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VIS-À-VIS THE EU BUDGET AND A PROPOSAL FOR REFORM

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Facing the Monster ‘Juste Retour’

On the Net Financial Position of Member States vis-à-vis the EU Budget and a Proposal for Reform *

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ABSTRACT

Under the current system of the EU budget there is no way to avoid extreme net financial positions without exemptions, and the whole bargaining process cannot be based on another principle than that of fighting for a ‘juste retour’. The solution proposed in the paper faces the ‘juste retour’ problem frontally instead of negating or circumventing it. Net financial positions would be pre-fixed and they would reflect the individual member states’ levels of development relative to the EU average. Thus there remains no need for exemptions or any other non-rule-based regulation. An increased flexibility in allocation of EU co-financed expenditures in member states would be able to neutralize ‘juste retour’ motivated discussions on the current and future importance of individual EU policies.

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Introduction

Preparatory activities for the 2008/2009 review of the EU budget have switched to high gear. Member states' positions on the subject are taking shape. The European Commission set up a website for reform proposals coming from governments and non-governmental organisations, the research community and citizens.* One of the central issues of the contributions posted so far has been the 'juste retour' attitude, namely each EU member state's focus on securing the best possible net financial position vis-à-vis the Community budget over any other consideration concerning the Community budget. This policy brief proposes a solution to the 'juste retour' problem. A detailed analysis and proposal are available in a recent publication of the wiiw.†

The net financial position in the prevailing system: myth and reality

Major and minor net payers

The differences between member states in terms of net financial positions are indeed remarkable. In the period 1997-2006 the group of major net payers (the Netherlands, Germany, Sweden and Austria) had an average 'deficit' vis-à-vis the EU budget amounting to 0.35% of their GNI. As for the group of minor net payers (Denmark, France, Finland and Italy) the respective indicator was only 0.08% on average. The UK with its rebate rather belonged to the second group. The enlargement has increased the number of net beneficiary member states but the full impact of this change will only be felt in 2013, when the 'phasing-in' process will have been nearly completed. An estimation for the net financial positions for 2013 shows that minor payers' net financial positions will deteriorate to an important extent and that the gap between major and minor net payers will thus become much smaller than it was before the enlargement. The majority of the new members will enjoy a substantially smaller 'surplus' vis-à-vis the EU budget than the cohesion countries did before the enlargement.

Contributions to the Community budget: pay as you earn?

Contributions to the EU budgetary revenues should be in proportion to the relative prosperity of the member states. Solidarity (i.e. differentiation) among member states is to be manifested on the expenditure side of the EU budget. The current system, if adjusted for the effects of the UK rebate, would roughly correspond to this requirement, but in the prevailing arrangement does not. Could a European tax fix this problem? Various candidates for this tax (VAT, tax on motor fuel for road transport, corporate income, personal income and various forms of financial transactions) were tested as to whether

* http://ec.europa.eu/budget/reform/issues/submit_en.htm

† Richter, S. *Facing the Monster 'Juste Retour': On the Net Financial Position of Member States vis-à-vis the EU Budget and a Proposal for Reform* wiiw Research Report No. 348 May 2008, Vienna.

they would fulfil the said requirement of proportionality. The results show that they would not. A group of member states would contribute substantially more to the budget while another group would contribute significantly less to the Community budget than their share in the aggregate EU GNI. One can conclude that the large deviations that the proposed taxes may produce would open up a new battlefield for discussions motivated by the 'juste retour' attitude.

Expenditures from the EU budget: how to reconcile eternal losers?

On the expenditure side of the EU budget, conditions of eligibility for support have evolved over decades in the framework of various EU policies. This has led to great differences in the extent of financial support between member states. Financial support was decoupled from their relative prosperity. Comparing the member states' shares in the EU GNI and in major expenditure headings in the past ten years, it can be seen that two member states, Germany and the UK, were overall 'losers': in each main policy area their share was substantially lower than in the aggregate EU GNI. While the UK obtained a rebate to remedy this situation, Germany was compensated only with a rebate in financing the UK rebate. The Netherlands joined the club of overall 'losers' from 2003 on. Pre-allocated expenditures (direct payments, rural development and cohesion) allow for an estimation of member states' participation in various EU policies in 2013. The results indicate an increasing polarization: 8 member states will be 'losers' both with respect to agricultural and cohesion expenditures while 13 member states will be 'winners' in both areas, and only 6 of the 27 will occupy a mixed position.

Net financial positions are only one part of the picture

For a proper assessment of the significance of member states' net financial positions it is expedient to see them in a broader context. In 2006 the group of net payers achieved a nearly six times higher surplus in trade with the group of net beneficiaries than the sum of their 'loss' due to the fact that they paid more to the EU budget than they received. The surplus of the major net payers Germany and the Netherlands in trade with the net beneficiary member states was six times and seven times, respectively, that of Austria 19 times higher as their negative net financial positions. Concerning gains from FDI, in 2005 repatriated profits of Austrian firms from beneficiary member states were three times more than Austria's 'deficit' vis-à-vis the EU budget, for Germany the respective sums were very similar. The opening up of the new member states' market is worth money: This can be clearly seen with regard to the EU's agreements with Norway and Switzerland. Both of these non EU members enjoy all the advantages of the EU enlargement through their special arrangements and both of them were also ready to pay for these advantages. While receiving nothing from the EU budget, since it is a non-member, Norway currently contributes to transfers for new member states annually by € 47 per capita. This is higher

than the per capita net financial contribution to the EU budget of Austria, Finland, Italy and the UK; and it is only marginally less than that of France.

The way out from the 'juste retour' attitude - proposal for a radical reform

The guiding principles

The main idea behind the proposed reform is that the member states' open or disguised endeavour to achieve 'juste retour' is a fact that cannot be ignored. The way to a lasting solution implies the acknowledgement that this endeavour exists and ultimately governs member state attitudes. The reforms which have a chance for success are those which sufficiently satisfy member states demands. The three *guiding principles* of the proposed new EU budgetary system are:

- fair sharing of burdens between member states, citizens and firms;
- clear and simple rules for the collection of revenues and the allocation of expenditures, without exemptions;
- greatest flexibility possible in the utilization of resources from the EU budget.

New rules of cross-member state redistribution

One of the two cornerstones of the proposed system is the EU-27 average per capita GNI, at market/official exchange rates.[‡] Each member state would annually receive a transfer from the EU budget that corresponds to 1% of the *EU average per capita* GNI multiplied by the number of inhabitants in the member state concerned. The revenues of the EU budget would be secured through contributions from the member states, which would amount to 1% of the *member state* GNI, the second cornerstone of the reform. Member states whose average per capita GNI is higher than average would thus be net payers, those whose average per capita GNI is lower would be net beneficiaries. Net contributions and receipts, respectively, would clearly reflect the differences in relative prosperity between the member states.

The proposal is illustrated by a practical example for 2006. 1% of the EU-25 per capita GNI in 2006 amounted to EUR 245. Finland, with its about 5.3 million inhabitants, would have received from the EU budget EUR 1,293 million. 1% of Finland's per capita GNI amounted to EUR 320; thus the country's contribution to the EU budget would have been EUR 320 times the number of inhabitants, EUR 1,686 million. The Finnish *per capita* net financial position would have been EUR -75, that of Finland EUR -394 million. Taking a net beneficiary member state with a per capita GNI below the average of the EU as an example, Latvia would have received from the EU budget the same amount as Finland,

[‡] A similar solution for allocating the expenditures of the EU budget was put forward in a proposal based on GDP of individual member states multiplied by a coefficient in Quaisser, Wolfgang and John Hall (2002), 'Toward Agenda 2007: Preparing the EU for Eastern Enlargement', Working Papers, No. 240, Osteuropa-Institut München, February 2002.

EUR 245 for *each* of its about 2.3 million inhabitants, in total EUR 561 million. Latvia's contribution in that year would have been 1% of its GNI, EUR 157 million (EUR 69 per capita), which would have led to a positive net financial position ('surplus' vis-à-vis the EU budget) of EUR 404 million, i.e. EUR 177 for each inhabitant in Latvia.

The 1% key applied in the proposal is chosen arbitrarily, but its feasibility is proven by the funds allocated in the 2007-2013 financial perspectives. This key can be higher or lower than 1%, but it is important that it be a *unified* rate both across member states on the revenue side and for the aggregate GNI of the EU on the expenditure side of the EU budget.

Revenues of the EU budget

The *value of member states' contributions* would be exactly defined through the above rules. Contrary to the current system, contributions would be collected from the *citizens* and *firms* in each member state. A pre-fixed share, half or two thirds, of the required sum would come from re-channelling a part of the *VAT tax revenues*, the other half or one third from a part of *corporate income tax* revenues, both collected by the *national authorities* in each member state. There would be *no direct EU tax*, revenues from two existing taxes would be split up between domestic and EU destinations. To make this understandable to EU citizens, all invoices with VAT rates would have to display the *national* and the *EU* tax rates separately. A similar solution would have to be found for the split between the EU versus the national share in the corporate income tax revenues as well. This solution would combine the accuracy of national account calculation (fixing contributions at 1% of GNI) with the request to leave the national treasuries out of the game.[§] Simultaneously, it would raise the sensibility of EU citizens through direct and visible participation in EU budgetary processes. Furthermore, a partial re-channelling of corporate taxes of the EU budget would fulfil the justified request that those who benefit the most from the unified European market (the business sector) should contribute directly to the maintenance of the system. It is important to find the appropriate tax rates which guarantee that the revenues channelled to the EU budget are sufficient in any year to cover the pre-fixed sum of member states' contributions. The part of revenues earmarked for the EU which surpass the pre-fixed sum of member states' contribution would be *re-channelled* to the member state treasury.

[§] This solution is similar to Iain Begg's proposition to cap the gross contributions by member states and allow each member state the free choice to select the sort of European tax which is thought to be the most suitable for the member state concerned. Begg, Iain, 'The 2008/9 EU budget review', EU-Consent EU-Budget Working Paper No. 3, March, 2007 p. 17. See at www.eu-consent.net.

Expenditures of the EU budget

In the new system, the sum of expenditures for individual member states would be fixed *ex ante*. For each member state, transfers from the EU budget as calculated above should be made available solely for financing eligible expenditures within the framework of EU policies, i.e. these transfers must not be disbursed for any other purposes than those agreed upon by the member states. That means that member states would dispose of a 'basket' whose internal proportions could be determined in optional ways. The new system would allow for both the allocation of expenditures according to uniform proportions in a highly centralized way directly from Brussels and for a greater extent of flexibility with member states' individual patterns of allocation across eligible spending targets. The author of this paper thinks that increased flexibility, compared to the current situation, in the allocation of EU expenditures across EU policies/targets in individual member states would be an important asset of the reform. The remaining question is, however, what extent of freedom should be given to national governments. Without doubt, the changeover to the new system would open discussions about the rationale of cross member state redistribution in the EU. Yet, in the current system discussions about and member states' attitudes on the various EU policies financed from the Community budget are strongly biased by the unspoken deliberations concerning the member state net financial positions. As these considerations necessarily vanish in the new system, a new chapter could be opened in the discussion on terms such as the European value added, subsidiarity. A complete reconsideration of agricultural support, structural policies and expenditures to enhance competitiveness would become possible.

Net payer member states: better net financial positions after the reform

Table 1 displays the real net financial positions of the net payers in 2006 and the estimated net financial positions if the reform would have already been in place in that year, further the estimated 2013 net financial positions both under the current and the reformed regime, respectively. The 2013 figures show that the net financial positions of all but two net payer member states are better in the reformed than in the current regime. This is especially the case if we take into consideration that the effect of the UK rebate is not included in the estimation of the current regime, i.e. in real life the improvement would be somewhat larger than in this estimation because the basis for comparison would be smaller (certainly not for the UK). The assessment of the UK position is not easy. However, if we take into account the rebate which the UK will still enjoy, be it to a reduced extent, we can make the cautious assumption that the UK's relative position in the reformed system would remain unchanged in 2013 compared to that assumed to evolve under the current regime.

Table 1

**Net payer member states: comparison of real and estimated net financial positions
in 2006 and 2013, in % of GNI**

Member state	Current regime 2006 (fact)	New regime 2006	Difference 2006 new/current	Current regime 2013*	New regime 2013	Difference 2013 new/current
	(1)	(2)	deviation in % points (2)-(1)	(1)	(2)	deviation in % points (2)-(1)
Netherlands	-0.47	-0.27	0.20	-0.53	-0.25	0.28
Sweden	-0.28	-0.27	0.01	-0.43	-0.26	0.17
Germany	-0.27	-0.13	0.14	-0.45	-0.12	0.33
Belgium	-0.23	-0.18	0.05	-0.57	-0.17	0.40
Denmark	-0.23	-0.40	-0.17	-0.39	-0.39	0.00
France	-0.17	-0.14	0.03	-0.32	-0.13	0.19
Finland	-0.14	-0.23	-0.09	-0.32	-0.22	0.10
Austria	-0.12	-0.20	-0.08	-0.36	-0.19	0.17
Italy	-0.12	-0.02	0.10	-0.31	0.00	0.31
Luxembourg	-0.11	-0.59	-0.48	-0.64	-0.58	0.05
UK	-0.11	-0.23	-0.12	-0.57	-0.22	0.35
Ireland	0.71	-0.31	-1.02	0.07	-0.29	-0.36

* Without the UK rebate.

Source: EU budget 2006. Financial Report, Annex 5, p. 63. Office for Official Publications of the European Communities, Luxembourg, 2007. ; own estimations.

Net beneficiary member states: smaller but secured net gains

Compared to the estimated net financial positions in 2013 under the old regime the new member states would suffer considerable losses under the reformed system (see Table 2). The most important losers would be Hungary, Lithuania and Estonia (from 2.3 to 1.9 percentage points relative to the GDP), but for different reasons: Hungary because of the high basis in the comparison due to an exceptionally good combination of eligibilities both under the current CAP and cohesion policy, Lithuania due to the high basis and rapid catch up, and Estonia mainly due to its exceptionally rapid economic growth. Smaller but yet considerable losers (around 1.5 percentage points) are the Czech Republic, Latvia and Slovakia. Another group of net beneficiary member states would lose 1 percentage point or less: Poland, Greece, Portugal, Malta and Slovenia. Spain and Cyprus would gain from the changeover. Does it mean that these member states would oppose the reform?

Not necessarily. The prevailing rules will not change until 2013. It is extremely important to point out that all the exercises for assessing the net financial positions in the year 2013 clearly bear a message for the period *after* 2013. We have several open questions related to the post-2013 era: Will direct payments still be available? What will happen to the UK rebate? Which poor new member states will join because it hopes to tap EU resources? Finally, to what extent will the highly developed member states be prepared to participate further on as donors in cross member state redistribution? Current beneficiaries must not extrapolate the volume of transfers from the EU budget in the 2007-2013 period for the

years beyond 2013. The emerging tensions, the desperate efforts to avoid a breakdown of cross member state redistribution, and the chaotic compromise finally achieved in 2004-2005 do not allow too much optimism for the net beneficiary countries concerning the forthcoming negotiations in 2010-2011, if the current practices of cross member state redistribution remain the same. Clear rules for the post-2013 years, smaller, but secured and foreseeable transfers from the EU budget in the long term, further significantly increased flexibility in using EU resources may win the net beneficiary member states for the reforms proposed. Last but not least, it is almost impossible to argue against the proposed system on the basis of a fair sharing of burdens and gains.

Table 2

Net beneficiary member states: comparison of real and estimated net financial positions in 2006 and 2013, in % of GNI

Member state	Current regime 2006 (fact)	New regime 2006	Difference 2006 new/current	Current regime 2013*	New regime 2013	Difference 2013 new/current
	(1)	(2)	deviation in % points (2)-(1)	(1)	(2)	deviation in % points (2)-(1)
Lithuania	2.52	2.59	0.07	3.57	1.66	-1.91
Malta	2.09	1.06	-1.03	1.43	0.72	-0.71
Latvia	1.63	2.57	0.94	3.04	1.57	-1.47
Estonia	1.4	1.62	0.22	2.76	0.86	-1.90
Hungary	1.35	1.98	0.63	3.94	1.61	-2.33
Poland	1.16	2.61	1.45	2.99	1.98	-1.01
Slovakia	0.76	2.11	1.35	2.87	1.44	-1.43
Slovenia	0.49	0.68	0.19	1.06	0.37	-0.69
Czech Rep.	0.36	1.35	0.99	2.42	0.95	-1.46
Cyprus	0.73	0.35	-0.38	-0.29	0.12	0.40
Spain	0.4	0.13	-0.27	0.00	0.14	0.14
Portugal	1.54	0.74	-0.80	1.37	0.76	-0.61
Greece	2.68	0.44	-2.24	1.34	0.47	-0.88
Ireland	0.71	-0.31	-1.02	0.07	-0.29	-0.36

* Without the UK rebate.

Source: as in Table 1

Further enlargements affordable in the reformed system

The proposed system was tested for the impact of the EU accession of six West Balkan countries (Albania, Croatia, Bosnia- Herzegovina, Macedonia, Montenegro and Serbia), then the accession of Turkey. The results suggest that the impact of the West Balkan enlargement by six countries in 2013 would be relatively small, the accession of Turkey would bring about a larger rearrangement of financial positions (see Table 3 and 4). In the EU-34 with the West Balkans and Turkey, the average GNI would be EUR 242 only,

Table 3.

**Net payer member states: comparison of estimated net financial positions
before and after forthcoming enlargements, in % of GNI**

Member state	New regime 2013,			EU-33 compared to EU-27 deviation in % points	EU-34 compared to EU-27 deviation in % points
	EU-27	EU-33	EU-34		
Netherlands	-0.28	-0.31	-0.37	-0.02	-0.09
Sweden	-0.30	-0.32	-0.38	-0.02	-0.09
Germany	-0.16	-0.19	-0.27	-0.03	-0.10
Belgium	-0.21	-0.24	-0.31	-0.03	-0.10
Denmark	-0.42	-0.44	-0.49	-0.02	-0.07
France	-0.17	-0.20	-0.27	-0.03	-0.10
Finland	-0.25	-0.28	-0.35	-0.03	-0.09
Austria	-0.23	-0.25	-0.32	-0.03	-0.10
Italy	-0.05	-0.08	-0.17	-0.03	-0.12
Luxembourg	-0.60	-0.62	-0.65	-0.01	-0.05
UK	-0.26	-0.28	-0.35	-0.03	-0.09
Ireland	-0.33	-0.35	-0.41	-0.02	-0.08

Source: Own estimations.

Table 4.

**Net beneficiary member states: comparison of estimated net financial positions
before and after forthcoming enlargements, in % of GNI**

Member state	New regime 2013,			EU-33 compared to EU-27 deviation in % points	EU-34 compared to EU-27 deviation in % points
	EU-27	EU-33	EU-34		
Spain	0.09	0.05	-0.05	-0.04	-0.14
Portugal	0.68	0.62	0.47	-0.06	-0.21
Greece	0.39	0.35	0.22	-0.05	-0.17
Lithuania	1.53	1.45	1.22	-0.09	-0.32
Malta	0.64	0.58	0.43	-0.06	-0.20
Latvia	1.44	1.36	1.14	-0.08	-0.30
Estonia	0.77	0.71	0.55	-0.06	-0.22
Hungary	1.49	1.40	1.18	-0.08	-0.31
Poland	1.83	1.74	1.48	-0.10	-0.35
Slovakia	1.32	1.24	1.03	-0.08	-0.29
Slovenia	0.30	0.26	0.14	-0.04	-0.16
Czech Rep.	0.86	0.80	0.63	-0.06	-0.23
Cyprus	0.06	0.03	-0.07	-0.04	-0.13
Bulgaria	4.62	4.43	3.92	-0.19	-0.70
Romania	3.26	3.12	2.73	-0.14	-0.53

Source: Own estimations.

EUR 35 less than in the EU-27. The net redistribution (the sum of net payers' contributions to the EU budget less the transfers these member states receive, what is equal to the sum

that net beneficiary member states receive in transfers, minus what they contribute to the EU budget) would increase from 0.16% (EU 27) to 0.23% (EU 34) of the EU GNI. While the change might seem significant compared to the EU-27, it is interesting to compare this rate of net redistribution with the respective figure, 0.22% of the EU GNI in 1997, when the EU had only 15 members and cross member state differences in relative prosperity were much smaller than in an EU-34 with Turkey.

Conclusions

Under the current regulations, a group of highly developed member states has been contributing to the EU budget to a substantially larger extent than the rest of the highly developed member states. Special, non-rule-based regulations (UK rebate, rebate on the financing of the UK rebate, number of exemptions agreed upon at the December 2005 summit) have been necessary to avoid the collapse of cross member states redistribution in the EU. Although the next round of negotiations on the post-2013 financial framework is still far away, there is no way to avoid extreme net financial positions without exemptions under the current system, and the whole bargaining process cannot be based on another principle than that of fighting for a juste retour.

The chief attraction of the proposed new system is that it addresses the juste retour problem directly instead of negating or circumventing it. After the introduction of the reform, simply no room would remain for the juste retour attitude. Contributions to the EU budget would reflect the relative economic strengths of the member states. The popularity of the European integration may increase due to the fact that per capita expenditures are equally high for each EU citizen; at the member state level expenditures would only be the function of the size of the member state population. The net financial positions would reflect the levels of development of the individual member states relative to the EU average. Thus, there would be no need for exemptions or any other non-rule-based regulation. The increased flexibility in allocation of EU co-financed expenditures in member states would neutralize 'juste retour motivated' discussions on the current and future importance of individual EU policies, as there will be no linkages between the net financial positions of member states and their more or less intense involvement in certain EU policies. Notwithstanding, it would become necessary to accept transitory regulations for member states for which expenditures from the EU budget would drop beyond a certain extent compared to those received in the last years of the outgoing system.