained a net contributor to the EU, and is the fourth largest contributor,[20] behind Germany France and Italy,[21] it actually **pays the least of all EU Member States into the EU budget *as a share of GNI* and has consistently done so**. The UK pays 0.65% of GNI with the highest contribution as a share of GNI 1.3% for Belgium. In terms of *per capita contributions*, the UK's are much lower than Germany, Sweden, the Netherlands, Austria, Finland, France and Belgium. However,

[15] Begg, I Who pays for the EU and how much does it cost the UK? Available at: http://ukandeu.ac.uk/wp-content/uploads/2016/01/Who-pays-for-the-EU-and-how-much-does-it-cost-the-UK-Disentangling-fact-from-fiction-in-the-EU-Budget-Professor-Iain-Begg.pdf [accessed 04.04.2016]
[16] https://fullfact.org/economy/our-eu-membership-fee-55-million/ [accessed 06.02.2016]
[17] http://www.centreonconstitutionalchange.ac.uk/sites/default/files/papers/britains_decision_0416.pdf [accessed 05.05.2016]
[18] http://news.cbi.org.uk/campaigns/our-global-future/factsheets/factsheet-2-benefits-of-eu-membership-outweigh-costs/ [accessed 04.02.2016]
[19] http://www.ifs.org.uk/uploads/publications/bns/BN181.pdf [accessed 06.05.2016]
[20] Other assessments have the UK as the second largest contributor http://blogs.ec.europa.eu/ECintheUK/the-eu-budget-and-uk-contributions-the-facts-2013/ [accessed 04.02.2016];
[21] Begg, I Who pays for the EU and how much does it cost the UK? Available at: http://ukandeu.ac.uk/wp-content/uploads/2016/01/Who-pays-for-the-EU-and-how-much-does-it-cost-the-UK-Disentangling-fact-from-fiction-in-the-EU-Budget-Professor-Iain-Begg.pdf [accessed 04.04.2016]

the UK also has the lowest per capita receipts from the EU Budget of any of the 28 Member States despite being far from the richest.

WALES AND THE EU BUDGET

In Wales, the calculations are complicated by the fact that budgetary contributions originate from UK Treasury, without any direct contribution from Welsh Government; monies originating from Welsh taxpayers are channeled through the overall UK tax system. Receipts from the EU on the other hand, under the two most significant budget headings (agriculture and cohesion policy) are territorially specific and hence can be easily determined at a Welsh level. In the UK, EU receipts are treated as public expenditure and administered centrally by HMT through allocation within 'Departmental Expenditure Limits', appearing in the Welsh Block Grant ring-fenced as non-assigned EU transactions. EU rules on additionality dictate that, in order to ensure genuine economic impact, EU funding should not replace national sources of public funding. EU receipts should ideally be transferred *en masse* as a separate budget item within the Block Grant and not be reduced in any way by HMT.[22]

Nevertheless, efforts to quantify the Welsh contribution to the EU agree that **Wales receives more per capita from the EU than any other part of the UK, and is a net beneficiary of EU membership**. Bell (2016) calculates that Wales receives around £503 million per year more from the EU than it contributes.[23] The Centre for European Reform (2015) report that whilst the net *contribution* per capita for the UK as a whole is £117, for Wales there is a net *benefit* of £273 per person.[24] Figures produced from the Wales Governance Centre show a **net benefit to Wales of being in the EU of £245 million or £79 per person in 2014.[25]** These figures take account only of EU receipts to Wales under the Common Agricultural Policy and Cohesion Policy. Other EU receipts originate from transnational programmes or schemes directly managed by the EU such as the Connecting Europe Facility, ERASMUS+ and Horizon2020, as well as emergency funding available for major natural disasters such as floods, forest fires, earthquakes, storms and drought. Precise figures for Wales are not available for all of these alternative funding sources, suggesting that the **overall net benefit to Wales is in fact higher**. For example, nearly £12 million of research and innovation related funding could be identified as going to Welsh universities in 2014 under the 7th Framework Programme and Horizon 2020.

Unsurprisingly, the Welsh Government position on EU budgetary contributions has, whilst recognizing the need for budget restraint, looked for a settlement that would

[22] Based on the coverage of Cohesion Policy in UK for 2014-2020, verification of additionality to the European Commission is however not required.
[23] http://www.centreonconstitutionalchange.ac.uk/sites/default/files/papers/britains_decision_0416.pdf [accessed 05.05.2016]
[24] Centre for European Reform (2014), The economic consequences of leaving the EU, available at: http://www.cer.org.uk/sites/default/files/smc_final_report_june2014.pdf [accessed 07.02.2016]
[25] http://sites.cardiff.ac.uk/wgc/2016/05/24/news-wales-net-benefit-from-the-eu-budget-estimated-at-around-79-per-head/ [accessed 26.05.2016]

enable the continuation of support to Welsh communities and rural areas under Cohesion Policy and the Common Agricultural Policy.

WHAT ARE THE POSSIBLE CONSEQUENCES OF THE UK LEAVING THE EU?

If the UK were to vote to leave the EU there would be no tangible implications for Wales in the case of budgetary contributions to the EU. Monies collected from Welsh tax payers are currently channeled through the overall UK tax system and, depending on the outcome of proposals for further fiscal devolution to Wales, would continue to be. Any resultant *direct* savings from ending budgetary contributions to Brussels would be felt at UK / HMT level. It is not possible to state that either the gross or net contribution would be freed up for specific spending priorities in the UK with any certainty without further information about the UK's future relationship with the EU (with financial contributions expected) and the effect of withdrawal on the wider economy.[26]

Receipts from the EU that are territorially allocated would no longer be available to Wales in the event of a UK withdrawal (see individual briefs on Cohesion Policy and Agriculture).

The Welsh Ministers have been designated as having the power to implement EU law in specific areas, in line with section 2(2) of the European Communities Act 1972.[27] The Welsh Assembly has legislative competence in the areas of agriculture and economic development[28] and were the UK to leave the EU, powers currently exercised within the framework of EU membership would revert to Wales. However, the UK Government may be expected to develop UK wide policies in these areas rather than a Wales-only approach. Certainly without replacement funding from central government, Welsh Government would not be able to fund the policies to the same extent as currently occurs. Hence unless budgetary savings by HMT were used as a form of UK redistributive regional policy, the Welsh Government could be forced to re-evaluate its economic strategy and policies in these areas.

The most significant issue facing Wales in this area is the loss of EU receipts from Cohesion Policy and the Common Agricultural Policy. Under the 2014-2020 period Wales has been allocated more than €2.4 billion under Cohesion Policy, €2.5 billion under the Common Agricultural Policy[29] and €20.4m under the Fisheries Fund.

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[26] http://www.ifs.org.uk/uploads/publications/bns/BN181.pdf [accessed 06.05.2016]
[27] As foreseen in Section 59 GOWA 2006.
[28] Schedule 7 GOWA 2006. The current designation is found in the Structural Funds (Welsh Ministers) Regulations 2014 (SI 2014/92) and the Rural Development Programmes (Wales) Regulations 2014 (SI 2014/3222).
[29] https://www.gov.uk/government/news/uk-cap-allocations-announced [accessed 15.01.2016]

Amounts received by Wales under other EU policies such as Horizon 2020 and ERASMUS, for which no comprehensive figures currently exist, would also potentially become unavailable, depending upon the type of future relationship negotiated with EU (third country partners are often able to participate although only if they self-fund).

There are additional issues of relevance to the debate that are not specific to Wales. For example, other sources of EU financing are available to Wales and the UK that operate externally to the EU budget. The European Investment Bank (EIB) has legal personality and financial autonomy under the Treaties and borrows on capital markets to fund (mostly EU-based) operations as oppose to drawing on the EU budget. In 2015 the Bank lent €7.77 billion to UK projects.[30] In a joint initiative with the European Investment Fund and the European Commission under the Investment Plan for Europe, the EIB has established the European Fund for Strategic Investments (EFSI) that expects to unlock €315 billion of investment over the next 3 years through mobilizing private financing. Welsh public and private entities are able to apply for loan funding for capital investment projects that contribute to EU policy objectives across all sectors of the economy.

POST BREXIT SCENARIOS

Finally, **any future relationship with the EU that involves access to the Single Market will require some form of UK financial contribution to the EU**. Open Europe has put this cost at 94% of the current UK contribution.[31] In the case of Norway (as an EFTA/EEA member), figures quoted by Downing Street state that it is the 10th largest contributor to the EU budget. In 2014, the country contributed about £586m, or £106 per capita to the EU (to the UK's £153) in order to access the single market (albeit not fully), yet has no seat at the meetings where EU decisions are made.[32] If the UK left the EU and instead contributed to the EU budget on the same basis as Norway, it is estimated its net contributions would only fall by around 25% per person.[33]

Switzerland has a relationship with the EU based upon a series of more than 120 bilateral sectoral agreements that require the incorporation of a broad raft of single market and four freedom provisions into Swiss national legislation without any input into the legislation. The Swiss budgetary contribution per head is roughly 50% of that of the UK's contribution.[34]

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[30] TFEU Part 6 Chapter 4 and Protocol 5. Also see: https://www.gov.uk/government/news/new-figures-show-record-european-investment-bank-investment-in-uk-in-2015 [accessed 11.04.2016]; https://assemblyinbrief.wordpress.com/2016/03/11/eu-budget-uk-net-contribution-confused-by-the-figures/ [accessed 05.06.16]

[31] http://www.theguardian.com/politics/2015/mar/16/eu-exit-norway-option-costs-thinktank [accessed 04.02.2016]

[32] http://www.nfuonline.com/news/eu-referendum/qa-the-eu/ [accessed 18.01.2016]

[33] House of Commons Library Briefing Paper, Exiting the EU: UK reform proposals, legal impact and alternatives to membership, number 7214, 16 October 2015

[34] http://www.economist.com/news/britain/21692883-why-britains-eu-budget-burden-no-longer-valid-eurosceptic-gripe-budget-didnt-bark [accessed 16.02.2016]; http://www.regents.ac.uk/media/15.pdf [accessed 17.02.2016]