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THE DIPLOMATIC BARGAINING PROCESS  
OF THE BRITISH BUDGETARY REBATE

DEPARTMENT OF WORLD ECONOMY

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CORVINUS UNIVERSITY OF BUDAPEST

INTERNATIONAL RELATIONS

PH.D. PROGRAMME

THE DIPLOMATIC BARGAINING PROCESS

OF THE BRITISH BUDGETARY REBATE

PH.D. DISSERTATION

PÉTER VASS

BUDAPEST, 2008

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**Motto:**

**'I want my money back'  
/Margaret Thatcher/**

**“There is nothing so bad or so good that  
you will not find an Englishman doing  
it; but you will never find an  
Englishman in the wrong. He does  
everything on principle.”  
/George Bernard Shaw/**

# 1 INTRODUCTION

On 26 June 1984 the European Council at Fontainebleau reached agreement on an issue that had stalled the Community's business for a decade the so-called 'British Budgetary Question' (BBQ). The resulting Agreement of Fontainebleau had a twofold outcome: it settled the long lasting dispute between Britain and the EC concerning the excessive UK net contribution to the Community's budget and also represented an accord regarding the increase of the Community's own resources required to fund the Community's policies, especially the Common Agricultural Policy. Although Fontainebleau did not solve the financial problem of the Community for the 1980s, the agreement put an end to a particularly difficult issue that had coloured the first 11 years of the UK's EC membership. While the dispute has officially been settled in 1984 the the issue resurfaces again and again with the financial bargaining of the forthcoming new financial perspectives. In a broader context the question of 'fair contribution' will always be an evergreen issue in the Union.

The **term of BBQ** is used in the dissertation firstly, to denote the disparity between the relative wealth of Britain and the size of its net contribution to the European Community (EC) budget, secondly as the associated efforts of consecutive British governments to reduce their considerably high net contribution compared to other Member States.

The **BBQ** is based on the problem of the UK's large net **contribution**, which means the difference of the money that the UK pays to the EC budget and that it gets back from it. While Britain was the largest net contributor to the Community budget, it was only the seventh regarding the GDP per head index. The contributions consist of three elements: the custom duties, the levies and the VAT factor, while the receipts came largely from the EAGGF (FEOGA), financing the agricultural sector. The problem of the excessive British net contribution was twofold. Its gross contribution was higher than the community average. Britain's high reliance on imported raw materials resulted in a high contribution in custom duties - paid one fourth of the custom duties while France only one seventh at that time. Moreover, its significant agricultural imports falling under the CAP regime generated 18.6 per cent of the levies paid to the EAGGF (FEOGA). Finally, Britain paid 17.4 per cent of the VAT contributions to the EC budget [Francoise de la Serre, 1987, p 155-6]. On the other hand, the receipts of the UK from the EC budget were much less than those received by other countries. Its small agricultural sector could not benefit sufficiently from what was by far the biggest part of the EC expenditures [Office for Publications of the European Communities, 1988, p 33].<sup>1</sup> Moreover, the Structural Funds did not compensate the UK much, due to their small budgetary importance. Since the UK's large net contribution resulted from high gross contributions and low receipts, each resulting from its highly

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<sup>1</sup> The EAGGF represented 76,8 per cent of the EC budget expenditures in 1973.

industrialised and open economy, with its relatively small agricultural sector, chapter 5 considers the causes of the problem in some detail.

Having an idea about **the scale of the amount of money for which the consecutive British governments fought**, may give some indication of whether the time, energy and money invested in the BBQ were proportionate to the importance of financial stakes. The whole Community budget was not more than 2 percent of the Member States' public expenditures, in fact, and remained far below 1 percent of the national income. The refund that Britain demanded was a negligible part of the UK budget. 'The gap around which the argument revolved – approximately 400 million ecus a year – was tiny in relation to, say, the size of Britain defence budget.' [Roy Jenkins, 1991, p 500]

Although in a narrow sense the BBQ embraces the period between 1979-1984, in a wider sense the period from 1969 and the period from 1982-2007 also constitutes an essential part of the question. Moreover, the ever-closer integration of the European Union and the forthcoming enlargement(s) give(s) a new importance to the BBQ. The UK managed to maintain its exceptional budgetary status within the EC for 24 years and fought successfully in the AGENDA 2000 negotiations and also in the budgetary bargaining of the on-going financial perspective (2007-2013) to keep its rebate intact.

The **BBQ** is typically seen as a British problem, yet it was **multi-faceted**, in a large part arising from the nature of the EC. **The aim of this dissertation** among others is therefore to analyse the BBQ with particular emphasis on its French-related aspects: firstly, it identifies those factors that come from the differences between the economic structure of Britain and France. Secondly, the dissertation highlights the different approaches of the two countries concerning the financing of the Community. Thirdly, it intends to consider the different British and French sources to highlight the French side of the issue, their involvements, and motives during the negotiations and the settlement of the BBQ.

In terms of **structure**, the dissertation is divided into six main chapters excluding the Introduction, the Conclusions, the Afterword Glossary and the Annexes.

The second chapter makes a review of the theoretical background by analysing the way of how each school approaches the relationship between integration and community budget, and the positions of net contributors and net recipients. The second chapter (numbered as 3) makes the analysis of own resources. I am analysing in the first part the formation of the said resources, while in the second part their future, as the British rebate since 1984 is in a close and indivisible relationship with the structure of the budget and the “redistribution” system among Member States. During my research, it was reinforced the conclusion that

among the possible new tax categories analysed in the literature there is no one single candidate that would be ideal under all aspects.<sup>2</sup> Unambiguously, the reform of the incomes side of the budget cannot leave untouched the question of refunding to Great Britain.

In the framework of the treaty basis of the BBQ, the next chapter analyses the relevant articles of the Treaty of Rome and the Council decision of 1970 setting up the system of own resources, which creates the phenomenon of net contributors and net recipients. Although, the BBQ did not have its roots directly in the Treaty of Rome, the treaty provisions and their impacts contributed to the emergence of the BBQ owing to the agricultural issue. The chapter examines to what extent contributed to the BBQ the fact that the UK was confined to a latecomer position due to its early withdrawal from the process of the European integration. The section evaluates how far this phenomenon gave the opportunity to France to influence the Community structure at its setting up, according to French interests, which affected the BBQ basically.

After having outlined Britain's incapability of influencing the Community structure owing to its late accession, the following chapter examines the British specificities and also the inherent differences between the British and Community structures.

After the overview of the so-called 'soft elements' of British specificities (special relationship, sovereignty), in the second part of chapter I analyse the two major factors (agriculture, commonwealth

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<sup>2</sup> Political and diplomatic bargaining will have a decisive impact on a possible selection.

factor) that played a leading role in the development of the BBQ. The agriculture, shaped by strong French influence in the Community, had a completely different structure in the UK. The other factor that plays a decisive role in the BBQ is the relationship of the UK with the Commonwealth countries. The traditional openness of its economy firstly contributed to the formation of an insignificant agricultural sector and secondly the traditionally high imports from the Commonwealth had serious impacts on Britain's budgetary contributions under custom duties.

The final two chapters cover the step-by step diplomacy of the BBQ from 1973 to 2007 concentrating on the Thatcher period after 1979. The British expected the problem of the contribution to be solved through the diversification of the revenues and expenditures (budgetary reform) or through the development of new Community policies. Since these expectations did not materialise, the UK found the situation unacceptable and insisted on an adjustment of its 'excessive net contribution'. The first demands for refunds were made right after the accession under the Wilson Government in 1974. In this early stage of the BBQ, the emphasis was laid on the gross contribution (payments to the EC Budget) rather than the net contribution (difference of payments and receipts from the EC budget), although it was the latter that represented the bigger part of the problem. The question was not seen as a substantive issue due to two reasons: firstly, because politicians in Britain thought that the problem would not emerge earlier than 1980, when the complete own

resources system would be achieved. Secondly, the renegotiation of the terms of entry was seen in other Member States as an internal political issue of the Labour Party that needed only a 'cosmetic solution'. As a result a Financial Mechanism was agreed and introduced in March 1975. But conditions to be fulfilled before it could be activated were so complex that the UK never benefited from a refund of gross contribution. The second phase of the BBQ started with the Callaghan government in 1978 one year before Thatcher came into power. Contrary to the first phase this time the negotiations concentrated on the whole issue rather than simply to the gross UK contribution and aimed to reach a refund for Britain. After tough debates, under the Brussels Agreement the UK reached a refund for 1980 and 1981 the 30th May 1980. It also gave the possibility of an extension of the refunds to 1982. Later the refunds were extended to 1982 and 1983 as well. The deal at Brussels meant technically that the refunds were paid from the Community budget to the UK at the end of the year to which the refund referred. This condition was accepted by the British because according to the Brussels Agreement the UK had to receive the bulk of its refunds before the end of its financial year on 31 March. The Agreement also gave a mandate to the Council to find a permanent solution to the problem that would have consisted in the restructuring of the EC budget and the reduction of the CAP expenditures through the reform of the CAP. The failure of implementing this mandate led to the extension of the ad hoc refunds

(from 1980 through to 1983). The negotiations of the Thatcher Government, that ended successfully in Fontainebleau, were designed to resolve the problem of the temporary payments converting them into permanent annual refunds. Finally, in the last chapter I continue with the research of BBQ step-by step diplomacy until the debate on the financial prospect for the period between 2007 and 2013 was settled.

My heartfelt **thanks** go to my dedicated supervisors, Dr. Julie Smith, of Robinson College, University of Cambridge and Dr. Tibor Palánkai, of Corvinus University of Budapest for reading the text several times, making many useful comments and guiding me all along my research. I also would like to thank Dr. Geoffrey Edwards for giving me the right orientation in the early stage of my dissertation. A very special word of thanks goes to Mr Paul Bébin, the former chief advisor of the Committee on European Community at the National Assembly of the French Republic, who was always available for advice, accurate information and documentation concerning the French aspect of the BBQ. Finally, it would ceratinly not have been possible to complete my research without the services of the Churchill Archives (University of Cambridge) and the Institute for World Economics of the Hungarian Academy of Sciences.

The **sources** used to write this dissertation are varied. I visited several times the Churchill Archives in Churchill College at Cambridge, where the Thatcher papers are kept. While the private and classified

papers are unavailable for researchers and scholars, as they are bound by the 30-year rule, I had access to the Thatcher CD ROMs in the Archives gathering all her speeches, articles etc., which provided a valuable set of primary materials. I also had the opportunity to conduct interviews with some French, Hungarian and British experts in relation with the different aspects of the dissertation.

Apart from the limitation of the 30-year rule, some other information was inaccessible as well, for example the verbal communication between the Prime Minister and the Chancellor of the Exchequer, for which there is obviously no written evidence. The essential negotiations and bargaining of the BBQ took place between the Heads of State and Governments and states making it more difficult to find primary sources, since the meetings are held very much behind closed doors. Because of the opaque functioning of the Council, memoirs and autobiographies played a crucial role in the gathering of information. On the British side, Thatcher's autobiography gave a solid view of the British side of events that was complemented by the views of other key participants. On the French side, the death of the President, François Mitterrand, without leaving memoirs, meant it was impossible to obtain his views of the issue. However, the memoir of his special advisor, Jacques Attali, provided a brilliant overview on the French side of the BBQ. To round off the French sources I had the opportunity to conduct interviews with the former advisors of the Committee on the European

Community of the National Assembly and the Senate. I also had access to their Archives as to the French Archives of Sciences Po. These primary sources have been backed up by a big number of secondary sources, which contributed valuable external analysis to this dissertation.

The research performed from several perspectives **proved** that the BBQ is a unique phenomenon based on Great Britain's historical, social, economic and political uniqueness and might only evolve in the given international political situation, and might be "cast" into the EC system as a result of a step-by-step diplomacy. The French-German-English triangle, Thatcherite assertiveness and the then existing financial situation of EC were unavoidable prerequisites for reaching the final result.

**The author is fully determined to continue the research, extending it to the period following the present financial perspective as well.** It is expected that the period starting in 2014 will have as a result even more stress on budgetary positions (net contributors and net recipients), which will challenge the existing BBQ system. This is also the time when the 30 year confidentiality restriction of the documents that are not accessible as primary sources will end. These two factors together are a serious reason for the further and deeper research of the subject.

I closed my dissertation on the 3<sup>rd</sup> of April 2008.

## 2            **Communitary Budget and Budgetary Positions in the Light of Theoretical Schools**

**motto:**

**'Theories are like chicken soup—  
enjoyable, wholesome, but not a cure-  
all'**

**'...theories are like different languages  
and no one is yet sure how to translate  
between them'  
/Patrick L Barry/**

**'Theories are like 'big-picture'  
roadmaps, that are meant to orient us in  
the midst of a lot of facts, ideas, beliefs,  
opinions etc., to make general sense out  
of them.'  
/Brian Donohue-Lynch/**

**'...theories are like Escher drawings,  
correct in detail but inconsistent over  
all.'  
/Elin Whitney-Smith/**

The integration evolving in the Western half of Europe differs from similar processes that took place in other parts of the world. It has such distinct features which due to their 'sui generis' character caused some changes that influenced the international legal system of the second

part of the 20<sup>th</sup> century (primacy of EU law, pre-emption, extended law interpretation of the European Court etc).

Because of the above reasons, European integration is hard to categorise. For the description of gradual deepening and intensification of economic development and integration, the literature adopted the categories of Hungarian-born Béla Balassa. As professor of Johns Hopkins and Yale universities, Balassa, in his work published in 1961 and entitled '*The Theory of Economic Integration*', defined the following phases: free-trade zone, customs union, single market, economic and monetary union, and political union.<sup>3</sup>

Albeit these categories follow the history of European integration in a relatively good manner, they are not suitable for an exact match, since boundaries are slurred in real life and do not appear as pure as they are in theory.

In Balassa's interpretation the European integration intensively started the "season of competition". Using the analogy of high jumping, we can even say that by missing the initial height (free-trade), the emerging EC passed directly to the first stake, the customs union phase. Continuing the BENELUX customs union initiative (the Treaty of BENELUX customs union was signed on 17 March 1948), leaning on the triple pillars of ECSC (European Carbon and Steel Community,

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<sup>3</sup> The Balassa-Samuelson effect, named after Balassa and Nobel Prize winner economist Paul Samuelson, a consultant to two American presidents, is also credited to Béla Balassa.

established in 1951<sup>4</sup>), EEC (European Economic Community, established in 1957<sup>5</sup>), and EURATOM (European Atomic Energy Community, established in 1958<sup>6</sup>) it was possible to jump over the first stake, and the customs union was formed. Of course, it is important to underline here that beside the application of unified external custom duties the disassembling of internal restrictions was not comprehensive. (It is the irony of life that the United Kingdom that kept herself far from the European unification process was then working on the implementation of the free-trade phase within the British Commonwealth.)

Year 1968 is usually considered as the start for preparing the free flow of the four factors (goods, services, capital, and manpower). The literature usually places the implementation of the single market at the beginning of 1990s, with the addendum that the four basic freedoms still were not perfectly implemented.<sup>7</sup> The penultimate level of Balassa's scale of five, i.e. the establishing of the economic and monetary union, is usually linked to the 1<sup>st</sup> of January 1999 when the single European currency was introduced<sup>8</sup>. In accordance with my above statement, it is

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<sup>4</sup> On 18 April 1951, the Benelux states, the Federal Republic of Germany, France and Italy signed the Treaty establishing the European Coal and Steel Community. The High Authority established as part of its institutional framework was first chaired by Jean Monnet.

<sup>5</sup> On 25 March 1957, encouraged by the experience of successful regulation of the steel and coal sector, the six members of the Coal and Steel Community signed the Treaty of Rome.

<sup>6</sup> The other sectoral co-operation, of strategic importance under the circumstances of the Cold War, was launched in practice on 1 January 1958.

<sup>7</sup> Protectionist reactions were mainly triggered by cross-border services.

<sup>8</sup> Only used as account money at this stage, but also circulated as cash in early 2002

also important to mention that the common currency was not introduced in all countries, but only in the so-called eurozone.

However, in addition to the Balassa-type classification of the European integration started after World War II, we can also make reference to the integration theory schools and the international system theory approach, in order to sort out, as Brian Donohue-Lynch said, from the abundance of facts, ideas and opinions some more general findings. Therefore, at the beginning of the dissertation, I analyse in detail how each school and professional workshop perceives the relationship between integration and community budget, and net contributor and net recipient positions that could result from the community budget.

It is not a purpose of my dissertation to give a full cross-section of the views represented by each school, since this would largely exceed the scope of my work. This study intends to examine those relevant statements and views of different schools that are related to the above-mentioned two questions.

Finally, in addition to the importance of theoretical review, I consider the following saying worthy of being chosen as a motto: 'Theories are like chicken soup - enjoyable, wholesome, but not a cure-all.'

## 2.1 LIBERAL THEORETICAL CONCEPTS

Since it is not the purpose of this dissertation to give a detailed and comprehensive analysis of all integration theory schools, the unitary review of the classical and neoliberal schools, having common theoretical roots, cannot cause analysis problems.

The classical liberal school, based on the four freedoms, i.e. the free flow of services, goods, capital, and manpower, considers the international co-operation implementing the free-trade as already being a form of integration. In this theoretical system, the participating countries, as if becoming aware of their own interests, and as a preliminary condition of taking part in the trade, dismantle those barriers that are rising as bounds separating them.

The trade free of any restrictions and the absolutely free competition among participants are the economic spinal column that supports the argument system of this early school of integration theory. Even such a remarkable representative of the classical school as Kindleberger, defines integration as price equalisation through market interactions: “I define economic integration as equalisation of prices of production factors, that is to say the equalisation of wages, interest and profit.” [Kindelberger, 1966]

Speaking of Great Britain, we cannot forget the fact that this is the very school that was built on the free-trade history of the United Kingdom, and in its literature designates the period until 1914 as being

the age of standard (model-like) economic integration. It was Wilhelm Ephemeral who unequivocally stated the model-like character: *“If there is something that deserves the label of international economic integration, then that is the world economy that developed before 1914.”* [Röpke, 1959, p 225]. However, I must state that this theoretical ‘Röpke-type formula’ of the early period, including mainly the 19<sup>th</sup> century, never existed in its chemical purity, as Myrdal correctly observed, too. [Gunnar, 1972] The free-trade itself was mainly concentrated around Great Britain, but the protectionism still remained in many countries as a significant factor. In reality, the relationship among the actors of free-trade, or even the product structure may essentially differ from the market homogeneity stated by the classical liberal school that had to evolve by participation in free-trade, through division of labour and factor flow. The free factor flow of the classic free-trade period of integration can only be accepted with reserves, since it only meant the international exchange of products that were suitable for trade in the given circumstances and any associated financial payments in the opposite direction. Because of technical, logistics and other barriers only a small part of goods were suitable for international trade<sup>9</sup>, but the free movement of capital cannot be restricted to the process of financial offset of goods [Palánkai, 1995, p 36-7]. The free movement of services, and

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<sup>9</sup> For instance, technical conditions and various types of know-how which would have made it possible to transport perishable goods (e.g. soft-fleshed fruit or fresh agricultural produce) without waste were non-existent at the time. Such techniques – cooling vessels, ripening fruit in gas-filled containers, etc. – are available at system level today, but back then, the lack of these means excluded certain goods from international trade by nature.

even more of manpower did not reach for example even the fraction of the present level of EU. Consequently, on the contrary to Kindleberger's statements, despite relative equalisation of prices the factor prices (profit, interest, wages) do not equalise on international level, and this is especially true of wages and interests [Palánkai, 1995, p 36].

European integration as an idea was already conceived in the theoretical and practical environment of free-trade. Even though, contrarily to the liberal view presented before, I do not consider the primary free-trade association as integration, I can assert with confidence that basically free-trade is an essential and determinant character of the present, more complex status of European aspiration for unity that passed in the meantime through several integration levels. In the early stage of European integration, it was possible to compare the development level of different Member States, so the dismantling of barriers against factor flow caused no significant trouble or asymmetry. As for this dissertation, just the asymmetries potentially evolving between entities of different development level participating in the free-trade were the ones that generated the establishing of a compensation instruments system. The redistribution system intended to exclude the appearance of unilateral dependencies can be interpreted as an embryonic form of budget. Albeit the budget and its conceptual system already existed at the very beginning of European integration, they had a minimal compensatory role among Member States.

Thus, the concepts of net contributor and net recipient cannot be explained from the integration concept of the classical liberal school, since the establishment of free-trade among actors of the same development level does not require the existence of equalising compensation mechanisms. The equilibrium has formed automatically and by definition.

## **2.2 APPROACH OF THE REGULATION SCHOOL**

The next logical step of integration theory-based overview of the subject of this dissertation is the regulation or dirigist school.

The concept associated with the school considers, in accordance with its name, that the guarantee of well-working economies is the etatist (state) control of the economy. Another important integration school balancing the liberal and neoliberal trend considers that the basic mechanisms operating the liberal model are not acceptable as system factors accurately describing the working of economies. Dirigists say that the working of liberal elements of market mechanisms does not reach their target, the free-trade. Albeit the adherents of regulation do not reject the basic concepts of the liberal school, they issue harsh critics. Free market mechanisms are supplemented with the indispensable element of state control. “Therefore, in accordance with regulation theories, the economic policy must be integrated as well, which means the international uniformisation, harmonisation and co-ordination of

international economic policies, and ensures the collective enforcement on certain areas of these policies. Accordingly, the international integration means that the state regulation and intervention will be shifted to international (community) level.’ [Palánkai, 1995, p 41]

The negative and positive conceptual system of integration was introduced by Jan Tinbergen, an emblematic figure of the regulation school. The double tool system of integration means the dismantling of commercial barriers among partner economies (elimination of quantity restrictions and reduction of custom duties levied on imports), and the establishing of common institutions and operation mechanisms that promote integration [Tinbergen, 1965, p 77-8].

In the European integration we can clearly find both regulation instruments. On the one hand, it is trivial that a conscious and explicit intention and strive to dismantle the commercial barriers discussed under liberal theories existed from the beginning. On the other hand, the institutional element, with the aim to help the implementation of objectives of community Member States, also appears from the very beginning of integration.

As it regards the subject of this dissertation, we shall focus during our analysis on whether some kind of budget system will be created in connection with the positive integration element, and if yes, will it establish net contributor or net recipient positions? During the formation of common institutions and operation modes, the primary characteristic

was not redistribution, but the operating expenses of institutions coordinating the operation. Consequently, the net contributor and net recipient positions, as concepts based on the difference between contributions and allocations cannot be directly interpreted in the start phase of the European integration. Therefore, the regulation theory, due to its positive integration element, requires the creation of some kind of “integration budget”, but without the redistribution and equalising effect of the latter. During the history of European integration the institution financing ratio (share) at the three integration institutions (ECSC, EEC and EURATOM) was different, but the said financing shares within the budget of each community can also vary in time in a dynamic way. The share of the latter in the entire budget gradually decreased.

### **2.3 THESES OF THE FUNCTIONALIST SCHOOL**

The functionalist and neofunctionalist theoretical background are well connected to the dirigist approach, as they are also centred around the state, but from different angles and with different signs (+ or -). In accordance with the functionalist approach, in the changing international system, the state holding the control of economy and politics is less and less able to effectively perform some of its basic tasks. As a direct consequence for the state of this situation is the possibility to transfer some of the political, social, economic regulation and other tasks to a higher level, i.e. to international integration. In addition to the fact that

the state has lost its ability to satisfy the basic and natural demands of the society, it inherently includes the possibility of war. The functionalist school that started to flourish after World War II considers as an opportunity to avoid a new catastrophe to implement the integration through international sectorial organisations, established by professional areas, on the basis of non-political principles and avoiding state structures. David Mitrany, one of the leading representatives of the school, defines the suprastatal, functional co-operation of technocratic states as the key element for achieving the primary goal: international peace. Mitrany creates in his book the concept of “spill over”, which means the spreading out of international functional co-operation in certain functional areas [Mitrany, 1966]. Finally, the vision about international co-operation results, in a manner of speaking, in a world government, which would be the top body of the international functional co-operation and co-ordination.

I do not agree with the basic theses and final conclusions of the “Mitrany-type”<sup>10</sup> theory that intends to explain the European integration, too. Although there was and is an unambiguous need for co-operation among national states, a phenomenon that already appeared at the very beginning of EC and was linked to specific sectors (atomic energy: EURATOM, carbon and steel production – ECSC etc.), these organisations never were apolitical and functionalist in their nature. The

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<sup>10</sup> Far from being alone in the main stream of functionalism, but with a decisive influence on the views and theses of the school

national state interests and politics always and basically impregnated the more and more dense fabric of integration. The motor of European integration was even built on the dynamic political and economic interdependence caused by the post-war French-German relationship and the European status quo.

'La Guerre entre la France et l'Allemagne doit être rendue non seulement impensable, mais matériellement impossible, la mise en commun de la production de charbon et de l'acier doit jeter les bases d'une unification économique, première étape d'une fédération européenne.' [Angel, Lafitte, 1998, p 23]

If we want to analyse the budget aspects of functionalism, we can only do that indirectly, since the common budget does not explicitly appear as redistribution system in the centre of gravity of bureaucratic and functional international co-operation, and hence we cannot draw any relevant conclusions on net recipient or net contributor positions. With that exception, however, it unambiguously results from the theses of functionalist and neofunctionalist theory that the financing of international integration organisations is unavoidable. The financing of institutions providing international sectorial co-operation is based on the contribution of nation states, which from the point of view of our subject is some kind of a theoretic entrance-hall of the budgetary question. On the latter subject, I will classify the functional and neofunctional schools in the same category with the dirigist school.

The neofunctionalists (Ernst Haas, Leon Lindberg, etc), by building on the basic ideas of functionalists, brought many new ideas in integration theory. In the integration level, they put more stress on regional rather than global issues. In connection with the functional spill-over, locking-in (it is hard to stop during integration, and impossible to go back), *engrenage* (Europeanisation of national bureaucracies and decision makers in parallel with the progress of integration, which makes the co-operation and agreements among bureaucrats easier) phenomena, they considered that integration is surely advancing toward political integration [Kende, 1995, p 86-9]. Neofunctionalist views built on functionalist bases gave one of the most comprehensive analysis of the European integration, but their more intensive analysis within the frame of this dissertation would be unjustified, since it would not add any new relevant information on the net recipient and net contributor positions.

## **2.4 FEDERALIST VIEWS**

The federalist vision was to a certain degree the extension of the nation state model to the international stage, where the task system to be performed was divided in an effective and multilevel-like manner among states participating in integration and central institutions resulting from federalism. However, in accordance with federalists the United Europe would be created not as a federal state, but more likely as an extension of

regional co-operation and institution systems of nation states. The target of federalism is the political union.

Let us now examine the budget- related aspects of the federalist school. As opposed to the aforementioned schools, the federationists already deal with the budget as an important and accentuated issue. The question is handled not only partially, in connection with the financing of the operation of the international system of institutions, but already appears the concept of redistribution, and thus the net contributor and net recipient statuses can be interpreted. Of course, it must be recognised that this latter criterion appeared as a consequence only, and does not form the backbone of this theory.

The undoubtedly revolutionary character of the common budget introduced by the European Community is the system of own resources. In other words, it was not one of the above discussed, ordinary models that worked, i.e. the Member States financed the operation charges of organisations set up by international agreement from their own budgets, but the international organisation was managing the income acquired on its own right. In this way, on the other hand became independent from the states that created it, and on the other hand came closer to the European citizens as well, even if the latter did not pay any kind of “community tax”.

Overall, the European integration has not confirmed federalists in many respects. The separation of power branches at different levels was

not implemented to the required extent and regularity, the EC did not built its own local executive power and keeps using the executive power systems of Member States to perform certain local tasks. (As a compensation for the tasks performed in connection with the budget, each Member State can withhold as “rental fee” a centrally specified percentage of its contribution and use it for the tasks connected with the budget.) [Kende, 1995, p 84-5]. However, I do not share the opinions of J. Richardson and S. Mazey, stating that “*the EC only appears in the shadow of national governments, except normative actions, which do not clearly separate from the national legal regulations*” [Mazey, Richardson, 1993, p 37-51] As the integration goes forward the decisive part of the legislation (codification) work is taken over by the EU’s institutions specialised in this field. In the EU legislation, because of the legal principles that became known as “pre-emption”, ‘direct effect’ and ‘direct applicability’, the role of the national-level codification became secondary, while the community codification gained an unequivocal primacy. Nor I can agree with the opinion of Mazey and Richardson that “in all relevant questions national governments have the decisive word, which is well reflected by the fact that lobbying groups activate around national governments and not around EC institutions.” [Mazey, Richardson, 1993, p 37-51] The authors think about the Council of Ministers (CM) formed by ministers of national governments and the Council of Europe (CE) formed by European head of states and prime

ministers, which otherwise are EU institutions and weigh heavy in the drawing up of conceptual directions (CE), and concrete codification and management of related lobbying and package deals (CM). As for the European Parliament, because of its ever strengthening decision making position, it became the newest target of professional lobbying companies.

## **2.5 INTERGOVERNMENTAL APPROACH, REALISTIC SCHOOL**

The intergovernmental approach that became known as an integration-focused current of the realistic school best known for its “*billiard ball theory*” (Robert Keohane, Stanley Hoffmann, etc) is based on the international competition of nation states driven by their own interests. The nation states, as single independent and real actors of the international arena measure their swords in a “*zero-sum game*”. A direct consequence of the interest enforcement of states is the conflict that is an accepted, inherent element of the system. The operating principle and rules of the international system are determined by the world of sovereign states, similarly to the hard-shelled billiard balls that are colliding, but not penetrating each other.’ [Kiss J., 1997, p 11]

The intergovernmental approach can be best understood as a counterpoint to the federalist school, so it is not by chance that it reached its zenith between the mid 60s and mid 80s, the period of “*eurosclerosis*”. In my view, the most symbolic statesman of this period and school is General de Gaulle, who familiarised his European counterparts with so

many ways of enforcing the national interest. One of these ways was the veto raised in connection with the British adhesion, the rigid rejection of majority principle in decision making stipulated by the Treaty of Rome, or his very assertive steps taken in the area of common agricultural policy, and more specifically in order to protect the interests of the French agriculture and farmers. Though this is only indirectly linked to the subject of European integration (EC), the 1966 French withdrawal from NATO has an important theoretical role concerning the establishing and operation of international organisations. The French withdrawal was an out-of-the-common manifestation of the primacy of national interests in international politics and diplomacy. From this point of view, it gives an authentic and practical denial of the neofunctionalist locking-in phenomenon. That is to say, during integration you can not only stop, but go back or fall behind. The possibility of this “spill-back” was analysed by Pierre Soldatos in “*Le Systeme institutionnel et politique des communautés Européennes dans un monde en mutation*”. [Soldatos, 1989, p 64]. The “empty chair policy”, that probably was the greatest crisis of European integration lasting for half a year and closed by the 1966 Luxembourg compromise, erected an impenetrably high wall in front of the practical implementation of the supranational, bureaucratic model-state with sectorial control, as drawn up by functionalists and neofunctionalists. This barrier was somewhat removed by the “*relance*” of the second half of the 1980s.

In the light of the inter-governmental approach and the European practice that only partially confirms it, I can identify with Stanley Hoffmann's statements only to a certain extent, i.e. the establishment of supra-national and regional institutions does not yield the desired results because international integration independent of the interests of nation states does not take into consideration the diversity of nations making up such integration or bureaucracies set up in those nation states. For this reason, it may not be an alternative to the nation state [Hoffmann, 1966, p 862-915]. It must be admitted that integration challenges the operation of nation states, however, it cannot and did not intend to neglect or replace them either. It is another issue whether the emphasis is on being halfway through or it has switched to supranational integration in the bipolar system of nation-states and integrational organizations. Analysing the development of the EC one can also definitely state that those believing in the inter-governmental approach underestimated the co-operation, conflict resolution and efficiency developments derived from the co-operation of clerks as experts. In relation to sectoral co-operation (industry-specific transnational interests) the industry-specific loyalty of experts taking part in the negotiations strengthened, and their loyalty to national bureaucracy decreased. The intergovernmental approach promoting the pool ball theory is best suitable to describe bargains in the course of European integration. [Wallace, 1977, p 322]

I can only partly identify with Tamás Kende's view that it set an excellent example for politics based on national interests that the principle of "rightful consideration" emphasised by Margaret Thatcher was accepted by each Member State in the years of BBQ. Thus it was declared that every state had the right to gain from integration as much as it contributed to it. In my view, such interpretation of the BBQ in the above respect is a kind of simplification because the mere lack of interpretation of the issue caused the debate to last for years and, on the other hand, Member States did not accept the principle that a particular Member State can take as much out of the EC budget as much it has contributed. This would have meant that they agreed to abolish the roles of contributors and beneficiaries. It was agreed, although only in Fontainebleau, that contributions and budgetary shares must be proportional to the welfare and wealth of the particular Member State.

One can surely state that, based on theory history, the inter-governmental approach is key to the topic of the dissertation as well as the step-by-step negotiation procedure leading up to it. International purchases based on national interests, bundled bargains and the time differences between the sale and purchase of diplomatic business are also present in it.<sup>11</sup> It is declared among governments resolutely representing national interests that an agreement may be reached if the economic, social and/or political programmes of the governments of large Member States

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<sup>11</sup> One Member State yields against its national interest in the hope that such a debt might be exchanged with another Member State in relation to a transaction which it considers more significant.

being the backbone of integration are identical or, in lack of such identity, if the government willing to enforce its national interest can avail itself of tools when negotiating with its partners, which, if used, have a bigger impact on negotiating partners (governments) than the potential consequence of domestic politics do after the acceptance of the deal. [Kende, 1995, p 91] All the way parallel to BBQ, the question arose how politicians can explain and communicate their conduct and results attained at the negotiation table to their own citizens. Parliamentary and presidential election periods that occur periodically but at totally different dates in Member States participating in the European diplomatic bargains is a separate element in the system. Such cyclic elections further complicate the aforementioned system of negotiations that is already complex enough.

## **2.6 THE INTERDEPENDENCE THEORY**

Although the interdependence theory took shape in the two decades following World War II more like an interpretation of global trends and not as an explanation of the Western European integration. However, it is suitable to describe and explain certain phenomena characteristic of the EC. In the world of the Soviet-American bipolarity and nuclear parity featuring the Cold War, mutual avengement and Mutually Assured Destruction were the most important driving forces behind the birth of the theory of interdependence. The avoidance of open conflicts based on

the possibility of mutual (American-Soviet) nuclear destruction is a practical example of the theory known as Nash Equilibrium<sup>12</sup>, or Cournot-Nash Equilibrium<sup>13</sup> in game theory. In the international power struggle, the possibility and role of the overpowering use of military power is gradually decreasing. Nation states as players in international politics can also gain advantage and assume a leading role in world economics even if such states do not possess any potential that is militarily significant or is proportionate to their economic position. Earlier, economic and military power were going hand in hand because it was easy to convert one into the other. A cleaner, new form of the growth of economic influence that was not converted cyclically to military power was a novel phenomenon in international politics.

Two prominent representatives of the theoretical school are co-authors Joseph Nye and Robert Keohane of the book *Power and Interdependence*. Keohane mentions the multitude of network-like relationship channels instead of the primacy of classic diplomatic channels. As a result, various coalitions and agreements take shape in the network of relationships. In such agreement and interest-enforcement procedures resulting from the aforementioned situation, the participating states may obtain a significant position independent of their size. [Nye, Keohane, 1977, p

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<sup>12</sup> According to the theory, equilibrium between players is achieved if all players make their best decisions taking into account the position of the remaining players. Naturally, this is a point of equilibrium, but not one which is ideal, as the outcome could still be improved along a common strategy. Published in 1950 in the PhD dissertation 'Non-cooperative games' by John Nash.

<sup>13</sup> A precursor of Nash's equilibrium theses was 19<sup>th</sup> century French philosopher and economist Antoine August Cournot, who in his economic model called duopoly arrived at Nash's conclusions, although with reference to two players only.

31] The latter has high significance in European conflicts of interest, such as the British rebate, lasting for decades. I agree with Keohane that it is product bundles and association systems that make the European integration a nearly coherent power and economic fabric. The latter one is also relevant from the point of view of BBQ. I discuss the various forms of it in the chapter describing step-by-step diplomacy. Although the national and, above all, the EU budget does not appear in a conspicuous manner in the theory of interdependence. However, on the one hand, European institutions funded by the common budget are specific participants of European multiplayer games. On the other hand, they shaped the history of BBQ by means of assuming an active role. In this regard, the theory of interdependence significantly contributes to the understanding and analysis of the British rebate subject to this dissertation.

## **2.7 THE INSTITUTIONALIST APPROACH**

Let us devote some more time, now for the last time, to the institutionalist approach with the question that was originally posed, i.e. whether the particular school of theory provides a firm ground in terms of the history of theory regarding the EU budget and positions of net contributors and beneficiaries.

The international system-based institutionalist approach considers the emergence of the various supranational institutions as one of the consequences of co-operation evolving parallel to nation states. International

co-operation cannot be clearly separated from regional integration. Co-operating countries co-operate in the hope that, taking their system of values into consideration, co-operation leads to a result of higher usefulness than self-sufficient conduct would. [Kiss J., 2003, p 40] This practical and rational apprehension justifies co-operation which, by means of the gradual growth of its intensity, turns local co-operation originally commenced in a dispersed manner into one of the phases of integration proper.

Integration and the common institutions sustaining it made joint financing carried out by Member States indispensable. As integration deepened, EC obtained, although partially, its own income and thus managed to finance not only the sustention of its institutions but also its common goals. It further enhanced the significance of the joint budget that co-operation gradually enhanced and deepened. It was unique among international organisations that the integration, i.e. the EC, created by the founding nation states – and according to the enhanced law interpretation of one of its institutions, the European Court of Justice – [Craig, de Burca, 1999, p 178-83] could not only pursue its activity within the scope defined by the founders but could also proceed vertically deeper and horizontally wider.<sup>14</sup>

Nevertheless, the EC's (and today's EU's) budget is of a lesser volume compared to the GDP of Member States and their own budgets as

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<sup>14</sup> Cf. Van Gend an Loos case, as well as the Costa v. ENEL case

a nation state, budgetary debates always came along with the history of the Community.

## **2.8 CONCLUSIONS DRAWN FROM THEORETICAL OVERVIEW**

Now it is evident that no conclusion can be drawn from the various theories of theoretical schools, namely, that budget is clearly and closely attached to integration and thus the positions of net payers and beneficiaries cannot even evolve. Integration can, at least to a certain extent, develop without a particular budgetary reallocations mechanism.

Nevertheless, views adopted in sections 2.1 – 2.7 provide some theoretical support for us to state that the redistribution system takes shape at a certain level of the progress of integration. These factors, based on the logic of payments and redistribution, give birth to their “children”, i.e. the positions of net contributors and beneficiaries that are in permanent and irresolvable conflict. On the one hand, the objectives of the European integration may not have been reached without implementing and sustaining a joint budget. Thus, there was a PONR (Point of No Return) on the 5-point Balassa-scale from where only the existence of the joint budget led the way through (with all its blessings and curses). On the other hand, it is economically evident that the system of the Member States that are at a different level of development but are operating within a single market requires budgetary redistribution. The single market also leads to the equality of work productivity, the aggregation of volumes of

demand and the convergence of purchasing power. In addition, the joint budget supporting the above developments entails – as I detailed above – the birth of budgetary positions.

### **3 SYSTEM OF OWN RESOURCES**

In this chapter I analyse the system of own resources that is of a fundamental significance from the point of view of BBQ. In the first half of this chapter, I summarize the fundamentals of the system set up, while in the second half I analyze the future of the system of own resources. The latter is of fundamental importance from the aspect of this dissertation because any material changes to the system will affect the BBQ as the parties tied the sustention of rebate to the permanence of VAT-based payments at the European Summit of Fontainebleau in 1984.<sup>15</sup>

#### **3.1 INTRODUCTION OF THE OWN RESOURCES SYSTEM**

The Decision of 21 April 1970<sup>16</sup>, taken by the Council pursuant to Articles 201 of the EEC Treaty and 173 of the EAEC Treaty created a new system of revenues and expenditures for the Community, the EC's 'own resources'. [Strasser, 1991, p 28] However, it has to be stressed that the whole system was implemented by all Member States only in 1980. In 1970 three resources were introduced<sup>17</sup>. Between 1958 and 1970, Member States contributed the resources of the common budget against their own budgets as a kind of membership fee, in accordance with the

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<sup>15</sup> See the Conclusions of the Presidency in the Appendix.

<sup>16</sup> See: OJ L 94, 04. 28. 1970

<sup>17</sup> The fourth resource, the GNI factor was introduced much later to prevent having a 'deficit' in the EC Budget

proportions provided for in the Treaties. The system of own resources to replace the contributions by Member States was adopted on the basis of Article 201 of the Treaty of Rome. The motive and logic behind its implementation was to allow the EC to enjoy financial independence. Although using everyday terminology, own resources are often referred to as taxes, they are not to be considered as equivalents of national taxes.

The EU has unique characteristics in this respect as well:

- the “taxpayers” of own resources are not the natural and legal persons of Member States, but Member States themselves,
- the EC does not have the classical authority to levy taxes, and finally,
- it has not established and does not operate its own system of local institutions (located in Member States) for collecting taxes.

The system of own resources comprises three different elements: customs duties, agricultural duties and revenues based on the VAT.

### **3.1.1 REVENUES FROM CUSTOMS DUTIES**

Under the Custom Union system, custom duties were levied on imported goods from third countries. Transferring customs duties to the EU budget is a logical consequence of integration (customs union). As the total revenues of all Member States from customs duties are fed into the central EC budget, advantages or disadvantages may be evaluated only in comparison to each country’s situation upon its entry into the Un-

ion. If, prior to its accession, a country had extensive trade relations and intensive external partnerships, it will lose such customs-type revenues, substantial in amount, in the same way as another candidate would whose economy is more closed and therefore its volume of international trade is smaller and so are its revenues from customs duties.

### **3.1.2 AGRICULTURAL DUTIES AND SUGAR LEVIES**

Agricultural duties and sugar levies are flexible variable customs tariffs charged on cheap imported goods from the world market in order to equalise internal and external prices ‘automatically’. In such a case, it again makes a difference whether a given candidate Member State specialises in the import of cheap agricultural produce from the world market or has extensive production capacities of its own. Naturally, the significant difference is the most apparent if both the revenues and expenditures of the EC budget are taken into account, as in certain Member States, revenues from agricultural subsidies are a key source of revenue.

### **3.1.3 CONTRIBUTIONS BASED ON VAT**

VAT-based contributions are paid by Member States on a monthly basis in proportion to the annual amount calculated in advance. During the existence of the common budget, the percentage payable on the VAT base has been modified on several occasions. The initial 1.4% was reduced to 1% in 1999 and again to 0.5% in 2004. Apart from the relatively

frequent changes, the VAT-based contribution has several additional handicaps:

- Unlike the previous two resources, the VAT-based contribution is not a real own resource, as it is not based directly on the application of any community policy.
- Moreover, it is not added as a fixed percentage to national VAT rates, but calculated using a key which is specific to the VAT base of each Member State.
- The volume of the VAT base has nothing to do with the VAT rates charged on it. The VAT base is primarily related to the volume of consumption, which varies by country.
- The greater the proportion of consumption to the GNI of a country (a characteristic of less affluent nations), the larger the figure which will be multiplied by the given rate in proportion to its wealth. One element in the multiplication is fixed, while the other varies depending on the volume of consumption. That is, the country will not contribute more than an affluent Member State to the common budget in absolute value, only relatively speaking, as the level of affluence also has to be taken into account.<sup>18</sup>

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<sup>18</sup> For this reason, only a percentage of the GNI is considered for the purpose of calculating the contribution.

## 1. Table – The composition of EU own resources

(in per cent of total own resources; cash basis)

OWN RESOURCES 1996-2005										
	1996	1997	1998	1999	2000	2001	2002 <sup>1</sup>	2003	2004 <sup>2</sup>	2005 <sup>3</sup>
TOR	19,1%	18,8%	17,2%	16,8%	17,4%	18,1%	11,9%	13,0%	12,0%	11,4%
VAT	51,3%	45,5%	40,3%	37,8%	39,9%	38,7%	28,8%	25,4%	14,6%	14,1%
GNP/GNI	29,6%	35,7%	42,5%	45,4%	42,7%	43,2%	59,3%	61,6%	73,4%	74,5%
Total own resources (€ billion)	71,1	75,3	82,2	82,5	88,0	80,7	77,7	83,6	93,3	108,5

1 As from 2002 the % of TOR retained by Member States as a compensation for their collection costs was raised from 10 % to 25 %. This difference represented about € 2.2 billion in 2002 as well as in 2003.

2 Preliminary draft amending budget 8/2004 (EU-25).

3 Preliminary draft budget 2005.

Source: Report from the Commission Financing the European Union Commission report on the operation of the own resources system TECHNICAL ANNEX Financing the European Union Commission report on the operation of the own resources system COM(2004) 505 final Volumes I & II

### 3.2 THE UNITED KINGDOM'S CORRECTION AS PART OF THE SYSTEM OF OWN RESOURCES

Subsequent to the Own Resources Decision (ORD) mentioned earlier, the system of the UK rebate has become integrated into the system of own resources and as such it has followed its changes in every aspect. Such changes included those of 1988, 1992 and 1999 as well. (See the chapter on the BBQ for details.) Since then, any changes to the UK rebate has required a unanimous decision of the European Council. In other words, the solution immediately coded the new problem in the system.

The end of the transitional period in 1978 which followed the accession of the UK nearly coincided with the introduction of the VAT re-

source. Britain assumed full obligation to contribute to the common budget when a new budget was introduced, as a result of which Britain contributed a larger share of the costs than other Member States. Britain was not compensated by the European Regional Fund established in 1975, as its weighed much less than the CAP did, and when its volume started to increase, it was mostly new entrants that benefited from it.

**Several attempts were** made following the UK's accession **to resolve the BBQ on economic grounds**. The first stage of this was the mechanism of the dynamic brakes established at the Dublin Summit in 1975. These required three conditions to be fulfilled at the same time for the capping of each Member State's contribution. The first condition was that the GDP of the Member State in question had to stay below 85% of the EC average. Additionally, its rate of economic growth also had to be less than 120% of the EC average. Finally, its share of contributions to the common budget had to exceed its share of the community GDP by over 10%. (See also the chapter on the step by step diplomacy.)

The second attempt is also linked to Dublin, but the focus in 1979 was on the regulation of the opposite side (budgetary expenditures), owing to the failure of the first attempt. From 1980 until Fontainebleau, the UK received various amounts of rebate.

The **calculation of the rebate** was essentially as follows:

- In the first step, two rates were subtracted, which determined the UK's net contribution to the common budget as a percentage. The first of these was Britain's share of the total contributions to the EU budget, and the second was Britain's share of the total refund volume available to Member States.
- The rate obtained as a result was multiplied by the volume of available refunds to Member States, which produced the amount of the UK's net contribution.
- 66% of this amount was refunded to the UK.

The **magnitude of the rebate** amounted to about two thirds of the UK's excess contribution. In terms of its funding, it is important to underline that other Member States paid the rebate proportionately to the harmonised VAT base and since 1988, to the GNI calculated at market prices. Only 25% of its share of the rebate has been paid by Germany since the system was launched, and by Austria, the Netherlands and Sweden since 2002<sup>19</sup>. Naturally, the UK does not contribute to the funding of the rebate payable to it.

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<sup>19</sup> See AGENDA 2000

### **3.3 PROPOSALS BY THE EUROPEAN COMMISSION FOR THE RESOLUTION OF THE BBQ**

In its decision of 29 September 2000, the European Council instructed the Commission to draft proposals on the system of own resources by the beginning of 2006.<sup>20</sup>

The Commission was unusually fast in its performance and issued its report including its proposals as early as 2004. For the purposes of this dissertation, I will discuss the five preliminary proposals by the Commission for the management of the British rebate, as well as its final proposal for the Generalised Correction Mechanism (GCM).

#### **3.3.1 POSSIBLE ALTERNATIVES**

All of the proposed solutions described below would have had different impacts on the UK and the other Member States<sup>21</sup>, but since most of these proposals are not applicable today I did not include comparative charts related to these.

- 1) Reducing the rate of the rebate

This would have interfered with the correction mechanism at a single point, replacing the 66% rate with a lower rate (e.g. 33%).

- 2) Capping the amount of the correction

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<sup>20</sup> This affected the future of the British rebate as well as the entire structure and mechanism of the system of own resources.

<sup>21</sup> It is reasonable that the largest net contributors (the Netherlands, Germany and Spain) be treated separately here.

This would have involved the maximisation of the rebate in absolute value rather than as a percentage. The Commission proposed EUR 4.5bn. This equalled the average of the amounts refunded to the UK between 1996 and 2002.

### 3) Phasing out the rebate

This would have meant linear reductions over a 7-year period (2007-2013), followed by the elimination of the rebate (reducing the original amount by one seventh each year).

### 4) Phasing out the rebate combined with the capping of its amount

As the title also suggests, this would have involved the combined application of the previous two solutions. In practice, that would have meant the gradual elimination of the EUR 4.5bn amount.

### 5) Ignoring the costs incurred by the expansion of the EU

The costs of expanding the EU were heavily represented in the UK's correction, therefore ignoring in the course of calculation would have reduced to a rebate of EUR 4.2bn.

## **3.3.2 THE 2004 PROPOSAL OF THE COMMISSION FOR A GCM**

Prompted by the potential anomalies created by the five independent proposals, the Commission finally presented a more compromising and complex proposal, which intended to give the situation a more comprehensive treatment independently of specific countries rather than fo-

cusing on a solution to the UK's excess contributions. This solution was based on the following key elements:

- **Special treatment of the largest net contributor:** The UK, being the largest net contributor, would have its correction progressively phased in as compared to the initial state in which the system of the British rebate exists.<sup>22</sup>
- **Threshold:** Any country would have the right to use the correction mechanism the excess net contribution of which <sup>23</sup> is greater than 0.35% of its GNI. That is, in cases of insignificant proportions the mechanism would not be triggered, only when it became considerable. This value is referred to as the Reasonable Net Contribution (MNH).
- **Phasing in the correction for other Member States:** In order compensate top-up payments to the UK in the first four years, a progressively phased in rate is appropriated for Member States financing them instead of the 66% refund rate.

#### **Other criteria:**

- The 66% rate is automatically decreased if the amount of correction reaches the EUR 7.5bn maximum <sup>24</sup> in a given year;
- Member States receive the correction only for their net contribution in excess of the threshold.

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<sup>22</sup> It would receive a fixed sum progressively reduced over the four years between 2008 and 2011.

<sup>23</sup> Vagyis amennyivel többet fizet, mint amennyit kap az EU költségvetésből

<sup>24</sup> Not including the amount of the top-up payment to the UK

- The criterion for Member States' participation in the correction mechanism is their GNI expressed in the purchasing power standard.

## 2. Estimated net budgetary balances for net contributors

(average 2008-2013)

<i>in % of GNI</i>				
	Without correction	Current UK correction	GCM with 0.35% threshold & cap at € 7.5 bn	Commission Proposal: GCM + transitional period
	(1)	(2)	(3)	(4)
Belgium	1,32%	1,21%	1,26%	1,26%
Czech Republic	3,26%	3,17%	3,20%	3,20%
Denmark	-0,20%	-0,31%	-0,26%	-0,26%
Germany	-0,52%	-0,54%	-0,48%	-0,49%
Estonia	3,85%	3,76%	3,79%	3,78%
Greece	2,25%	2,16%	2,19%	2,19%
Spain	0,32%	0,23%	0,26%	0,25%
France	-0,27%	-0,37%	-0,33%	-0,34%
Ireland	0,56%	0,47%	0,51%	0,50%
Italy	-0,29%	-0,41%	-0,35%	-0,36%
Cyprus	-0,28%	-0,37%	-0,33%	-0,34%
Latvia	4,51%	4,40%	4,45%	4,44%
Lithuania	4,50%	4,41%	4,44%	4,43%
Luxembourg	5,89%	5,80%	5,83%	5,83%
Hungary	3,15%	3,06%	3,09%	3,09%
Malta	1,16%	1,06%	1,10%	1,09%
Netherlands	-0,55%	-0,56%	-0,48%	-0,50%
Austria	-0,37%	-0,38%	-0,41%	-0,41%
Poland	3,85%	3,76%	3,79%	3,79%
Portugal	1,60%	1,50%	1,54%	1,53%
Slovenia	1,40%	1,31%	1,34%	1,33%
Slovakia	3,36%	3,27%	3,30%	3,30%
Finland	-0,14%	-0,25%	-0,20%	-0,20%
Sweden	-0,47%	-0,50%	-0,45%	-0,46%
United Kingdom	-0,62%	-0,25%	-0,51%	-0,46%

Source: Commission, 2004

The formula proposed by the Commission for the calculation of the GCM would have been as follows:

$$C_x^{RR} = \left[ \left( \frac{TP_x}{TP} - \frac{E_x}{E} \right) * E - RNC * Y_x \right] * RR$$

$$\text{if } C_x^{RR} > 0$$

where  $RR = 0.66$  if  $\sum_x C_x^{0.66} \leq MARV$  and

$$RR = \frac{MARV}{\sum_x C_x^{0.66}} * 0.66 \text{ if } \sum_x C_x^{0.66} > MARV$$

Where: TP = Total VAT- and GNI-based payments made by all Member States in respect of year  $t$   
 $TP_x$  = VAT- and GNI-based payments made by Member State  $x$  in respect of year  $t$   
 $E$  = Total allocated expenditure in respect of year  $t$   
 $E_x$  = Expenditure allocated to Member State  $x$  in respect of year  $t$   
 $C_x^{RR}$  = Correction (at refund rate  $RR$ ) to be granted to Member State  $x$  in respect of year  $t$   
 $RNC$  = Reasonable net contribution (= threshold) expressed in % of GNI  
 $Y_x$  = GNI of year  $t$  of Member State  $x$   
 $RR$  = Refund rate  
 $MARV$  = Maximum available refund volume  
 $\sum_x C_x^{0.66}$  = Total sum of corrections if  $RR$  is equal to 0.66

Overall, also considering compensations, this would result in an annual sum of EUR 7.2bn, to be reduced to EUR 6.7bn following the excess expenditures of the transitional period. However, these figures could lead to false conclusions, as they might suggest that the solution would cost more than operating only the UK's rebate system (EUR 4.6bn per year). However, it needs to be taken into account that while that latter system only involves payments in one direction i.e. only the UK receives payments from the other Member States, the GCM involves cross payments, therefore its net costs should be compared to the same figures of the other system. That on the other hand is close to EUR 3.8bn [Somai, 2004], significantly lower than the average EUR 4.6bn refunded to the UK between 1997 and 2003.

### **3.4 FUTURE OF THE OWN RESOURCES SYSTEM**

BBQ being the topic of the dissertation is evidently closely and inseparably connected to the structure of the budget and the system of redistribution among Member States. Any changes to this may affect BBQ. Since Britain's EU accession and through the Fontainebleau Summit the budget of the EU has seen numerous changes to date. However, BBQ remained a constant issue. The EU has long been long trying to reform the budget. In this area the European Commission has the pioneer's role, however, the complex system of Member States' interests has been an inevitable brake in the process up until now. Member States thinking only at national level have a hard time eschewing their specific influence practiced by the fact that they are clearly payers of the community's budget. As seen above the Iron Lady herself has already resorted to the interest enforcement or, to be more explicit, blackmail tool that meant the periodic or constant withholding of payment by a Member State. However, they were aware of the fact that the possible use of such tool would imply court proceedings resulting in the UK fighting a losing battle. Nevertheless, they included it in their political arsenal.

In regards of the topics of the dissertation, material changes to the budgetary system may have extra significance due to the fact that the budget reform is closely linked with the BBQ.

‘The correction formula foreseen in paragraph 2 (second indent) will be part of the decision to increase the VAT ceiling to 1.4 per cent, their durations being linked.’ [Simon, Nicoll, 1997, p 99-104]

The EU has already dealt with the enhancement of the system of own resources several times. However, it has had no chance to be diplomatically discussed as a realistic political option so far. Member States, behaving as ‘disintegrating billiard balls’, do not wish to abandon their direct budgetary influence, and do not either intend to eschew their view which compares budgetary payments (net budgetary positions) at a nation state level. Thus, the budgetary “fire-trench” turned into a positioned warfare within the interests of nation states. Studies supporting the above theory within the circles of the Commission and experts analyse potential sources of income from various points of view, however, they may be realistically applied only on the medium-run.

An explanation to this is, on the one hand, that the budget planning model divided into seven-year periods offers a single date exclusively at the end of the seven-year period, which would provide a real opportunity to implement a fundamentally new system. Remembering the intense conflicts regarding the approval of the last financial perspective, the premature re-negotiation of a consensus-based agreement on the seven-year period would mean political unreality.

On the other hand, supporting studies elaborated in various professional workshops are not at a level of development to manifest them-

selves in specific, applicable and politically negotiable recommendations. However, to attain the desired state of affairs, would require less scientific work but, instead, the political rethinking of professional results reached so far.

### **3.5 EXPECTATIONS RELATED TO POTENTIAL NEW RESOURCES<sup>25</sup>**

The eight expectations listed below are normally categorized based on their characteristics. Accordingly, the aspects of sufficiency and stability relate to the size and calculable availability of the new own resource to be introduced, the next three concern efficiency connected to the introduction while the last two are related to the principle of equality. Let us discuss these aspects one by one.

#### **3.5.1 SUFFICIENCY**

In case of an own resource to be newly introduced, short and medium term aspects have to be considered alike. Accordingly, it needs to be taken into account whether the total of the budgetary sum of the EU will increase, stagnate or decrease in the period to come. Although matching up is not direct, based on its tendencies one can surely state that

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<sup>25</sup> Chapters 5.2 and 5.3 discuss Philippe Cattoir's 'Tax-based EU own resources: An assessment' published in the periodical *Taxation Papers* of the European Commission, the so-called Langes Report for the Committee of Budgets of the EP, 'Report for the Committee of Budgets on the System of Own resources in the European Union', which appeared in *European Parliament Working Documents*, the 1997 EP paper by I. Begg, N. Grimwade and P. Price 'The own resources of the European Union: Analysis and possible developments', as well as the study made by Tamás Szemlér. Additional relevant sources and documents are referenced in the Bibliography.

a disintegration process would lead to a shrunk total of the budgetary sum while deepening integration would result in a stagnating or even in an increasing budget total.

Being cognizant of the changes of the budgetary total, it also needs to be given consideration what other resource the new own resource has to replace because its volume must be in harmony with that of the replaced item, and also the change of the budgetary total.

### **3.5.2 STABILITY**

Identifying and defining the volume of the new resource to be administered is not sufficient in itself. It also needs to be considered that a resource which is not contributed by Member States as a single amount cannot be guaranteed to be available in an even distribution. A budgetary resource which varies from one business cycle to the next could result in either a budget deficit or a surplus. This presents the problem of how a budget surplus, or rather more frequently, a deficit, is to be managed. That issue could be highly problematic to reconcile with budgetary principles followed currently.

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<sup>26</sup> Obviously, their magnitude varies depending on resource. Items on the revenue side significantly vary in size, therefore it is not indifferent which item political intent would prefer to replace. Presumably, this would require prolonged diplomatic bargaining in order to crystallise.

### **3.5.3 VISIBILITY (TRANSPARENCY)**

Similarly to direct EP elections, direct EU taxes would create a more direct relationship between the Union and its citizens. As a result of direct payments, EU citizens will have a much clearer understanding of the resources and costs of running the institutional system of the integration and of what is funded from the eurocents which they have paid. It is no accident that also in Hungary, with projects financed from former PHARE and other pre-accession funds as well as under the National Development Plan and the New Hungary Development Plan, cost-effectiveness has not been a key criterion once the funds were those of the EU. Such funds are regarded as money that just came and went.<sup>27</sup> Presumably, direct taxation will strengthen the need for accountability and consequently, budgetary authorities of the EU will become more stringent in their examination of both financial aspects and content.

### **3.5.4 LOW OPERATING COSTS**

Introducing each new tax has its own costs. Throughout its existence, the European Union has been using the same structure to manage its revenues. Rather than developing local administration in parallel with the system of national institutions in each Member State, it is outsourcing such tasks for a flat fee of Member States' contributions to the previously established institutional system of their governments. Irrespective of this

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<sup>27</sup> The author has 10 years of experience with planning, implementing and in certain cases reviewing projects which are funded by the EU.

otherwise cost-effective solution, the cost of introducing a new EU tax could be either low or high depending on how it is aligned with currently existing elements of the system.

### **3.5.5 EFFICIENT ALLOCATION OF RESOURCES**

Rather than using its budget simply to operate the national mechanism to sustain and serve the community, every nation state, without exception, strives to accomplish goals in line with various government programs and general values through its fiscal policy. In terms of the budget, both appropriately parameterised revenues and alternatives for structuring expenditures may serve those purposes. In this sense, one could even argue that the maximum amount which a government has at its disposal to achieve its goals equals twice its gross budget.<sup>28</sup> The source, grounds and extent of revenues collected by the government (e.g. in the form of taxes, duties, etc.) are just as strong an influence on the behaviour of market operators as the benefits which it intends to provide to them for some advantage or compensation.

Whenever introducing a new own resource, it needs to be considered how the net effect of the new resource to be introduced and the element to be eliminated<sup>29</sup> impacts on the operators of the economic region

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<sup>28</sup> Obviously, this is only a theoretical maximum, as government budgets may only be varied within narrow limits, given that a considerable proportion of their expenditures are required to perform core functions. Nevertheless, the author intended to draw attention to the fact that this is not only a feature of expenditures but also of revenues such as taxes.

<sup>29</sup> Naturally, the new element to be introduced is expected to have a much stronger impact than the one to be eliminated (especially with more direct GNI-based resources), as all candidates in the list are

of the community. In an ideal case, introducing the element will improve the allocation of resources in the internal market, steering the system towards overall market efficiency.

### **3.5.6 HORIZONTAL EQUITY**

In accordance with the principle of equal opportunities, any new element introduced should have the same effect across various Member States on taxpayers with identical characteristics. Certain aspects of this could be very subjective, while the diversified nature of national tax systems also does not facilitate the assertion of this criterion. Apart from being discriminative, failure to implement it fully could even cause taxpayers, natural persons and businesses alike, to migrate between Member States.

### **3.5.7 VERTICAL EQUITY**

Adding a new type of revenue to the system currently in use still would not allow the Union to connect directly to its citizens in terms of expenditures. Benefits are provided to citizens by each Member State according to the subsidiarity principle. The question is whether or not introducing a new, direct element of own resources would call for the introduction of a direct expenditure item as well.

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revenues with a direct impact which may appear much more straightforward to individual economic operators.

### **3.5.8 FAIR CONTRIBUTIONS**

The principle of fair contributions is especially important for the purposes of this dissertation, being concerned with what drives and underlies the BBQ: whether or not the national aggregate of the new EU taxes collected in each Member State will be commensurate with the economic potential and affluence of a particular State. Failure to do so for any reason would suggest that a balancing mechanism might be justified. Another question adding to the complexity of the situation is whether the accurate comparison of Member States is possible if, for instance, a Hungarian firm relocates to Cyprus and its taxes are taken into account as part of Cyprus' national contribution.

### **3.6 POSSIBLE CANDIDATES**

The following list of possible new taxes is not comprehensive but represents a kind of common multiple in international literature. A considerable proportion of these is already found in working materials issued in preparation for the financial perspective of 2000-2006 [Comission, 1998], while the rest have been added to the list of potential candidates in line with the trends of development within the community and in the global economy.

### **3.6.1 MODULATED VAT**

It is reasonable that VAT, one of the most obvious forms of own resource, should be discussed first. [Langes, 1994]. The case appears simple, however, as several prominent researchers of the subject have observed, including H. Langes, P. Cattoir, Tamás Szemplér, András Bakács, Gábor Róbel, Gábor Túry, Anna Wisniewski, András Székely-Doby, Tamás Novák, etc., it is a solution heavily dependent on the fulfilment of certain marginal conditions and prerequisites. According to the consensus formula reported in international literature, one part of the excise duty levied by Member States on various goods and services would be used by national budgets, whereas the rest would be disposed of by the EU. The distribution of these two parts also represents a fairly uniform arrangement. It is a generally supported argument that when introduced, the EU rate should be around 2 per cent. The option of applying lower rates to inferior goods than to normal goods, prevalent in the practice of Member States, is considered as a further improvement of the concept. The rate for the former would be around 1.5%, that for the latter around 3%. Introducing the EU VAT rate would not lead to increased prices and therefore political anomalies in individual Member States, as nation states would decrease their own VAT rate by the extent of the EU rate. Lost revenues of the national budget would be offset by the partial or complete elimination of contributions to the EU budget based on GNI or VAT.

However, introducing the EU VAT presents several problems, including but not limited to the following:

**Zero-rated goods:** Owing to differences in the application of this practice across individual Member States, if no EU VAT is levied on zero-rated goods to avoid political problems, then the contribution of each Member State to the EU budget would depend on the prevalence of the practice in its system. This would implicitly call for a compensation mechanism to be established. A simpler but more drastic measure could be the elimination of the zero rate system within the Union. This would be technically viable in a relatively short term, but could potentially lead to economic and political turbulence.

**Harmonised VAT base:** Despite the considerable progress made at the level of the community in the harmonisation of tax bases, unique differences continue to exist<sup>30</sup>, which would also call for some sort of balancing mechanism to be established.

**Black economy:** Regarding the black economy, I agree with Parsche's opinion [Parsche et al., 1996] that similarly to the practice of VAT exemption, the presence of the black economy varies by Member State but is considered significant [Parsche, Steinherr, Waller, 1996]. States with relatively greyer national economies would be seen as "community tax evaders" depending on the proportion of their black economy. Similarly to the previous two cases, this would also raise the issue of compensation, the difference being that unlike in those cases, even the amount

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<sup>30</sup> Example: tax relief provided to SMEs.

eligible for compensation would not be possible to determine with such precision.<sup>31</sup>

The EU VAT as a possible new tax is generally considered sufficient [Comission, 2003]<sup>32</sup> in terms of volume and efficient [OECD, 2000] regarding its cyclical character. A reference is appropriate to the fact that the tax based on consumption is more stable in terms of its cyclical character than its GDP-based counterpart which also includes commerce and investments (fourth GNI based resource). Whereas introducing the EU VAT would improve transparency associated with the EU budget and its administration would also be viable at a low cost<sup>33</sup>, it would have a limited impact on the optimal allocation of resources owing to the negligible extent of the EU VAT rate. While resolving the issue of a harmonised tax base and VAT exemption (zero VAT rate) creates horizontal equity, vertical equity is only partly attainable through the practical implementation of the proposed two-rate VAT. The main reason for this is that consumers with higher incomes spend a smaller proportion of their income on consumption than their counterparts with lower incomes. Therefore, in proportion to their incomes, citizens with lower incomes contribute more to financing the EU.<sup>34</sup> Various analyses of Member States' VAT-based contributions (Langes Report, a 1997 study by the

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<sup>31</sup> The assessment and quantification of the black economy is not trivial and due to the logic of contributions, each nation state will have an interest in admitting to a lower rate of the black economy.

<sup>32</sup> According to a 2003 study by the Commission, the VAT turnover of Member States in 2001 amounted to 7% of their GDP on average. The 2% rate mentioned above would be equal to 0.8 to 1.3 of the GDP of Member States, approximating or even exceeding the rate of their current contributions to the EU, which is about 1%.

<sup>33</sup> All Member States have developed structures for collecting VAT.

<sup>34</sup> Naturally, this applies only in proportion to their incomes and not in absolute value.

European Parliament on a similar subject, etc.) have shown that payments might be largely disproportionate owing to the impact of factors such as differences in the proportion of household consumption within the GNP or the varying proportions of household and community consumption across Members States. For the above reasons, managing inequities would presumably call for the introduction of some sort of compensation mechanism.

### **3.6.2 EU CORPORATE INCOME TAX**

The corporate income tax as separate EU tax has long been the subject of consideration and study. However, it has been discussed mostly in studies, workshops and expertise rather than in official documents of substance. Although following the 1990 EP Report, it was indirectly represented in AGENDA 2000, one of the fundamental financial documents of the 7-year perspective following the millennium, this lacked specific data and was mostly limited to mere references.

However, prior to the introduction of the EU corporate income tax, the administration in Brussels faces a plethora of issues to decide upon and of solutions to adopt. First of all, similarly to the case of the EU VAT, a uniform tax base should be established for this tax as well. Subsequently, decision needs to be taken regarding the scope of the new tax to be introduced i.e. which companies will be subject to the EU corporate

income tax on a mandatory basis.<sup>35</sup> As a further step, it should be determined what uniform rate to apply and whether this should replace the national corporate income tax for businesses within its scope or Member States should have the authority to levy a national corporate income tax in addition to the EU tax.

The corporate income tax as a potential EU tax candidate presents several problems. First of all, there is no consensus among Member States regarding the harmonisation of the tax base. On the other hand, the resource which the introduction of this tax would provide is neither sufficient<sup>36</sup>, nor relatively stable over time<sup>37</sup> for financing the EU budget or replacing current third or fourth resources. Contrary to Cattoir, I consider it important to stress that an EU corporate income tax would significantly improve transparency, because although it is only citizens involved in entities subject to payment of community taxes who would be directly affected by the tax, the entire society of the Union would become aware of operating the structure and perceive its extent. Obviously, this is not in conflict with the assumption that introducing an EU VAT rate which affects every citizen directly would also result in greater transparency. In the same manner, I wish to put only moderate emphasis on the extra ad-

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<sup>35</sup> In an extreme case, this could apply to all businesses, or a limited range of entities determined by some consistent logic. The limits of the scope may be set on the basis of size (sales revenues).

<sup>36</sup> Although the corporate income tax of Member States amounts to 2.6% of their GDP on average, which would be sufficient to provide the funds for the entire EU budget, if the new EU tax were to be introduced with a limited scope, it would already fall short of targets. [P. Cattoir, 2004]

<sup>37</sup> Various studies establish entirely different relationships in the course of their analysis of the same countries in terms of the connection between changes in the GDP and the rate of the corporation income tax (elasticity study), with only a few years' difference [OECD, The size and role of automatic fiscal stabilizers in the 1990s and beyond, Economics Department working papers, n°230, 2000; E. Albi, R. Paredes, E. Corona - Corporate tax as a possible fifth own Community resource: how much harmonisation is necessary?, 1997, European Commission Study ]

ministrative costs incurred by restricted introduction (affecting only a certain segment of businesses). One reason for this is the possibility of uniform introduction (without restrictions on its scope i.e. for all entities), whereas if the option of adding a national corporate tax to the EU rate is not taken into account (which would be rather difficult to carry out for political reasons), then introducing the tax will not impose any substantial administrative burden on budgets. Introducing the tax would clearly facilitate a more effective allocation of resources within the economic region of the EU and would contribute to both horizontal and vertical equity. This latter would be made somewhat more subtle by the fact that the corporate income tax would affect only a part of society. Taking the significant differences between the tax systems of various Member States into account, the revenues made available by introducing the new tax would not necessarily reflect the level of development of a given country.<sup>38</sup>

### **3.6.3 ENERGY TAXATION**

Essentially, two possible directions have emerged at the level of the Union for the introduction of an energy tax. One is the customs duty levied on the energy sources listed in the directive effective as of 1 Janu-

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<sup>38</sup> The presence of multinationals as well as the openness of the economy, both varying by country, could cause the volume of contributions to deviate from the amount that would be justified by the level of development of a given Member State. See BBQ.

ary 2004<sup>39</sup>, and the other is the duty levied on fuels used in transportation<sup>40</sup>.

Overall, the potential introduction of this tax has unquestionable advantages in terms of sufficiency, the effective allocation of resources, horizontal and vertical equity as well as low implementation costs. Contrary to Philippe Cattoir, I do not consider the question of transparency problematic, because although the issue at hand is indeed sensitive socially, European society is seen as one with a marked environmental awareness even from a global perspective. Finally, I am of the opinion that debates on implementation focus on implementation itself and the associated costs<sup>41</sup> rather than the criterion of transparency. Relating to the criterion of fair contributions, the fact that revenues from the energy tax vary by Member State<sup>42</sup> may create anomalies.

#### **3.6.4 EXCISE DUTIES ON ALCOHOL AND TOBACCO**

According to the 2003 paper by the Commission [Commission, 2003] analysing the 7-year perspective, tax revenues from alcohol and tobacco products amount to EUR 90 billion, corresponding to somewhat more than 1% of the GDP of the EU. However, as the EU tax rate would presumably be lower than that applied currently, the revenues from the EU tax would also be less than what is collected as part of the system of

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<sup>39</sup> Natural gas, coal, mineral oil and electricity

<sup>40</sup> Diesel, kerosene, LPG (for gas powered vehicles), etc.

<sup>41</sup> One such item adding to costs could be media expenditures on communication, for example.

<sup>42</sup> According to the 2003 paper by the European Commission, there might be differences of over 100% in the amount of revenues from the energy tax relative to the GDP.

each nation state. Accordingly, significant amounts could be collected in taxes levied on the two products, however, it is questionable whether it could replace current resources as intended. Due to the low price and GDP elasticity of demand<sup>43</sup>, the tax would provide a relatively stable resource in the event of its introduction. Transparency would not be as marked as with VAT for instance, while implementation costs would be increased by costs incurred by the indication of the EU tax content, on the other hand, horizontal equity would be ensured. Combined with vertical inequity, a medium level of transparency (the indication of EU tax rate) as well as a better allocation of resources would be ensured by the introduction of the new tax. As current rates of excise duty and consumption both vary by Member State, the correlation would not be strong between the volume of contributions received from each Member State and the ranking by Member States by affluence.

### **3.6.5 INFLATION TAX<sup>44</sup>**

The amount of the tax ‘levied’ on inflation would cover only a part of current resources intended to be replaced, what is more, the amount of revenues from the tax might also vary substantially depending on business cycles. This tax, being technical in character, would not really be visible to citizens, however, owing to the very same character, costs associated with its implementation would be low while fulfilling

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<sup>43</sup> Goods of low price elasticity.

<sup>44</sup> The official denomination in Cattoir’s article is: ‘Transfer of Seigniorage Revenue’

the criteria of both horizontal and vertical equity. The principle of fair contributions may be influenced by the fact that some Member States of the Union have adopted the single currency while others have not entered this stage yet. This could lead to some degree of difference between Member States.

### **3.6.6 TAXATION OF COMMUNICATION AND TRANSPORT**

A series of reports and professional papers conclude that owing to their uneven geographical distribution, various methods of maritime and rail transport cannot be considered as possible areas of taxation, as opposed to telephony as a method of telecommunication. With the first two, it is the harmonisation of existing national vehicle taxes and aviation taxes that needs to be achieved, while there is no prevalent national tax on telephony. This means that a uniform new EU tax would have to be introduced and all associated implementation costs would have to be taken into account as well. The grounds for the tax to be levied on telephony are far from solid, since apart from securing revenues, introducing a tax also involves a deliberate regulation of behaviour by the sovereignty levying the tax (whether a state or the EU). However, the EU by no means defined imposing restrictions on telecommunication as one of its objectives. With taxes to be levied on motor vehicles and aviation, the issue of the efficiency of regulation remains to be resolved. The fight against environmental pollution is steering thinking towards road tolls

and fuels instead of taxes based on property such as the registration tax. Also in the field of aviation, instead of the former tax to be levied on passengers, thinking has been focused on a tax based on polluting emissions.

The aggregate of the above potential resources amount to only a part of the current resources intended to be replaced, and the fluctuation of revenues collected through these taxes prevent them from becoming ideal. While the tax in question would improve transparency<sup>45</sup>, the collection system for the new tax to be levied on telephony has yet to be established, which does not qualify this tax among the cheapest potential taxes to be introduced. Although this type of tax fulfils the criteria of both horizontal and vertical equity as well as of fair contributions, it would by no means contribute to the effective allocation of resources.

### **3.6.7 PERSONAL INCOME TAX**

The personal income tax appears to be one of the most trivial direct EU tax. In the course of time, there have been several specific alternatives for its implementation. One such alternative was a personal income tax levied on every EU citizen at a uniform rate. A personal income tax assessed independently of income would disagree with the social sensitivity of all Member States to such a degree that this version has not been published by any expert as an alternative for years. A second alternative would retain income taxes currently applicable in Member States,

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<sup>45</sup> Transportation taxes as well as that levied on telephony would affect a large group of taxpayers and would obviously be possible to indicate to citizens who intend to use such services.

to which a fixed amount of EU personal income tax would be added for all citizens of the Union. With regard to the fact that unlike the systems used by Member States, the EU tax would not be progressive, serious political and social tension could be created.<sup>46</sup> Therefore, a refined version of this second solution would involve payment of a certain percentage of the national personal income tax the amount of which is different for every individual. Finally, a third solution is presented by a progressive system of EU personal income tax established in parallel with national systems.

Overall, the introduction of the EU personal income tax could become a leading solution in several aspects. The revenues that could be collected in personal income taxes are a multiple of the resources to be replaced. The EU personal income tax would ensure stable revenues, meet the requirements of horizontal and vertical equity, while representing a national contribution commensurate with welfare (GDP, GNP). While it does not have a significant impact on the optimal allocation of resources, practical problems could only be caused in the course of implementation by operating a parallel tax return system corresponding to the Quebec model<sup>47</sup> rather than adding the EU personal income tax to its national equivalent.

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<sup>46</sup> In proportion to their incomes and tax obligations, EU citizens with higher incomes who pay higher amounts in national personal income taxes would contribute less to the EU budget than their counterparts with lower incomes.

<sup>47</sup> In Canadian practice, the systems of federal and provincial tax returns are operated in parallel.

### **3.6.8 TAX ON FINANCIAL TRANSACTIONS**

Although in a growing number of Member States, taxes levied on financial transactions were gradually abandoned over the past two or three decades (by the Netherlands, Sweden and Italy in the 1990s and by Austria in 2000), a separate EU tax assessed on a similar basis is still considered by Brussels as an alternative.

The concepts explained in literature involve a tax on financial transactions assessed proportionately to the value of each transaction. Payments into the EU budget would be made either by financial market operators themselves or by supervisory authorities.

The tax on financial transactions presents several problems. On the one hand, due to the constant instability of financial markets, the resource is not to be considered balanced, while the amount of revenues that may be collected through this resource is also uncertain and can be approximated only with hypotheses. The EU tax on financial transactions, to be introduced instead of previously abandoned national taxes or levied in addition to similar taxes still in existence in some countries, would probably cause strong deviations in the financial markets. Referring to a study, Cattoir asserts that the level of sensitivity in financial markets is such that a tax rate of 0.1% would cause a 83% fall in the volume of transactions [CSF, 2001, p 50].

While the technical implementation of this tax does not appear to be much of a challenge because of its concentration to financial markets,

its visibility would be rather limited for the same reason. Even the interpretation of the question of fair contributions is difficult with this tax, as the growing intensity of integration in financial markets and the rapid and cross-border flow of capital are not making it possible for taxes collected from a particular financial market to be linked to a single Member State. I disagree with Cattoir's opinion that the new tax is a good means to ensure vertical equality. It is important to stress for instance that a certain proportion of shares are held by pension funds, therefore a tax on financial transactions would affect wealthy segments of society investing in shares as well as their less affluent counterparts. Regardless of the above, horizontal equity is attainable in the event of introducing the new tax, i.e. taxpayers in similar circumstances in different Member States would be subject to equal treatment following implementation.

### **3.6.9 CLIMATE CHARGE ON AVIATION**

In order to internalise the externalities of aviation, it appears logical to ask why the aviation tax could not be the new EU tax. Among others, aircraft pollute the environment through their emissions of CO<sub>2</sub> and various nitrogen oxides.<sup>48</sup> Given the dynamic growth of civil aviation, the area could be regulated most effectively by the International Civil Aviation Organization (ICAO), but with the differences in the values adopted by the signatories to the international agreement taken into ac-

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<sup>48</sup> This includes condensation trails and the impact on cirrus formation as described in literature.

count, this is not realistic for the time being. The lack of success of ICAO has been one of the EU's incentives to initiate inquiries into the possibility of assessing a rate first on fuels and later on the amount of harmful emissions. [Comission, 2001]

A possible EU tax on aviation would provide the Union with a fundamentally insufficient resource the availability of which would not be stable enough. According to Witt and Dings, calculating with a rate of EUR 30/ton, the tax collected would be less than 10% of the EU budget (around 6%), even with the growth of civil aviation over the period since the publication of the study is taken into account [Wit, Dings, 2002]. (The study was published in 2002, when the impact of 9/11 was still strongly felt in aviation.) The same authors draw attention to the fact that low implementation costs of the solution in question would be subject to the extension of the Route Charge System of Eurocontrol to the collection of the new tax. In addition to a more effective allocation of resources, the new tax ensures vertical and horizontal equity as well, since with equal treatment (horizontal equity), citizens with higher incomes contribute more to the EU budget through the greater frequency of their journeys.

### **3.6.10 WHICH CANDIDATE TO PREFER?**

In an overview of possible new taxes, it is important to underline the fact that there is no ideal candidate for the role of the new EU tax, as

all available solutions have advantages and drawbacks as well. Whatever good features a given candidate might have, the final decision concerning the choice of the EU tax(es) lies with policy-makers.

For the purposes of this dissertation, the introduction of a new EU tax would be especially significant. Not only because it would impact on citizens' relationship with the EU and bring about fundamental changes to financing the Union, but also because it would cause the main lines in the network of Member States' interests to be restructured. As a result of the 1984 Fontainebleau Summit, the British rebate will definitely have to be renegotiated, and the British Prime Minister is expected to enter this diplomatic bargaining with rather weak chances. This is partly due to the fact that even in 1984, Thatcher's deal was considered as exceptional treatment which no other Member State was granted ever since, and was the product of the Iron Lady's cold assertiveness and the unique political constellation emerging at the time. Today, no such situation is likely to emerge, nor is there a British Premier of similar capacities in charge, and nor would economic facts support an argument that was used 25 years ago.

In any case, the British rebate seems certain for years to come, as 7-year financial perspectives establish the key targets as well as the structure of the budget for a fixed period (revenues and expenditures). Additionally, such a fundamental restructuring of financing will by necessity be the outcome of a rather prolonged bargaining process, as the European

structure of interests, subtle as it was, has become more even more complex following the expansion of the EU in Eastern Europe.

## 4 FOOTPRINTS OF THE BBQ IN THE EARLY HISTORY OF THE EC INTEGRATION

The origins of Britain's budgetary problems go back to the origins of the EC treaties themselves. Agricultural issue was a key point of the BBQ, but also an important part of the negotiations and of the Treaty of Rome itself. **This section outlines the treaty basis of the issue.** It follows how the UK lost its influence on the continent, arriving at an isolated situation, while the continent entered a new phase with the Treaty of Rome that aimed at a wider and deeper integration of its members. The Treaty assured a general framework for the Member States and determined the main traits of the Community.

We can agree with Geoffrey Denton that the Council decision of 1970, set up the system of own resources [Denton, 1984, p 120] that made the Community more independent from its members. Since the EC does not possess an executive body to collect its receipts (custom duties, VAT, levies), the authorities of the Member States execute this task, keeping 10 per cent of their payments to cover their costs. [Community Budget, 1997, p 18]

It will be argued that the UK's absence from the early period of the process of integration ensured that it was not very likely to be able to affect the process. The BBQ can be originated right from the differences between the general characteristics of the EC outlined in this chapter and the specificities of the UK.

#### **4.1 THE CONFERENCE OF MESSINA AND THE SPAAK REPORT**

After the failure of the European Defence Community and the European Political Union in 1954, the Benelux countries took the initiative<sup>49</sup> to relaunch the European integration. They presented a Memorandum on European Integration to the other Member States of the European Coal and Steel Community. This memorandum was discussed at the meeting of Foreign Ministers held in Messina in June 1955. The declaration adopted in Messina envisaged the establishment of a common market. At the meeting they agreed that an intergovernmental conference would prepare the Treaty and that the preparatory work to it would be done in a Committee composed of the delegates of the different governments. The Committee was presided over by Paul-Henri Spaak, Belgian Foreign Minister. According to the Resolution adopted in Messina, the UK was invited to the preparatory work of the intergovernmental conference as associate of the ECSC and member of the Western European Union.

‘The Government of the United Kingdom, as a State belonging to WEU and associated with ESCS will be invited to participate in this work.’ [Salmon, Nicoll, 1997, p 61]

According to Salmon and Nicoll, ‘there is some difference of interpretation or recollection over whether Britain was pushed out or withdrew’ from the negotiations. [Salmon, Nicoll, 1997, p 61] However

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<sup>49</sup> Paul-Henri Spaak had a predominant role in this relaunch.

what is certain is that the UK was represented at a much lower level<sup>50</sup> than the other countries, which appeared to reflect its lack of commitment to the subject. At the meeting of the Foreign Ministers of the Six in Venice in May 1956 the Spaak Report was presented. The Report was accepted and unanimously recommended to the governments of the Six as the basis of the negotiation of a Treaty. The only difference between the Treaty and the Report is that the French demanded<sup>51</sup> that the overseas territories of the Member States could be included into the Treaty. It is an early example of how France could impose its national interest within the EC, in the absence of the UK. The UK was treated as a latecomer and had numerous disadvantages due to its outsider position.<sup>52</sup>

In the Spaak Report, a separate chapter was dedicated to agriculture, which steered midway between the different approaches in agriculture. In the early 1950s numerous plans<sup>53</sup> were put forward concerning the international organisation of agriculture. Among others, the British also had a plan put forward, the Eccles Plan, which rejected supranationalism in favour of international product agreements and an intergovernmental consultative conference. The competition between the

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<sup>50</sup>Russell Bretherton, an official of the Board of Trade was sent, whereas others sent their foreign ministers

<sup>51</sup> In practice, it almost meant the form of ultimatum.

<sup>52</sup> It is equally interesting to notice the parallelism of the relationship between France and her former colonies and that between Britain and the Commonwealth. Their fate was completely different and Britain had a lot more difficulty maintaining its old colonial cultural and commercial relationships with the Commonwealth than France with its territories. A large number of the French colonies gained their independence in the mid 1960s.

<sup>53</sup> Pflimlin Plan, which is also called the Green Pool; the Charpentier Plan; Mansholt Plan, see: J. Bourrinet, *Le problème agricole dans l'intégration européenne*, Paris, 1964

British and Continental models<sup>54</sup> was finally settled with the Spaak Report and later by the Treaty of Rome. It was another moment that the UK had lost its influence over continental (here also agricultural) issues. Conversely it showed French leadership could 'constitutionalise' its own initiative in the form of the Treaty, where the UK could no longer change the rules.

Though, the Treaty provisions aimed at the realisation of a common market, the problems of agriculture in Western democracies had not disappeared. Therefore, a common solution and a transitional period were required during which agriculture could be adjusted. It is important to underline that the Spaak Report laid down a number of fundamental questions, which required answers. Arguably the Treaty failed to give the right and detailed answers to them. Thus a large part of the future budgetary problem of the EC and later of the UK had their origins in this period.

The Spaak Report raised the questions of:

- the degree of self-sufficiency that the Community wanted to achieve;
- the price stability that the Member States wanted to maintain later,
- the size of the workforce in the agricultural sector and the speed and methods to transfer farmers to other occupations;
- family farm size and their capability to develop and implement new and efficient methods of production.

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<sup>54</sup> It was characterized by strong supranational elements

The Report had envisaged market regimes introduced for only a limited number of products on the basis of product specific problems and their importance to farmers' income. It also warned that it would be necessary to avoid the realisation of a vast area protected against third countries coupled with an unrealistic price level. [Fennell, 1997, p 13]

The Foreign Ministers of the Six in Venice discussed the Report in May 1956 and although important issues remained unsolved, as stated above, the draft was agreed and the Treaty signed in the following year. There were certain hesitations among the Member States during the negotiations concerning the incorporation of the agricultural sector into the Treaty. It was indeed included at the insistence of France. General De Gaulle, who was out of office when the Report was agreed, described the inclusion of agriculture and the French commitment to achieve this purpose as follows:

‘...However, this Treaty which was complete and precise enough concerning industry, was not at all so on the subject of agriculture, and for our country it had to be settled. Indeed it is obvious that agriculture is an essential element in our national activity as a whole. We cannot conceive of a Common Market in which the French agricultural world would not find outlets in keeping with its production ... In other words ... we were led to impose the entry of agriculture in the Common Market

as a formal condition ... but very difficult and very complex arrangements were needed....<sup>55</sup>

## **4.2 PROVISIONS OF THE TREATY AND THE CONFERENCE OF STRESA**

From the point of view of the BBQ it would be irrelevant to analyse all the articles of the Treaty concerning the agriculture because their impact on the BBQ is quite indirect and partial. This dissertation will therefore merely outline firstly, the contradictions that were built into the Treaty under Article 33.1 (ex Article 39.1), which enumerates the objectives of the CAP, and, secondly, the fact that provisions had not been made for the CAP at the moment of the drafting of the treaty. The chapter will also scrutinise the reasons behind them, and establish up their relevance from the point of view of the BBQ.

The Treaty specifies in Article 3.1 (ex Article 3.1) the tasks, activities of the Community saying:

‘For the purpose set out in Article 2 (ex Article 2), the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

(e) a common policy in the sphere of agriculture and fisheries’

[Foster, 2000, p 2]

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<sup>55</sup> See the complete text in the Annexes. Speech of President De Gaulle at the Press Conference on 14 January 1963

The Treaty itself contains its agricultural-related provisions as Articles 32 – 38 (ex Articles 38-46) under title two of the second chapter. All provisions concerning agriculture but not mentioned in this chapter are enclosed in the dissertation as annexes. The most important provision concerning the CAP is Article 33 (ex Article 39), which lists the objectives of the CAP.

‘1. The objectives of the common agricultural policy shall be:

(a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in a particular labour;

(b) thus to ensure a fair standard of living for agricultural community in particular by increasing the individual earnings of persons engaged in agriculture;

(c) to stabilise markets;

(d) to assure the availability of supplies;

(e) to ensure that supplies reach consumers at reasonable prices.

2. In working out the common agricultural policy and the special methods for its application, account shall be taken of:

(a) the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between various agricultural regions;

(b) the need to effect the appropriate adjustments by degrees;

(c) the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole.’[Foster, 2000, p 9]

Most of the authors (Ritson, Harvey, etc.) agree that during the drafting and negotiation of the Treaty, agriculture did not seem a top priority. A working group was not even set up during the meeting of the future Member States delegations at the negotiation of the Treaty. It shows quite well, that the heads of governments were excited by the realisation of the EC, but that agriculture represented only one field out of ten sectors to be integrated. They did not want to be held up by such sectoral issues that seemed to be of partial importance compared to the scale of the whole project. Thus, as one would expect with a formal treaty, the Treaty of Rome lists the objectives and general goals but does not specify the means by which they should be achieved.[Ritson, Harvey, 1991, p 25]

In line with other authors in this field, Krause draws attention to the contradictions laid down in article 33.1 of the Treaty (ex Article 39.1). For example, ‘The desired increase in agricultural earnings could come either from increased productivity, which would in practice require a drastic disregard of structural problems in the member countries, or from higher product prices, which would disregard the consumer interest’ [Krause, 1968, p 89]. Indeed a ‘fair’ standard of living for farmers could not be reconciled with the insurance of ‘reasonable prices’ for the consumers. Only Article 34 (ex Article 40) provides vague references

and guidelines to policy instruments. The same article<sup>56</sup> also contains a reference to the budgetary aspect of the CAP, the creation of funds to finance the CAP. Nevertheless, it is important to underline that the signing of the Treaty in 1957 did not lead to a Common Agricultural Policy immediately. It was not until the mid 1960s that CAP took its ‘definitive’ form.<sup>57</sup>

Almost all the work concerning the CAP was postponed after the Treaty came into force. The founders were aware of the fact that the CAP had to be worked out and refined much more. Therefore the Commission was given the task of convening a Conference immediately after the Treaty came into force to compare the different agricultural policies of the Member States and within two years submit proposals after consultation:

Article 37 (ex Article 43) states:

‘1. In order to evolve the broad lines of a common agricultural policy, the Commission shall, immediately this Treaty enters into force convene a conference of Member States, with a view to making a comparison of their agricultural policies, in particular by producing a statement of their resources and needs.

‘2. Having taken into account the work of the Conference provided for in paragraph 1, after consulting the European Economic and

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<sup>56</sup> The article is included in the annexes: ‘Articles of the Treaty of Rome Concerning Agriculture’

<sup>57</sup> This form represented the first and basic form of the CAP that went through modification after that the BBQ was settled.

Social Committee and within two years of the entry into force of this Treaty, the Commission shall submit proposals for working out and implementing the common agricultural policy, including the replacement of the national organisations by one of the forms of common organisation provided for in Article 34 (1), and for implementing the measures specified in this Title.’

The conference was held in Stresa, Italy between the 3<sup>rd</sup> and 12<sup>th</sup> of July 1958. Although the agreement reached was not legally binding, it offered a clearer view of the prospective CAP than the Treaty. Like the Treaty it was a declaration of objectives but lacked detailed specifications, which would have been very important for the possible implementation of the CAP. This lack of further precision was due to the disagreement between the participants of the conference. The compromise arose from Commissioner Mansholt, who was responsible for agriculture. Mansholt himself and most of the representatives of the Member States had further doubts about many issues. These doubts also appeared in the Commission’s report that followed the Conference in which it outlined these views concerning the CAP. The relevance of this report is that it proves that already at the birth of the CAP, the CE was aware of the major possible future problems. Furthermore, these threats were almost the same as those concerning the BBQ.

The report considered as its central problem the inequalities between the farmers’ income and the income of those working in other

sectors. It underlined the importance of maintaining commercial relationships with third countries that meant that the Community should not become 'self-sufficing entity'. And thirdly, it warned of the potential dangers that price support could have and the production of surpluses. [Commission of the European Communities, 1958, p 67-72]

The CAP to some extent represented a trade-off between Germany and France. [Harris, Swinbank, Wilkinson, 1983, p 36]. The French rejected entering a common market where agricultural products were not included.<sup>58</sup> In the future West European integration the only strong partner for France to bargain with was Germany as the UK withdrew from the negotiations earlier and later in the 1960s, De Gaulle vetoed its accession twice to insure the absolute respect of French interests<sup>59</sup>. By 1957 Germany had become an important industrial power however, it still had a significant agricultural sector. As France had a comparative advantage over Germany in agriculture but not in industry, the two countries settled a deal in the form of the Treaty of Rome in which France gained access to the German market for its agricultural products and Germany gained access to the French market for its industrial products.<sup>60</sup> The concept of a CAP was incorporated into the Treaty of Rome, although the details were not worked out. It contained broad

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<sup>58</sup> See De Gaulle's statement at the Press Conference of 1963 in the Annexes

<sup>59</sup> In his press conference of 1967 De Gaulle emphasised that the UK has to adopt the whole agricultural regime with the membership: '...whether Great Britain can ... cease any pretence that her agriculture be privileged...' (See Annexes)

<sup>60</sup> France intended to maintain political leadership in the EC since Germany was an economical giant but a political dwarf.

objectives and general means. The CAP was only one sector of co-operation out of ten, and was much less important at that time than later. Problems emerged in Stresa, where a compromise was made, but the outcome was once again a general document [Ritson, Harvey, 1991, p 27]. However, the Member States and the Commission had already been aware of the major problems and threats to the CAP. Most of the problems and threats, like the relationship with third countries (in the context of the BBQ, with the Commonwealth), the price support or the production of surpluses (in the context of the BBQ, the budgetary burden of the CAP on the EC budget and on the economies of the non-agro oriented Member States) reappeared in the BBQ and had their origins here in 1957. Finally, it must be stressed that at the same time the UK concentrated on the world market and its relations with the Commonwealth countries it lost all possible influences in the shaping of the EC or the CAP. The CAP's share of the EC budget increased rapidly in the second half of the 1960s, reaching its climax of 86.9 per cent in 1970. [The Community Budget, 1997, p 32]

## 5 ORIGINS OF THE BBQ IN BRITISH SPECIFICITIES

In the first part of this chapter I will proceed with an analysis of the development of the **British-American ‘special relationship’** as well as the development of the increasingly strong European integration of the UK paralleling the marginalisation of the aforementioned ‘special relationship’. The US-English ‘special relationship’ accompanied Great Britain's heydays and its gradual ‘downfall’. Parallel to the USA's continuous rise, the UK came to be the exact counterpart. UK history is predominantly about the way in which a declining country, which is being gradually reduced to become a middle-sized power, seizes every possible opportunity given according to its own interest. A former world power and capitalist ‘model country’, Great Britain had not just been reduced to a middle-sized power after 1945, but to a European middle-sized power. I do not use ‘European middle-sized power’ in a pejorative sense, just to indicate that this does not equal the status of a global middle-sized power anymore.

The second part will analyse questions of **British sovereignty**. British sovereignty with its characteristics being so different from its continental counterpart was making integration only more difficult. Even though it is not the basis of the BBQ, it is however an unevadable factor for the analysis of UK's compatibility with Europe.

In chapter three I will examine the **specific problems arising from the unique character of British agriculture** in comparison to the continental, especially the French agricultural sector and trade. Apart from the sensitive issue of sovereignty and the increasingly indirect transatlantic relationship, agriculture is one of the key factors of the BBQ. This is why this chapter - just like the last one focusing on the **free trade structure** - is amended by a comparative analysis.

## **5.1 THE EUROPEAN MIDDLE-SIZED POWER AND THE 'SPECIAL RELATIONSHIP'**

**Motto:**

**'I tend to regard the United States as Europe overseas, which is certainly true to a great extent.'**  
**/Margaret Thatcher/**

**'For us European unity is what it has always been — not an end in itself but a means to the strengthening of the West. We continue to support European Unity as a component of broader transatlantic relations'**  
**/Henry Kissinger/**

Because of UK's geographical position, British history mainly mirrored European history.

In the 15<sup>th</sup> and 16<sup>th</sup> centuries European countries at coastal areas of the Atlantic were rapidly getting wealthy as a consequence of the conquering expeditions. The golden era of Spain and Portugal dawned. In spite of the enormous geographical distances Europe's supremacy was becoming more and more evident (carving up the world, colonisation, opening up of Far-Eastern countries. Until the second half of the 19th century and the beginning of the 20th century Europe had become the unquestionable global hegemonial power. In 1800 European powers were ruling over one third of the mainland, in 1878 this number had risen to two-third and by 1914 already to 84%.

The Atlantic relationship had started out as one between a strong European trading nation and a colony. The dawn, golden age and downfall of the 'Pax Britannica' was inseparably connected to the faith of Europe and also developed in line with the special relationship.

By the time of decolonisation in the 1960s UK was already struggling as not more than a European middle-sized power to overcome its economic and political problems. At the same time, neighbouring Europe was living its golden age (*les années d'or*) and was 'towering' over the island with its economy strengthened as a consequence of economic integration. At this stage the 'special relationship' with the USA, which had existed before already, was becoming increasingly important to Great Britain.

The term ‘special relationship’ is not formally binding. Nixon and Churchill used to call it the same as I do in my dissertation, however Wilson used the term ‘close relationship’ and the Iron Lady preferred ‘extraordinary alliance’.

It was an unusual constellation for a special relationship to develop between the antagonists of an economic war. The USA had entered the stage of ‘official’ history as a insurgents against England. This special relationship rested on three pillars. The first pillar was a common heritage of ideology and mentality, the second the frequent correlation of interests and the third the intelligent, ‘intimate’ diplomatic relations intensified by personal relationships. All this was complemented by common roots regarding history, culture and language. I shall proceed with an analysis of the historical changes and different forms of the special relationship in order to be able to draw conclusions relevant for the BBQ at the end of this chapter.

One of the most important moments which has to be mentioned in connection with this relationship is the war against Napoleon. During these wars England came to appreciate the role of the USA in an entirely new way, since the US had remained practically England's only neutral trading partner. Until the 1800s the relationship had however developed into mutual dependence. The USA served as a market for sophisticated industrial products and supplied England with raw material.<sup>61</sup>

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<sup>61</sup> At that time the majority of immigrants came from Europe and most of them from England.

As the Spanish colonies were becoming independent, Great Britain supported the USA in the Spanish-American War<sup>62</sup>The relationship of the two countries was however drastically kicked out of balance by the enormous credits granted by the USA during World War One. England's 'splendid isolation' after the world war and war expenditures, its economic amortisation on the one hand and the still intact US economy and military on the other irrevocably created a disequilibrium between the two states. The United States was the only country to emerge from the war than it had been before. In spite of common military operations, research and agreements, President Truman would not share the secret of the atom bomb with his British allies after the war. Only later on, when he realised how useful a new base would be for the US from a strategic point of view, did he give out the documents in exchange for British uranium ore. The events of the Cold War<sup>63</sup>, put the two countries back again in the same boat.<sup>64</sup>

The basis for the post-war reconstruction of Great Britain was provided by the 2.4 billion USD from the Marshall Plan. (Out of 16 billion USD all together.) The forerunner of the OECD, the CEEC (Commission for European Economic Cooperation) which had the task to allocate aid from the Marshall Plan was founded under the leadership of British Foreign Secretary E. Bevin.

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<sup>62</sup>, whereas the USA supported England in the Boer War on the principle of reciprocity.

<sup>63</sup>, which had been set off with the speech at Ful

<sup>64</sup> With the proclamation of the 'Truman doctrine' the containment of Communism became the common goal for politicians from both countries.

After the Treaty of Brussels no independent European defence system could be established. The English were not really bothered by this fact, since they could only conceive of the protection of Europe within a Euro-Atlantic system. The creation of NATO in 1949 provided an additional framework for deepening the already strong military ties (joint Berlin Airlift - international success).

The balance within the 'special relationship' was increasingly shifting. A symbol of the loss of power and prestige by Great Britain was the 'handover' of territories under British influence in the Pacific Ocean. In 1951 UK faced another loss of prestige when the USA, Australia and New Zealand signed the ANZUS-Treaty. The establishment of the military alliance in the Pacific could be interpreted as the US's expansion of the 'Monroe Doctrine' to the Pacific region.

British national pride for the Empire again suffered a serious blow in connection with the 1956 twin crisis when President Eisenhower forced British powers to retreat and referred to Britain's reaction as 'old-fashioned imperialist aggression'.

After having reached the nadir, Great Britain requested its accession to the EEC in 1963.

The veto by De Gaulle and the Elysée Treaty<sup>65</sup> further aggravated the situation of the Island, which had just reoriented itself towards Europe.

American-English relations were revived soon however. Hysteria resulting from the launch of the first Sputnik by the USSR and the European veto brought the two countries together again. The Nassau Agreement irrevocably aligned the British nuclear arsenal with the US and by this the island became the European outpost of the superpower. The second veto against the accession of UK, the ‘Trojan horse of America’, to the EU by De Gaulle was soon to follow. He commented his veto as follows:

‘As to the current state of affairs, this is absolutely impossible.’

At the same time, the concept of ‘Atlantic Partnership’ emerged in official US foreign policy, which did not denote an American relationship anymore, but came to comprise a US-European relationship.

When UK announced the ‘East of Suez’ policy, which meant the end of British military presence east of the Suez channel, it gave up one of the last of its positions as a world power.

The neo-conservative turn which had started in the 1970ies and reached its peak in the 1980ies emerged as an identical phenomenon in both countries. The aforementioned ‘intimate’ diplomatic relations and personal sympathy between the leaders of the USA and England brought

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<sup>65</sup> Chancellor Adenauer and President De Gaulle ratified the so called Elysée Treaty in Paris on economical and political co-operation between France and the FRG. This led to the emergence of the ‘European special relationship’, ‘Europe’s strangest marriage’.

back the transatlantic relationship which had seemed to be doomed. Reagan and Thatcher, who forged a pact against the Evil Empire, were sceptical about the idea of European union and rather opted for an ‘Anglo-Saxon concert of powers’. Thatcher and Reagan really had an outstanding relationship, even if the Iron Lady commented on it as follows:

‘ We knew that Ronie didn't have much between his ears, but we still liked him a lot.’

Many different factors contributed to the steady but periodical decline of the ‘special relationship’. Two important factors of these were the changes and shifts of balance in politics and economy.<sup>66</sup> There were however also so called ‘soft’ elements leading to a weakening of relations. Pristine demographic trends had changed: The ethnic composition of the USA was not anymore coined by immigrants from Europe or England, but rather by those from Asia (41%) and Latin America (42%).

Acheson was right in warning against overestimating the significance of the ‘special relationship’ which could blur Great Britain's vision of the current world political situation. This situation required UK to recognise and admit the limitation of its power to Europe.

The analysis of the special relationship leads to following conclusions:

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<sup>66</sup>US-EC relations had already become more important for the US than the ‘special relationship’.

1.) The internal structure and balance of British-American relations was gradually shifting and turned around. Originally dominated by the British, the relationship gradually became balanced and later on the USA clearly took over the leading position. (This transition was demonstrated well in the political-economic overview.) Concerning the BBQ, the latter is more relevant, however it is interesting to see how the two factors separated.

2.) Due to the abovementioned restructuring and periodical shifting of the special relationship it was going through a rather weak phase after the 1956 crisis. This could have influenced Great Britain to reorient itself towards Europe.<sup>67</sup>

3.) The special relationship, which had originally been restricted to Americans and British, was 'passed on' to the EC after UK's accession. (The EC has taken UK's place in some ways.) The special relationship - or at least its economic aspects (intensive trade) - was slackened just like the one with the Commonwealth after the accession and contributed to the emergence of the BBQ.

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<sup>67</sup> The Habsburg Empire's turn towards Hungary after Bismarck's victory (just before the Compromise of 1867) might serve as an interesting historical analogy.

## 5.2 BRITISH SOVEREIGNTY

**'The customs union is not to be taken as homeland and mutual interest in milk prices will not constitute a state in itself.'**

**/Le Monde, 24 January 1966/**

The question of British sovereignty is indirectly linked to the BBQ. Just as a doctor or a psychologist would not examine their patients looking at their problems isolatedly but would take antecedents and hereditary factors into consideration, I believe that it is not enough to examine specific, individual features of British history. I consider the in-depth analysis of the question of British sovereignty to be indispensable. The short comparative analysis of the field of sovereignty proves clearly that the same event - namely being forced to give up sovereignty partially - does not evoke the same effect in two countries.

For the citizens and political leaders of the former empire the accession to the EC was not easy to digest, since this meant the complete abandonment of the independent, sovereign path of the empire and also meant that they had to give up the relations of the empire almost completely. The scope left by political reality after having joined the EC did not anymore allow for the upkeep of reflexes of the former empire. However, it is interesting to compare the national reactions of France and Britain to the loss of their position as an empire. Whereas France had the

possibility to shape the structure of this new form of integration, Great Britain renounced this chance, but did still do better on the international stage than France in giving up its position as an empire.

On the peak of power, the British world empire was an open, liberal trading nation. Due to the gradual loss of power however, it withdrew into a certain kind of isolation. Instead of being the hegemonial power of global economy, it chose to become the hegemonic power of its own empire and the Commonwealth. At first it did not have to face any challenges there. This position of a 'local hegemonic power' was first shaken in the 1960ies by the anti-colonialist movements. Both the traditional, open free-trade mentality and trade relations with the countries of the British Commonwealth became fundamental factors for the BBQ . This did not only mean a budgetary burden for the country, but also a social problem: being forced to give up the free choice of the prevailing economic structure as well as the relations with the Commonwealth meant a serious blow to the sovereignty of the former empire. (I will analyse arguments connected to free trade in further detail in my chapter under the same title.)

The transatlantic special relationship and the accession criteria of the EC meant the inception of a new era, the era of interdependence for Great Britain. When Great Britain signed the Single European Act, which aimed at deepening integration, they did not realise what kind of

sovereignty transfer this process - including the Maastricht Treaty - would actually require.

But why is sovereignty such a dramatic issue in UK and in the BBQ? Several factors played a role in that. First of all, we have to look at how this sovereignty had developed. While on the continent sovereignty developed within the framework of and in concordance with monarchy, in Britain it emerged in a long struggle for power between the king and parliament and was finally embodied in the institution of the Parliament. The gradual transfer of national sovereignty to Community level was less of a problem for countries on the continent than for UK. British sovereignty is embodied by the Parliament amongst others. There is no homogenous national identity in the UK, but rather - true to its name (United Kingdom) - separate Welsh, Scottish, English and of course Northern Irish identities. Thus, the transfer of sovereignty shook the well established British system much stronger than continental countries which may serve as comparison.

There is no better way to illustrate the sensitive character of British sovereignty than the British refusal to introduce the common currency, according to Balassa the fourth step of European integration, which is the establishment of the European Monetary Union. According to Margaret Thatcher the Pound Sterling is the guarantee of British sovereignty.

For the English, who had opted for Common Law, a product of a specific historical development, it was not easy to accept the codified Community law which did have elements of case law, but was still rather like continental law. (Britain does not even have a written constitution, there is only a collection of cardinal laws. The recognition of the supremacy of EC-legislation, vastly different from Anglo-Saxon legislation, again was a fundamental turning point for British sovereignty.

Thus, it is clear that British accession had a number of elements which fundamentally effected Great Britain's sovereignty and also indirectly effected the emerging BBQ.

### **5.3 THE SPECIAL ROLE OF AGRICULTURE**

**‘Agricultural policy in developed and developing nations is a tangle of contradictions. Throughout the world, governments have one foot on the accelerator and the other foot on the brake – simultaneously encouraging and discouraging increased farm production.’**  
**/World Bank Report 1990/ [Knudsen, Nash, 1990]**

In this chapter I will analyse a field which is connected to my topic more immediately and directly than sovereignty: agriculture as a factor leading directly to the BBQ via the position as net contributors.

The difference between the continental and the British agricultural structures was one of the major elements of the British Budgetary Question. The continental agricultural model took form in the CAP on French initiative, which was based on the guaranteed price mechanism, which resulted in a far higher food price level compared to world market prices. The British ‘deficiency payments’ [Brassley, 1997, p 119-20] model was a mixture of the free-market model of the pre-war period and a farmers subsidising system. The difference between the continental and the British model was that the first one subsidised its farmers through high food price level, while the second one compensated farmers by paying for the difference between the average market price and the guaranteed price. The complete adaptation of the agricultural acquis by Britain was a major issue in De Gaulle’s veto<sup>68</sup>. In 1973 the UK became a member of the EC and adopted the CAP regime. However, this adaptation caused severe losses to the UK through its contribution and receipts of the EC budget. The BBQ, which was to a great extent an agricultural problem remained a determining factor until its settling in Fontainebleau in 1984.

When the Common Agricultural Policy had been set up it represented a new common policy to be implemented in a unified manner in the different Member States of the EEC. These countries obliged

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<sup>68</sup> ‘...to bring Britain into the Community without her being really bound by the agricultural regulations by the Six would amount automatically to disrupting the system ...’ See: President De Gaulle Press Conference 1967 in Annexes

themselves to respect the CAP principles not only in their internal relationships but also in their external ones.

However, to have a clearer view of the CAP it is important to see that it was a child of its time and it had to be assessed accordingly. Its motives, logic, and structure cannot be understood without the agricultural context of the aftermath of World War II. These post-war conditions had not changed radically by the time the CAP was set up, whose structure therefore reflected those priorities. As time went on, the international economic and political conditions changed but the CAP's structure remained almost unchanged during the following decades.[Ritson, Harvey, 1991, p 36] Thus, the CAP gradually was tailored to the prevailing economic conditions while its form became more and more questionable.

However, it is important to understand that despite the sustained level of general economic expansion and the technological revolution of the 1950s and 1960s<sup>69</sup>, the sector itself was dominated by wartime experiences and the short-term difficulties of the agricultural sector of each Member State. Despite the general belief that the CAP was designed to favour and was beneficial to the farmers' community of the Member States it is important to emphasise that it is only partially true. The governments' intentions in this period were to ensure food supply to their

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<sup>69</sup> In the French terminology, this period is characterized as "les trentes glorieuses". It refers to the economic and technological expansion of the aftermath of the post-war period.

countries and increase the domestic food consumption to restore the pre-war conditions.

### **5.3.1 TENDENCIES OF FOOD SELF-SUFFICIENCY**

WWII and the following events led the governments in Western Europe to move towards self-sufficiency in the agricultural sector. There were two main motives. The first was the intention of restoring a stable food market. The second was the insurance of food supply that emerged as a new national security matter after WWII.

The first motive, namely the restoration of the food market, was twofold: on the one hand, to improve the food supply for the well-being of the whole society and on the other hand, to raise the general consumption of the population that fell down considerably during WWII. To improve the food supply there were two options available to the national governments. Firstly, importing it from foreign markets and secondly insuring the necessary quantity from the internal agricultural production of the country. The first solution was generally limited in size due to the shortage in foreign currencies notably the dollar since the value of imports exceeded the exports. Thus, the governments were immediately confronted by the problem of balance of payments. As a possible remedy to this dilemma the European governments had a general reaction of adopting the policy of producing as much as possible at home. [Fennell, 1997, p 2] The intention to increase self-sufficiency in

agriculture thus seemed to be the appropriate solution for two reasons. Firstly, because the increased domestic production could reduce and in many cases replace the imports and, secondly, because surpluses that could be sold abroad had a beneficial effect on the balance of payments.

The second motive, the insurance of food supply, originated from the bitter wartime experiences [Brassley, 1997, p 118]. By the mid 1950s the initial difficulties had passed, food supply became almost adequate and the level of consumption was satisfactory. However, in the Cold War climate with political tensions among the opposite camps wartime experience was even more exemplified and sustained the argument of producing as much as possible at home.

### **5.3.2 CHANGES IN THE INTERNATIONAL ENVIRONMENT**

As mentioned above tendencies of the aftermath of WWII inspired the governments to adopt the strategy of self-sufficiency. Nevertheless, conditions of the world food market changed gradually in terms of supply and demand, as world agricultural production improved considerably.<sup>70</sup> As a result of the increase in farm commodities supply the prices fell on the world market. With the general improvement of national economies new potent demand emerged. [Grant, 1997, p 63-8]

Regardless of the above-enumerated improvements compared to the after war situation their immediate impact on the agricultural policies

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<sup>70</sup> The agricultural supplying regions expanded significantly in North America for instance and elsewhere

in Western European countries remained insignificant. The logic of balance of payments for supporting domestic agriculture has been used long after it could be deemed rational. Nevertheless, it has to be admitted, that the possibility of a possible nuclear war from the 1950s modified slightly the aspect of food security.

### **5.3.3 FARMERS' INCOME AND THE END PRIZE GUARANTEES**

Parallel to the economic restoration of Western countries the average income level increased. Although, it was a general phenomenon, this increase did not affect all sectors the same way. While in the industrial and in the service sector income levels increased rapidly, the agricultural sector did not reflect the same result. The majority of the farms were small in size with low yield, producing the bare necessities for the farmers and their families with a small surplus to sell.[ECE/FAO, 1954, p 18]

The labour market in the 1950s was characterised by a contradictory problem. While rural areas struggled with unemployment partially due to seasonal employment in the sector, urban regions were experiencing a shortage in labour supply. Intra-state migration could seem a logical solution. However, those working in the agricultural sector were unsuited for the employment opportunities in the urban regions.

Governments aiming to raise farmer's incomes and to stabilise prices opted for a combination of means. They tried to raise end-prices for agricultural products and thus ensure higher incomes for farmers and at the same time to keep the inflation rate at a politically acceptable level. These means included external customs tariffs, quantitative restrictions, minimum import prices, variable levies, and state trading, internally stockpiling, guaranteed or fix prices, input and consumer subsidies. [Fennell, 1997, p 6]

#### **5.3.4 COUNTRY SPECIFIC APPROACH**

This section is dedicated to the brief analysis of the Six and the UK from the point of view of their agriculture, the differences which contributed to the UK's hostility to the CAP, which did not reflect its interest, and also led to low receipts for the UK from the EC budget. The six founding countries of the EEC had all different agricultural sectors with diverse characteristics and interests, but nevertheless had several things in common. Before analysing the provisions of the Treaty it would be useful to cover the different characteristics, motives and the logic [Gardner, 1996] behind them. These country specific factors have been regrouped in the following table:

**3. Table: The situation of the agricultural sector of the Six in the 1950s**

	France	Germany	Italy	Belgium	Luxembourg	Netherlands
<b>Farm size</b>	Small	Small	Small	Small	Small	small
<b>Land quality</b>	Relatively good	Scarce	regional disparities	Scarce	Scarce	scarce
<b>Efficiency in the sector</b>	Low	Low	very low	Low	Low	medium and constantly improving
<b>Farmers income</b>	Low	Low	Low	Low	Low	low
<b>Government intentions</b>	improve the balance of payments	ensure self-sufficiency	improve the balance of payments	improve the balance of payments	improve the balance of payments	ensure efficiency and liberal trade
<b>Farmers' society size</b>	Large	Large	Large	large	relatively large	large but decreasing
<b>Government intention</b>	maintain the farmers' number high	maintain the farmers' number high	maintain the farmers' number high	maintain the farmers' number high	maintain the farmers' number high	intended to decrease the farmers' number
<b>Agro-importer /exporter</b>	agro-importer	did not want to be agro-importer	agro-importer	agro-importer	agro-importer	exporter
<b>Market protection</b>	Strong	Strong	Strong	strong	Strong	weak
<b>Country specific element(s)</b>	- political instability of the Fourth Republic - hopeless farmer society	- government programme for retraining farmers - positive belief among farmers and politicians - political stability, Agriculture Act - shortage of labour force in other sectors	-strong regional disparities between South and North - increased need for land reform	- harmonisation of the agricultural policy within the Benelux -underemployment on the overpopulated farms	-harmonisation of the agricultural policy within the Benelux	- efficiency - intended decrease in - the farmers' society - government program for retraining farmers - exporter - harmonisation of the agricultural policy within the Benelux
<b>Attitude to the incorporation of the CAP into the Treaty of Rome</b>	extremely strong lobbying	certain hesitation	certain hesitation	certain hesitation	certain hesitation	certain hesitation

Source: author's own scheme deriving from other sources used in this chapter (Rosemary Fennel, Wyn Grant, Christopher Ritson and David Harvey)

**France** had a leading role in the incorporation of the CAP into the Treaty of Rome as it was detailed in chapter 4. After WWII the French government did no more than erect a protective wall for the agricultural sector. The lack of a coherent internal policy and the chaotic political conditions of the Fourth Republic led to a stagnating market and a hopeless farmer society. The main dilemma of the frequently changing governments was that they wanted to raise the agricultural production to increase exports in order to resolve the problem of the balance of payments; and at the same time they desired to keep consumer prices and inflation low. Yet they were afraid that increased farming output could lead to an over-supply resulting in unsaleable stocks both at home and abroad, and consequently to a fall in farming incomes. The OEEC characterised the French situation as follows:

‘...The present size of the agricultural population and its distribution over a large number of small, non-specialised holdings which in most cases cannot provide the funds for essential investments, suggest that no rapid increase in the average level of productivity and no substantial reduction in production cost can be regarded as likely.’[OEEC, 1956, p 65]

France had traditionally a significant agricultural sector and intended to become a net exporter of agricultural products. The country also suffered from imbalances of the workforce between the three

sectors. Nevertheless, a large number of farmers was socially desirable at that time.

While Germany played a crucial role in directing the Community's industrial policies, the French government and the French farm lobby were of crucial importance in the establishment of the CAP. France ensured with the CAP an outlet for its agricultural products in Germany. As the following table illustrates the French had a predominant role in the agriculture of the EC. It represented over 45 per cent of the Six's total agricultural area and gave around 40 per cent of the total food production of the Community. It was by far the biggest exporter of agricultural products.[Clerc, 1979, p 353-63]. The CAP through the French agriculture was the most important driving force behind the economic growth of the EC in the 1960s. [Ritson, Harvey, 1991, p 35]

**4. Table: Agriculture of the Six**

	France	Italy	Germany	Netherlands	Bel-Lux
Total arable area (sq.km)	346.330	209.650	143.320	23.100	18.720
Proportion of EC arable area (%)	46.7	28.3	19.4	3.1	2.5
No. employed in agriculture (m)	3.7	5.0	3.0	0.4	0.2
Proportion of total EC workforce (%)	9.0	25.0	11.0	10.0	20.0
Proportion of EC food production (%)	39.4	26.3	23.0	6.4	4.9

Source: adapted from De La Mahotiere and Lindberg quoted in *The Common Agricultural Policy and the World Economy*, edited by Christopher Ritson and David Harvey, CAB International, 1991

Another specificity of France was that its farmers were not committed to any particular political party or doctrine, they were floating voters. [Tangermann, 1980]

**Germany**<sup>71</sup> in contrast had an early objective, to increase the labour productivity in farming. It was triggered by the fact that other sectors tended to attract workers from the farming sector due to the economic boom and the shortage of labour in the two other sectors (industry, services). Compared with France, the interconnectivity between the two sectors was much higher. As in France, the increase of agricultural production was a major concern for the German government, the logic behind it was absolutely different. Instead of the export-import consideration, they only intended to ensure the food supply for the population and insure self-sufficiency. Their vision of the future and of their respective countries were entirely different. The German Government did not wish Germany to become an agro-exporter country but rather a highly industrialised one. Whereas, the farm structure was far worse in Germany than in France, the positive desire among farmers and politicians to change the situation was quite general. Hence, as a result of political stability and the positive atmosphere the Bundestag passed a general Agricultural Act in 1955. [OECC, 1957, p 90]. The German objectives laid down in this Act were very similar to Article 39 of the Treaty of Rome. This reflects the fact that Germany had an important

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<sup>71</sup> Meaning, here, the Federal Republic of Germany (FRG)

contribution to the realisation of the CAP. As Wyn Grant stressed, the establishment of the Common Market was to ensure that German manufacturing exports had access to the French market and that French agricultural exports had access to the German market, in other words one might think that Germany was prepared to sacrifice the interests of its farmers to advance the interests of its manufacturers. [Grant, 1997, p 63]

Agriculture was even more controversial in **Italy** than in France and Germany. It was characterised by a serious regional imbalance between the North and the South. Furthermore, unlike in France, Italy had only very low percentage of highly productive land but its rural areas were overpopulated. In many cases it meant that farms had too many workers, which resulted in a very low level of productivity. As the OEEC described the Italian situation:

'The yields were, in general, double in the North to what they were in the South...' [OEEC, 1957, p 152]

Similarly to France the government's intention in Italy was to raise the volume of production to reduce the level of imports (logic of balance of payments). Despite the above-mentioned characteristics of the Italian farming sector, the most distinctive one was the increased need for land reform. The result, namely the creation of smallholdings, was in sharp contrast with the aims of land reforms in other Member States.

The **Benelux** countries (Belgium, the Netherlands and Luxembourg) took the joint decision in 1955 to harmonise their agricultural

policies within seven years. The agricultural sector of Luxembourg was of marginal importance. It had a severe climate, low soil fertility, small, and heavily fragmented farm structure and pursued a protectionist policy.

**Belgians**, like the French, were concerned by the possible difficulties that the increased agricultural production might have on the price level and thus on the farmers' income. The government policy encouraged labour-intensive production. The reason for this was, that the small and fragmented farms were overpopulated generally and consequently suffered from underemployment. Nevertheless, the government intended to maintain a large agricultural population as socially desirable.

The **Netherlands** represented a special case among the Six. While the other five countries were importers of agricultural products, the Netherlands by contrast, was a net exporter. It also encouraged the movement of farmers into other sectors, thereby reducing the over-supply of the workforce. [Ritson, Harvey, 1991, p 37-9]. The transformed agricultural sector mainly imported raw materials into exportable agricultural products. This orientation made necessary a high level of efficiency in the production. Also as a result of this specialised profile the import regime was more liberal than in the other countries.

The case of **Great Britain** differed significantly from the Six. One of the major reasons was its geographical situation and the effect that

WWII had on it. Before WWII, Britain, a highly industrialised country, being a net importer of agricultural commodities, had well-developed and intense commercial relationships with third countries of the world [Rueno, 1999, p 13], mainly the Commonwealth countries. While France also had a colonial empire its relationships were much less concentrated on agricultural commerce because it was itself a much more agricultural country than the UK. The British reliance on the free market and agricultural imports were challenged from the beginning of WWII when German U-boats jeopardised the food supply. Thus the British government persuaded its farmers to invest in production. In exchange it provided a guaranteed price system. Its commercial fleet could be used for the transportation of the vital military equipment from the US. The feeding of the population was predominantly based on own resources. The expression of the time ‘digging for victory’ describes this phenomenon quite well.[Brassley, 1997, p 118]

After such a strong and sudden change, the government’s post-war dilemma was whether to return to import-oriented free trade in agriculture or stick to the newly introduced war regime to promote home production, using the price mechanism. On the one hand, WWII underlined the vulnerability of the UK from the security point of view due to its strong dependence on food imports [de la Serre, 1987, p 154-59], while on the other hand, the general opinion was that farmers deserved support for their wartime contribution. However, it was

predictable that world food shortage would pass relatively rapidly and world prices would fall. Furthermore, Britain had both its wartime agricultural capacity and its huge fleet to restore its pre-war commercial relationships and to have access to cheaper world products. Thus, contrary to France and other continental countries<sup>72</sup>, the UK could make a choice regarding its after-war regime. Finally the government chose a pragmatic solution: a mixture of these two possibilities instead of one. It meant maintaining the agricultural production capacity of the time, while they returned to the free market practice in order to benefit from the low world prices. The consideration behind it was to some extent of a security nature. This logic was not only the old reflex to the war but was equally triggered by the new logic of the Cold War. The maintained domestic agricultural sector had the capacity for rapid expansion that could secure the food supply to the British population in case of an emergency. This, so-called 'deficiency payments system', consisted of paying farmers to compensate them for the difference between the average market price and the guaranteed price, funded by the British taxpayer. [Harris, Swinbank, Wilkinson, 1983, p 8]. The payments took place weekly similarly to price assessments. The consumers had access to the agricultural products at the world market price. Internally, the price negotiation occurred on annual basis between the farmers' unions and the government. [Brassley, 1997, p 120]

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<sup>72</sup> Here it means the six founding countries

The comparison between the UK and continental Europe can contribute highly to the understanding of the BBQ's background. Within the Six there were a lot of shared characteristics, as shown in comparative table of this chapter, even if they had some peculiarities. The UK alone was markedly different in approach.

The economies of the Six were devastated compared to the British one, whose territory had never been under German occupation. The commercial links of the continental countries with third countries were less important. Even if they had these, they were not typically as dominated by agricultural imports as the British one. Their rural regions generally suffered from labour surpluses and unemployment. Contrary to Britain, they had almost no choice concerning the future agricultural system to introduce. They had no agricultural free trade with third countries before WWII, thus the re-erection of protectionist barriers and the endeavour to reach self-sufficiency was in line with their traditions. In 1957 at the creation of the EC the task of the founding Member States was relatively simple. The creation of the CAP thus only required them to move their protectionist agricultural barriers from the national frontiers to the external ones of the Community and introduce certain mechanisms. [Brassley, 1997, p 120]

Even at the millennium, British agriculture continues to bear the marks of weak self-sufficiency despite major improvements in its cir-

cumstances. Its level of self-sufficiency was 63.4% in food and 74.2% in foodstuffs which could be produced in the country [Defra web page].

### **5.3.5 BRITAIN AND THE CAP**

The huge relevance of this difference became more telling later when British membership had to be negotiated, and again when its terms of membership were renegotiated during the BBQ crises. While this protectionist system was in tune with the continental mentality, it was almost unacceptable for the British, [Simon, Nicoll, 1997, p 101] with the different attitudes having their respective roots in the different geographical conditions. In other words, Britain was a free-marketeer almost by definition due to its economy's strong dependence on agricultural imports. It is for this reason that the subsequent adaptation to the CAP was extremely painful, long and financially unprofitable.<sup>73</sup>

The abandonment of the open economy meant the abandonment of the cheap food policy at the same time. In economic terms, as already noted, this policy had been based on two basic instruments: first, the deficiency payments system to subsidise producers and secondly the system of low tariffs to ensure the cheap import from the world market. Ending these instruments caused their respective problems to the UK, which was topped by the adoption of the CAP. This market

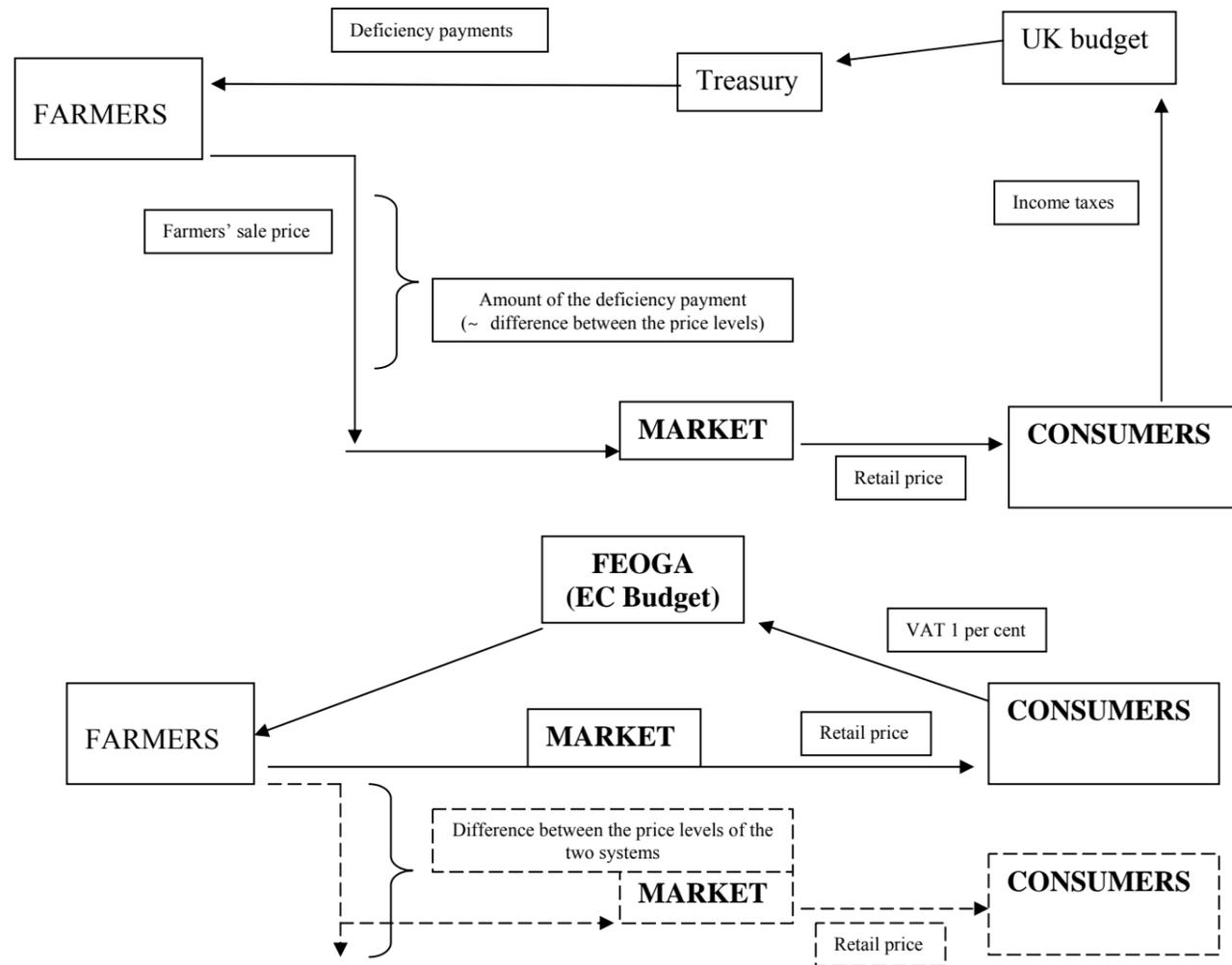
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<sup>73</sup> The very high level of local consumption of its import led to vast losses when according to the own resources system of the EC the UK was deprived of its custom incomes and at the same time its consumers had to pay a much higher price for agricultural products than the world market prize.

interventionist system constituted the third major problem. [Ruano, 1999, p 11]

The abandonment of the deficiency payments system had an economic and consequently social implication on the British society. The adoption of the CAP switched the costs of subsidising agriculture from taxpayers to the consumers. In the abandoned British system the farmers' sale prices were fixed during the annual Review process between the National Farmers' Union (NFU) and the Government. These sale prices were guaranteed and financed from the budget by the Treasury. In contrast, the Community's system subsidised the customer prices through market interventions. The prices had been fixed annually at the meetings of the Council of Ministers with the assistance of the Commission after consultation with the COPA (Comité des Organisations Professionnelles Agricoles des Pays de la Communauté Economique Européenne) We can agree with Ruano, this transition required Britain to move from a progressive to a regressive system. In the first system it was the taxpayers who financed the agricultural subsidies while in the second one the price had been paid by the consumers. [Ruano, 1999, p 11]. Furthermore while subsidies were paid according to the income levels in the Deficiency payments system, the CAP policy affected prices. Financially this mainly affected the poor because they spend proportionally more of their income on food than the wealthy part of the society.[Young, 1973, p 75]

**1. Scheme: The economic aspect of the deficiency payments model**



Source: author's own scheme based on Brian Gardner, *European Agriculture, Policies, Production and Trade*, London, Routledge, 1996, p 30-43, Paul Brassley, *Agricultural Economics and the CAP*, Oxford, Blackwell Science, 1997, p 118-126



To be more accurate, it is important to underscore that both the UK budget and the EC budget were based on taxes. However, while in the UK national system it was income and corporation tax, but through the ‘own resource’ system of the Community it was a tax based on consumption.<sup>74</sup> As a consequence, the EC model<sup>75</sup> was less progressive than the British one. The second characteristic of the changing of system is that the average consumer prices increased considerably. Thirdly, not only the final financiers (taxpayers or consumers) have been changed but the mediators (UK or the EC) as well. The national financial support through taxes and the national budget had been replaced by Community support through the EAGGF. It also meant that the system became much less transparent. Finally, besides the higher agricultural prices, the distribution of financial burdens (taxpayers⇒consumers), arising from agriculture policies was now dependent on Community-wide activity. Consequently the UK partially financed other MS’ agriculture as well.

The basic differences between Britain and the founding countries of the EC, which became crucial later during the BBQ, are summed up in the following table

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<sup>74</sup> Naturally, both the UK and the EC had other income sources but these taxes (income tax and VAT) represented the major sources of the respective budgetary systems.

<sup>75</sup> The expression of EC model is used as equivalent expression to CAP or Community system

**5. Table: Characteristics of continental Europe and Britain and the impact of these differences on the BBQ**

Six	Britain	Impact on the BBQ
<ul style="list-style-type: none"> <li>➤ strong protectionist traditions in the agricultural sector</li> <li>➤ self sufficient or net agro-exporters in agricultural products</li> <li>➤ small and heavily fragmented farm structure</li> <li>➤ low productivity</li> <li>➤ low yields</li> <li>➤ structural disparities: overpopulated rural areas afflicted by unemployment, and short of labour force in urban areas</li> <li>➤ farmers' income is low mainly compared to the incomes of the other sectors</li> <li>➤ governments find it desirable to maintain a considerable agricultural sector</li> <li>➤ governments make efforts to shift work force from agriculture to other sectors but with small success</li> <li>➤ governments intend to increase the farmers' income</li> <li>➤ introduced mechanism: guaranteed price mechanism</li> <li>➤ governments' principle concern based on economic and geographical conditions: balance of payments</li> <li>➤ the consumers finance the agriculture</li> <li>➤ agricultural products' average price level is extremely high (compared to world market prices)</li> <li>➤ the consumers pay their contribution through the high retail price, and on the basis of consumption. It takes the form of a national contribution of 1 per cent of the VAT.</li> <li>➤ financial transactions go through the FEOGA (and EC budget)</li> <li>➤ the UK subsidises partially other MS' agricultural sectors as well</li> </ul>	<ul style="list-style-type: none"> <li>➤ long free marketeer traditions (except: WWII)</li> <li>➤ import dependent agriculture, traditionally net food importer</li> <li>➤ large and medium sized farms</li> <li>➤ higher productivity</li> <li>➤ medium yields due to the higher efficiency in the sector and to the farm structure</li> <li>➤ no or unimportant structural disparities between the agricultural and industrial sectors</li> <li>➤ farmers' income is low mainly compared to the incomes of the other sectors</li> <li>➤ government intend to maintain a small but efficient agricultural sector for security reasons</li> <li>➤ government intends to increase the farmers' income</li> <li>➤ introduced mechanism: deficiency payments' mechanism (a mixture of cheap world food prices coupled with compensation paid to farmers)</li> <li>➤ government's principle concern based on economic and geographical conditions: return to free trade (with some security concerns)</li> <li>➤ the taxpayers finance the agriculture</li> <li>➤ agricultural products' average price level is relatively low. (world market prices)</li> <li>➤ the taxpayers pay their contribution to the farming sector mainly in form of income taxes</li> <li>➤ financial transactions go through the national budget</li> <li>➤ the UK subsidises only its own agriculture</li> </ul>	<ul style="list-style-type: none"> <li>➤ the adaptation of the UK to the protectionist CAP went against its traditions and mentality. It caused fundamentally different views of the optimal agricultural system between Thatcher and other head of governments.</li> <li>➤ The high import dependence of the UK and its net importer status caused severe losses to the UK budget compared to the others, since customs went as part of the own resources to the EC budget while goods were consumed in the country.</li> <li>➤ Both side's intentions were similar namely to increase farmers' income, but the means were different.</li> <li>➤ The UK had a tiny but more efficient agricultural sector than the Community average. Consequently its receipts from the EC budget were proportionally smaller than other MS. It became another strong argument of Thatcher during the BBQ.</li> <li>➤ The UK had a better position than the Six after WWII; it even had a choice of systems. However it was no longer a big empire and later it couldn't avoid joining the EC and the CAP in the establishment of which initially it did not want to assist. Thus it had to adapt to something alien to its mentality, practice, and interests. Furthermore, in 1973 at the moment of its accession it was too late to challenge the basic structure of the EC</li> <li>➤ The adoption of the CAP regime and the abandonment of the deficiency payments system was socially unjust because the financial burden was transferred from the taxpayers (on the basis of their revenues) to the customers (on the basis of their consumption).</li> </ul>

Source: Author's own scheme on the basis of other sources used in this chapter (Wyn Grant, Christopher Ritson and David Harvey (eds), Paul Brassley, Rosemary Fennel, )

Their impact was varied. Firstly, the adaptation of the UK to the protectionist CAP went against its traditions and free-market mentality. It caused fundamentally different views on the question as to what would be the ideal agricultural system for the EC. It contributed a lot to the disagreements between the French and British governments. Secondly, the high import dependence of the UK and its net importer status caused severe losses to the UK budget compared to the others, since customs went as part of the own resources to the EC budget, while imported agricultural products were consumed in the country. Thirdly, the UK had a tiny but more efficient agricultural sector than the Community average. Consequently, its receipts from the EC budget were proportionally smaller than those of other Member States, which was one of Mrs. Thatcher's key arguments during the BBQ. And finally, Britain had a better position than the Six after WWII; it even had a choice of systems<sup>76</sup>. However it was no longer a big empire and later it could not avoid<sup>77</sup> joining the EC and the CAP, in the establishment of which it initially did not want to assist. Thus it had to adapt to something alien to its mentality, practice, and interests. Furthermore, in 1973 at the moment of its accession it was too late to challenge the basic structure of the EC. Nevertheless one of the main considerations behind joining the EC was that it would be much easier, and advantageous to change its structure from inside.

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<sup>76</sup> Protectionist as it had from 1939-1945 or free-marketer as it had before.

<sup>77</sup> The political argument of the Heath government was: 'There is no alternative.'

#### **5.4 BASED ON FREE TRADE - THE COMMONWEALTH FACTOR**

British agriculture suffered a great deal from the consequences of the abolition of the Corn Laws in 1846. Cheap imported corn caused the level of agricultural self-sufficiency to fall dramatically and a great number of farmers abandoned farming [Somai, 2005]. This was also part of establishing the British system of free trade.

Ruano claims that ‘the Commonwealth issue was very prominent in the negotiations of 1961-63, but by 1970-71, it had broken down into a number of fairly marginal technical problems...’[Ruano, 1999, p 13] Hedges underlines that according to opinion polls in 1974 two-thirds of the population felt that ‘Britain should have developed links with the Commonwealth rather than joined the Common Market’.[Jowell, Hoinwille, 1976, p 54]

Relations with the Commonwealth constituted an important issue in the UK’s accession negotiations and later in the BBQ, albeit indirectly in the latter case. Traditional ties with the Commonwealth had a psychological impact on the UK’s relations with the EC; economic links with the Commonwealth especially high levies of imports, ensured that high levels of customs duties had to be levied and handed over to the EC as part of ‘own resources’, as did significant agricultural levies. High levels of the food and industrial raw material imports ensured revenue for the EC budget via payments of the custom duties. Similarly, the agricultural imports were also subject to levies. Through the imports the

Commonwealth factor resulted in an important gross contribution, however it also affected significantly the receipts' side. Being the world leading empire for a long time, the UK developed a highly open economy and cultural links with its colonies. Its poor climatic and natural conditions coupled with its cheap import possibilities led the UK to rely on the agricultural products of the Commonwealth. Conversely, Britain's relatively small agricultural sector attracted only few EC funds (from the EAGGF).

As France had the second largest colonial empire it seems to be logical to analyse the impacts of its relations with its former colonies. This section will give an explanation as to why the relationship with the former colonies played a different role in the case of France and in its financial situation within the Community.

The major issues of the BBQ were obvious for both sides<sup>78</sup>, the Community and the UK, even before the UK's accession and more than twenty years before the question was settled in Fontainebleau. After WWII when the UK was offered the possibility to choose its way of integration, it opted for co-operation with the Commonwealth instead of the EC. In a way it was a version of splendid isolation but was certainly less splendid than the first used by the US. Sacrificing the special

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<sup>78</sup> The detailed problems of the BBQ can be found in the text of the Press Conference of De Gaulle. See Annexes, Document 32 President De Gaulle, 'Press Conference', May 1967, in: Salmon and Nicoll, *Building European Union*, Manchester, Manchester University Press, 1997, p 99-104

relationship with the Commonwealth<sup>79</sup> deemed to be necessary for the UK to enter the EC, at least in the eyes of General De Gaulle, who vetoed the UK's accession twice. The Commonwealth issue was important for at least three reasons during the accession negotiations:

First, because the former colonies were heavily reliant on the British market for their exports. Therefore they were likely to be severely damaged by the UK's accession to the EC and the adoption of the CAP regime.

Secondly, because of the British liberal trade philosophy and the openness of its economy the UK was equally reliant on cheap raw materials. The UK specially needed agricultural products due to its unfavourable climate and its comparative disadvantage in the sector, although it safeguarded a small domestic agricultural sector for security reasons [Brassley, 1997, p 119]. For the latter purpose, a system of deficiency payments had been set up as noted previously.

Thirdly, Britain and the Commonwealth had strong cultural and historical links.

These three factors influenced both politicians and the public. While the two first reasons had a direct economic impact on the BBQ the impact of the third was rather indirect since it influenced politicians by the pressure of public opinion to safeguard British interests concerning the Commonwealth.

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<sup>79</sup> See: Annexes, Document 32 President De Gaulle, 'Press Conference', May 1967, in: Salmon and Nicoll, *Building European Union*, Manchester, Manchester University Press, 1997, p 99-104

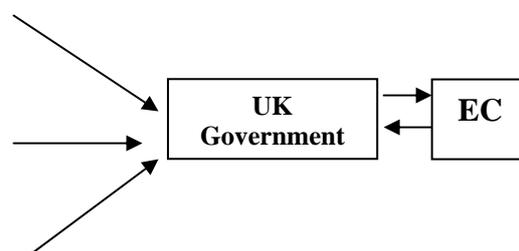
At the time of UK's accession, the EC represented less than 30 per cent of British trade (The Community average was about 50 per cent at that time). [de la Serre, 1987, p 155]. Ten years later, one year before the BBQ was settled it represented more than 43 per cent, an increase of nearly 50 per cent. Furthermore, the trade with the EC-neighbouring EFTA countries corresponded to another 15-16 per cent. Germany became as important export market for Britain as was the US in terms of value, even though the US had a four time larger population. This fact is even more important if we take into consideration the privileged status of the US due to cultural, historical and the special relationship links with the UK. Nevertheless, the value of British exports to the Community increased by 480 per cent while to the US only by 234 in the period 1972-1980. The other EC Member States with the exception of Ireland, Denmark<sup>80</sup> and Greece, ranked among the ten most important export markets for the UK.[Jenkins, 1983, p 146-153]. This comparison between the beginning of the British membership and the mid 1980s highlights extremely well how open its economy was. Although, the British commercial orientation altered significantly during the first decade of its membership, due to the trade deviation of the custom union, UK's economy remained more open than those of other Member States and this caused severe problems during its membership.

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<sup>80</sup> These countries were equally new Member States that joined the EC with the UK in 1973

## 2. Scheme: The Commonwealth issue

Reasons	Means
Reliance of the Commonwealth countries on the British market absorption	Economy (export market) and historical, social links
Liberal trade philosophy and openness of the economy in the UK (reliance on cheap raw materials)	Economy (balance of payments)
Historical and cultural links	Public opinion



Source: Author's own scheme based on the sources used in this section

France, like the UK, also wished to maintain close relations with its former colonies. However, the motives, the means and the result were slightly different. France influenced the other founding countries of the Six to give an associate status to its former colonies. In May 1963, after they became independent from France, these colonies signed a new convention of association (The Convention of Yaounde), which was renewed in 1969 by the Second Convention of Yaounde. This Second Convention was in force until 1975. Then together with the realisation of the custom union (in 1968) the EC established a free trade area for industrial products within the framework of the Convention. It was not necessarily bilateral, because the associated countries could maintain unilaterally their import duties or restrictions. But regarding agriculture, they received preferential treatment only in relation to a limited range of products regulated by the CAP regime. With some exceptions the

preferential articles represented only 1-2 per cent of associated countries' exports.[Palánkai, 1995, p 156]

In the same period, when France granted its former colonies the status of associated countries and established an industrial free trade area (which was also, to a very limited extent, agricultural) with them; the UK maintained its system of trading preferences with the Commonwealth. However, already in the period before the UK joined the EEC in 1973 certain countries of the Commonwealth developed special links with the EC. The two Arusha Conventions<sup>81</sup> embraced three East African former British colonies (Tanzania, Kenya, Uganda). Drawing a comparison between the EC Conventions signed with the former colonies of France and Britain, respectively, it is clear that, firstly, the Conventions of Arusha were set up later and secondly, that they were less extensive in scope than the Conventions of Yaounde. The Arusha Conventions were only limited systems of liberalisation instead of being a free trade area, they did not contain financial aids, allow preferential asymmetries and were restricted to industrial products.[Palánkai, 1995, p 157] Thus, it could be argue that the former territories of France received a more favourable treatment than the small number of Commonwealth countries involved in the Arusha Convention. The French-connected countries had serious advantages in three aspects: they were involved in the co-operation with the EC earlier, in much greater number, and to a greater

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<sup>81</sup> First Convention of Arusha 1968-1969, Second Convention of Arusha 1969-1975

extent. However, it must be stressed that at that time, the UK was not a member of the EC yet, but only an applicant country. Thus these disparities in the period of 1957-1973 were understandable.

In the period after 1973 the disparities were reduced significantly. The accession of the UK facilitated the transformation of the Commonwealth countries into the group of EC-associated countries. As a result of UK lobbying, a new convention was signed in 1975, the Lome Convention. Later it was renewed consecutively [Grant, 1993, p 73-74]. While the 46 signatory ACP<sup>82</sup> countries included both the French and British former colonies, it is important to note that the Asian countries of the Commonwealth were excluded from the Convention from the beginning. For the non-Asian Commonwealth countries and other former colonies this convention meant an industrial free trade area without restrictions. It also represented a further step as compared to the Yaounde Conventions.<sup>83</sup> Furthermore, it linked two issues of the BBQ, agriculture and the Commonwealth, having dismantled the customs tariffs for agricultural products but applying partially or totally the system of levies.

The UK's relation with the Commonwealth contributed to the BBQ by virtue of the fact that the UK traded extensively with the Commonwealth, thereby paying high levels of custom duties and agricultural levies. This was in marked contrast with France, which had

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<sup>82</sup> African, Caribbean and Pacific countries

<sup>83</sup> Due to the increase in agricultural products (without the application of customs when entering the EC) involved in the co-operation.

managed to secure special relations with its former colonies, so avoided heavy costs.

It can be concluded that France was in a more favourable position concerning its former colonies than the UK. First, because France as a founding country managed to give its former colonies the status of associated countries (by exerting pressure on the other founding members). British former colonies could not be involved in such co-operation even after the two British applications. After becoming a Member State the UK had to lobby for two more years to obtain roughly the same conditions for the Commonwealth countries (restriction in number). Secondly, because the French economy was less dependent on imports (mainly agricultural) than the British one. Finally, France wanted the UK to pay the price of delayed accession.

## **6           STEP BY STEP DIPLOMACY**

The previous chapter went through the causes of the BBQ that emerged from the contradictions between the general structure of the EC and the special characteristics of the UK. These contradictions were obvious even before accession. In the 1960s these contributed to underpinning De Gaulle's veto arguments. As this chapter shows, the Heath government decided that UK had to enter the EC first and then deal with the remaining problems as a member. The Accession Treaty gave the legal basis to renegotiate the terms of entry. The first attempt at this was in 1975 with only a specious solution. With the arrival of the 'Iron Lady', Mrs Thatcher the BBQ gained new impetus. The agreement of 1980 brought an interim solution but for a permanent agreement Britain had to wait another four years. However, Fontainebleau meant not only the settlement of the BBQ but also a further step in the financing of the Community.

## **6.1 ACCESSION AT ALL COSTS**

**‘Everything possible should have been done to avoid differences between Britain and the Six, even though it was hard to foresee circumstances in which Britain might join the Community.’  
/Edward Heath/**

After De Gaulle's departure as President of France and the arrival of Pompidou as new President of the Republic, Britain finally gained access to the Communities. The negotiations were concluded in the Elysee Palace on the 21<sup>st</sup> of May 1971. As Edward Heath recalls in his memoir: 'We all felt keyed-up, knowing that everything depended on this meeting. In two full days of discussions, we were going to thrash out the major problems outstanding in the negotiations between our two countries.' [Heath, 1988, p 354] The Government's White Paper, 'The United Kingdom and the European Communities', which treated such questions as the community budget and the relations between the UK and the Commonwealth (included some special agricultural aspects like sugar, dairy products etc.) [Her Majesty's Government, 1971] was debated in Westminster on 21-26 July 1971. On 28 October 1971 after the six-day debate Parliament voted in favour of entry to the EC. The Commons voted 356 in favour and 244 against British membership, while the House of Lords voted 451 in favour and 58 against. [Howe, 1994, p 67] The Accession Treaty signed in Brussels on the 22<sup>nd</sup> of January 1972 came into force with the adoption of the European Communities Bill by the Parliament in February 1972. [Salmon, Nicoll, 1997, p 117] As a result of the accession negotiations, the EC enlarged for the first time on 1 January 1973 with the United Kingdom, Denmark and the Republic of Ireland all becoming members.

During the whole negotiations process it was obvious for the British side that if the financial arrangements of the EC remained unchanged this would cause an excessive financial burden to the UK. Despite the British consideration the reaction of the communities was to say that with the emergence of new community policies and the intended reduction of CAP expenditures the British contribution could be more balanced. [Salmon, Nicoll, 1997, p 182] However, it has been added that: 'should an unacceptable situation arise... the very survival of the Community would demand that the institutions find equitable solutions.' [Salmon, Nicoll, 1997, p 182]

Although the Heath government was aware of the possible financial threats of the membership, he felt there was no alternative to membership. The possibility of influencing the course of community events from inside seemed to be a satisfactory guarantee besides the EC commitment signed in the Accession Treaty.

After the double veto France had once again a leading role in letting the British in to the Community. While the five other Member States have done everything to express their positive attitude towards enlargements, Paris remained the last obstacle to deal with. If the negotiations between Heath and Pompidou failed 'there was nothing further they [the Five] could do to help Britain.' [Heath, 1988, p 354]. Whereas President Pompidou contrary to his predecessor did not raise an obstacle to the British entry, he was determined to defend the interests of

French farmers in the negotiations concerning agriculture as it can be seen in the dialogue between Pompidou and the British Prime Minister: ‘If you ever want to know what my policy is, don’t bother to call me on the telephone. I do not speak English and your French is awful. Just remember that I am a peasant, and my policy will always be to support the peasants.’ [Young, p 276]

As in the second half of the 1960s, during the accession negotiations the budgetary consequences of the British accession were well known to both sides. As previously outlined, both the French<sup>84</sup> and the British side saw clearly the possible negative budgetary effects of the British accession. Despite this fact Britain found satisfactory the commitment made by the Community and the Commission’s intention to reduce CAP’s share in community expenditures and to develop other community programmes, from which the UK could benefit more significantly. The French, playing a decisive role in the British accession, did not seem to give up the defence French national interests. It kept a firm position concerning the reform of the community budgetary arrangements concerning, among other things the CAP, which had a major impact on Britain’s budgetary contributions.

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<sup>84</sup> See De Gaulle’s Press Conference of 1963 and 1967 in Annexes

## 6.2 THE WILSON'S COSMETICS OF 1975 – THE FIRST WAVE OF THE RENEGOTIATIONS

**'The renegotiation of Britain's terms of entry, which had been concluded in March at the Dublin European Council where a special 'Financial Mechanism' had been agreed to prevent Britain shouldering too heavy a financial burden, was simply not serious: the mechanism was never triggered and so never yielded a penny piece.'**

**/Margaret Thatcher/**

Though certain changes and improvements took place in the Community's policies, mainly in the fields of Social and Regional Funds, the basic problem for Britain was not resolved. The Europe policy of the new Labour government was criticized by Conservatives. Edward Heath in his memoir claims that his government was always very keen on the fairness of the British contribution. He felt Britain was entitled to use its veto in the Council of Ministers as a last resort. He mentions that in the course of his meeting with the German Chancellor, Helmut Schmidt in January 1974 personally discussed the rearrangement of the budgetary provisions of the British Treaty of Accession. [Heath, 1988, p 543]. However, Wilson's triple objective was 'to keep his party in power and in one peace and Britain in Europe' [Pimlott, 1992, p 659] and his main purposes were not easy to achieve.

The first wave of the renegotiation of the terms of entry goes back to Labour's manifesto of 1974. It contained the following European

issues: a vote on the EC membership, the renegotiation of the terms of entry, and to reach a new agreement for the Commonwealth countries. [Butler, Kavanagh, 1974, p 55-6, p 89-91]. For the first time the European membership issue became a government-wrecking issue under the Wilson premiership. [Hennessy, 2000, p 365]. Callaghan, who was nominated Foreign Secretary, received the difficult task of making a deal with the Community regarding the renegotiation. His opening speech at the first meeting of the Council of Ministers he enumerated seven objectives. As time went on these seven objectives were reduced to four, namely the CAP reform, the Commonwealth, the prevention of Brussels' obstruction of the British regional and industrial policies, and the renegotiation of the terms of entry. [Young, 1993, p 121] In due course the serious financial inequity of budgetary contributions was broadly agreed, its degree was hard to define. The basic inequity consisted of the fact that Britain paid more into the EC budget than it got out and paid more than would normally have been the case given its relative wealth<sup>85</sup>. According to estimates made in Brussels at that time this situation was about to get worse in the next few years. [Young, 1998, p 280]. In the meantime significant changes have occurred in European high politics: following the death of President Pompidou in 1974, Giscard d'Estaing came into power in France; in Germany, Willy Brandt had been succeeded as Chancellor by Helmut Schmidt. These changes caused a slight delay in the renegotiation process. On the 25 of July 1974 Wilson

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<sup>85</sup> It was measured on the basis of the GNP factor compared to the EC average.

and Callaghan decided that a renegotiation period of twelve months would be followed by a referendum on Britain's EC membership. [Benn, 1989, p 192-3, p 206-7] Wilson, to make use of the commitments made by the Communities during the accession negotiations, used the referendum issue to influence other Member States in the bargaining over the British contribution. While a vote on the British membership was an element of the Labour manifesto, it did not stipulate that this would be a referendum. At home Wilson received numerous criticisms to endanger Britain's EC membership 'negotiating with the EEC with the threat of withdrawal in the background' [Young, 1993, p 120]

In an attempt to settle the BBQ, the newly-elected French president convened a summit in Paris. Before the December summit meeting two other meetings were arranged, first between Wilson and Helmut Schmidt and later between Wilson and Giscard d'Estaing. The importance of the first meeting was that it was the German Chancellor who convinced Wilson to arrange a bilateral dinner in Paris between Wilson his French counterpart. The Chancellor also supported his British colleague in his endeavour to renegotiate the BBQ influencing the French President to adopt a more receptive approach towards Wilson's proposal.[Jenkins, 1991, p 399-400] Heath evokes this agreement as a deal between the two politicians. The price of a few concessions in the renegotiation was the assurance of the British Prime Minister to take part in the 'YES' campaign. [Heath, 1988, p 544] Although concession

regarding the temporary measure reached later at the summit of Dublin went through German mediation as outlined above, the most important obstacle to tackle was French reluctance.

At the Wilson-Giscard meeting, the French president was reluctant to make any reduction to Britain on its budgetary contribution. The difference in the French and British approaches concerning the question had already appeared in this early stage of the BBQ. While the French President was arguing on the basis of the 'own resources', i.e. that any monies according to the EC as 'own resources' belonged to the EC and should not be seen as the member states' funds, Wilson requested a 'refund' instead of a reduction reflecting his view that the monies were indeed British. This period avoided the total confrontation that took place later under the Thatcher era. Labour's promise to renegotiate the terms of entry reached its climax at the summit of Dublin in March 1975 where an agreement seemed to have been reached. According to the British government, the results of the Dublin's negotiation among others were that 'the CAP now works more flexibly, the new terms insure that Britain will pay a fairer share.' [Thatcher, 1995, p 334] In contrast Michael Butler from the Foreign Office characterized the deal, saying it 'never produced any financial results.' [Butler, 1986, p 93] Similarly, Michael Palliser, British ambassador in Brussels, linked the internal and external aspects of the renegotiation mentioning: 'It soon became clear to me that the whole object of the exercise was to keep Britain in, and get

something that could be presented to the British as politically adequate.’

[Young, 1998, p 281]

The outcome of Dublin was mainly pure formality for Britain, vital questions for the UK as its budgetary contribution and the regime of the CAP was ‘barely scratched.’[Heath, 1998, p 366] The formula of the temporary measure that would apply to UK’s Gross National Product per head was lower than the 85 per cent of the Community average. In Nigel Lawson’s view, the problem with the formula was that it was conceived to reduce the gross budgetary contribution of the UK instead of taking into consideration its net contribution. [Financial Times, 1979]

After the deal was settled in Dublin, Wilson and his Foreign Secretary seemed to have been persuaded that their country’s position was strengthened within the EC. However, whereas the vote of the Government’s White Paper on the ‘renegotiation’ resulted in a majority of 226, it was not unanimously well received among politicians. Out of 315 Labour MPs only 138 voted in favour and 145 (including 38 Ministers) voted against. [Heath, 1988, p 545]

1975 saw the European issue jeopardise the unity of the government and the stability of the internal policy. At that time the BBQ constituted only a part of the European issue and was still not as important as at the end of the 1970s. The importance of the renegotiation was to solve the tensions in Britain’s internal political situation rather than to outline and to ensure acceptance of a well-elaborated long-term

rebate mechanism. The formula concentrated on the gross, rather than the net British contribution. Due to these factors the temporary measures reached in Dublin seemed to be inoperative. The Wilson Government made political instead of economic capital out of the renegotiation. The effect of this contradiction weighed more heavily on the shoulders of the succeeding Labour government in the second half of the 1970s when the British budgetary burden became far more important due to the economic changes in the international environment.

In any case, the first trial to renegotiate the British contribution under Wilson was really a cosmetic solution. Roy Jenkins evaluates the renegotiation as ‘a largely cosmetic enterprise, producing a maximum of ill-will in Europe and a minimum result.’ [Jenkins, 1991, p 492]

### **6.3 MADAME WITH THE HANDBAG**

**‘She cannot see an institution without hitting it with her handbag.’  
/Julian Critchley/**

**‘When Mrs Thatcher emerged from the sea of electoral hazard, perhaps looking more like Boadicea than like Botticelli’s Venus, it was natural that she should quickly seize the BBQ as her main point of engagement with Europe.  
/Roy Jenkins/**

Margaret Thatcher's entrée into the European diplomacy was marked by the resurrection<sup>86</sup> of the BBQ as an issue on the EC agenda, which was considered her hobby-horse in European politics. This section retraces the BBQ until the Dublin summit where she received the first offer from her counterparts.

#### **6.4 'JUSTE RETOUR'<sup>87</sup> VERSUS 'OWN RESOURCES' OR THE FIGHTING PRINCIPLES**

**'Behind this opposition of principle was the less principled and entirely practical factor that the French and others were doing extremely well out of the existing arrangements...at our expense.'**  
**/Lord Carrington/**

This section of the dissertation will present the different approaches of France and the UK regarding the basis of the argumentation over the British refund. The financial arrangements introduced in 1970, known as the system of 'own resources', did not take into consideration the net contributions of the Member States, the difference of their contributions to the EC budget and their receipts from it. The Community calculating method was based on agreed criteria and the receipts were calculated by different criteria, hence contributions were not measured against receipts.

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<sup>86</sup> In the French terminology it is used as 'relance'

<sup>87</sup> Fair return

In contrast, the British argumentation was based on a different perspective, they linked the two sides of the budget emphasising the net contribution and they judged the fairness of its volume by comparing it to the relative wealth of the country within the EC.<sup>88</sup>

Although the Community promised to find an adequate solution within the Community's framework<sup>89</sup>, no changes were achieved. The French position was founded on the invulnerability of the principles governing the Community<sup>90</sup> and on the defence of the 'acquis' represented by the CAP and its financial rules. Yet, it also underlined that the British accounting method comparing the contributions to the receipts could not show the real benefit of membership. [Lawson, 1992, p 110] This approach was unable to show the non-quantifiable advantages of UK membership, interprets Taylor the 'French view'. [Taylor, 1983, p 294] While certain authors (Taylor, Casy, Denton, De la Serre, etc.) stress the non-quantifiable advantages and the ideological differences in the French and British approaches, others (Thatcher, Lord Carrington, etc) underline the importance of French economic advantages of the CAP regime. Françoise de la Serre argues that the challenge caused by the British claim to obtain a rebate was of capital importance for Paris, but that this was not perceived entirely in London. It was partially due to the fact

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<sup>88</sup> Based on the interview with Jean-Pierre Delannoy former advisor on budgetary issues at the Committee on European Community at the National Assembly of the French Republic,

<sup>89</sup> It meant the intended reduction of the CAP share in the overall budget and the development of new Community projects from which the UK could more broadly benefit.

<sup>90</sup> Based on the interview with Paul Bebin former chief advisor of the Committee on European Community at the National Assembly of the French Republic, See also: Nigel Lawson, *The View from No. 11*, London, Bantam Press, 1992, p 110

that the British queried the important French benefits deriving from the CAP, while failing to recognise the German non-quantifiable advantages coming from the industrial free trade within the Community. [de la Serre, 1987, p 160] The British approach infuriated the French because in their view the principle of 'juste retour' was not a genuine community approach. In this Franco-British dispute, Casy, arguing from the French point of view, considers understandable that France defended the acquis on the basis of principles. Having claimed the autonomy of Community policies vis-à-vis national ones they resisted against all trials to modify the financing of the Community policies. [Politique étrangere, 1980, p 389-405] Analysing the role of Bonn in respect of these principles, it can be stated that it was slightly ambiguous. While at the beginning of the BBQ, the British request of a rebate was rejected by Bonn, the notion of budgetary imbalance was admitted by the German government. Yet, at the same time, Germany sought to reduce its participation in the financing of the British refund. [de la Serre, 1987, p 160]

As it appeared from this section France took a moral highground and argued for the autonomy of Community policies and their invulnerability while Britain based its argumentation on comparative logic. Germany, the second biggest contributor to the EC before Fontainebleau, played a far less important role in the fight over principles. It rather sought the reduction of its financial participation in

the British refund. This aspect of the BBQ underlines that the most involved country of the EC was France.

## 6.5 NESSIE RESURFACES

**‘In 1978 the problem resurfaced like the Loch Ness monster, except that no one was in serious doubt that its subsequent normal position, unlike that of the monster, was going to be above and not below the water.’**  
**/Roy Jenkins/**

As a result of the unexpected changes in the international economic environment<sup>91</sup> the BBQ remained in the background during the first two years (1976-77) of the Callaghan government. Though, after the setting up of the Financial Mechanism of 1975 the structural problem of the BBQ persisted but was almost invisible due to economic reasons. As the problem ‘went underground and Britain had virtually no grievance during those years’[Jenkins, 1991, p 492] it deprived the government of grounds for a further renegotiation. By 1978 the BBQ re-emerged.

In the last year of Callaghan’s government Britain’s contribution increased significantly. This tendency was the result of the growing community expenditures of the CAP.[Carrington, 1988, p 315]

With the elections of 1979, a new period began in the United Kingdom from numerous points of view. Margaret Thatcher was the first

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<sup>91</sup> The average food price level in the EC and on the world market changed significantly.

woman prime minister and the first post-war prime minister who experienced the WWII as a student. Another important heritage from her father was her relative Germanophilia. In her autobiography she characterised Germany as ‘a cultured developed, Christian country...’ [Thatcher, 1995, p 31] She grew up under the influence of her father’s Francophobia. Though it cannot be argued that her relationships with Giscard and Schmidt and later with Mitterrand and Kohl were analogue to the attitude of her father to these respective countries, it is certain that he influenced her initial views on France and Germany. Although she was on good terms with Schmidt, in the BBQ he also became a significant opponent like Giscard ‘whom the British leader thought cold and patronising. Olympian but not patrician, she acutely called him.’ [Young, 1998, p 314] According to Lawson’s assessment, unlike with Kohl, she got on well with Mitterrand who was able to ‘score a hit with her by treating her as a woman’, although, she also had a considerable respect for Kohl’s predecessor, Schmidt. [Lawson, 1992, p 275]

During her early political carrier Mrs Thatcher was pro-European and maintained this image until the very beginning of her premiership. Through the BBQ one can follow quite well the metamorphosis concerning her attitude towards Europe. As Young describe it ‘once routinely favouring Europe, she became its passionate enemy.’ [Young, 1998, p 311] Another element that could be important in regarding her attitude to the BBQ, is her profession and background: as a scientist she

probably had a numerical and pragmatic approach rather than a flexible one.<sup>92</sup>

After having briefly touched on a couple of elements of Thatcher's personality and her relationship with her German and French counterparts, it could be interesting to throw a glance at the Franco-German relationship. Both constellations, Giscard-Schmidt and Mitterrand-Kohl, got on well and secured a strong and well-operating Franco-German axis to the Community. Furthermore, the two came into office within a one-year interval 1974 and 1981/82. As the BBQ had a strong economic aspect, the fact that both Giscard and Schmidt were finance ministers before, could have influenced the course of events. Thatcher, herself saw the French role within the axis as that 'France has long feared the power of Germany and hoped that by superior Gallic intelligence power can be directed in ways favourable to French interests.' She considered that Germans, in return for their high financial contributions got valuable 'international respectability and influence' [Thatcher, 1995, p 61]

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<sup>92</sup> The author's own remark

## 6.6 RAISING THE QUESTION – STRASBOURG 21-22 JUNE 1979

**‘President Giscard proposed that as time was getting on we needed to get ready for dinner, the matter of the budget should be discussed the following day. Did the Prime Minister of the United Kingdom not agree? And so at my very first European Council I had to say ‘no’**

**/Margaret Thatcher/**

Mrs Thatcher arrived at her first European Council with a double objective. First she aimed to raise the topic of the BBQ ‘without going into too much detail’[Thatcher, 1995, p 63] and secondly she wanted to insure the support of her partners that the Commission put forward proposals regarding the issue for the next Council. Contrary to her objectives she managed to get into an altercation with the two big countries (France and Germany), three small ones (Netherlands, Denmark and Ireland) and the Commission right after the beginning of the meeting.[Jenkins, 1991, p 494-5] The French President, who hosted the meeting, treated Thatcher badly not allowing her to begin the afternoon session with the BBQ although he promised it to her. [Jenkins, 1991, p 494] Moreover, he had arranged the seating plans of the banquets, so that their seats were far from each other, preventing a possible dialogue between them. Finally, resisting Giscard’s delaying trials, she succeeded in raising the BBQ at the end of the first day of the Council. The outcome of Strasbourg was that the Commission received

the task to prepare proposals for the next Council meeting, while her partners were shown the importance and the problematic character of the BBQ.

Concluding the effects of Strasbourg on the BBQ one could assume that Thatcher's becoming embroiled in an altercation with Giscard was unavoidable due to his behaviour. At this early stage of the BBQ France tried to delay raising the issue, however at the end of the summit it was obvious for each participant that the BBQ could not be neglect in the future.

## **6.7 THE FIRST OFFER - DUBLIN, 29-30 NOVEMBER 1979**

**'Britain cannot accept the present situation on the Budget. It is demonstrably unjust. It is politically indefensible: I cannot play Sister Bountiful to the Community while my own electorate are being asked to forego improvements in the field of health, education, welfare and rest.'**  
**/Margaret Thatcher/**

After the introductory meeting of the second wave of the BBQ in Strasbourg Thatcher had talks with Giscard and Schmidt to seek wider understanding for her problem. Before Dublin the Thatcher Government examined in detail the possibilities for how the UK could put pressure on the other Member States to reach a deal. It identified two possible options from which the first, the withholding of British payments to the EC

budget, was for various reasons <sup>93</sup> inapplicable, while the second one, the obstruction of the agricultural price increases, affected mainly France and Germany. [Lawson, 1992, p 110] The atmosphere of this second Council was even worse than the previous one. After a four-hour long presentation by Thatcher, Roy Jenkins, who was Commission President at that time, writes that ‘Giscard, who as he had not been in charge of the seating plan was next to her, leaned back in contented disengagement...Schmidt got impatiently bored and pretended (but only pretended) to go to sleep.’ [Jenkins, 1991, p 498] The French negligence towards Thatcher’s issue can be highlighted by the fact that ‘Giscard had his motorcade drawn up at the door, engines revving, to signal that he would delay no longer. “I will not allow such a contemptible spectacle to occur again,’ he said as he departed.’ [Young, 1998, p 314] In Dublin the British requested for the reduction of their net contribution, and a ‘broad balance’. The British net contribution was more than £1 billion at that time. [Thatcher, 1995, p 80] The first offer made to the British request was £350 million, roughly one third (‘a third of a loaf’ in Thatcherite language) of the whole UK net contribution.[Young, 1993, p 185-87] The proposal put forward by the Commission suggested the reduction of the CAP share in the Community expenditures combined with special programmes to increase the UK’s benefit from the EC budget. The proposal and the sum were rejected by Thatcher for two reasons, despite appealing advice from the Foreign Office [Lawson, 1992, p 109] .She

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<sup>93</sup> It was mainly due to legal considerations undertaken by Britain in the Accession Treaty.

considered the amount was far from sufficient and rejected a refund that was not permanent<sup>94</sup>. What the Iron Lady could not accept was ‘the attitude that fairness as such did not seem to enter into the equation at all.’[Thatcher, 1995, p 81]

The importance of the negotiation of the Commission’s proposal was that it underpinned the British argumentation giving ground to the principle of ‘juste retour’ [de la Serre, 1987, p 158]. As the first offer was rejected, Dublin did not produce any result for the BBQ, except to mark the relationship between Thatcher and her partners.<sup>95</sup>

## **6.8 BBQ AS BLOODY BRITISH QUESTION**

**Mettre en oeuvre le «Mandat» dans sa globalité revenait en effet a résoudre la quadrature du cercle puisqu’il aurait fallu tout a la fois développer des politiques communes autres qu’agricoles, sans remettre en cause les principes de la PAC (et notamment son financement) et sans augmenter les ressources propres.  
/Françoise de la Serre/**

The BBQ that originally meant the British Budgetary Question became ‘a war of words’ [Salmon, Nicoll, 1997, p 181] between the UK and its partners from 1980. As the struggle for British rebate ‘became for a time all-dominating’[Jenkins, 1991, p 491] issue, the initial

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<sup>94</sup> Thatcher claimed: ‘the arrangement must last as long as the problem.’

<sup>95</sup> Thatcher contributed broadly to this atmosphere emphasizing at the Press Conference after the summit that she refused the community approach of ‘own resources’ and talking about Britain’s money instead of Community’s.

abbreviation of the BBQ gained a second wittier interpretation, namely Bloody British Question.

In Mrs Thatcher's view, her government had passed the clear message to the other heads of states and governments in Dublin that they would never have any peace until the BBQ was settled. In contrast other authors as Jenkins do not back up her view. [Jenkins, 1991, p 500] After the Dublin Council, the British Prime Minister was motivated partially by the Commission's report saying that it was possible to achieve a broad balance between the UK's contributions and receipts, in line with the Community principles. [Thatcher, 1995, p 79]

As the following European Council was to be held in Italy, Mrs Thatcher had a private talk with the Italian Prime Minister, Francesco Cossiga to prepare the summit. In the event, the Council was held in Luxembourg due to the Italian government crisis later on, 27-28 April 1980.

## **6.9 LUXEMBOURG 27-28 APRIL 1980**

**'The essential trouble was that everybody except Mrs Thatcher had become bored to death with the dispute.'**  
**/Roy Jenkins/**

Before the Summit itself a meeting was arranged between Schmidt and Thatcher regarding their respective budgetary contributions. According to Foreign Office sources, after this meeting Schmidt told other Member States leaders that the British withholding of the EC

budgetary contribution was a threat to the Community. [Thatcher, 1995, p 83] As a result of Thatcher's shrill behaviour Schmidt made it clear that he could not establish a normal rapport with his British counter-part and that he had adopted a hard-line position towards the BBQ.[Jenkins, 1991, p 501] The interpretation by the British government and that of the Commission differed regarding the role, the importance and viability of the basic French proposal. The French put forward a proposal concerning the BBQ but Mrs Thatcher felt it was designed to reach another deal with the UK on various agricultural issues<sup>96</sup>. In contrast, in the Commission's view the French proposal was constructive and thus became the basis of the final Luxembourg offer [Jenkins, 1991, p 502] The negotiations of the two issues were held parallel and arrived at the following results: the French reached their intended objectives concerning the CAP, whereas the UK was offered a generous rebate of £760 million leaving the British net contribution at £325 million for 1980. The Luxembourg offer contained the same amount for 1981<sup>97</sup> meanwhile a study would be achieved to find a permanent arrangement. [Young, 1993, p 142] Although the offer was found to be generous by the other participants, she rejected it for two reasons: first, it gave a possible solution for only two years [de la Serre, 1987, p 161] instead of being permanent and secondly, the two-thirds rebate was not seen to be enough. Although the President of the Commission, her Foreign Secretary, her two senior

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<sup>96</sup> farm prices, lamb and fishing rights

<sup>97</sup> It was done on the generous offer of Giscard.

advisers<sup>98</sup> and several head of states and governments tried to convince her, she replied to one of them: ‘Don’t try persuading me: you know I always find persuasion very counter-productive.’ [Jenkins, p 593]

The French proposal in Luxembourg was more generous than the previous one, nevertheless, Britain rejected it due to its time limitation and its scale.<sup>99</sup> The importance of the summit lay in the fact that it was the first occasion when the UK could have profited from a possible linkage situation (French agricultural issue – UK’s BBQ) but failed to do so. From the French point of view, Luxembourg demonstrates France’s recognition as to how well it could benefit from the parallel negotiation of a French related (CAP prices) and a British related (BBQ) question.

#### **6.10 BRUSSELS AGREEMENT - BRUSSELS 29 MAY 1980 (THE MAY MANDATE)**

**‘The ministers arriving at Chequers uncertain what to expect from the compromise they had agreed over the midnight oil in Brussels, were met by the leader’s almost uncontrollable wrath.’  
/Hugo Young/**

The consideration of several heads of state and governments to settle the problem before the following European Council in Venice resulted in a meeting in Brussels on 29 May. The BBQ was sent to

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<sup>98</sup> Robert Armstrong and Michael Palliser

<sup>99</sup> Based on the interview with Jean-Pierre Delannoy, former advisor on budgetary issues at the Committee on European Community at the National Assembly of the French Republic

Foreign Ministers to find a solution to it. After a twenty-four hour long intensive discussion a compromise was reached. [Carrington, 1988, p 319] At the beginning of the negotiation there was deadlock since those Member States who were in the position of financing a possible increase of the rebate were not prepared to do so and the British representatives had no permission to accept an offer that did not differ significantly from the Luxembourg one. Both the German and the French Foreign Ministers were substituted by other members<sup>100</sup> from their respective governments. These substitutions had a beneficial effect on the negotiations and at two o'clock in the morning Dohnányi put forward a new proposal, which was adopted by all participants. [Jenkins, 1991, p 506-7] The result was £1570 million rebate for 1980 and 1981 (for the two years) that left the British net contributions at £370 million and £440 million in these years. [Lawson, 1992, p 110] The difference between the Luxembourg offer and the Brussels' arrangement consisted of a different basis of calculation while the amount of the refund for 1980 and 1981 remained unchanged, with a more explicit arrangement for the year 1982. The Community took the commitment of solving the problem of budgetary imbalances by 1982 and making the necessary structural modifications. If another unacceptable situation arose it was agreed, 'the Commission would put forward proposals inspired by the solutions of 1980 and 1981 and the Council would decide accordingly' [Bulletin des Communautés

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<sup>100</sup> Dohnányi represented Germany instead of Genscher and Bernard-Reymond came instead of François-Poncet

européennes, 1980]. Thus the result could be argued to be better, the same or worse than the offer in Luxembourg according to the Foreign Ministers' needs of selling it to their governments. [Jenkins, 1991, p 506] Lord Carrington's opinion was summarised in the telling remark that 'half a loaf is better than no bread.' [Carrington, 1988, p 319] While Lord Carrington's recollections of Mrs Thatcher's reaction regarding the deal [Young, 1993, p 201] are not recorded, other sources<sup>101</sup> do not leave us in any doubt. Ian Gilmour, the other representative of the UK in Brussels recalls: 'She was like a firework whose fuse had already been lit; we could almost hear the sizzling.' [Gilmour, 1992, p 238-41] Thatcher accused Gilmour and Carrington of giving in and having made a settlement with worse conditions than she had already declined before. [Young, 1998, p 317] Thatcher in her autobiography attributes her acceptance of the Brussels package to the fact that they had to accept only 5 per cent of the increase in farm prices and that it represented a huge development compared to the initial situation of her government.<sup>102</sup> Undoubtedly, the threat of Gilmour's and Carrington's resignations should she not accept the deal [Carrington, 1988, p 319] contributed greatly to her acceptance.

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<sup>101</sup> Jenkins: 'They departed after three and a half hours of hostile cross-examination and without any indication that she would recommend the settlement to the cabinet on Monday.' Thatcher: 'My immediate reaction was far from favourable.'

<sup>102</sup> As stated above it had to be obvious for her as well that the Brussels package contained the same money only worked out with a different algorithm. Concerning the period limitation there was no significant improvement either.

Comparing French and British sources it can be stated that the former stress the package deal character of the Mandat of May<sup>103</sup> in contrast to latter ones. De la Serre underlines that France and to a smaller extent Germany dissuaded the UK from linking the issue of the CAP with the BBQ. In de la Serre's view, Brussels was the first time when Britain made use of linkage politics. Thatcher notes in 'Downing Street years' that the British government has indeed sought a means to put pressure on the EC. The first, was a threat to withhold the British contribution<sup>104</sup>, another was the linkage of the increase in agricultural prices with the BBQ.

The Brussels meeting was a good opportunity to demonstrate the French aspect of the BBQ since its outcome for France was a deal on the increase of agricultural prices, while for Britain it had no more significant a result than that once already offered in Luxembourg.

### **6.11 TRENCH-WARFARE IN THE INTERIM PERIOD OF 1982-1983**

This period of the BBQ was somewhat similar to the trench-warfare of the First World War, where both sides invested a lot in the struggle but the frontline did not want to move in either direction. This

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<sup>103</sup> the Brussels package

<sup>104</sup> Thatcher admits that the rumours about the withholding in public opinion in the UK pleased her, though she remained cautious in public on the subject due to its incompatible trait with the Treaty of Rome. See: Margaret Thatcher, *The Downing Street Years*, London, HarperCollins Publishers, 1995, p 83

period embraces first of all the fight for the rebate of 1982 promised by the Mandate of May, secondly the battle for a permanent solution.

## **6.12 QUESTION OF 1982 AND ITS SOLUTION**

As a result of the 'Mandat of May' the European Council's meetings were almost relieved of the desperate quarrels surrounding the BBQ for the years of 1980 and 1981, as payments agreed in Brussels meant a definite solution for those years. Although, Luxembourg offered the UK the possibility of a rebate for 1982, which was confirmed in Brussels, it was not quantified. The simple fact that the payments of 1982 and 1983 had to be negotiated effectively meant the failure of the May Mandat. The Commission gradually realised that it was impossible to develop further Community policies leaving intact the CAP without the increase of the own resources. Consequently it put forward different proposals to rearrange the whole structure of the Community budget including the increase of the VAT factor and the reform of the CAP. In the interim it proposed that the British rebate would be paid by those Member States whose receipts from the EAGGF (FEOGA) are significant.[de la Serre, 1987, p 164] The reduction of agricultural prices was the crucial point of this document and those that accompanied it.[Bulletin des Communautés Europeennes, 1981] The meeting of the European Council in London in November 1981 admitted the failure of the Mandat of 1980.

There were two possible solutions. One concerned the increase of the VAT ceiling and was supported by France and other net recipients of the EC. The second was backed by the UK and Germany and would have meant the restructuring within the existing financial frame of the Community, and it was against the increase of the own resources at all costs.<sup>105</sup>

As Thatcher considered the scope of the May Mandat extending to 1982 as well, she demanded 1,400 million ECU for that year. A new corrective mechanism was envisaged by Gaston Thorn, the new president of the Commission and Lev Tindemans, the president of the Council to ensure a rebate for Britain for the next five years at around 850 million ECU per year. France opposed strongly this formula.[*Politique étrangère*, 1982, p 125-132] On 15 March 1982 Thorn, Tindemans and Mitterrand had their meeting in Paris to prepare for the Council Meeting the following week. The main topic of the negotiation was the BBQ. While the president of the Commission reported on the British demand (1,400 million ECU), Mitterrand did not want to go over 600 million in any case. At the meeting of the Agricultural Ministers in Brussels<sup>106</sup> the British Prime Minister vetoed the annual farm price increases through the UK Agriculture Minister, Peter Walker. [Young, 1993, p 132] The participants had firm and contradictory positions. The Commission proposed 9 per cent, the British rejected to go above 7 per cent, while the

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<sup>105</sup> Based on the interview with Jean-Pierre Delannoy, former advisor on budgetary issues at the Committee on European Community at the National Assembly of the French Republic

<sup>106</sup> On 23 March 1982

French were not disposed to go under 12 per cent. In Paris ten thousand farmers were demonstrating; Mitterrand was keen to have a better deal than Giscard had in Brussels, so it was impossible for the French Agricultural Minister to give in to the British request. [Attali, 1993, p 195] It represented an important step in the BBQ and in the history of the Community as the Compromise of Luxembourg was cited to justify the veto. The rise of the veto was badly perceived by the other Member States, which was due to two main reasons. First, because the Community had backed the Thatcher government in the Falkland War, secondly, because the UK got back more in 1980 and 1981 than it was intended previously due to the increase in world agricultural prices. While Mrs Thatcher argued in 'Downing Streets Years' that her experts had examined in the early stage of the BBQ the different means of pressures of which the veto of the annual price increase was one, she does not mention the weakness and failure of this secret weapon. Her veto provoked lively reactions from the Community, mainly from France, and was overridden later in May<sup>107</sup>. The following day Robert Armstrong, Thatcher's senior advisor and Jacques Attali, Mitterrand's special advisor, met in London to prepare for the forthcoming European Council. Armstrong offered a deal to Attali, namely if Mitterrand did not raise the question of agricultural prices, Thatcher would not raise the BBQ [Attali, 1993, p 196] at the Council in Brussels<sup>108</sup>. Not surprisingly

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<sup>107</sup> The veto was raised on the Council of Agricultural Ministers of 18 May 1982.

<sup>108</sup> The Brussels European Council took place on 29-30 March 1982

the summit of Brussels passed off without raising the above-mentioned issues.

The uncertainty surrounding the rebate of 1982 came to an end with the agreement reached at the meeting of the Foreign Affairs Ministers in Brussels on 24 May 1982. The final figure was 850 million ECU, which was the result of a long discussion. The French Foreign Minister, Cheysson, sent a telegram on the morning of the meeting saying:

‘We finished the painful negotiation with the British late in the night in Brussels. ... Based on the figure of 1981 agreed in 1980 the British demanded 400 million more for 1982 (1300 million ECU). Following your meeting with the British Prime Minister the demand was reduced to 1008 million ECU. ... We have decreased this amount even further firstly to 875 then to 850 million that will be paid from the budget of 1983.’ [Attali, 1993, p 232] Attali adds that Cheysson omitted to mention to his president that he agreed to pay half of the German part of the British rebate in return for German support in bringing pressure on the British. Otherwise, Genscher<sup>109</sup> wanted to pay only the third, as they originally expressed it in June 1981<sup>110</sup> and informed Cheysson that Germany would only pay a quarter in the future. Cheysson also misjudged the French overall part (which included half of the German

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<sup>109</sup> The German Minister of Foreign Affairs

<sup>110</sup> *Agence Europe*, 13 June 1981

payment) arguing that it was 290 million while in reality it came to 400 million ECU. [Attali, 1993, p 232]

### **6.13 TOWER OF BABEL – STUTTGART**

The European Council of Stuttgart (more than a year later in June 1983) was postponed<sup>111</sup> due to the British general elections. There is no evidence in primary or secondary sources or any other reason to suppose that Mrs Thatcher's European partners speculated on her defeat<sup>112</sup>, however she claims in her autobiography that they probably hoped 'to extract a few more concessions from a newly re-elected government than from one under the domestic pressures that elections pose.' [Thatcher, 1995, p 312]

Before the European Council of Stuttgart the advisors of the respective leaders of France and Great Britain met to prepare for the summit, where Attali confirmed to Armstrong that the British rebate could not be settled without the complete analysis of the Community finances and it could not take place before Athens. He added that it was very improbable that France would agree to give anything to the British for 1983 because of the overpayments that occurred in the previous years and because the French public opinion would hardly accept paying any subsidies to the UK whose balance of trade was in surplus due to its oil, while France did not possess such a natural resource. [Attali, 1993, p

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<sup>111</sup> From 6-7 June to 17-18 June 1983

<sup>112</sup> To have a new colleague in the Council who could be only less difficult than she was for them.

470] This latter point was a brand new element in the French argumentation, although there is no further evidence in the primary or secondary sources that this element was part of the official French argumentation or was evoked at other meetings<sup>113</sup>.

It was clear that after the failure of Mrs Thatcher's secret weapon<sup>114</sup> Mitterrand's new linkage policy, linking the BBQ settlement to a broader review of the EC financial mechanism, came as a delaying tactic from France. As the Community arrived at a stage near bankruptcy, Thatcher worked out and used another policy linkage, which was not in breach of the Treaty of Rome, in opposition to the increase of own resources.<sup>115</sup> She wanted to use this new means to urge settlement and to neutralise the French delaying tactics.

As the European Council was presided over by Kohl, Germany had an important role at that time. Furthermore, as it was his first presidency Kohl was keen that Stuttgart should be a success. According to the view of the British Prime Minister, the interests of German farmers were overruled by those of the German taxpayers at that time resulting to the opposition of the Kohl government to any further increase in the VAT ceiling. [Thatcher, 1995, p 313] While the future financing of the EC was sent to the Foreign and Finance Ministers, a refund of 750 million ECU for 1983 was provisionally agreed for Britain.

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<sup>113</sup> According to the author's opinion, this might have been the result of the weakness of this argument and its untenable character. There is no evidence that this argument was also used by Mitterrand.

<sup>114</sup> Vetoing the annual farm price increase

<sup>115</sup> The increase of the 1 per cent VAT ceiling had to be approved by each Parliament.

In contrast to the British, French sources underline a palpable difference between the interpretations of the two sides concerning the result of Stuttgart. This was reflected in the letters written by the French and in reaction by the British to Helmut Kohl.<sup>116</sup> The misunderstanding appeared when Thatcher announced at the Press Conference after the summit that the difference of 500 million ECU between her initial demand of 1250 million ECU and the agreed 750 million of Stuttgart was to arrange the over-receipts of 1980 and 1981. Mitterrand was shocked to hear it and told to Attali: 'Elle n'a encore rien obtenue, et le trop-perçu reste à rembourser.' [She even did not receive anything and the over-receipts are still to be reimbursed.] [Attali, 1993, p 471] Avoiding the misunderstanding Mitterrand had Cheysson prepared a draft letter to Kohl. In this letter Mitterrand clarified that 'the over-receipts of 1980 and 1981 will not be arranged with the conditional refund of 1983, because in any case its nature is different from the previous. The corrections concerning 1980 and 1981 were not taken into consideration and must be examined based on real figures.' [Attali, 1993, p 471] The French President's letter was based on the French position as shown in the minutes of the Stuttgart Summit, while Thatcher's letter that followed Mitterrand's was based on the conclusion of the summit. It argues that the summit's conclusion supports without any doubt the British position. She claims Mitterrand's interpretation to be a unilateral one, which does not affect in any case the validity of the unanimously approved

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<sup>116</sup> The copies of both letters was sent to the other participants of the Stuttgart Council

conclusion.[Attali, 1993, p 476] This summit was a perfect example of how the participants of the BBQ made their contradictory own interpretations on a unanimously-agreed text. This scene could to some extent be a modern adaptation of the story of Tower of Babel.

#### **6.14 RUN-UP TO FONTAINEBLEAU**

**‘I think Mrs Thatcher will yield at 1100 million. It will make her scream but everyone will be relieved to say yes.’  
/Helmuth Kohl/**

The period between the Summit of Brussels (19-20 March 1984) and Athens (4-5 December 1983) was a turning point in the French attitude toward the BBQ. Their main concern became the wish to find a permanent solution at the cheapest price and not to waste more time and energy renegotiating the rebate each year. The ever closer, financial crisis of the Community added another new element to this period.

Mitterrand mentioned to Thatcher in the course of their private meeting preparing the meeting for Athens that he could not see any chance to resolve the contentious issues in March, which would remain unresolved in Athens in December. Also to prepare for Athens the British outlined a threshold or ‘safety net’ system. It meant that the those Member States whose GDP per head was below 90 per cent of the Community average should not be net contributors at all, while those who are wealthier than the Community average should gradually become

net contributors. [Thatcher, 1995, p 336] However, Athens was a pure fiasco, Mitterrand refused all concession to Thatcher and the Council could not even agree on a communiqué.[Young, 1993, p 148] There were two noteworthy phenomena. First, which is witnessed in the memoir of Attali, on Monday when the blockage and chaos were complete the French president was briefed by the four highest ranked French civil servants. The notice said that the failure of Athens would have meant the withdrawal of the UK refund of 750 million for 1983 resulting in the withholding of their contribution. This situation could escalate into the insolvency of the FEOGA that contributes 40 per cent to the French agricultural exports.<sup>117</sup> Mitterrand stopped reading it and treated it as a means of blackmail to make a compromise with Thatcher.[Attali, 1993, p 549-50] The second phenomenon was the sudden change in the French position concerning the BBQ, reported by Thatcher [Thatcher, 1995, p 337-8]: France ceased to support a permanent solution regarding the BBQ. Thatcher perceived this change as part of Mitterrand's tactic 'to delay the settlement until he could take credit for it in his own presidency.'

On the 1<sup>st</sup> of January 1984, France took over the presidency from Greece. Mitterrand has decided to settle the BBQ at last making use of the huge diplomatic machinery of his country but without making too many concessions to Thatcher.[Young, 1993, p 148]. The above-

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<sup>117</sup> In 1982, the 40 per cent of the 100 billion FRF exports was due to the 9 billion FEOGA payments. According to the report, this fact would have made the French trade balance incredibly sensible to the bankruptcy of the Community.

mentioned views of Thatcher can be backed-up by the report of Mitterrand's chief advisor on the preparatory meeting of the French presidency on 9 January 1984. It shows that Mitterrand had a clear view on the programmes and objectives of his presidency. Among other things he mentioned as a primary objective the increase of the VAT ceiling to 1.4 per cent for March. After having dealt with the issues of the VAT ceiling, the milk quotas, and the compensation payments, he intended to settle the BBQ and to open the way to the enlargement. [Attali, 1993, p 567]

At the beginning of 1984, the figures were badly modified. Thatcher was stuck at the amount of 1.5 billion ECU, while her French counterpart's basis of negotiation was 600 million and his ceiling was 1 billion that could not be exceeded.<sup>118</sup> The same amounts were discussed at the Thatcher-Mitterrand working breakfast<sup>119</sup> at Marly, where Mitterrand ensured the Iron Lady that he intended to find a permanent solution but she had to be content with a two-thirds rebate. Thatcher tried to evade the restrictive French offer saying that she did not care about the proportions, she was only interested in the final outcome, which must be around a net British contribution in the range of 500 million ECU.<sup>120</sup> It was also clear from that meeting that she was opposed to accepting Athens as a basis of calculation for a permanent solution. [Attali, 1993, p

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<sup>118</sup> These figures were discussed between the two sides' advisors at the meeting of 19 January 1984 to prepare the private meeting of their

<sup>119</sup> On 23 January 1984

<sup>120</sup> It practically meant 1500 million refund but formulated from another way. It was obvious for Mitterrand as well who rather changed the topic as it was clear for him that they could not have a common denominator that day.

575-6] At the other meeting of the three (Mitterrand-Kohl) the German Chancellor ensured that Mitterrand settled the BBQ under the French presidency. Mitterrand offered a French undertaking to shoulder financial burden from Germany. At the last Mitterrand-Thatcher meeting she accepted to reduce her demand to the two-third (1333 million ECU) of the initial 2000 million net contribution. [Attali, 1993, p 575-6]

At the European Council of Brussels [Attali, 1993, p 575-6] there were three different proposals concerning the VAT ceiling increase. The Commission and France proposed 1.6, Ireland 1.8, and Germany and the UK would have accepted maximum 1.4 per cent. Following a desperate, but lively discussion on the BBQ Kohl put forward a new offer of 1000 million ECU for five years. While British primary sources seem uncertain whether it was a result of a Franco-German deal, French sources support this hypothesis and give a detailed report on the Mitterrand-Kohl agreement. It went without saying that Thatcher rejected the offer one more time (though, of course, this is a different offer from those previously available). Brussels was another fiasco in the long series of European Councils trying to deal with the BBQ. It failed to advance in the area of the BBQ or on the VAT ceiling bargaining. [Young, 1993, p 148]

The failure of Brussels led the British Government to re-examine the possibility of the withholding of the UK contribution. While this possible measure seemed to be a viable means of political threat in

Thatcher's eyes, her experts warned her that the UK would lose the case before the Court (ECJ). The immediate French reaction was the consideration of excluding Britain from the new EC initiatives in the future, thus threatening a 'two-tier Europe' [Young, 1993, p 383-5] Taking into consideration the different possibilities and impacts, she decided 'not to go down the path of withholding contributions.' [Thatcher, 1995, p 539]

### **6.15 'PERFIDIOUS ALBION' OR DIPLOMATIC TRIUMPH - FONTAINEBLEAU JUNE 1984**

**'The ten EEC heads of government must have hoped they were saying a more lasting farewell to the British Budget problem than the Old Guard did to Napoleon on his departure for Elba.'**  
*/The Economist/*

Two important preparatory events seemed to be important before the Fontainebleau summit. The first was a telephone conversation between Kohl and Mitterrand<sup>121</sup>, where Kohl told Mitterrand that he doubted whether they could offer less to the UK than the Commission did. According to the testimony of Attali, Mitterrand feared letting loose his German ally and permitting the creation of an Anglo-German agreement. [Attali, 1993, 635-6] The other important event was the

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<sup>121</sup> On 11 May 1984

personal meeting of the two leaders itself <sup>122</sup>. The only obstacle before the enlargement was the unsolved BBQ at that time. It was vital to Mitterrand to ensure that if the British block the situation the Nine (Ten without the UK) could go on in the building of the Community. He had to ensure strong German support for it. Although Mitterrand did not want to go over 1066 million, two-thirds of the British net contribution, Kohl was convinced that Thatcher would not give her consent to an amount less than 1100 million ECU [Attali, 1993, p 641-2]. Finally they came to an agreement to put joint pressure on Thatcher at Fontainebleau.

A triple motivation influenced Thatcher before and during the summit. First, it seemed harder to secure a settlement under subsequent Presidencies when France, no longer constrained by its role as President could actually press its own case. Secondly, Britain's refund for 1983 (750 million ECU) was being withheld, and she did not have any arrangement either for the current or for the following years. [Thatcher, 1995, p 541] Thirdly, according to Attali she must have known that France managed to arrange everything in order to evade the British blockade.[Attali, 1993, p 658] Thus, Thatcher was prepared to accept a different method of calculation but she was keen on the amount of the refund and the permanency of the system.

The question of UK's contribution was sent to the Foreign Ministers who put forward a new method to calculate the refund instead

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<sup>122</sup> On 26 May 1984

of the British threshold system. This new system, forced by the French, represented a simple percentage of the British net contribution leaving out the factor of wealth of the country instead of a complex computation that was required to the threshold system.[The Economist, 1984, p 47-8]

Another French proposal came to modify the outcome of the BBQ: they argued that the British refunds had to be calculated on the basis of the VAT payments only. This calculation omitted that part of the British contribution that the UK paid under the two other (own) resources: the custom duties and the levies.

Since, the French-proposed a basic system (simple percentage of the net contribution) and the French also proposed basis of calculation (VAT payments only) seemed to be accepted by all participants, in the second half of the summit the bargaining went on to consider the pure percentage. Basically Thatcher intended to reach more than 70 per cent, but according to the meeting of the Foreign ministers it was probable that the offer would not exceed 60 per cent.[Thatcher, 1995, p 543]

At the Mitterrand-Kohl breakfast of the second day they fixed the percentage at 65 per cent. Later in the discussion Thatcher became isolated and after the German Chancellor took the French position ‘she was on the verge of tears. She was about to agree on everything’, Attali remarked.[Attali, 1993, p 658] While this ‘astonishing spectacle’ is not mentioned in the ‘Downing Street Years’, the triumphant finale is described as follows: ‘I was determined to get the full 66 per cent..... I

said that it would be absurd to deny me my 1 percentage point. The French President smiled and said: “Of course, Madame Prime Minister, you must have it.’ And so the agreement was reached.’ [Thatcher, 1995, p 544]

### 6. Table: Results of Fontainebleau

Britain’s 1983 budget rebate of 750 million ecus (£440 million) was unfrozen leaving the British net payment for 1983 of 1200 million ecus.
Britain received a rebate of 1066 million ecus <sup>123</sup> in 1984.
It’s rebate for the subsequent years has been 66 per cent of the gap between its VAT payments to the Community and EEC expenditure in Britain.
The limit of the EEC’s VAT revenues was raised from 1 per cent to 1.4 per cent of Member States’ VAT income from the beginning of 1986.
British rebates were guaranteed as long as the 1.4 per cent VAT ceiling would not be renegotiated and increased within the EC. Such an increase requires unanimous agreement, thus the British claimed to have a cast-iron guarantee that the rebates cannot be stopped or amended without their consent.

Source: The table draws on the fact enumerated in: The Ten hope its adieu, not au revoir, *The Economist*, 30 June 1984, p 47-48

After the arduous negotiations Fontainebleau resulted in a rebate of £600 million [Lawson, 1992, p 110] (1000 million ecus) in 1984 and a regular rebate of 66 per cent of the British net contribution calculated on the basis of its VAT payments. At the same time, the British Prime Minister agreed to increase the VAT ceiling from 1 to 1.4 per cent, representing a 25 per cent increase in the total revenues [Denton, 1984, p

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<sup>123</sup> The original article mentioned 1000 million ecus, however other French and British sources unanimously mention 1066 million ecus. Thus the author rather relied on these latter sources.

127] of the EC budget and thus made it possible to avoid the bankruptcy of the Community. The charge coming from the refunds given to the UK was distributed among the Member States according to their VAT share, taking into consideration the special reduction of Germany's contribution to the British refund. [de la Serre, 1987, p 178] Facing criticism from the House of Commons, Thatcher argued that the agreement would be permanent in the sense that the refund would last as long as the VAT ceiling remains unchanged. According to her views even if the moment of a future renegotiation would arrive: 'I would be in just as strong a position as I had been in Fontainebleau to veto any extra 'own resources' unless I had a satisfactory deal on Britain's budget contributions.' [Thatcher, 1995, p 544-5] Throughout the BBQ the British argued that it was not a strictly British question and other Member States could and should be involved as well [Denton, 1984, p 126], France and the Community argued completely the opposite. This dispute had a certain after-life in the agreement since the agreement states that '...any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time.'

<sup>124</sup> However, in the last 23 years no other Member State could not make use of Fontainebleau (although the British argued that with the Mediterranean enlargement [1985] Portugal could find itself in a similar net contributor role). Though Mitterrand estimated that the arrangements

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<sup>124</sup> See Annexes for the complete text of the Fontainebleau Agreement

of the Agreement would end when the increased Community resources were exhausted, Thatcher argued at the Press Conference of Fontainebleau and in the House of Commons that the permanency of the refund is guaranteed (because a further increase of the VAT ceiling would require a unanimity). [de la Serre, 1987, p 181] This final Franco-British dispute of the BBQ was decided in 1988 when the fourth own resource was introduced leaving the VAT ceiling at 1.4 per cent.

## **7 REVIVAL OF THE BBQ**

The Fontainebleau Summit etched the system of rules of the British rebate and its algorithm in stone, which was rather difficult to modify later. However, going parallel to the fade and disappearance of the significance of factors triggering the rebate, it proved to be the most difficult to question the rightful existence of the rebate and then technically realise it by means of amendments. That is to say that the mechanism itself was retained, however, the economic cause and effect system making it legitimate gradually faded away in years.

In addition, changes did not occur only on one side but, in accordance with BBQ, on both sides of the budget (income and expenditure).

### **7.1 CHANGES TO BUDGETARY REVENUES**

In my description of the system of own resources I stressed that less prosperous countries proportionately contribute more to the EU's budget in the system of VAT-based contribution than their more well-off counterparts. This is because in the case of this type of contribution the size of the same significantly depends on the size of internal consumption compared to gross domestic product. In the meantime, however, two things have changed.

- First of all, the UK set off on the path leading to economic prosperity.

- Second, parallel to prosperity, the ratio of VAT-based resources drastically decreased in the system of contributions.

### 7. Changes to the system of own resources in the EU's common budget between 1988 and 2004

	1988	1991	1994	1997	2000	2001	2002	2003	2004
TOR	28.5%	24.8%	20%	17.6%	15.3%	16.6%	12.2%	11.7%	11.4%
VAT	57.2%	55.8%	50.4%	42.5%	38.1%	32.7%	23.6%	23.5%	14.4%
GNI	10.6%	13.3%	26.8%	33.4%	42.3%	37.5%	48.7%	55.5%	73.4%
Other	3.7%	6.1%	2.7%	6.5%	4.3%	13.1%	17.6%	9.2%	0.8%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: European Parliament Working Document N° 2 on the European Communities' own resources: The current Own resources system - Problems and shortcomings; In: Somai, 2004

The table clearly shows that the ratio of VAT-based contributions of 60% in 1988 practically shrank to approximately one-quarter, cca. 15% by 2004. Parallel, the role of GNI strengthened, which on the one hand does not qualify as an own resource at all, i.e. it decreased the "self-sustention and independence" of the EU budget and, on the other hand, it directed the budget toward a juster system of burdens because it was based on a welfare index. More affluent Member States paid proportionately more than less prosperous ones into the central budget.

## 7.2 CHANGES TO BUDGETARY EXPENDITURES

- Similar to the decrease in revenues from VAT-contributions, the share of agricultural spending significantly shrank on the side of expenditures.

### 8. Changes to the share of agricultural spending depending on budgetary expenditures in 1997 - 2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Share of agricultural spending in total EU expenditure	50.63%	48.08%	49.53%	48.61%	51.93%	51.11%	49.01%	46.91%	46.20%

Source: European Parliament Working Document N° 2 on the European Communities' own resources: The current Own resources system - Problems and shortcomings, p 5

The nearly 2/3 share of agricultural spending at the time of the UK's accession (1973) shrank to less than 50% (46.2%) by 2005.

- The other factor is the improvement within British agricultural shares due to multi-round agricultural reforms. As a result of the reform, the subsidy of products (beef, sheep, crops, etc.), which were the current strengths of Great-Britain's agriculture, significantly improved, i.e. Britain could turn such changes into benefits<sup>125</sup>. [Somai, 2004]

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<sup>125</sup> In 2003, the UK was the 3<sup>rd</sup> largest wheat producer among the EU 25, the 4<sup>th</sup> largest barley producer, tied for the second place in beef production and shared the first place in producing sheep.

## 9. GNI per capita of net contributors

(in PPS) EU-15 average = 100

	2003	1984
United Kingdom	111.2	90.6
Denmark	111.1	104.0
Austria	109.8	--
Netherlands	106.6	95.0
Sweden	104.6	--
France	104.2	104.0
Germany	98.6	109.6
Italy	97.3	92.9

Source: Report from the Commission Financing the European Union Commission report on the operation of the own resources system TECHNICAL ANNEX Financing the European Union Commission report on the operation of the own resources system COM(2004) 505 final Volumes I & II

The above table illustrates well that the economic situation has very significantly changed since the Fontainebleau Summit and that Great Britain is no longer the poor country which, in the midst of its economic recession, must bear a disproportionately heavy financial burden compared to that of other Member States. Somai stresses that in 2001 a rather absurd situation occurred, i.e. while the British net position came to a balance (its value was 0.04%) it also received a rebate of EUR 7.34 billion.

**Thus, on the one hand, the size of the net contribution by Britain decreased and, on the other hand, the country's economic prosperity significantly improved. These two factors clearly showed that the burden was not as big as it was in 1984, and Britain was able to easily shoulder this lesser burden. Consequently, several Member**

**States as well as the Commission rightfully raised the issue that Britain should take a bigger share of burdens while going for a “joint European outing”.**

In spite of all this, the British rebate survived the AGENDA 2000 as well as the painful period of the approval of the current budgetary perspective, which was, in a large part, attributable to British diplomacy.

### 7.3 THE LUXEMBOURG AND BRITISH PRESIDENCIES

**Motto:**

**‘I will do my level best to reach a financial agreement in December’**

**/Tony Blair/**

**From the point of view of France, the favourable solution has three characteristics: solidarity, fairness and stability. This includes that the amount and mechanism of the British rebate needs to be revised for the long-run so that Great Britain take its share of funding expenditures derived from expansion.**

**/Jacques Chirac/**

**‘It is unsustainable that keeping a surplus cow receives an amount of EU subsidy 1.5 times higher than the aid a starving child gets.’<sup>126</sup>**

**/Bob Geldof/**

One of the most important objectives of both the Luxembourg and the UK Presidency was to make Member States accept the draft budget for the period 2007–2013. Milestones of such acceptance were the size

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<sup>126</sup> British rock musician supported the UK government in its criticism of the CAP when he scheduled one of the most ambitious tours of all time before the G8 Summit in July 2005. The quote is from the press conference. Source: MTI: UK rebate and CAP, or “why 5 per cent gets 40 per cent”, 18 July, 2005.

of the budgetary total, the share of specific policies and other internal distributions within the budget. From the point of view of the dissertation, these are not unimportant elements; however, this chapter will focus only on the issue of the UK rebate due to limitations on length.<sup>127</sup>

The Luxembourg Presidency in the first half of 2005 failed undeservedly. There is consensus that it was the UK's resistance that made agreement impossible, although there had been several other exacerbating factors. Juncker, despite the size of his country, was considered one of the most distinguished politicians of the EU and was declared 'European of the Year' among other awards, yet even he could not guarantee success. His chances of success were prejudiced by several factors. One was the fact that the Luxembourg Presidency was followed by the UK Presidency and the issues of the rebate and CAP were not possible to avoid. Just as the first major stage of the BBQ could only be resolved in 1984 in Fontainebleau, that is, in France, the EU budget debate on ransoming refunds 'needed' the UK Presidency to be resolved.<sup>128</sup> Virtually, Britain turned down a version of the Conclusions of the Presidency of the Luxembourg Presidency which already lacked any reference to the proposal of the Commission for the GCM detailed above, i.e. the comprehensive extension of the correction mechanism.

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<sup>127</sup> Nevertheless, the chapter includes a chart to illustrate magnitudes and the process.

<sup>128</sup> Demanding requirements such as those expressed by the Netherlands are good example to illustrate the difficult situation. Dutch Prime Minister Jan Peter Balkenende announced that the Netherlands as the country with the largest per capita contribution intended to reduce its EUR 5.3bn annual contribution by EUR 1.5bn.

## 10. Various Proposals for the EU Budget for 2007–2013 and the Final Outcome

Proposal	Gross Budget (in billion EUR)	GNI
Proposal by the European Council	EUR 1,025bn	1.24%
Proposal by the Luxembourg Presidency	EUR 871bn	1.6%
First proposal by the UK Presidency	EUR 846.745bn	1.03%
Second proposal by the UK Presidency	EUR 849.3bn	1.03%
Final outcome	EUR 862.363bn	1.045%

Source: Author's table

During the UK Presidency, neither experts nor the press had seen much chance of the 7-year budget being approved before the end of the Presidency. Member States had extremely different and inflexible interests.

In his argument, Blair emphasised that the rebate was supposed to correct unreasonable distribution, which is unreasonable because 40% of the EU budget was still spent on CAP, a sector employing a mere 2% of the whole population of the EU. The other pillar of his argument was that the UK was willing to compromise on the amount of correction provided that the CAP was reformed. He attempted to prove that the amount of the UK rebate (close to EUR 5bn) was ‘reasonable’ by the fact that France’s annual receipts under the CAP, nearly EUR 8.8bn, was much more. [MTI, 2005]

Chirac, whose ground for diplomatic manoeuvres became considerably limited as a result of the French refusal of the Constitution<sup>129</sup>, argued that Blair should waive the rebate and the CAP should remain intact. In Chirac's battle with Blair, several major countries took to the British side (Sweden, the Netherlands, and even Germany). This did not make business for the French President any easier at the beginning of the bargaining process. Sweden also found the EU budget excessive, whereas the Netherlands wished to have their own contributions reduced. The change in the Chancellor's seat in Germany had not come at a good time for Chirac either, because while Schröder was more annoyed by the illegitimacy of the UK rebate, Angela Merkel found it more disagreeable that France called for correction to be eliminated while retaining the CAP.

“It is simply unfair to claim that agricultural subsidies are sacred and untouchable and to demand flexibility of the British at the same time.”<sup>130</sup>

While Blair made the following promise to the press:

“I will do my level best to reach a financial agreement in December,”

the proposed EU budget he presented was very poorly received by the international press, and he did not appear to be doing his best. In the words of DIE WELT:

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<sup>129</sup> The outcome of the Dutch referendum was also the refusal of the Constitution.

<sup>130</sup> Index, Öldöklö pénzharc Brüsszelben, 7 November, 2005

“The performance of the UK Presidency is closer to reckless bargaining than to high diplomacy.’

According to the Czech daily PRAVO,

“the speech on solidarity is no more than a bluff by the Brussels bureaucracy.’

Blair’s reputation was not improved by being denounced by José Manuel Barroso as the modern-day Sheriff of Nottingham, who takes and does not give to the poor, since he had proposed to compensate the burden of net contributors at the expense of new Member States. British diplomacy did not appear consistent anyway. While the spokesperson in charge reported regular negotiations between the Prime Minister and the Chancellor of the Exchequer, there were allegations that Blair had not consulted Gordon Brown on reduced amounts of refund. The Financial Times wrote that in November, prior to the UK Presidency, there had been disagreement over the extent of reducing the rebate between Prime Minister Tony Blair, Foreign Secretary Jack Straw and Chancellor of the Exchequer Gordon Brown. [Origo, 2005]

Nevertheless, the achievements of the UK Presidency must to be acknowledged. Starting from a hopeless position, a solution had been reached by the end of the Presidency to the satisfaction of nearly all parties. Although the British opposition and press termed the outcome a failure, that does not qualify as objective assessment. They blamed Blair for the loss incurred by waiving EUR 10.5bn from refunds and leaving

the CAP intact until 2014. In fact, that was the first time that substantial changes had been made to the algorithm for calculating corrections, much to the delight of the French. Of course, leaving the CAP intact until 2014 and the waiver of a part of the rebate by the UK were a major compensation for French identity. The new feature of the new correction mechanism<sup>131</sup> was that payments to new Member States were subtracted from the denominator of the second rate. Subtracting a greater subtrahend from a minuend that is constant in theory (if the denominator of a fraction is reduced, the value of the fraction will increase) would produce a smaller net budgetary position for the UK.

Expenditures on new Member States are introduced to the calculation of the rebate in three steps of various magnitudes. The rate will remain the same until 2009 (0%), whereas costs projected for new Member States would be considered in the denominator at 20% from 2009, 70% from 2010 and 100% from 2011.

Additionally, as on several previous occasions, the Council instructed the Commission to carry out a comprehensive review of the budget in terms of both revenues and expenditures, including the UK rebate as well as the system of own resources. A report on review findings is to be released both in 2008 and in 2009, based on which the Council can make its decision. According to the Conclusions of the Presidency, the findings of the review would be taken into account while preparing the financial perspective of the following period.

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<sup>131</sup> See the detailed description of the calculation of the UK rebate.

According to the Council's decision the European Commission launched a 'broad consultation with interested parties at local, regional and national levels, as well as at the European level, to stimulate an open debate on EU finances' the end of 2007. To highlight the most recent tendencies in the topic I will quote the most important results of the study made by the Swedish Institute for European Policy Studies (SIEPS) and the Institute for World Economics of the Hungarian Academy of Sciences (IWE) covering important issues related to the EU budget review. 'The survey<sup>132</sup> concludes that a number of reforms may take place but a far-reaching reform should not be expected, at least not in the short to medium-term perspective. The most important conclusions concerning the BBQ are the following:

- The net position is still at the very centre of thinking in most Member States. A change in the long run is conceivable but a departure from juste retour seems highly unlikely in the near future.
- Fundamental changes to the own resources system seem to be difficult to achieve. While it should not be ruled out that a change from the current to a new system funded by one or several EU taxes is possible in the long run, the survey shows that feelings against such a change are quite strong even with a horizon of more than 20 years. However, major changes are conceivable in the short to medium-term perspective: the debate on the UK rebate seems to have reached a degree of maturity, as important changes are expected by almost everyone.

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<sup>132</sup> in form of questionnaires sent to researchers and policy-makers within the EU. (See in Annexes)

Moreover, the really new element is the fact that the reform of the Common Agricultural Policy (henceforth CAP) is in the air and thus a UK veto is not a given outcome.

Very probably traditional debates will probably continue if not during the review, then at the latest during the discussions on the post-2013 Financial Framework. '[Szeplér, Eriksson, 2008]

In interviews conducted with them, researchers Tamás Szeplér and Miklós Somai both expressed the opinion that currently, the system of own resources is shifting towards the GNI factor, and if any breakthrough is to be expected, it will occur only in the medium to long term. In his paper [Somai, 2008], Somai examines the possible consequences of abandoning the CAP, the UK rebate or both<sup>133</sup>. A new element in the debate on budgetary balances is that by the end of the decade, the net receipts of France from the CAP will exceed its contribution to financing the UK correction [Laffineur–Vinçon 2004]. As a result, the moment of truth may come when the substance of the system of British arguments is put to the test in reality<sup>134</sup>, as it will hardly matter to France whether or not subsidies under the Agricultural Policy are abandoned if there is no correction mechanism for the UK either. This is only mathematics of course, and political decisions are also influenced by much softer factors, and agricultural policy, especially in France, is also an emotional issue to a great extent.

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<sup>133</sup> See the Appendix for the related chart

<sup>134</sup> During the UK Presidency, Tony Blair argued that the rebate might be waived at the cost of waiving the CAP as well.

It is apparent therefore that the British problem existing from the very beginning has not been resolved, only its shape evolved continuously. This was the case with the UK Presidency as well, which temporarily closed the issue. Owing to the cyclical nature of financial perspectives, the BBQ is beginning to resemble the Old Faithful geyser of Yellowstone National Park, which got its name from its well timed eruptions, scheduled as they were, and continues its activity below the surface between two eruptions. Similarly, the EU enjoys such exceptional moments every seven years, followed by temporary silence.

Unfortunately, there are no signs today indicating that a just and reasonable solution is possible in the medium term to the BBQ, which has become completely intertwined with the issue of the budget reform by now.

## 8 CONCLUSIONS

This chapter contains the findings of the author's independent research based on Hungarian and international literature for each chapter.

The multi-perspective research confirmed that the UK budget rebate is a unique phenomenon which could only evolve on the basis of Britain's unique historical, social, economic and political situation in a particular constellation of international politics and become firmly integrated into the system of the community as a result of step-by-step diplomacy. Anglo-French relations, Thatcher's assertiveness and the economic situation of the EC at the time were also required for the final result to be achieved.

### CONCLUSIONS: COMMUNITY BUDGET AND BUDGETARY POSITIONS IN THE LIGHT OF THEORETICAL SCHOOLS

- 1) The liberal school of integration theory focuses on the free flow of factors of production and the elimination of barriers to trade. In the early stage of EC integration, the free flow of factors of production is only acceptable with restrictions, as under the circumstances of the time, this was virtually limited to the international exchange of products suitable for free trade. A single budget was not a prerequisite for eliminating the barriers to free trade, therefore the concept of the redistribution function and the positions of

net contributors and net recipients are also not applicable at this stage. Founding Member States involved in the early stage of European Integration were at a comparable level of development, therefore the elimination of barriers to the flow of factors caused no major problems or asymmetries. It was the potential asymmetries forming between entities at differing levels of development participating in free trade that called for a compensation system. Although the budget and its conceptual system already existed at the very beginning of European integration, they had a minimal compensatory role among Member States. Thus, the concepts of net contributor and net recipient cannot be explained from the integration concept of the classical liberal school, since the establishment of free trade among actors at the same level of development does not require the existence of equalising compensation mechanisms. The equilibrium has formed automatically and by definition.

- 2) The establishment of regulation, the cornerstone of dirigist theory, as well as common institutions and methods of operation was characterised by raising funds for the operation of the international organisation rather than budgetary redistribution. Consequently, net contributor or net recipient positions as concepts based on the difference of contributions and receipts are not perfectly applicable. Therefore, regulation theory, due to its positive integration element, requires the creation of some kind of “integration budget”, but without the redistribution and equalising effect of the latter.

- 3) As a result of Mitrany's "spill over", integration will become broader and deeper through its reverberations across various functional areas. At the same time, states are gradually becoming less capable of performing certain core functions in a changing international system. As a result, they may transfer some of their political, social, economic, regulatory and other responsibilities to a higher level, that of international integration. In theoretical terms, functionalist theory is a sort of precursor to a budget performing tasks of redistribution (and consequently to the positions of net contributors and recipients), as it avoids separating the redistributing function of the common budget explicitly, however, sectoral co-operation requires certain transfers in order for economic convergence to be achieved.
- 4) Although a common budget is treated as a consequence in federalist views rather than as a central element of the theory, federation makes redistribution and various transfers necessary. At this point, the budgetary question is not interpreted partially anymore, in relation to financing the operations of the international system of institutions, but in its entirety, thus the positions of net contributors and beneficiaries are conceived.
- 5) Although the national and, above all, the EU budget does not appear in a conspicuous manner in the theory of interdependence. However, on the one hand, European institutions funded by the common budget are specific participants of European multiplayer games. On the other hand, they shaped the history of BBQ by means of assuming an active role.

- 6) According to the theoretical position of institutionalism, countries co-operate in the hope that, taking their system of values into consideration, co-operation would lead to a result of higher usefulness than self-sufficient conduct would. This practical and rational apprehension justifies co-operation which, by means of the gradual growth of its intensity, turns local co-operation originally commenced in a dispersed manner into one of the phases of integration. Beyond a certain point, intensifying co-operation and completing each step of integration will make various transfers and a mechanism for redistribution necessary, enabling the positions of net contributors and beneficiaries to be established.
- 7) The objectives of the European integration may not have been reached without implementing and sustaining a joint budget. Thus, there was a PONR (Point of No Return) on the 5-point Balassa-scale from where only the existence of the joint budget led the way through (with all its blessings and curses). On the other hand, it is economically evident that the system of the Member States that are at a different level of development but are operating within a single market requires budgetary redistribution. The single market also leads to the equality of work productivity, the aggregation of volumes of demand and the convergence of purchasing power.

## CONCLUSIONS: SYSTEM OF OWN RESOURCES

- 8) The nature of the structure and proportion of both incomes and expenditures had very different impacts on the economies of the different Member States. Some were in more favourable position than others, because the EC budget was more tailored to their economies. As a general rule, it can be claimed that Member States with large agricultural sectors and significant export of agricultural products falling under the scope of the CAP, were net recipients of the EC budget. On the other hand, those countries of the EC that had small agricultural sectors with a high dependence on food imports were generally net contributors.
- 9) The own resources system created an algorithm that encoded the notion of inequity and redistribution in the Community and created institutionalised channels through which the Community principles took form. However, the different policies were created for countries with specific, shared characteristics. When a rather less homogenous country, the UK, sought to join, it became clear that the policies were ill-adapted to states with a different socio-economic composition.
- 10) Member States, behaving as 'disintegrating pool balls', do not wish to abandon their direct budgetary influence, i.e. do not want to exchange the EU budget for a system comprised exclusively of own resources. This would lend legitimacy and independence to the EU, also establishing a closer and more transparent relationship between the Union and its citizens, while significantly reducing Member States' influence on the

budgetary regime. Conversion to a system which is based exclusively on own resources would limit Member States' systems of budgetary means to the process of adopting budgets (approvals, recommended changes, etc.) and collecting revenues. (The EU does not maintain a system of local institutions for this purpose, but outsources such tasks to Member States instead.)

11) Conversion to a pure system of own resources would cause the main lines in the network of Member States' interests to be restructured as well, since at the 1984 Fontainebleau Summit, the Parties tied the sustention of rebate to the permanence of VAT-based payments. Regardless of this fact, no structural change is possible without a consequent renegotiation of the UK rebate.

12) Most Member States limit their view of the common budget to the concepts of contributions and receipts. There is no ideal candidate among the potential new types of revenues proposed in background materials drafted by the Commission promoting the logic of community as well as other professional workshops. This is not only because all of the candidates have their own strengths and weaknesses, but primarily because politics, compromise and package deals will have the final say in selection anyway, rather than expert technocrats.

13) The British rebate is certain for some years to come, as 7-year financial perspectives establish the key targets as well as the structure of the budget for a fixed period (revenues and expenditures). Additionally, such a

fundamental restructuring of financing will by necessity be the outcome of a rather prolonged bargaining process.

14) Whatever reasons and circumstances there may be for the renegotiation of the UK rebate, it will present a task to the British government of the time that is nearly impossible to resolve. Not only because the fundamentals of the economic and legal arguments valid in the Thatcher era have become eroded, or because no premier is seen on the horizon who could match the Iron Lady in determination or calibre, but also because the European structure of interests, subtle as it was, has become even more complex following a series of enlargements. (I presume that with such a number of participants, *ceteris paribus*, even Margaret Thatcher's diplomacy would have failed.)

## CONCLUSIONS: FOOTPRINTS OF THE BBQ IN THE EARLY HISTORY OF THE EC INTEGRATION

- 15) There is some difference of interpretation or recollection over whether 'Britain was pushed out or withdrew' from the negotiations. However what is certain is that the UK was represented at a much lower level than the other countries, which appeared to reflect its lack of commitment to the subject. UK's withdrawal from the Messina negotiations led to the complete loss of influence on the EC agenda, hence the framework reflected Franco-German interests far more than UK interests. It must be also stressed that at the same time the UK concentrated on the world market and its relations with the Commonwealth countries. In practice, Britain's exit from the EFTA and application for EC membership may be interpreted as a subsequent admission of a wrong decision, but by that time, the French advantage (CAP) had become impossible to make up.
- 16) The competition between the British model (Eccles Plan: international product agreements and an intergovernmental consultative conference) and Continental models (strong supranational elements) concerning the international organisation of agriculture was finally settled with the Spaak Report and later by the ToR. The Spaak Report laid down a number of fundamental questions, which required answers. Arguably the Treaty failed to give the right and detailed answers to them. The Spaak Report had envisaged market regimes introduced for only a limited number of products on the basis of product specific problems and their importance to

farmers' income. It warned that it would be necessary to avoid the realisation of a vast area protected against third countries coupled with an unrealistic price level. There were certain hesitations among the Member States during the negotiations concerning the incorporation of the agricultural sector into the Treaty. Not surprisingly, it was indeed included at the insistence of France, where the UK could no longer change the rules.

17) The Treaty of Rome (ToR) itself ensured only a very vague framework for regulating such a complicated policy that became the CAP. The details were not worked out, it contained broad objectives and general means. This 'negligence' became more apparent after the setting up of the system of own resources, when the CAP represented around two-thirds of the EC budget. (The CAP's share of the EC budget increased rapidly in the second half of the 1960s, reaching its climax of 86.9 per cent in 1970.) That vague framework ensured a brilliant opportunity for France to impose its national interest within the EC in the absence of the UK. Another important advantage was when France demanded that the overseas territories of the Member States could be included into the Treaty (ToR). After its accession the UK was treated as a latecomer and had numerous disadvantages due to its outsider position.

18) The Member States and the Commission had already been aware of the major problems and threats to the CAP. Most of them, like the relationship with third countries (in the context of the BBQ, with the Commonwealth), the price support or the production of surpluses (in the context of the BBQ,

the budgetary burden of the CAP on the EC budget and on the economies of the non-agro oriented Member States) were outlined in the Commission's report that was published after the Conference of Stresa. The relevance of this report is that it proves that already at the birth of the CAP, the EC was aware of the major possible future problems. Thus the BBQ and had their origins here in 1957 and 1958.

### CONCLUSIONS: ORIGINS OF THE BBQ IN BRITISH SPECIFICITIES

- 19) The internal structure and balance of British-American relations was gradually shifting and turned around. Originally dominated by the British, the relationship gradually became balanced and later on the USA clearly took over the leading position. (This transition was demonstrated well in the political-economic overview.)
- 20) The special relationship, which had originally been restricted to American and British parties, was "passed on" to the EC after the British accession. (The EC has taken GB's place in some ways.) The special relationship – or at least its commercial aspects (intensive trade) – was slackened just like the one with the Commonwealth after the accession and contributed to the emergence of the BBQ.
- 21) In terms of the BBQ, British sovereignty played only an indirect role, however, it may be asserted that it was one of the factors of its "EU incompatibility" that are worth analysis. The gradual transfer of national

sovereignty to Community level was less of a problem for countries on the continent than for Britain, where sovereignty is embodied by the Parliament. There is no homogenous national identity in the UK, but rather separate Welsh, Scottish, English and not the least Northern Irish identities. Thus, the transfer of sovereignty had a much stronger impact on the British system than that of continental countries.

22) The British refusal to introduce the single currency, according to Balassa the fourth step of European integration, which is the establishment of the European Monetary Union, retaining the sterling as an important token of British sovereignty, was also due to the politically sensitive question of sovereignty. The problematic recognition of the supremacy of EC legislation, different from Anglo-Saxon legislation, was due to the same reason.

23) Britain had a wider choice than the Six after WWII; concerning its trade system (free-marketer or protectionist). It had both its wartime agricultural capacity and its huge fleet to restore its pre-war commercial relationships and to have access to cheaper world products. However, it was no longer an empire and later there was no alternative of joining the EC and the CAP. Thus it had to adapt to something alien to its mentality, practice, and interests.

24) In 1973 at the moment of UK's accession it was too late to challenge the basic structure of the EC. Nevertheless one of the main considerations

behind joining the EC was that it would be much easier, and advantageous to change its structure from inside.

25) The adaptation of the UK to the protectionist CAP went against its traditions and free-market mentality. It caused fundamentally different views on the question as to what would be the ideal agricultural system for the EC. It contributed a lot to the disagreements between the French and British governments.

26) On the one hand, the high import dependence of the UK and its net importer status caused severe losses to the UK budget compared to the other EC countries, since customs went as part of the own resources to the EC budget, while imported agricultural products were consumed in the country. On the other hand, the UK had a tiny but more efficient agricultural sector than the Community average. Consequently, its receipts from the EC budget were proportionally smaller than those of other Member States. These elements formed an important part of Mrs. Thatcher's key arguments during the BBQ.

27) The Commonwealth issue was important for at least three reasons during the accession negotiations:

- First, because the former colonies were heavily reliant on the British market for their exports. Therefore they were severely damaged by the UK's accession to the EC and the UK's adoption of the CAP regime.
- Secondly, because of its liberal trade philosophy and the openness of its economy the UK was equally reliant on cheap raw materials. It

specially needed agricultural products due to its unfavourable climate and its comparative disadvantage in the sector.

- Thirdly, Britain and the Commonwealth had strong cultural and historical links.

28) The comparison between the beginning of the British membership and the mid 1980s highlights extremely well how open Britain's economy was. Although, the British commercial orientation altered significantly during the first decade of its membership, due to the trade deviation of the custom union, UK's economy remained more open than those of other Member States and this caused severe problems during its membership.

29) France was in a more favourable position concerning its former colonies than the UK. First, because France as a founding country managed to give its former colonies the status of associated countries (by exerting pressure on the other founding members). British former colonies could not be involved in such co-operation even after the two British applications. After becoming a Member State the UK had to lobby for two more years to obtain roughly the same conditions for the Commonwealth countries (restriction in number: asian former colonies excluded). Secondly, because the French economy was less dependent on imports (mainly agricultural) than the British one.

## 9 AFTERWORD

The British Budgetary Question is a specific issue that embraces the particular problem of the excessive British net contribution, however, it has a more general interest since it touches on British EC membership from various aspects. Firstly, a wide range of questions is involved in the issue (British specificities) like relations with the Commonwealth, special relationship with the US, the British agricultural sector or UK's trade orientation. Secondly, the BBQ spans not only the period of 1979-1984 but began with the French vetoes of the 1960s and has reverberations even today as seen in the failure of the latest financial arrangements of the European Union to overthrow it.

The world famous statement of Margaret Thatcher, '**I want my money back**', which was chosen as an overall motto of the dissertation, describes quite well the distinctive traits of the BBQ. The word '**I**' highlights the fact that the negotiations and deal were done at the highest level in the European diplomacy, the level of the heads of state and government. Furthermore, it reflects faithfully the fact that the British Prime Minister '... convinced of both, her own rectitude and own ability, she has tended to reduce the cabinet (and the FCO [Young, 1998, p 316]) to subservience.' [Hennessy, 2000, p 400] The word '**WANT**' is an indication of the language she used with her counterparts: 'sent shudders down many a Continental spine' [Carrington, 1988, p 319]. The second half of the expression '**MY MONEY BACK**' refers to the irreconcilable

contradiction between the argumentation of France and the Community considering the own resources invulnerable and that of Mrs Thatcher claiming the British contributions to be properly British.

As the dissertation outlined the battle that Britain fought against the Community, and principally France for its money, one could conclude that it was a heroic and successful battle that was worth investing such energy and time in it. However, several authors claim that ‘the outcome of the Budget negotiations persuaded her that it always paid to be bloody-minded in dealings with the Community. This was to prove increasingly counterproductive in practice.’ [Lawson, 1992, p 111] As Jenkins claims, ‘... it was a heavy price to pay for 400 million ecus.’ [Jenkins, 1991, p 501]

The BBQ is, a European question with effects touching the whole Community, it is a specifically French issue as well, since France played a leading role in the BBQ as it was demonstrated in the previous chapters. The UK withdrew from the preparatory steps of the EC and found itself in an isolated position in the late 1950s. In the meantime France set up the EC in which the CAP was integrated on its initiative and strong insistence. Later with the budgetary arrangements in place and CAP was agreed, the CAP represented two-thirds of the budget. This was the main area where the interests of France and the UK were irreconcilably opposed. This apparent contradiction between the two countries was one of the arguments in the French veto, and became one

of the causes of the BBQ. The BBQ also meant a deep struggle of principles between the British mentality of 'my money' and fair contribution and the French-led community belief in Community 'own resources'. While the whole period of the BBQ was marked by the interaction of the three countries - France, Germany and the UK - France played a predominant role on the Community's side. Though Germany was the other net contributor to the Community, its relative wealth coupled with other factors [Grant, 1997, p 63] did not inspire it to join the British initiative, however, it contributed several times to facilitate that the British could reach their objectives. France in the first phase of the BBQ tried very hard to dissuade Britain from using linkage politics. In the second phase Thatcher tried to link the annual farm price increases to the settlement of the BBQ, but was overruled by the other Member States. France did manage to use linkage politics, however linking the settlement of the BBQ with the overall reform of the Community's finance to delay the settlement for the BBQ. In the third phase, the impending bankruptcy of the Community, the new British possibility to link the settlement of the BBQ with the increase of the VAT ceiling, and finally, the need for French diplomatic successes concluded in a package deal in Fontainebleau. Although at the beginning the French were against giving Britain a rebate on its contributions, in the end they considered it cheaper to have an agreement than to waste time and energy on the dispute.

The final aspect is related to the interpretation of the results of Fontainebleau, namely whether or not it represented a permanent solution. While at the Press Conference after Fontainebleau and the next day in her speech at the House of Commons Thatcher interpreted it as a permanent solution, Mitterrand considered it as an interim solution, which would obviously expire with the next increase of the VAT factor. However, the need of further money to finance the Community was satisfied not by changing the VAT percentage, but by introducing the fourth factor - GNP.

Although it is still uncertain whether the solution to the BBQ is temporary or permanent (it is very likely to be temporary), it is certain that even if the institution of the British rebate were to be abolished upon the next financial perspective coming into force, it was not such a temporary solution Mitterrand considered in 1984 as would span a quarter of a century. British government and diplomacy is definitely to be considered successful in this respect.

As we have seen, the British rebate has become inseparably integrated with the EU budget and any reform implemented to it. Whereas the original causes of the BBQ have been largely eliminated or gradually lost their significance, the number of EU Member States has increased to 25. That is, the legal grounds for the BBQ have become weak and disintegrated, while the number of stakeholders to be convinced and managed has risen dramatically. Moreover, the Union has

been joined by Member States whose financial and economic circumstances only emphasise the absurdity of the surviving rebate system. In such an environment, any budget reform such as the introduction of a new own resource would call for the renegotiation of the British budget rebate in relation to changes in the positions of net contributors and recipients as well as a potential compensation mechanism to be adopted as a result. Although the most recent series of negotiations of the 2007–2013 financial perspective have not abolished the institutionalised system of the British rebate, additional negotiations are very likely to bring fundamental changes to it. In a series of negotiations on this subject, representatives of the British government will start off in a much weaker position than the Iron Lady did in the late 70s. Obviously, this fact is not to lessen Margaret Thatcher's merits in achieving the rebate to be granted. In this respect, various heads of state and prime ministers may want to consider Mrs Thatcher's determined attitude towards the initial facts:

**'The facts? The facts? I have been elected to change the facts!'**[Hennessy, 2000, p 403]

## 10 GLOSSARY

ACP	African, Caribbean and Pacific Countries
BBQ	British Budgetary Question
CAP	Common Agricultural Policy
CFP	Common Fisheries Policy
COPA	Comité des Organisations Professionnelles Agricoles des Pays de la Communauté Économique Européennes
COREPER	Permanent Representatives Committee
DG	Directorate General
EAEC	European Atomic Energy Community
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council of the EC
ESCS	European Coal and Steel Community
ECU	European Currency Unit
ECJ	European Court of Justice
EDC	European Defence Community
EEC	European Economic Community
EFTA	European Free Trade Association
EP	European Parliament
EPC	European Political Community
EPU	European Payments Union
ERM	Exchange Rate Mechanism
EU	European Union
FCO	Foreign and Commonwealth Office
EAGGF	European Agricultural Guidance and Guarantee Fund

FEOGA	Fond Européen d'Orientation et de Garantie Agricole
FRG	Federal Republic of Germany
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GNP	Gross National Product
ICAO	International Civil Aviation Organisation
IMF	International Monetary Fund
MS	Member State
NATO	North Atlantic Treaty Organisation
NFU	National Farmers' Union
OECD	Organisation of Economic Cooperation and Development
OEEC	Organisation for European Economic Cooperation
ORD	Own Resources Decision
RNC	Reasonable Net Contribution
ToR	Treaty of Rome
TOR	Traditional Own Resources
UK	United Kingdom
US	United State
VAT	Value Added Tax
WEU	Western European Union
WWII	Second World War

## 11 ANNEXES

### 11.1 ARTICLES OF THE TREATY OF ROME CONCERNING THE AGRICULTURE

#### Article 32 (ex Article 38)

1. The common market shall extend to agriculture and trade in agricultural products. 'Agricultural products' means the products of the soil, of stockfarming and of fisheries and products of first-stage processing directly related to these products.

2. Save as otherwise provided in Articles 33 to 38, the rules laid down for the establishment of the common market shall apply to agricultural products.

3. The products subject to the provisions of Articles 33 to 38 are listed in Annex I to this Treaty.

4. The operation and development of the common market for agricultural products must be accompanied by the establishment of a common agricultural policy.

#### Article 33 (ex Article 39)

1. The objectives of the common agricultural policy shall be:

(a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural produc-

tion and the optimum utilisation of the factors of production, in particular labour;

(b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;

(c) to stabilise markets;

(d) to assure the availability of supplies;

(e) to ensure that supplies reach consumers at reasonable prices.

2. In working out the common agricultural policy and the special methods for its application, account shall be taken of:

(a) the particular nature of agricultural activity, which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions;

(b) the need to effect the appropriate adjustments by degrees;

(c) the fact that in the Member States agriculture constitutes a sector closely linked with the economy as a whole.

Article 34 (ex Article 40)

1. In order to attain the objectives set out in Article 33, a common organisation of agricultural markets shall be established.

This organisation shall take one of the following forms, depending on the product concerned:

(a) common rules on competition;

(b) compulsory coordination of the various national market organisations;

(c) a European market organisation.

2. The common organisation established in accordance with paragraph 1 may include all measures required to attain the objectives set out in Article 33, in particular regulation of prices, aids for the production and marketing of the various products, storage and carryover arrangements and common machinery for stabilising imports or exports.

The common organisation shall be limited to pursuit of the objectives set out in Article 33 and shall exclude any discrimination between producers or consumers within the Community.

Any common price policy shall be based on common criteria and uniform methods of calculation.

3. In order to enable the common organisation referred to in paragraph 1 to attain its objectives, one or more agricultural guidance and guarantee funds may be set up.

#### Article 35 (ex Article 41)

To enable the objectives set out in Article 33 to be attained, provision may be made within the framework of the common agricultural policy for measures such as:

(a) an effective coordination of efforts in the spheres of vocational training, of research and of the dissemination of agricultural knowledge; this may include joint financing of projects or institutions;

(b) joint measures to promote consumption of certain products.

Article 36 (ex Article 42)

The provisions of the Chapter relating to rules on competition shall apply to production of and trade in agricultural products only to the extent determined by the Council within the framework of Article 37(2) and (3) and in accordance with the procedure laid down therein, account being taken of the objectives set out in Article 33.

The Council may, in particular, authorise the granting of aid:

(a) for the protection of enterprises handicapped by structural or natural conditions;

(b) within the framework of economic development programmes.

Article 37 (ex Article 43)

1. In order to evolve the broad lines of a common agricultural policy, the Commission shall, immediately this Treaty enters into force, convene a conference of the Member States with a view to making a comparison of their agricultural policies, in particular by producing a statement of their resources and needs.

2. Having taken into account the work of the Conference provided for in paragraph 1, after consulting the Economic and Social Committee and within two years of the entry into force of this Treaty, the Commission shall submit proposals for working out and implementing the common agricultural policy, including the replacement of the national organi-

sations by one of the forms of common organisation provided for in Article 34(1), and for implementing the measures specified in this Title.

These proposals shall take account of the interdependence of the agricultural matters mentioned in this Title.

The Council shall, on a proposal from the Commission and after consulting the European Parliament, acting by a qualified majority, make regulations, issue directives, or take decisions, without prejudice to any recommendations it may also make.

3. The Council may, acting by a qualified majority and in accordance with paragraph 2, replace the national market organisations by the common organisation provided for in Article 34(1) if:

(a) the common organisation offers Member States which are opposed to this measure and which have an organisation of their own for the production in question equivalent safeguards for the employment and standard of living of the producers concerned, account being taken of the adjustments that will be possible and the specialisation that will be needed with the passage of time;

(b) such an organisation ensures conditions for trade within the Community similar to those existing in a national market.

4. If a common organisation for certain raw materials is established before a common organisation exists for the corresponding processed products, such raw materials as are used for processed products in-

tended for export to third countries may be imported from outside the Community.

Article 38 (ex Article 46)

Where in a Member State a product is subject to a national market organisation or to internal rules having equivalent effect which affect the competitive position of similar production in another Member State, a countervailing charge shall be applied by Member States to imports of this product coming from the Member State where such organisation or rules exist, unless that State applies a countervailing charge on export.

The Commission shall fix the amount of these charges at the level required to redress the balance; it may also authorise other measures, the conditions and details of which it shall determine.

## 11.2 PRESIDENT DE GAULLE, PRESS CONFERENCE, JANUARY 1963

[Salmon, Nicoll, 1997, p 86-90]

The Treaty of Rome was concluded between six continental States – States, which are, economically speaking, one may say, of the same nature. Indeed, whether it be a matter of their industrial or agricultural production, their external exchanges, their habits or their commercial clientele, their living or working conditions, there is between them much more resemblance than difference. Moreover, they are adjacent, they interpenetrate, they are an extension of each other through their communications.

The fact of grouping and linking them in such a way that what they have to produce, buy, sell and consume is produced, bought, sold and consumed in preference among themselves is therefore in conformity with realities. Moreover, it must be added that from the point of view of their economic development, their social progress, their technical capacity, they are keeping pace. They are marching in similar fashion...

Then, finally, they are in solidarity through the fact that not one among them is bound abroad by any special political or military agreement.

Thus it was psychologically and materially possible to create an economic community of the Six, though not without difficulties. When

the Treaty of Rome was signed in 1957. It was after long discussions; and when it was concluded, it was necessary – in order to achieve something – that we French put in order our economic, financial, and monetary affairs...and that was done in 1959. From that moment the Community was in principle viable...

However, this Treaty, which was precise and complete enough concerning industry, was not all so on the subject of agriculture, and for our country this had to be settled. Indeed, it is obvious that agriculture is an essential element in our national activity as a whole. We cannot conceive of a Common Market in which French agriculture would not find outlets in keeping with its production. And we agree further that, of the Six, we are country on which this necessity is imposed in the most imperative manner.

This is why when, last January, consideration was given to the setting in motion of the second phase of the Treaty – in other words a practical start in its application – we were led to pose the entry of agriculture into the Common Market as a formal condition. This was finally accepted by our partners, but very difficult and very complex arrangements were needed and some rulings are still outstanding.

Thereupon Great Britain posed her candidature to the Common Market. She did it after having earlier refused to participate in the Communities which we were building, as well as after creating a sort of Free Trade Area with six other States, and finally – I may well say it as the

negotiations held at such length on this subject will be recalled – after having put some pressure on the Six to prevent a real beginning being made in the application of the Common Market.

England thus asked in turn to enter, but on her own conditions. This poses without doubt to each of the six States, and poses to England, problems of a very great dimension. England in effect is insular, she is maritime, she is linked through her exchanges, her markets, her supply lines to the most diverse and often the most distant countries; she pursues essentially industrial and commercial activities, and only slight agricultural ones. She has in all her doings very marked and very original habits and traditions. In short, the nature, the structure, the very situation that are England's differ profoundly from those of the continentals...

The system of the Six consists of making a whole of the agricultural products of the entire Community, strictly fixing their prices, prohibiting subsidies, organizing their consumption between all the participants, and imposing on each participant the payment to the Community of any saving which they would achieve in fetching their food from outside instead of eating what the Common Market has to offer. Once again, what is to be done to bring England, as she is, into this system?

One might sometimes have believed that our English friends, in posing their candidature to the Common Market, were agreeing to transform themselves to the point of applying all the conditions which were accepted and precise by the Six...But the question is to know whether

Great Britain can now place herself, like the Continent and with it, inside a tariff which is genuinely common, to renounce all Commonwealth preferences, to cease any pretence that her agriculture be privileged, and more, than that, to treat her engagements with other countries of the Free Trade Area as null and void. That question is the whole question. It cannot be said that it is yet resolved. Will it be so one day? Obviously only England can answer.

The question is ever further complicated, since after England other States which are linked to her through the Free Trade Area, would like or wish to enter the Common Market for the same reasons as Britain. It must be agreed that first the entry of Great Britain, and then of these States, will completely change the whole of the adjustments, the agreements, the compensation, the rules which have already been established between the Six, because all these States, like Britain, have very important peculiarities. It will then another Common Market whose construction ought to be envisaged. But this Market, which would be increased to eleven, would without any doubt no longer resemble the one which the Six built.

Further, this Community, expanding in such fashion, would see itself faced with problems of economic relations with all kinds of other States, and first with the United States. It can be foreseen that the cohesion of its members, who would be very numerous and divers, would not endure for long, and that finally it would appear as a colossal Atlantic

community under American domination and direction, which would quickly have absorbed the European Community. It is a hypothesis, which in the eyes of some can briefly justified, but it is not at all what France wanted to do or is doing – and which is a properly European construction.

Yet it is possible that one day England might be able to transform herself sufficiently to become part of the European Community, without restrictions, without reserve, and in preference to anything else, and in that event the Six would open the door to her and France would raise no obstacle, although obviously the very fact of England's participation in the Community would considerably change its nature and its volume.

It is possible, too, that England might not yet be so disposed, and this is certainly what seems to emanate from the long, long Brussels conversations. But if that is the case, there is nothing dramatic about it. First, whatever decision England takes in this matter there is no reason, as far as we are concerned, for the relations we have with her to be changed. The consideration and the respect which are due to this great country, this great people, will not thereby be in the slightest impaired...

Moreover, I repeat, even if the Brussels negotiations were shortly not to succeed, nothing would prevent the conclusion between the Common Market and Great Britain of an agreement of association designed to safeguard exchanges and nothing would prevent close relations between England and France being maintained, nor the pursuit and development

of their direct cooperation in all kind of fields, notably the scientific, technical, and industrial – as the two countries have just proved by deciding to build together the supersonic aircraft *Concorde*.

Lastly, it is very possible that Britain's own evolution, and the evolution of the universe, might bring the English towards the Continent, whatever delays this achievement might demand...

### **11.3 PRESIDENT DE GAULLE, PRESS CONFERENCE, MAY 1967**

[Salmon, Nicoll, 1997, p 86-90]

#### Great Britain and the Common Market

The movement which now seems to be leading Great Britain to join up with Europe instead of staying outside, can cause nothing but satisfaction to France. This is why we have taken sympathetic note of the progress in this direction to which the intention declared by the British Government and the step taken by it seem to point. For our part, there cannot be, nor has there ever been, any question of a veto. The issue is merely one of the knowing whether success is possible in the framework and under the conditions of today's Common Market, without involving it in destructive disturbances, or, otherwise, in what alternative framework and under what alternative conditions such success could come about, unless one wants to safeguard what has just been built up until such time as it may conceivably appear possible to receive a Great Britain which, for her part and on her own account, would have transformed herself fundamentally.

I have spoken of destructive disturbances inside the Common Market: we all know that it took ten years of gestation to bring it into full operation...And the Six still have to agree on the highly arduous problems of energy, taxes, social costs, transport, etc...And once they have

finished building the structure in theory, they will have to live together in it, that is to say, year after year, to submit to the regulations, the compromises, the sanctions which have been and will be evolved. In short, the Common Market is a kind of prodigy. To introduce new and massive factors now in the midst of those which have been reconciled with such difficulty would obviously mean bringing both the structure as a whole and the details back into question and setting the problem of an entirely different nature; all the more so since, if we have succeeded in building this structure, it is because the parties involved were continental countries which were immediate neighbours, which admittedly differed in size but were complementary in their economic structures. Besides, the territories of the Six form a compact geographic and strategic whole. It should be added that, despite – and perhaps because of – their great battles of former times (I am speaking, of course especially of France and Germany) they tend now to support rather than oppose each other. Finally, conscious also of the potential of their material resources and human values, they all hope, whether openly or in secret, that together they will one day form a whole capable of balancing any power in the world.

In comparison with the motives which induced the Six to organize themselves together, one can well understand why Great Britain, which is not continental, which, because of her Commonwealth and her own insularity, has commitments far across the seas and which is tied to the United States by all kinds of special agreements, should not have merged

into a Community with specific dimensions and strict rules. Whilst this Community built up its organisation, Great Britain began by refusing to take part in it and even adopted a hostile attitude towards it, as though she thought it represented an economic and political threat. Then, she tried to negotiate entry into the Community, but in conditions such that the latter would have been stifled by her membership. This attempt having failed, the British Government then stated that it no longer wished to join the Community and directed its efforts towards tightening its ties with the Commonwealth and other European countries grouped around it in a Free Trade Area.

And now, Great Britain seems to have adopted a new state of mind and is declaring herself prepared to subscribe to the Treaty of Rome if she can be granted an exceptional and very long time limit and if, as far as she is concerned, essential changes can be made in the application of the Treaty. At the same time, she recognizes that, in order to attain this goal, obstacles would have to be overcome which the British Prime Minister, speaking from his vast experience and very great clear-sightedness, has described as formidable.

This is the case, for instance, with the agricultural regulations: it is well-known that these regulations are designed to enable the Community to feed itself from its own produce and to compensate, by means of what are known as financial levies, for any advantage which the various States might derive from imports of cheaper commodities from elsewhere.

Great Britain is very largely fed by produce purchased at low cost all over the world and, in particular, in the Commonwealth. If she submits to the rules of the Six, her balance of payments will be crushed by the levies and she will, on the other hand, be forced at home to bring the price of food up to the level adopted by the Six, to raise her workers' wages correspondingly and to charge correspondingly more for her manufactured goods which will be that much more difficult to sell. She clearly cannot do this. But, on the other hand, to bring Britain into the Community without her being really bound by the agricultural regulations of the Six would amount automatically to disrupting the system and therefore to upsetting completely the balance of the whole Common Market and robbing France of one of her chief reasons for being a member.

Another essential difficulty lies in the fact that, among the Six, the rule is for capital to flow freely in order to promote expansion, while in Great Britain, although capital can enter the country, it may not leave, in order to limit her balance of payments deficit, which is still threatening, despite praiseworthy efforts and some recent progress.

How can this problem be resolved? For it would be too great a risk for Great Britain to do away with the locks preventing capital from flowing out, and it would be unbearable for the Six to bring into their organization a partner that would be isolated in this respect in so exorbitant a system.

How, also can one fail to see that the peculiar position of Sterling prevents the Common Market from including Great Britain? Indeed, the fact is that the organization of the Six is bringing down all trade barriers between them necessarily entails that their currencies must have a constant relative value and that, if one of these were to be shaken, the Community would put it right. But this is only possible because the Mark, the Lira, the Florin, the Belgian Franc and the French Franc are in a thoroughly strong position. On the other hand, although we need not despair of seeing the Pound maintain itself, the fact is that we cannot be certain for a long time to come that it will succeed in this. We shall be all the less certain since, in relation to the currencies of the Six. Sterling has the special character of what is known as a reserve currency, which means that a great many States in the world, and particularly in the Commonwealth, hold enormous Sterling balances. Of course, one may attempt to draw a distinction between the fate of the Pound as a national currency and as an international one; it may also be claimed that, once Great Britain would be inside the organization, the Community would not be obliged to answer for what might happen to Sterling. But these are purely exercises of the mind.

When all is said and done, monetary parity and solidarity are essential rules and conditions of the Common Market and can assuredly not be extended to our neighbours across the Channel unless Sterling presents itself one day in a new position, with its future value seemingly se-

cure, freed, like the others, from its reserve currency role and with the burden of Great Britain's debit balances inside the Sterling Area having been eliminated. When and how will this come about?

What is already true now in the economic sphere could also become true in the political one. The idea, the hope which, from the beginning, led the Six continental countries to unite was undoubtedly to form an entity that would be European in all respect, that is to say, that it would not only carry its own weight in trade and production, but that it would be capable one day of dealing politically with anyone, for its own sake and on its own. In view of the special relations of the British with America, together, with the advantages as well as the liabilities arising for them out of these relations, in view of the existence of the Commonwealth and of the privileged relations they have with it, in view of the fact that the British are still assuming special commitments in various parts of the world, which set them fundamentally apart from the continental people, it is easy to see how the policy of the Six, providing that they have one, could, in many cases, be associated with that of the British. But it is not possible to see how the two policies could merge, unless the British resumed complete freedom of action, particularly with regard to defence, or unless the peoples of the Continent gave up the idea of ever building a European Europe.

It is true that the British quite naturally consider that their membership of the Community would automatically turn the latter into some-

thing quite different from what it is at present. Indeed, once their representatives had established themselves in the ruling bodies the Council of Ministers, the Council of Deputies, the Commissions, the Assembly – once the very considerable and very special mass of their economic and political interests and obligations were represented within these bodies, where they would have an importance commensurate with their numbers and audience and where they would immediately be joined by the delegations of a number of other European countries that are in the Free Trade Area with them, it goes without saying that the inspiration, dimensions and decisions of the Community of the Six as it is today would give way to an inspiration, to dimensions and decisions that would be entirely different. Indeed, the British do not hide the fact that, once they were inside the Community, they would set out to obtain many modifications.

Where France is concerned, the industrial, agricultural, commercial, monetary and, lastly, political conditions in which she would then find herself would certainly no longer bear any relation to those she accepts inside the Common Market.

It truly seems that if, by the general agreement, one wished to bring about a change in the position of the British in relation to the Six, a choice might have to be made between three solutions:

Either it could be recognized that, in the present state of things, their entry into the Common Market with all the exceptions that would necessarily accompany it, the inrush of factors entirely new in both kind

and quantity which it would inevitably entail, the participation of several other States which would certainly follow as a corollary, would amount to imposing the building of a completely new structure which would virtually wipe out everything that has just been built. What, then, would we end up with, other than the creation, perhaps, of a Western European free trade area, pending the Atlantic area which would deprive our continent of all real personality?

Or a system of association, such as is provided for by the Treaty of Rome and which could increase and facilitate the contracting parties' economic relations without causing any upheavals, could be set up between the Community on the one hand and Great Britain and certain other States of the little Free Trade Area on the other hand.

Or, lastly, before changing what exist, the third solution would be to wait until a certain internal and external evolution of which Great Britain seems to begin to show signs may possibly have been carried to its conclusion: that is to say, until this great people, so magnificently gifted in ability and courage, has first and for itself carried out the fundamental economic and political transformation needed to enable it to link up with the six continental countries. I really believe that this is the wish of many people who want to see the emergence of a Europe that would have its natural dimensions, and who have a great admiration and sincere friendship for Great Britain. If, one day, Britain reached this

stage, how wholeheartedly France would welcome such a historic conversion.

## **11.4 ‘CONCLUSIONS OF THE PRESIDENCY OF THE EUROPEAN COUNCIL’**

**Fontainebleau, June 1984 [Salmon, Nicoll, 1997, p 99-104]**

### Budgetary imbalances

1. Expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances.

However, it has been decided that any member State sustaining a budgetary burden, which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time.

The basis for the correction is the gap between the share of VAT payments and the share of expenditure allocated in accordance with the present criteria.

2. As far as the United Kingdom is concerned, the following arrangement is adopted:

for 1984, a lump of 1000 million ECU is fixed;

from 1985 the gap (base of the correction) as defined in paragraph 1 is, for the period referred to in paragraph 4, corrected annually at 66 per cent.

3. The corrections foreseen in paragraph 2 will be deducted from the United Kingdom’s normal VAT share in the budget year following

the one in respect of which the correction is granted. The resulting cost for the other member States will be shared among them accordingly to their normal VAT share, adjusted to allow the Federal Republic of Germany's share to move to two-thirds of its VAT share.

4. The correction formula foreseen in paragraph 2 (second indent) will be part of the decision to increase the VAT ceiling to 1.4 per cent, their durations being linked.

One year before the new ceiling is reached, the Commission will present to the Council a report setting out the state of play on:

the result of the budgetary discipline;

the Community's financial needs;

the breakdown of the budgetary costs among member States, having regard to their relative prosperity, and the consequences to be drawn from this for the application of the budgetary corrections.

The Council will re-examine the question as a whole and will take the appropriate decisions *ex novo*.

#### Own resources and enlargement

The maximum rate of mobilization of VAT will be 1.4 per cent on 1 January 1986; this maximum rate applies to every Member State and will enter into force as soon as the ratification procedures are completed, and by 1 January 1986 at the latest.

## 11.5 EVALUATION OF THE POTENTIAL EU TAXES

Tables published in Philippe Cattoir's article: 'Tax-based EU own resources: An assessment', European Parliament Working Documents

Criterion	Assessment of the Modulated VAT	Rating
<b>Sufficiency</b>	VAT is a buoyant source of revenue representing on average 7.0% of GDP in Member States in 2001 (European Commission, 2003). Applying a surcharge of 2% to the existing VAT base (including on zero-rated goods) would bring about revenues equivalent to between 0.8% and 1.3% of Member States GDP, as compared to a EU budget close to 1% of EU GDP. Moreover, tax receipts grow in line with increased spending on goods and services without any change in the VAT rate(s). Furthermore, in the long run, if resources need to be increased, this is achievable through an increase in the VAT rate(s).	***
<b>Stability</b>	Private consumption, which would be the principal component of the VAT base, has cyclical characteristics. OECD (2000) shows that the elasticity of indirect tax revenues to the GDP is close to one in most EU countries, with a minimum of 0.5 in Ireland and a maximum of 1.6 in Denmark. However, it is unlikely that the replacement of the third and (possibly) fourth resources with a VAT resource of the type proposed would introduce additional short-run variability in EU budget revenues. Indeed, the current third resource is closely related to VAT, while a consumption-based tax (the EU VAT) should be more stable than a GDP-based contribution (the GNI resource). This is so because the most volatile and cyclical components in GDP are investments and trade, while consumption and government spending are more stable. This also corresponds to the permanent income hypothesis with consumption smoothing over time. Overall, VAT could be a fairly stable source of revenue.	***
<b>Visibility</b>	In the form of two separate tax rates, a national and an EU one, the tax will undoubtedly be highly visible to taxpayers/citizens and is certain to be understood as a contribution to the EU budget.	***
<b>Low operating Costs</b>	Adding supplementary rates to the existing VAT system would not substantially modify the working of the current system.	***
<b>Efficient allocation of resources</b>	The impact of modulated VAT on the allocation of resources in the EU would probably be limited. This is due to the fact that the EU rates would be low, i.e. 1.5-3%, and apply to a broad tax base.	**
<b>Horizontal equity</b>	Provided a full harmonisation of the base is achieved and the issue of zero-rated goods is addressed, there will be an equal treatment of equivalent taxpayers in the EU.	***
<b>Vertical equity</b>	In general, VAT is regressive, since poorer people tend to consume a larger proportion of their total income. The proposal for a two-rate structure offers a partial solution to this problem, by setting lower rates on essential goods.	**
<b>Fair Contributions</b>	The EP (1997) has examined in depth the Member States' VAT contributions to the budget. From this study, it appears that 'VAT payments are influenced by many factors giving rise to inequities between Member States', e.g. the ratio of private consumption spending to GNP, the ratio of public to private consumption spending and the net trade balance for manufactured goods. More recent estimates, based on the so-called 'intermediate' base used for calculating VAT contributions to the EU budget, show that the EU VAT collected in the Member States would be relatively similar (between 0.8 and 1.3% of GDP). Given the possibility of inequities in gross 'contributions' resulting from a modulated VAT, the Langes report (1994) favoured an equalisation mechanism based on GNP, next to the VAT (see also EP, 1997).	**
<b>Overall evaluation</b>	As main positive arguments, the Modulated VAT would bring sufficient revenues to the EU budget. It would be highly visible to the citizens and present horizontal equity. It would also be based on a tax that is already used in the EU financing. In practice, the new system would thus mainly modify practical arrangements related to the third resource and maybe fourth resource. In general, there would not be major efficiency or equity arguments against this proposal. However,	

	<p>some institutional aspects would have to be further examined. In particular, the VAT raised could vary from one Member State to the next, thereby requiring some kind of equalisation mechanism. Furthermore, some adjustments to Member States' VAT systems would probably be required, in particular the elimination of the system of zero-rated goods and further harmonisation of the VAT base. This could cause serious political difficulties.</p>
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Criterion	Assessment of the EU corporate income tax	Rating
<b>Sufficiency</b>	The tax base of the EU corporate income tax would be relatively limited and unpredictable. Although the corporate income tax represents on average 2.6% of GDP in the EU in 2001 (see European Commission, 2003), depending on the design of the scheme only a limited number of companies would be concerned by the EU corporate income tax. But these account for only a part of total value added and taxes. For instance, a recent study highlights that the share of foreign controlled multinational companies in total value added represented between 11.7% and 17.9% for five EU countries in 1997 (Eurostat, 2001). In these circumstances, the EU corporate income tax could not be used as the main or only resource of the EU. It would probably need to be complemented by other resources.	**
<b>Stability</b>	Corporate profits have pronounced cyclical characteristics. However, estimates of output elasticity of the corporate income tax differ widely depending on the methodology used. The OECD (2000) for instance finds an elasticity of the tax to GDP of 1.3 for a sample of 20 OECD countries. For the same countries Giorno et al. (1995) found an average elasticity of 2.7. The replacement of the third and fourth resources with a resource of the type proposed would thus significantly raise the shortrun variability of EU budget revenues.	*
<b>Visibility</b>	Although the corporate tax would only affect directly those citizens who are owners of firms, the level of corporate taxation traditionally receives substantial attention in the political debates. As a result, depending on who was responsible for setting the EU tax rate, there could be an element of increased EU accountability if the citizens/voters were able to influence the level of taxation. This would in particular be the case in a scenario where the EU would be solely responsible for the corporate income tax.	**
<b>Low operating costs</b>	The obligation to deal with up to 15 (soon 25) tax systems and administrations is very cumbersome. Indeed, currently, any crossborder operation has to be monitored by at least two tax administrations. Market operators often complain about this. In the European corporate income tax system, the company would fill in only one tax form for all intra-Community transactions. This could lead to substantial savings in compliance costs for companies operating in the EU. The implementation of this tax could also lead to lower total administrative costs, since only one tax return would have to be prepared for participating companies. However, this positive view could be mitigated by the many practical difficulties that administrations would face when coping with the EU tax system parallel to the national system (should the EU tax be only applicable to a certain type of companies).	**
<b>Efficient allocation of resources</b>	A European corporate income tax could help eliminating tax obstacles to cross-border activities, thereby fostering a proper functioning of the Internal Market and lower compliance costs for economic operators [COM(2001)582]. Cross-border mergers and acquisitions would be easier. As a consequence, reorganisation of business activities and investments would be fostered. Furthermore, ceteris paribus, investment is located where it brings the highest after tax return. In other words, the current functioning of corporate income taxes is a source of distortions in the allocation of capital in the Internal Market. Harmonising the corporate income tax in the EU for multinational companies would allow for investments locations more in line with productivity. This would then improve efficiency in the EU.	***
<b>Horizontal equity</b>	Companies subject to the EU corporate income tax would face a common (compulsory) set of rules. Horizontal equity would thus be fully respected.	***
<b>Vertical equity</b>	The burden of corporate income taxation can fall on consumers, owners of the company capital or wage earners, depending on the context. It is therefore difficult to make a clear assessment of the effect of corporate income taxation on income distribution in the EU. However, CIT is often viewed as a withholding tax on dividends and thus on private capital owners, who can be assumed to be on the upper end of the income distribution. But this is not always true. For instance, most shares in UK listed companies are owned by pension funds which provide pensions for both low paid and high paid persons.	**
<b>Fair contribu-</b>	The differing corporate income tax revenues observed in the EU nowadays (between 0.6 and 7.7% of GDP in 2001) result from highly differing tax systems. Furthermore, the eco-	**

<b>tions</b>	<p>conomic structures, in particular the openness of the economy and the proportion of multinational companies could play an important role in the geographic impact of the EU tax. Amounts collected in the Member States could thus not fully reflect their economic development. At the same time, it has to be recognized that corporate income taxation is marked by a certain degree of 'regional arbitrariness'. This tax involves a mismatch between the geographical pattern of tax collection and tax burden, which makes any national reapportioning arbitrary. In this context, fair contributions are more difficult to define and assess.</p>	
<b>Overall evaluation</b>	<p>EU corporate income tax could offer significant benefits in terms of efficiency in the Internal Market. It could facilitate cross-border activities in the EU and make investments more efficient. On the other hand, there would be numerous technical difficulties, in particular if the new tax was defined for a specific group of market operators only. Furthermore, creating an EU corporate income tax would also require the development of – and unanimous agreement on – a harmonised corporate tax base.</p>	

Criterion	Assessment of the EU Energy Tax	Rating
<b>Sufficiency</b>	Taxes on energy represented 2.0% of GDP in 2001, while taxes on mineral oil accounted for 1.8% of EU GDP (EC and Eurostat 2003). A large part of mineral oils tax revenues relates to fuel used for transport. An EU energy tax, even it was limited to setting the EU tax rates at the level defined for the minimum rates in the directive, would probably bring sufficient revenue to cover a significant part of the EU budget. This is in line with previous Commission conclusions. For instance, in European Commission (1993) it was estimated that a USD10 tax per barrel of oil equivalent would yield about 1.1% of EU GNP in the context of a carbon/energy tax. In the longer run, the tax would also be sufficient: according to the European Parliament (1997), energy use correlates quite closely with GDP growth. Eurostat (2000) also shows that over the last 20 years, energy taxes have grown as a percentage of total taxes and as a percentage of GDP (from 1.62% in 1980 to 2.21% in 1997).	***
<b>Stability</b>	Being a tax based on quantities sold and not ad valorem, the energy tax would be relatively insensitive to the price of energy on the international markets because of the low price elasticity of demand. Past data shows that energy taxes revenues tend to be relatively stable (European Commission, 2003). The main changes (in % of GDP) have been observed in 1986 a year of sharp drop in oil prices (-0.15%) and in 1990-1992 a period of turbulences due the Kuwait crisis (+0.22%). In general, downward variations have been rather limited. Furthermore, as fuel prices only constitute a fraction of total transport costs (23%), the effects of a higher oil price would be correspondingly small on transport activities. Some simulations show that in the oil price hike in 2001, which translated into rocketing net fuel prices (+86%), total transport costs increased by less than 7%, triggering a reduction in transport demand and fuel consumption of 2-3% only.	***
<b>Visibility</b>	Public opinion is very sensitive to energy and pollution issues. It is therefore likely that any EU energy taxation would be widely publicised and debated.	**
<b>Low operating costs</b>	Energy taxation in the form of excise duties on a limited number of products, especially on motor fuels used for transport, would be relatively easy to administer compared to many other taxes.	***
<b>Efficient allocation of resources</b>	Provided the design of the EU energy tax leads to some harmonization in the tax rates for energy products, it can foster an efficient allocation of resources in the EU. In particular, increased harmonisation for fuel products used by professional transporters can lead to better allocation of transport activities in the EU and reduced pollution. Taxation of energy products may also potentially contribute to achieving EU environmental objectives as regards polluting emissions. In particular, it could help Member States in their efforts to comply with the obligations stated in the Kyoto Protocol.	***
<b>Horizontal equity</b>	The harmonisation of the EU energy tax base makes it possible to apply an equal treatment to taxpayers in the EU.	***
<b>Vertical equity</b>	When it comes to heating products the burden of energy taxation falls proportionately more on poorer households. For other energy products, such as gasoline used for transport, the burden of the tax falls more heavily on well-off people. Therefore, whether energy taxes involve income redistribution has to be examined on a product by product basis. Overall the assessment of the two options presented above may differ on this specific issue of vertical equity.	**(*)
<b>Fair contributions</b>	The level of energy tax revenues differs significantly across the Member States. Energy taxes represent 1.2% of GDP in Ireland compared with up to 2.7% of GDP in Denmark in 2001 and 2.8 % in Luxemburg (see European Commission, 2003). This is due to different climate conditions, economic circumstances, available natural resource and political choices. However, this does not constitute a serious indication of potential unfair contribution, should the rates be harmonised at EU level.	**
<b>Overall evaluation</b>	A European Energy tax, for instance focusing on motor fuels used for transport, could permit an efficient allocation of resources in the EU. It would also bring substantial revenues for the EU budget. Relatively easy to design and implement, it would nevertheless also have a number of drawbacks. Under the broad base option in particular there could be vertical equity problems.	

Criterion	Assessment of the EU excise duties	Rating
<b>Sufficiency</b>	Excise duties are estimated to be as high as €63bn in 2001 for tobacco (0.73% of EU GDP) and €27.2bn for alcohol (0.31% of GDP) (European Commission, 2003). Although the EU excise duties would probably not be as high as the existing duties, revenues raised could be substantial. However, as the European Parliament (1997) points out, revenues raised on alcohol and tobacco do not increase in line with GNP 'because taxes are usually defined in terms of quantities rather than values'. This problem could, however, be mitigated by the fact that revenue elasticities are high in relation to rate increases because the demand for such goods is typically price inelastic. Lower revenues could then be easily compensated by higher duties.	**
<b>Stability</b>	Low elasticities with respect to GNP and low price elasticities of these goods would imply stable tax revenues. There is thus a limited risk of experiencing marked changes in the revenues raised over the business cycle.	***
<b>Visibility</b>	Provided the EU tax is clearly indicated on the bills, it will be visible to the citizens. However, the excise duties will bear on a narrow range of products and affect part of the population only, i.e. smokers and consumers of alcohol.	**
<b>Low operating costs</b>	Some limited costs could arise from the obligation, for taxpayers or tax administrations, to indicate the amount of excise duties paid to the EU on tobacco or alcohol products. On the other hand, if the minimum EUwide excise duties lead to a reduction in the difference of total excise duties between Member States, it may lead to a reduction in fraud (smuggling) cases as these are directly linked to after-tax differences of alcohol and tobacco prices.	**
<b>Efficient allocation of resources</b>	Overall, EU-wide minimum rates of excise duties for all alcohol and tobacco products may lead to more uniformity in total excise duties levied on these products than is currently the case. This could limit distortions in the choices of (cross-border) consumption for these products. Nevertheless, this approximation of after-tax prices may be limited as national governments will still apply different supplementary rates on these goods.	**
<b>Horizontal equity</b>	The EU excise duty would be applied in a uniform fashion all across the EU. Equal treatment would thus be applied to equivalent consumers.	***
<b>Vertical equity</b>	Excise duties on alcohol and tobacco are regressive. Applying EU excise duties on these goods would not facilitate income redistribution at the EU level.	*
<b>Fair contributions</b>	The share of the bases of the excises in GNP differs substantially across the Member States. This is largely the result of social/cultural and economic differences. For instance, consumption per capita for tobacco and alcohol products tends to be highest in producing countries. This would not be consistent with the fair contributions criterion.	*
<b>Overall evaluation</b>	The main advantage of European excise duties on tobacco and alcohol relates to the fact that the tax base is already largely harmonised. In theory, it could therefore be relatively quick and easy to impose minimum EU excise duties on these goods. The main drawback of the proposal is linked to the unequal sharing of the tax base across Member States, which would probably require some equalization mechanism. Furthermore, excise duties on alcohol and tobacco also raise important redistribution issues. The analysis also underlines that the modalities of implementation of the tax can affect its assessment. For instance, there is a trade-off between more visibility given to the tax and the compliance costs for the taxpayers.	

Criterion	Assessment of transfer of seigniorage revenue to the EU	Rating
<b>Sufficiency</b>	Estimated seigniorage amounted to approximately €10 bn for the Eurosystem in 2001. It should be noted that this estimate very much depends on the underlying assumptions and accounting rules. As a comparison, the aggregate profit of the Eurosystem could be broadly estimated at €25 bn in the same year. This amount corresponds to the total net income collected by the system, after deduction of all costs, but before taxes and dividend payments.	*
<b>Stability</b>	In theory the revenues arising from seigniorage can be relatively unstable in the short-run since they depend on the demand for cash balances and interest rates, which are notably affected by the business cycle. However, in the EU context, these variables are relatively stable. In the long run, the evolution of seigniorage is uncertain. On the one hand, changes in payments habits and the generalised use of electronic means of payment might erode the tax base. On the other hand, the development of the Euro as an international currency may contribute to seigniorage through increased circulation of euro banknotes outside the euro area.	**
<b>Visibility</b>	As an implicit tax, seigniorage is not visible to most citizens.	*
<b>Low operating costs</b>	Compliance and administration costs would be very small, since there would be only a few 'taxpayers', i.e. the National Central Banks, and the tax base would be easy to define. Furthermore, fraud should be nonexistent due to the transparency of Central Bank activities.	***
<b>Efficient allocation of resources</b>	In principle, a transfer of seigniorage revenue to the EU budget can be organised in an efficient way.	***
<b>Horizontal equity</b>	The tax base would be harmonised, and defined in relation to the monetary income of the Central Banks in the EU. Specific rules would need to be devised for Central Banks not forming part of the Eurosystem, i.e. outside the euro area, in order to ensure equivalent treatment.	***
<b>Vertical equity</b>	In principle, a transfer of seigniorage would have no or fairly limited direct impact on income redistribution in the EU. This is so because a large part of revenue accruing from seigniorage would be transferred from national budgets to the EU budget, this transfer being compensated by a reduction in direct national contributions to the EU. Considering the independence of NCBs in the EU, transferring their seigniorage should not lead to a change in the inflation.	**
<b>Fair contributions</b>	In the euro area there is an allocation scheme for the monetary income that is independent of the inflation rates of the Member States. There can, however, be minor differences between contributions of Member States belonging to the euro area and the others, depending in particular on differences in inflation and interest rates. Furthermore, it should be noted that once the current 'transitional regime' is over, i.e. as from 2008, the Eurosystem's monetary income will be fully distributed to the NCBs (which are mostly owned by the Member States) according to the ECB capital key. This key is based equally on population and GDP. This could affect Member States' contributions to the EU budget, which is currently closely linked to GDP (VAT and GNI resources).	**
<b>Overall evaluation</b>	Transferring seigniorage to the EU budget is in theory a fairly convenient and efficient way of financing the EU. It offers a number of practical advantages such as very limited compliance and administration costs. Furthermore, it scores well in terms of equity and fair contributions. Due to the relative lack of visibility of seigniorage, the impact of this transfer on accountability of EU budgets would be limited. This, however, is sometimes seen as an advantage at a political level, as it could facilitate the adoption of such proposal. Furthermore, the revenues would only cover a small part of the EU budget. The main issue linked to seigniorage therefore seems a practical one. Due to differences in their revenues and costs structures, some central banks may incur deficits as a result of the introduction of the transfer of seigniorage. Depending on the size of the transfer and, notably, whether all seigniorage income or only a part of it would be transferred to the EU budget, this may create sustainability problems in the long term for which there could be no simple solution.	

Criterion	Assessment of the EU communication taxation	Rating
<b>Sufficiency</b>	Previous studies have shown that revenues from this source will be adequate to finance only part of the EU budget. Begg et al. (1997) estimate that an airport departure tax of ECU 15 would yield around 10% of the EU budget, while an annual average tax per telephone line of ECU 40 could finance another 10% of the budget. In the long run, 'communication' services are expected to continue growing at a significant pace. This would improve revenue prospects for the communications tax. On the other hand, it may become increasingly difficult to raise a tax on telephone lines in a fast-changing technological environment. Overall, an EU communications tax would have to be complemented by other resources if it were to finance the EU budget.	*
<b>Stability</b>	In principle, there are important cyclical components in telecommunications and air and road transports sectors. However, the vehicle tax and the tax on telephone lines are unlikely to present significant short-run changes. In case of economic recession it is unlikely that people would sell their cars or cancel telephone lines. Business cycle effects would be felt at the margin on the growth rate of the tax. On the other hand, the air travel tax may be more sensitive to short-run economic shocks, as both companies and citizens tend to cut back on travel expenses in case of economic hardship.	**
<b>Visibility</b>	The taxes on telecommunications, on road transport and on air transport would be very visible to many consumers. They would clearly appear on the bills of the taxpayers.	**
<b>Low operating costs</b>	Compliance costs would be moderate. On the one hand, the communications tax is a set of new taxes to be faced by consumers or economic operators. This will require new arrangements and may impose a burden on economic operators and tax administrations. On the other hand, revenues could be collected relatively easily through existing structures. The air travel tax and the telecommunications taxes could be collected via the economic operators (air and telephone companies). The scope for evasion and fraud would be rather limited. Vehicle taxes could be collected by national tax administrations in charge of vehicle taxation, parallel to the national vehicles tax.	**
<b>Efficient allocation of resources</b>	Although the Agenda 2000 indicated that this tax would be consistent with transport directives and with strengthening competitiveness through the trans-European network (TEN) initiatives, the analysis above leads to a different conclusion. As it is proposed, the communication tax would not tackle in an efficient way congestion or pollution problems and, in the case of a telephony tax, it seems difficult to justify it for efficiency reasons.	*
<b>Horizontal equity</b>	Provided an effective harmonisation of the different tax bases for the communications tax is achieved, there should not be discrimination between taxpayers.	***
<b>Vertical equity</b>	"The number of vehicles is linked to income while air travel tends to be greatest amongst the richer" (European Parliament, 1997). It seems likely that telecommunications services also increase with income. Overall, communication taxation would appear to be in line with vertical equity.	***
<b>Fair contributions</b>	"Telecommunications revenues appear to be correlated with GNP" (EP, 1997). Furthermore, "current statistics suggest that prima facie the incidence of air travel is somewhat uneven as between Member States, but the nature of air travel makes it difficult to interpret these data. A holiday (return) flight from Germany to Greece would show up as a departure from both Member States, but in both cases it would be German residents who paid the tax. Equally, major gateways such as Heathrow, Paris or Amsterdam will record departures by passengers who are from other Member States and often from outside the EU. Interpretation of air traffic figure could be problematic, although the difficulties lend support to the case for not apportioning revenues by Member States'.	***
<b>Overall evaluation</b>	A European communication tax, made up of different components could have some advantages. It would be visible and fare well in terms of equity. On the other hand, practical considerations, such as the difficulty to introduce a set of new EU taxes, and serious budgetary limitations will play against such a tax. Furthermore, some of the stated objectives associated with a communication tax could be better fulfilled with other instruments or alternative EU tax candidates.	

Criterion	Assessment of the Harmonised EU Personal income tax	Rating
<b>Sufficiency</b>	The EU personal income tax could yield sufficient revenues to finance completely the EU budget because the tax base is very broad. The personal income tax of Member States represent an estimated average of 10.1% of EU GDP in 2001 (European Commission, 2003). An EU tax equivalent to about 10% of the Member States' tax would thus yield revenues of approximately 1% of EU GDP.	***
<b>Stability</b>	Personal income is correlated with the business cycle. The elasticity of tax revenues with respect to GDP is one on average for 20 OECD countries (OECD, 2000). In the EU, it is lowest in France (0.6) and highest in Greece (2.2). There is no reason to believe that an EU personal income tax would be less stable than Member States' taxes. Actually, being an EU wide tax it could be more stable than national PITs because some of the fluctuations observed in individual Member States could neutralize each other.	***
<b>Visibility</b>	The visibility of the tax would be particularly high, as would the link between the financing of the EU and the good management of resources made available to the budget. Accountability of the EU would undoubtedly be enhanced.	***
<b>Low operating costs</b>	<p>An own and separate EU personal income tax (third option described above) would clearly result in more significant operating cost than a surcharge on a national tax. Even when the tax would be set-up in an extremely simple and standardised form, the necessary tax law and other administrative provisions to be implemented, the administrative set-up and the possible co-ordination with national tax systems would imply significant administration cost. Compliance costs would be increased as well. Furthermore, ensuring that parts of the taxable income, which are not taxed in some Member States (like capital gains in Germany or Belgium) are efficiently and effectively included in the tax base in these Member States or are excluded in the others could lead to serious difficulties. Related to this problem is the question of incentives for Member States to properly assess and collect the EU tax for the Community. If it were completely independent from the national tax system, there would be a very limited interest for Member States to ensure a correct and complete taxation of all national income underlying this tax.</p> <p>It should be noted that these problems would not exist for the second option envisaged above. In a system of national surcharges, operating costs are almost inexistent, as is highlighted by local surcharges observed in several Member States.</p>	<p>*</p> <p>***</p>
<b>Efficient allocation of resources</b>	It is unlikely that a harmonised EU personal income taxation would have any significant impact on the allocation of the tax base, investments, or consumption. This is even more so as national taxes could be decreased as a consequence of the replacement of contributions to the EU by the EU tax.	**
<b>Horizontal equity</b>	<p>Two equivalent taxpayers living in different Member States would have to pay the same tax.</p> <p>This comes in sharp contrast with the second option where surcharges between Member States would be different to take into account variables such as the national average per capita income.</p>	<p>***</p> <p>*</p>
<b>Vertical equity</b>	The harmonised European income tax could be progressive. The progression could notably result from a tax-free basic allowance. However, as it would probably be difficult to include a part of revenues accruing from capital, the income redistribution would mainly bear on labour income.	**
<b>Fair Contributions</b>	Being a tax on revenues, the harmonised EU personal income tax would probably allow collection of more receipts in richer countries. Variations linked to the share of labour vs. capital income in the GDP and the differences in wage distributions could be expected but they would be unlikely to modify substantially the fairness of national contributions.	***
<b>Overall evaluation</b>	A harmonised European personal income tax would clearly enhance accountability of the EU. It could also give access to very wide budgetary resources, in a relatively equitable way. Although	

the system would require some very difficult political discussions to determine a common approach for the tax base, the tax rates, the implementation of tax law and other provisions, and the functioning of the administration, it could prove a sensible way of financing the EU. The main disadvantage of this proposal would be the considerable administrative and compliance costs and the possible mismatches with the national income tax systems. A comparison of the assessments of the harmonised EU personal income tax and a tax based on an EU surcharge on national personal income tax highlights two main differences. While the harmonised EU tax would involve much more compliance and administrative costs than the EU surcharge, it would also fare better in terms of horizontal equity.

Criterion	Assessment of tax on financial transactions	Rating
<b>Sufficiency</b>	The tax could in theory bring substantial revenues. However, the exact amount is highly uncertain and would very much depend on the base and the rates used. It would also crucially depend on the reaction of market operators. In practice, considering the high mobility of the tax base it is likely that the rate of the tax would be very small. This would be in line with the experience in several Member States.	*
<b>Stability</b>	Stock markets activity is very unstable. It depends on many economic, technological and political factors. In addition, tax policies may directly affect the activity of stock markets.	*
<b>Visibility</b>	The tax would be visible to investors and financial market operators. However, a large proportion of the EU citizens would not be really concerned by the tax or to a marginal extent only.	*
<b>Low operating costs</b>	Compliance and administration costs could be fairly limited, since the Tax could be paid on an automatic basis to the stock market authorities.	***
<b>Efficient allocation of resources</b>	If the tax is extremely small, it would be possible to avoid major disruptions in the capital markets in the EU. However, it is difficult to define how small the tax should be. Taxes on transactions of shares have been eliminated in Austria (2000), Italy (1998), the Netherlands (1990), Sweden (early 1990s) in order to facilitate the development of local stock markets, while in most other Member States, the rates are a fraction of one % of the value of sales. The sensitivity of financial markets to taxes is such that it has been estimated that an EU tax on the transaction of currencies of 0.10% in the EU might lead to a 83% fall in the volume of transactions (CSF 2001, p.50). In short, even in the case of a small tax, the impact of the tax on the location of capital investments may be substantial.	*
<b>Horizontal equity</b>	In principle, there would be a harmonised tax base. However, the diversity of financial instruments would presumably allow similar investors to face different tax burdens according to their investment strategies.	**
<b>Vertical equity</b>	The tax would affect holders of investments in shares (and possibly in other financial products). This is likely to bear mostly on richer people.	***
<b>Fair contributions</b>	In theory, there is a positive correlation between investments in stocks, the development of capital markets and GDP. However, financial investments also very much depend on other factors not related to GDP. For instance, retirement policies and the existence of pension funds can largely affect the development of financial activities. Furthermore, considering the very high mobility of capital across borders and the increased integration of capital markets, it does not really make sense to identify capital with a specific country anymore. This regional arbitrariness would make it difficult to identify the contribution of Member States to the tax. This could facilitate its political acceptability.	**
<b>Overall evaluation</b>	A tax on financial transactions seems relatively straightforward to implement. It would also fare well on equity grounds. However, it has some major drawbacks. It is likely to disrupt the location of capital and financial investments in the EU. Should the tax be designed in order to avoid this problem, it would have to be so small that it would not bring sufficient revenues to the EU budget. Furthermore, these revenues would be subject to a significant instability and a large degree of uncertainty. Lastly, taxing capital is a very sensitive issue at the political level. Discussions on this proposal could easily be mixed with other debates, such as the possibility of introducing a Tobin tax.	

Criterion	Assessment of the EU climate charge on aviation	Rating
<b>Sufficiency</b>	Wit and Dings (2002) estimated the annual revenue arising from the aviation charge to amount to €1-9 billion, depending on the value attributed to each tonne of CO <sub>2</sub> and NO <sub>x</sub> emitted. In a scenario of €30/tonne CO <sub>2</sub> -equivalent and €3.6/kg NO <sub>x</sub> -equivalent, the charge would bring €5.3 bn. This amount has to be compared with an EU budget of slightly less than €100bn in 2003. However, it is important to note that this study did not address the climate change beyond that of CO <sub>2</sub> and NO <sub>x</sub> . Recent EU research [Tradeoff (2004)] suggests that the total climate change effect of aviation is in the range of 2-4 times higher than that of the CO <sub>2</sub> emissions alone. In the longer run, traffic forecasts generally suggest that the dominance of demand growth rates over efficiency improvement rates will continue to prevail in the future. This in turn will result in continued growth in the potential tax base.	*
<b>Stability</b>	Air transport can be significantly influenced by major events such as the outbreak of wars or events like the ones of September 11, 2001. This makes this potential resource a particularly unstable one in the short run.	*
<b>Visibility</b>	Already today, some airlines have adopted the practice of specifying the contribution of airport taxes to overall ticket prices. It is possible or even likely that airlines would adopt a similar practice if an EU wide climate charge were introduced. If not, such specification could be made mandatory or recommended practice. This would render the climate charge very visible to air transport passengers. However, citizens at large would not be made particularly aware of the 'cost of Europe' through a climate charge on aviation only.	**
<b>Low operating costs</b>	Wit and Dings (2002) conclude that the Eurocontrol infrastructure presently used to collect charges covering the costs of air traffic management (the "Eurocontrol Route Charge System") could be extended and used to administer a climate charge as well. The possibility of using an existing system suggests that operating costs could be kept at a low level.	***
<b>Efficient allocation of resources</b>	The costs relating to the climate change impacts of air transport are currently not reflected in the price seen by users of air transport. This means that the use of air transport and climate change mitigation technology and techniques is not optimal from a socio-economic point of view. Internalising the external costs would contribute to correcting the current market failure and lead to a more efficient allocation of resources and greater overall welfare.	***
<b>Horizontal equity</b>	The climate charge would be applied in a uniform fashion all across the EU. Equal treatment would thus be applied to equivalent consumers.	***
<b>Vertical equity</b>	While the price of air transport has generally decreased in recent years, air transport services are still used more frequently by high-income groups. Applying a climate change charge on aviation would thus be "progressive".	***
<b>Fair contributions</b>	Within a population, consumption of air transport services correlates strongly with income level. Not surprisingly, existing data also suggest a positive correlation with GDP. Furthermore, allocating the revenue from a climate change charge on aviation to the EU budget would be consistent with the international character of much air transport. The existence of a so-called 'regional arbitrariness' in the allocation of revenues would also play in favour of an aviation charge at the EU level.	***
<b>Overall evaluation</b>	The climate charge on aviation scores high on most criteria. However, this environmental charge would not bring sufficient or stable revenues to the EU budget. It should thus be a complement to other resources and would probably require having financial autonomy at EU level. The main obstacle for the short term implementation of such a tax is reluctance at political level to employ instruments in the air transport sector that could have impacts on the demand or competitive position of EU carriers. The EU and its Member States would generally prefer a worldwide agreement to take action. This is however unlikely to materialise given the differences in political priorities and views on how to address climate change problems between different ICAO Contracting States.	

## 11.6 THE EFFECT OF ABOLISHING THE CAP AND THE REBATE

### 11. The decline in the net budgetary positions of individual member states in the event of abolishing the CAP as well as both the CAP and the UK rebate, in 2007–2013 and annually

(Losses in billion EUR, negative figures indicate improved positions)

Csak a KAP szűnik meg			A KAP és a rebate is megszűnik		
Összes veszteség 2007–2013		Veszteség/év	Összes veszteség 2007–2013		Veszteség/év
20,35	Lengyelország	2,91	26,35	Egyesült Királyság	3,76
12,25	Görögország	1,75	18,97	Lengyelország	2,71
11,07	Franciaország	1,58	11,20	Görögország	1,60
8,21	Spanyolország	1,17	7,23	Magyarország	1,03
7,66	Magyarország	1,09	6,26	Írország	0,89
7,10	Írország	1,01	2,80	Litvánia	0,40
4,02	Csehország	0,57	2,57	Spanyolország	0,37
3,65	Portugália	0,52	2,34	Szlovákia	0,33
2,95	Litvánia	0,42	2,27	Portugália	0,32
2,57	Szlovákia	0,37	2,27	Csehország	0,32
1,86	Ausztria	0,27	1,36	Ausztria	0,19
1,11	Lettország	0,16	1,13	Franciaország	0,16
1,09	Finnország	0,16	1,03	Lettország	0,15
0,88	Észtország	0,81	0,13	Észtország	0,12
0,71	Dánia	0,10	0,47	Szlovénia	0,07
0,62	Szlovénia	0,09	0,31	Finnország	0,04
0,10	Málta	0,01	0,07	Málta	0,01
0,05	Ciprus	0,01	- 0,03	Ciprus	0,00
- 0,31	Luxemburg	-0,04	- 0,44	Luxemburg	-0,06
- 1,43	Svédország	-0,20	- 0,47	Dánia	-0,07
- 8,30	Olaszország	-1,19	- 1,62	Svédország	-0,23
- 8,85	Belgium	-1,26	-10,60	Belgium	-1,51
-10,20	Egyesült Királyság	-1,46	-14,09	Hollandia	-2,01
-13,37	Hollandia	-1,91	-15,35	Olaszország	-2,19
-17,59	Németország	-2,51	-20,25	Németország	-2,89

[Somai, 2008]



8. On a scale from 1 to 5 (5 being the best mark), how would you evaluate the importance of the following expenditure items in the EU budget?
- |                              |                            |                            |                            |                            |                            |
|------------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| • Competitiveness for growth | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
| • Cohesion for growth        | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
| • Common agricultural policy | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
| • European citizenship       | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
| • The EU as a global partner | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
9. How would you evaluate the actual share of the following expenditure items in the EU budget? It should be
- |                              |                               |                               |                                    |                                    |
|------------------------------|-------------------------------|-------------------------------|------------------------------------|------------------------------------|
| • Competitiveness for growth | <input type="checkbox"/> more | <input type="checkbox"/> less | <input type="checkbox"/> unchanged | <input type="checkbox"/> abolished |
| • Cohesion for growth        | <input type="checkbox"/> more | <input type="checkbox"/> less | <input type="checkbox"/> unchanged | <input type="checkbox"/> abolished |
| • Common agricultural policy | <input type="checkbox"/> more | <input type="checkbox"/> less | <input type="checkbox"/> unchanged | <input type="checkbox"/> abolished |
| • European citizenship       | <input type="checkbox"/> more | <input type="checkbox"/> less | <input type="checkbox"/> unchanged | <input type="checkbox"/> abolished |
| • The EU as a global partner | <input type="checkbox"/> more | <input type="checkbox"/> less | <input type="checkbox"/> unchanged | <input type="checkbox"/> abolished |
10. Would you like to see new expenditure items in the EU budget?  
 Yes. Please specify: .....  
 No.
11. Do you consider the EU budget at its present structure to be able to deal with the needs of further enlargement(s) of the EU?  
 Yes.  No. Please specify: .....
12. To what extent do you think the present structure of the EU budget reflects the objectives of the EU laid down in the Treaty? Please evaluate on a scale from 1 to 5 (5 being the best mark).
- |  |                            |                            |                            |                            |                            |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
|  | <input type="checkbox"/> 1 | <input type="checkbox"/> 2 | <input type="checkbox"/> 3 | <input type="checkbox"/> 4 | <input type="checkbox"/> 5 |
|--|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
13. It has been argued that *any* costs accrued to Member States as a consequence of their fulfilling the objectives laid down in the EC Treaty should be funded by the EU budget. Would you agree with this statement?  
 Yes.  No.
14. Do you consider the EU budgetary decision-making process optimal?  
 Yes.  
 No. Please specify whether you would prefer changes (multiple choices are allowed)  
 in the annual decision-making;  
 in the decision-making related to the financial perspective;  
 in the voting rules in the Council;  
 in the division of powers between the Council and the European Parliament;  
 other. Please specify: .....
15. Do you think the 2008/9 review of the EU budget will lead to important changes?  
 Yes, immediately.  
 Yes, but only in the long run (after 2013).  
 No.

If you have additional remarks that you consider to be important for the topic of the EU budget review, please share them with us! .....

.....

.....

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