HM TREASURY

European Community Finances

Statement on the 2001 EC Budget and measures to counter fraud and financial mismanagement

Presented to Parliament by the Economic Secretary by Command of Her Majesty

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Contents

European Community Finances

In 1980, following a recommendation by the Public Accounts Committee, the Government agreed to present an annual statement to Parliament giving details of the European Community Budget.

2. This White Paper is the twenty-first in the series. It describes the Budget for 2001 as adopted by the European Parliament and the United Kingdom's gross and net contributions to the Community Budget over the years 1996 to 2001. It also includes details of recent developments in EC financial management and the fight against fraud.

I. EC Budget

A. Budgetary process

(i) *The Budget process*

3. The annual European Community Budget is established by the budgetary authority, which consists of the Council of Ministers and the European Parliament, through a process known as 'the shuttle' (from the French 'navette').

4. The 'shuttle' begins, usually in May, with the establishment of a Preliminary Draft Budget for the following year by the Commission. On the basis of the Preliminary Draft Budget, the Council establishes its own Draft Budget in July. This is passed to the European Parliament for its first reading, which takes place in October. The Budget then returns to the Council in November for the Council's second (and final) reading. The European Parliament makes its second reading in December, after which the Budget is adopted by the President of the Parliament.

5. The Council has the final say on the amount and structure of compulsory expenditure, which is defined as expenditure necessarily resulting from the Treaty or from acts adopted in accordance with it. Spending carried out under the Common Agricultural Policy – accounting for just under one-half of the Budget – and certain small items in other sections of the budget, including the Monetary and Loan Guarantee Reserves, is classed as compulsory. The European Parliament has the final say on all other, non-compulsory, expenditure.

(ii) *The Financial Perspective*

6. Since 1988 the annual budget has been set within a multi-annual expenditure framework known as the Financial Perspective. In the 2001 budget the Financial Perspective sets out annual expenditure ceilings for seven broad expenditure categories (agriculture, structural operations, internal policies, external actions, administrative expenditure, reserves and pre-accession aid) which must be respected by the budgetary authority (Council and European Parliament) when it determines the Budget. The expenditure ceilings are set in terms of expenditure commitments, ie legal expenditure obligations entered into during the year which will lead to payments either that year or in future years.

7. The Financial Perspective covering the budget year 2001 was part of the wider agreement at the March 1999 Berlin European Council covering EU expenditure for the years from 2000 to 2006. This agreement is set out in an Inter Institutional Agreement between the Commission, the Council and the European Parliament.

(iii) The Own Resources ceiling

8. The annual Budget is also subject to a binding ceiling on the revenue side, known as the Own Resources ceiling. This is fixed in terms of a percentage of overall Community Gross National Product (GNP). It is equivalent to 1.27% of Community GNP. The ceiling sets the maximum amount of Own Resources (in effect, Member States' contributions to the European Community Budget) which the Commission is allowed to call up each year. Because the Community is not allowed to borrow, revenue must equal expenditure. The Budget is therefore effectively limited by the amount of Own Resources that can be called up from Member States.

B. Budgetary Discipline

9. Budgetary Discipline is maintained by the Financial Perspective, the Budget Discipline Decision and the Loan Guarantee Fund Regulation.

(i) Revision of the Financial Perspective

10. Paragraph 15 of the 1999 Inter Institutional Agreement allows for annual technical revisions of the Financial Perspective to take account of movements in Community GNP and prices, and the conditions of implementation of the Budget (primarily to adjust for under-implementation of the Structural Funds) in previous years. These amendments are purely technical in nature and bring the figures for commitments and payments up to date in the light of the rate of inflation.

(ii) Budget Discipline Regulation

11. On 26 September 2000, the Council adopted a new Budget Discipline Regulation. This new Regulation will ensure that the expenditure ceiling set for the Common Agriculture Policy (CAP) for 2000-2006 is respected. This ceiling forms part of the Financial Perspective agreed at the Berlin European Council in 1999. The new Budget Discipline Regulation will replace the Budget Discipline Decision adopted on 31 October 1994.

(iii) Loan Guarantee Fund

12. The Loan Guarantee Fund Regulation, adopted on 31 October 1994, imposes discipline on Community lending to non-Member States. Each time a loan or lending guarantee is approved by the Council, a proportion of the loan or guarantee is transferred to the Fund from the Loan Guarantee Reserve (one of the reserves under Category 6 in the Financial Perspectives). The proportion is determined by the provisioning rate, which is currently 9%.[1]

13. The Loan Guarantee Reserve ceiling, which is equivalent to 208 million euro or £130 million in the 2001 Budget, sets a limit on the total sum which can be used to make provision against external lending, and therefore to the volume of lending. Any defaults have to be met from the Fund.

C. The 2001 Budget

14. Table A sets out the amounts established for the 2001 Budget at each stage of the budgetary procedure – which ran from May 2000 to December 2000 – and relates these to the Financial Perspective ceilings.

15. The final adopted Budget amounts to 96.24 billion euro or £60.06 billion in commitment appropriations, which is 1.11 billion euro below the Financial Perspective ceiling. Total payment appropriations amount to 92.57 billion euro or £57.77 billion, or 1.11 per cent of Community GNP, well under the Own Resources ceiling of 1.27 per cent.

16. The 2001 Budget represents an increase over 2000 of 3.12 per cent in commitment appropriations, and an increase of 3.50 per cent in payment appropriations. Chart A shows payment appropriations in 2001 by broad expenditure category.

[1] As of 1 January 2000 (Council Regulation No 1149/99)

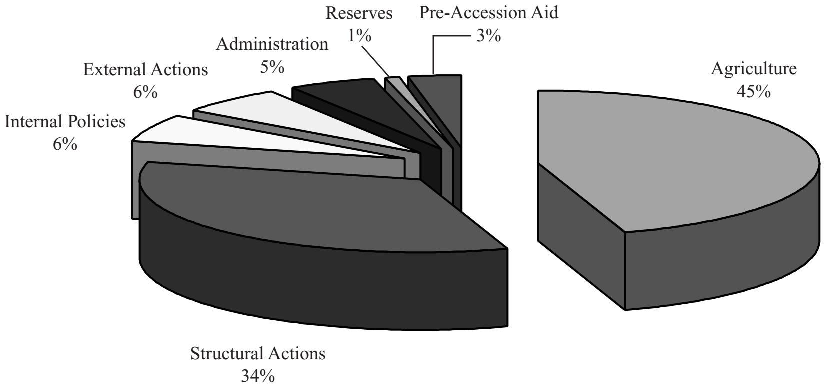
2001 EC Budget

Table A
million euro

	Financial Perspective Ceilings	Preliminary Draft Budget	Council's First Reading Draft Budget	European Parliament First Reading Draft Budget	Council's Second Reading Draft Budget	Adopted Budget
Commitment appropriations						
Common Agricultural Policy	44 530	43 168	43 545	44 097	43 298	43 298
Structural Operations	32 720	32 720	32 720	32 720	32 720	32 720
Internal policies	6 272	6 136	6 064	6 253	6 143	6 232
External Action[2]	4 735	4 949	4 550	4 731	4 625	4 929
Administration	4 939	4 927	4 859	4 904	4 862	4 904
Reserves	916	916	916	916	916	916
Pre-accession aid	3 240	3 240	3 240	3 240	3 240	3 240
Total Commitment appropriations	97 352	96 056	95 894	96 861	95 803	96 239
Total Payment appropriations	94 893	93 007	92 533	94 722	91 710	92 569
Payments as a percentage of Community GNP	1.13	1.07	1.06	1.09	1.06	1.11

[2] Given the unforeseen, exceptional needs for Serbia in 2001, the two arms of the budgetary authority, the Council and the European Parliament, agreed to make use of the flexibility instrument (which has a maximum availability of 200 million euro per year) as set out in paragraph 24 of the Inter-institutional agreement on budgetary discipline of 6 May 1999.

Chart A: 2001 EC Budget – Payment Appropriations

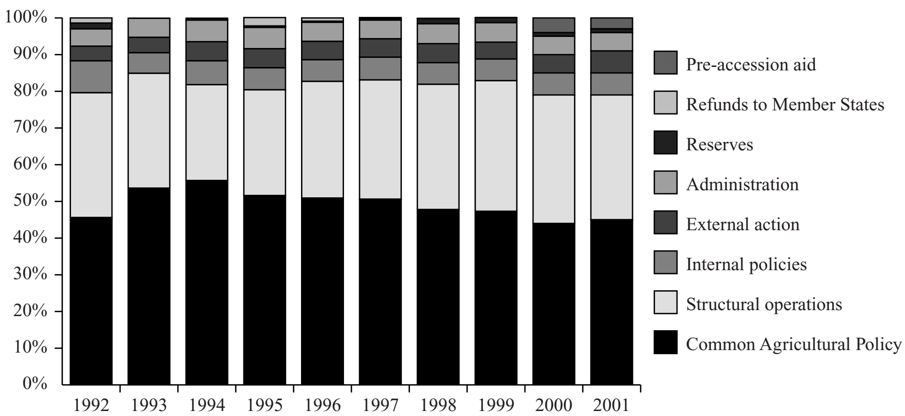


D. Developments in Community spending

17. Chart B shows the developments in Community spending over the period 1992-2001. The two most significant trends are the reduction in the proportion of spending on agriculture – which now forms under half the total budget – and the simultaneous increase in structural operations expenditure, which has increased to over one-third of the budget in 2001. Certain repayments to Member States (to Spain and Portugal in the early years of membership or in connection with the depreciation of agricultural stocks) have been discontinued, and a new Budget Category of pre-accession aid has been created, following the agreement at the Berlin Council in 1999. The other spending categories have remained fairly constant over the period.

18. Further details on spending in recent years are given in Tables 1 and 1a (pages 23 and 24). These tables show commitments and payments for the years 1996-2001 in euros[3] and sterling. These tables show the main spending programmes broken down by Financial Perspective category.

Chart B: Developments in Community Spending 1992–2001



3 On January 1 1999 the value of the euro was set to that of the ecu. For the sake of simplicity the euro is also used in this document in referring to past budget years.

E. Community revenue

(i) The Own Resources Decision

19. The arrangements for financing the Community Budget are set out in the Community's Own Resources Decision (ORD). The ORD sets a ceiling (the Own Resources ceiling) on the amount the Community can raise from Member States in any one year, expressed as a percentage of Community GNP. This ceiling may only be amended by unanimity, and, taken together with a small amount of miscellaneous revenue available to the Community (eg pensions payments of staff, sale of goods and services) sets an absolute limit on the size of the Budget in any one year.

20. The current ORD, which came into effect on 1 January 1995, increased the Own Resources ceiling, in steps, to 1.27% of Community GNP in 1999 and beyond. This ORD also gradually increased the proportion of the GNP-based resource while reducing that of the VAT-based resource and progressively reduced the cap on the VAT base.

(ii) The Revenue Structure

21. The ORD allows for four sources of Community revenue, or "Own Resources":

(i) *Customs duties, including those on agricultural products.* These are paid on a range of commodities imported from non-member countries. Following the agreement on agriculture during the Uruguay GATT Round, most agriculture duties are now fixed. However, for some key commodities, they continue to vary in line with changes in world prices;

(ii) *Sugar levies.* These are charged on the production of sugar to recover part of the cost of subsidising the export of surplus Community sugar onto the world market;

(iii) *Contributions based on VAT.* Essentially, the VAT resource is the amount yielded by applying a notional rate of 1% to a VAT base assuming an identical range of goods and services in each Member State. Each Member State's VAT base is however subject to a cap of, currently, 50% of 1% of its GNP;

(iv) *GNP-based contributions*. The amount due is calculated by taking the same proportion of each Member States' Gross National Product. Because the Community is not allowed to borrow, revenue must equal expenditure. The GNP resource is the budget-balancing item; it covers the difference between total expenditure in the Budget and the revenue from the other three resources, subject to the overall own resources ceiling.

22. The first two own resources are known collectively as the "traditional own resources" (TOR). The VAT and GNP-based contributions are often referred to as the third and fourth resources.

23. Member States pay their contributions for a given Budget year in monthly instalments (VAT and GNP-based contributions on the first working day of each calendar month, TOR on the first working day following the 19th of each month). The VAT and GNP-based contributions are subsequently adjusted in the light of a number of factors such as outturn figures for GNP (further details are given in technical annex I (pages 34 and 35). If outturn expenditure is below the amount raised from Member States, excess contributions are refunded in a subsequent Budget (a Supplementary and Amending Budget (S&AB) for the year).

(iii) Community Revenue in 2001

24. Tables 2 and 2a (pages 25 and 26) show the gross contributions, after taking account of the UK abatement by Member States, to the EC Budget for the years 1996 to 2001. The key points to note are:

- in 2001 revenue from TOR is estimated to be £8.9 billion, of which the UK's share is some 20.2%. In 2000 revenue from this source was estimated to be £8.4 billion, of which the UK's share was 19.9%;
- total VAT contributions in the 2001 Budget are forecast to be around £20.9 billion. The UK's share of this total (after abatement) is 4.5%. In 2000, total VAT contributions were estimated to be £20.7 billion, of which the UK's share (after abatement) was 9.5%;
- total GNP-based contributions in the 2001 Budget amount to some £27 billion, including a possible £0.6 billion contribution to Community reserves. The equivalent figure for 2000 was £23 billion, including £0.6 billion for the reserves (which were not all called up in 2000). The UK's share of the fourth resource in 2001 (including potential contributions to Community reserves) is 19% (in 2000 the equivalent share was 18.4%);
- the estimate of the UK's abatement in the 2001 adopted Budget (in respect of our net contribution in 2000) is around £3.3 billion compared with £2 billion in 2000;
- the UK's share of total gross contributions (including potential contributions to the reserves, but after abatement) in 2001 is 13.9%. This compares with 25.3% for Germany, 16.8% for France and 12.9% for Italy. The equivalent 2000 figures are 15.1% for the UK, 25.2% for Germany, 16.7% for France and 12.6% for Italy.

(iv) The Abatement and the UK's Net Contribution

25. Since 1984 the UK's contributions to the VAT own resource have been abated in recognition of the relatively low level of its receipts, compared with its contributions to the Community Budget. In broad terms the UK receives an abatement of its gross contributions equal to 66% of the difference between its unabated contribution and its receipts, subject to the following qualifications:

a. the abatement applies only in respect of spending within the Community. Expenditure outside the Community (mainly aid), amounting to around 7% of total EC Budget expenditure in 2001, is excluded;

b. the UK's contribution is calculated as if the Budget were entirely financed by VAT;

c. the abatement is deducted from the UK's VAT contribution a year in arrears.

26. The formula for the calculation of the abatement is set out in the ORD and in a Working Document first published in 1988 and revised in 1994.

27. The Commission is directly, and solely, responsible for determining the UK's abatement. It calculates the abatement on the basis of a forecast of payments from the Budget to Member States and of Member States' contributions to the Budget. This is subsequently corrected in the light of outturn figures. Corrections may be made up to three years after the year in respect of which the abatement relates, after which a final reckoning is made in the fourth year.

28. Table 3 (page 27) shows the UK's contributions to, abatement, and public sector receipts from, the Community Budget for the years 1996 to 2001. The figures for 2001 are estimates, those for earlier years are outturn.[4]

29. UK public sector receipts in 2001, mainly from the Agricultural Guidance and Guarantee Fund (EAGGF) and the Social and Regional Development Funds, are expected to be around £4.2 billion. The majority of these receipts are either paid to the private sector or used in its support.

30. Receipts for a number of small Community programmes, the bulk of which are for research and development, are mainly paid by the Community direct to the private sector. In 2001 these payments are expected to be around £375 million. As these payments go direct to the private sector they do not appear in Public Sector accounts and thus do not appear in Table 3 (page 27), nor are they included in the Government's financial year forecasts which appear in both the Financial Statement and Budget Report and the Departmental Report of the Chancellor of the Exchequer's Departments.

31. The UK's net contribution in 2001 is forecast to be some £1 billion, compared with an outturn of some £4.2 billion in 2000.

32. The UK's net contribution to the Community Budget can vary considerably from year to year. This is the result of a number of factors. The main reasons for the difference between the forecast for 2001 and the 2000 net contribution are:

(i) a small increase in our Traditional Own Resources payments (£2,098 million (2001) compared to £1,933 (2000)) more than offset by reductions to our VAT-based contributions (£3,623 million (2001) compared to £4,104 million (2000)) and GNP-based contributions (£3,903 million (2001) compared to £4,245 million (2000));

(ii) a much higher abatement in 2001 (£4,560 million) compared with 2000 (£2,085 million) reflecting high UK gross contribution to the 2000 EC Budget and lower level of receipts than expected. Also reflects expected adjustments, in the UK's favour, to the abatement in respect of earlier years;

(iii) a reduction in UK public sector receipts estimated for 2001 (£4,023 million) compared with the outturn for 2000 (£4,241 million).

33. The estimate of the UK's net contribution in calendar year 2001, shown in Table 3 (page 27), differs from the estimate for the financial year 2001-02 contained in Table 14b of the Departmental Report of the Chancellor of the Exchequer's Departments (Cm 5116) for three main reasons:

(i) first, the estimates relate to different time periods;

(ii) second, the figure in Table 3 reflects the actual net contribution expected to be paid in 2001, whereas the figure for 2001-02 in the Departmental Report reflects the trend in the UK's net contribution; and

(iii) the figures in Table 3 take into account information which was not available at the time the figures in the Departmental Report were prepared.

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[4] The amounts for the UK's gross contributions in Table 3 reflect payments made during each calendar year. They differ from the figures for gross contributions in Table 2 in that these figures, drawn from Commission documents, relate to payments to particular Community Budgets.

(v) Comparison between the Government's and the Court of Auditors' Figures for the UK's Net Contribution

34. In its Tenth Report, of 21 February 1996, the Public Accounts Committee asked the Government to provide each year an explanation for the difference between the Government's own outturn figure for the UK's net contribution and the figure for the UK's net contribution that can be derived from the European Court of Auditors' (ECA) annual report for the same year. This White Paper reports on the likely differences for the 1999 calendar year.

35. The main factors which appear to account for the difference between the two sets of figures are:

(i) the Government's figures are for the public sector only, whereas the Court's figures also include payments made direct to the private sector (estimated at around £350 million for 1999);

(ii) the late adoption of S&AB No.1/1998 meant that associated changes to contributions were not implemented until January 1999 and did not, therefore, appear in the Government's figures for 1998. The 1999 figures are some £272 million lower as a result. In addition, the late adoption of S&AB No.5/1999 led to a small adjustment to the UK's, and other Member States', GNP-based contribution not being implemented until January 2000. This does not, therefore, appear in the Government's figures for 1999 which are some £2 million lower as a result;

(iii) some payments to, and receipts from, a given Budget are made in the early weeks of a subsequent Budget year. We understand that under Community accounting rules these receipts and payments are scored in the accounts of the Budget for the previous year, whereas they are included in the Government's cash flow figures for the year in which the transactions took place. It would appear that the net effect of transactions of this kind is to make the Government's 1999 cash flow figure for the UK's net contribution up to some £58 million higher than that indicated by the figures for the UK in the ECA report on the 1999 Community Budget.

36. Technical annex II (pages 36 and 37) provides a comparison between the two sets of figures.

II FINANCIAL MANAGEMENT AND ANTI-FRAUD

F Financial Management

37. Financial management issues concerning the European Community Budget, and measures to counter fraud against the budget, continue to hold an extremely high profile.

(i) European Court of Auditors' Annual Report for 1999, and Statement of Assurance

38. The European Court of Auditors (ECA) is the institution of the Community which is responsible for the external audit of the other Community institutions. Article 248 of the Treaty requires the Court of Auditors to make an Annual Report to the European Parliament and the Council on the implementation of the Community budget, together with a Statement of Assurance as to the reliability of the Community's financial accounts and the legality and regularity of the transactions underlying them. The Court of Auditors also looks at whether the amounts of Own Resources which are due have been calculated and paid over correctly. The Court of Auditors scrutinises the expenses of the Community institutions and the direct expenditure on the Community's interventions which is managed by the Commission (eg humanitarian aid, research and development).

Expenditure managed by Member States (some 85% of the Community budget, mainly on agricultural and structural policies) is also scrutinised. The Court of Auditors is also required to look at the "soundness" of the Community's financial management.

39. The Court of Auditors sets out its findings in the Annual Report, which is specifically required by the Treaty, and in special reports on specific areas, which it may produce from time to time. The Annual Report includes a separate report on the management of the Sixth and Seventh European Development Funds and a statement of assurance on these. The Court of Auditors also produces separate observations on the accounts of various "satellite bodies" set up by the Community, which are subject to separate discharge procedures under the financial regulations governing them.

40. The Maastricht Treaty introduced a requirement for the Court of Auditors to supplement its annual reports with annual Statements of Assurance as to the reliability of the accounts and the legality and regularity of underlying transactions. To do this, the Court of Auditors examines a sample of transactions selected from the whole budget using statistical sampling techniques, such that the results from the audit of the sample can be used, with a good level of confidence, to form conclusions about the level of errors, and their likely value, in the whole budget. The first annual Statement of Assurance was produced in respect of the 1994 financial year.

41. The Court of Auditors' findings inform the Council and the European Parliament (the two arms of the Community's budgetary authority) when they come to consider, under Article 276 of the Treaty, whether to "discharge" the Commission from its responsibilities for execution of the budget for the year in question. The discharge granted to the Commission usually includes comments and requests for further action, on which the Commission has to report back.

European Court of Auditors' annual report on the 1999 budget

42. The latest Annual Report and Statement of Assurance from the Court of Auditors relate to implementation of the budget for the 1999 financial year, and were published together (in a provisional version) on 14 November 2000. These were formally published in the Official Journal (C349 Vol 42) on 3 December. The Court of Auditors acknowledged that 1999 was a transitional year – covering the period during which the former European Commission, led by Jacques Santer, resigned (in March), and the current Commission, led by Romano Prodi, took office (in September). The Court of Auditors praised the new Commission's immediate launch of a far-reaching reform programme, as set out in the White Paper published in March 2000, which they point out will address many of the weaknesses identified by the Court over the years. The Court particularly welcomes the proposal to revise the Financial Regulation, the move to Activity Based Management, and a strengthening culture of accountability and responsibility. Further improvement is needed in Member States' management and control systems, in order to reduce the level of error in the Structural Funds and the Common Agricultural Policy – however, the Court does accept that many irregularities involve only small overpayments to farmers, or claims made in good faith that are later found to be ineligible.

43. As in last year's report, the Court has paid considerable attention to the follow-up of its observations from previous Annual or Special Reports. For example, in the case of wine production, the Court made recommendations in its 1993 and 1996 Annual Reports. The 1999 Report acknowledges that the Commission has made progress on some of the recommendations, but that a number of shortcomings remain, such as the lack of vineyard registers and understaffing at the inspection body.

European Court of Auditors' Statement of Assurance

44. As in previous years, the Court of Auditors has given a positive opinion on the reliability of the accounts, and on the legality and regularity of revenue transactions and payment commitments. Once again it has declined to give a positive opinion on the legality and regularity of payment transactions due to the high level of formal errors and the unacceptable incidence of substantive errors which it found in its testing. The Court's Statement of Assurance for 1999 concluded that:

- The accounts for the financial year ended 31 December 1999 reflect reliably the Communities' revenue and expenditure for the year and the financial situation at the end of the year;
- In respect of revenue, the audit did not reveal a material incidence of error in own resources;
- In respect of commitments, the audit revealed that legal obligations entered into were 360 million euro in excess of available appropriations for international fishery agreements, Structural Operations and External Actions;
- In respect of payments, the audit revealed an unacceptable incidence of error which affected their amount, or the reality or eligibility of the transactions underlying them. Most of these errors occurred in areas of the Community budget managed by Member States' authorities;
- Therefore for the sixth year in succession the Court declined to provide assurance that the transactions underlying payments were legal and regular.

45. The Court has again given an assessment for each budget sector in the context of the Statement of Assurance:

- **Own resources:** the Court's checks on the reliability of the accounts for traditional own resources, and the legality and regularity of the underlying transactions, were satisfactory. For VAT and GNP own resources, the Court obtained reasonable assurances as regards the reliability of the collecting system;
- **Common Agricultural Policy:** the number of substantive errors affecting the legality and regularity of the underlying transactions is still high, and shows no significant improvement. The frequency of formal errors (which do not affect the value of the transactions examined) is also considerable;
- **Structural measures:** the Court's audit revealed a high incidence of error. Most of the substantive errors found concerned incorrect declarations of expenditure by final beneficiaries. Formal errors were caused by failure to follow correct procedures, or the inclusion of flat-rate amounts rather than actual expenditure;

- **Internal policies:** the Court found significant incidence of overcharging in this sector, which is managed by the Commission. There were a significant number of both substantive and formal errors. Most substantive errors stemmed from ineligible expenditure, while formal errors were attributed to failures by final beneficiaries to observe the terms of contracts;

- **External aid:** the Court's audit revealed only limited errors, but highlighted the need for the Commission to improve monitoring and control systems;

- **Administrative expenditure:** the Court's audit focussed on the main budgetary areas of this expenditure, for which procedures and controls were found to be satisfactory. There was no evidence of a material incidence of error;

- **Financial instruments and banking activities:** the Court's audit covered the Guarantee Fund for External Actions, the European Investment Fund and the financial mechanisms of the European Economic Area (including grants and loans provided by the European Investment Bank (EIB)). The Court made some criticisms, such as the continuing problem of access to the EIB's documentation.

46. The Court of Auditors has always distinguished between substantive errors and formal errors. A substantive error is a quantifiable error directly affecting the amount of the transactions underlying the payments made from Community funds. A formal error is an infringement of regulatory or control mechanisms such as an overdue but otherwise eligible payment. For both types, some of the errors may represent deliberate fraud, but most will represent genuine misunderstandings made in good faith, perhaps because of ambiguously drafted and complex regulations.

(ii) Council recommendation to the European Parliament

47. The Council's recommendation to the European Parliament on the terms of the discharge to be granted to the Commission for implementation of the 1999 budget was discussed by ECOFIN on 12 March 2001. As in previous years, the Council recommended that the Parliament grant discharge, but its recommendation was accompanied by detailed comments which criticised financial management in some of the areas discussed and called for improvements. The Council's approach, as in the past, has been to work constructively to bring about improvements reflecting an awareness that failings lie not only with the Commission but with all those who have a part in the administration of the budget (i.e. including the Council, the Member States and the European Parliament). The Council therefore makes a number of recommendations – not just for the Commission, but also for itself, the Member States and for the Court of Auditors.

48. The Council's recommendations included:

- The Advisory Committee on Own Resources should examine the methodology for improving risk analysis to combat VAT fraud;

- The Court of Auditors should give a better indication of the corrective measures to be taken by the Commission and the Member States, in the Common Agricultural Policy;

- Member States and the Commission should improve controls and shorten procedural deadlines to speed up the CAP Clearance of Accounts procedure;

- The Commission should set up systems to give a better overview of expenditure in the Structural Funds sector;

- The Commission should simplify contractual and administrative procedures for internal policies, and step up controls, including an increase in the number of audits;

- In the field of external aid, the Commission should endeavour to close programmes more rapidly, and to make dormant commitments re-available;

- Praise for the Commission on its management of adminstrative expenditure, but concern at the financing arrangements for new buildings for the European Parliament in Brussels and Strasbourg;

- The problem of access by the Court of Auditors to the European Investment Bank's documentation should be resolved as soon as possible;

- The Court of Auditors should publish error rates, so that progress can better be monitored.

49. The Commission is required to make a follow-up report to the Council, giving details of the action it has taken in response to the Council's recommendations. This report is expected to be published towards the end of 2001. In its follow-up report to the Council's recommendations on the 1998 budget, the Commission proposed to publish an annual action plan which, on the basis of the Court of Auditors' findings, would identify problem areas in the budget sectors, and suggest action which could be taken to reduce errors. Last year, in response to a call from the Council, the Commission presented a similar action plan, and the Council welcomed the proposal to make this an annual event. The Commission's 2001 Action Plan, which was also considered by ECOFIN on 12 March, contained an update on progress made with the Action Plan presented in 2000. Proposals for action and example of action already completed, included:

- **Own resources:** taking infringement proceedings against a small number of Member States (where the proper procedures have not been followed), amending Regulation 1150/2000 (formerly 1552/89) to strengthen the write-off procedure, proposal for a new Regulation on administrative co-operation in the field of VAT;

- **Common Agricultural Policy:** introduction of a new, simplified Regulation (1493/1999) to help reform the wine production sector, regular monitoring and improved systematic analysis of the aid scheme for skimmed milk and skimmed milk powder used as animal feed, proposal to charge interest on financial corrections (amounts recovered which were wrongly paid);

- **Structural Funds:** implementation of new, improved Regulations, adoption of detailed guidelines on the financial closure of operational measures, systems audit of Member States' control systems;

- **Internal Policies:** overhaul of the contract procedures, increase in the number of audits carried out, prior financial checks on potential contractors;

- **External Actions:** backlog of invoices cleared, new procedure manual for external aid approved, introduction of standard dossiers and contracts, systematic external audit of any contract worth more than 100,000 euro, introduction of standard project monitoring system;

- **Administrative expenditure:** internal control measures introduced for checking the entitlements of regular staff, better presentation of off-balance sheet commitments, adoption of a clear contractual position concerning expenditure on immovable property;

- **Financial instruments and banking activities:** evaluation and audit of the Growth and Environment scheme, maintain high-level contacts between the Commission, the European Investment Bank and the European Investment Fund.

50. For 1999, the European Parliament's Committee on Budgetary Control (COCOBU) considered the Council's recommendations on discharge and produced its own report. This contained the following ten-point plan for improvement, on which the Commission is required to report back to the European Parliament before November 2001:

- Each of the Commission's 29 Directorates-General is required to submit an Annual Plan including a summary of all completed and outstanding tasks for 2000;

- Each Commissioner, Director-General and Head of Delegation is to sign an Annual Declaration that adequate internal controls have been put in place, and that funds have been spent in accordance with the principles of sound and efficient management;

- A suitable management information system is to be introduced to facilitate qualitative and quantitative assessment and the sharing of best practice;

- Summaries of internal audit findings to be reported to the budgetary authority, regular policy evaluations by sector to be undertaken, and budget implementation figures to be explained to the Committee on Budgetary Control on a quarterly basis;

- Tighten implementation and application of existing provisions to restrict the business activities of former Commissioners, Cabinet appointees and officials;

- Inform the discharge authority, on an annual basis, of all cases involving whistleblowing by officials;

- Provide a summary of all disciplinary proceedings and closed administrative enquiries;

- Maintain a central database containing the names of companies and individuals found to have defrauded the EU budget, and publish details of convicted fraudsters on the Commission website, make a proposal to amend Council Regulation (EC) 1469/1995 on measures to be taken with regard to certain beneficiaries of operations financed by the Guarantee Section of the EAGGF (the so-called "black list" in the Common Agricultural Policy);

- Provide an annual progress report on the state of cleared and outstanding recoveries of irregular payments discovered by the Court of Auditors;

- Introduce improved document archiving facilities, using the latest cost-effective technology.

51. The European Parliament voted to grant discharge at its April plenary session.

(iii) European Court of Auditors' special reports

52. During the process of considering its discharge recommendation, the Council also considered the Court of Auditors' Special Reports 3/99 to 9/99, and 1-2/2000, 4/2000, 5/2000, 7/2000, 9/2000, 10-12/2000, 15/2000, 17/2000 and 20/2000. A full list of all the Special Reports published can be found in the Bibliography section of this White Paper.

(iv) UK response to the European Court of Auditors

53. The UK argued in the Council in 1995 in favour of a procedure for Member States to make responses to the Court of Auditors on the observations about them in its reports. Following endorsement by ECOFIN in November 1995 and the Madrid Council the following month, this has become established procedure. During the UK Presidency of the EU all Member States were asked to reply on the 1996 report by mid March 1998 and for the first time the responses were the subject of a discussion by Ministers, at the May 1998 ECOFIN. The responses are normally included in the follow up report which the Commission produces on action taken in response to the observations contained in the Court of Auditors' Annual Report. A copy of the UK response is always sent to both Houses of Parliament.

54. The Court of Auditors has tended to make less directly critical references to specific Member States in its Annual Reports for 1998 and 1999. There were very few specific criticisms of the UK in the Court of Auditors' report on 1999:

- *Absence of additional levy payments on milk quota overruns in four Member States (0.5 million in the United Kingdom)*
  The UK's total levy liability has been recalculated and most has been collected. Action has been taken to remind those responsible to submit accurate and timely returns.

- *Minor over-declaration of the number of head of livestock for animal premiums in three Member States, including the United Kingdom.*
  The UK has now made significant improvements in the Scheme administration, which it believes will lead to a reduction in errors found.

- *In the Clearance of Accounts procedure, all Member States' accounts bar one (the United Kingdom's) were submitted by the 10 February deadline.*
  The UK's accounts were submitted 6 days late. This was due to difficulties in completing reconciliations in respect of Second Category Accounts for Intervention Beef. The Commission was alerted to the possibility of a slight delay in January.

- *A financial correction was made with regard to the UK's Over-Thirty-Months-Scheme (OTMS).*
  The OTMS was introduced as part of the measures to resolve the BSE crisis. It involved the slaughter of all cattle more than thirty months old, and was subject to rigorous audit by both Commission and ECA auditors. The UK agreed that some minor shortcomings existed, particularly in the early weeks of the scheme in 1996, but has appealed against the amount of the financial correction imposed.

- *Import of New Zealand butter and cheese to the UK at preferential rates (follow-up to Special Report 4/98)*
  This refers to a complex long-running case first identified by the ECA in 1995-96. The UK Customs accepts that appropriate physical controls should have identified the irregularities at an earlier stage. But the key point, which is accepted by the Commission, is that there has been no loss of income to the Community budget and therefore no significant cost to Community funds. The arrears consist mostly of technical irregularities and are totally disproportionate to any benefit gained by the importers. Customs has since worked closely with the Commission to hasten the introduction of improved arrangements for control which came into effect in July 2000.

(v) NAO report on the Court of Auditors' report

55. The National Audit Office produces an annual report to Parliament (published this year on 27 April) explaining the findings in the Court of Auditors' Annual Report and Statement of Assurance. This year it also included a progress report on the Commission's reform plans.

(vi) Commission Administrative Reform Programme

56. The Commission has undertaken a great deal of work during the year to implement its White Paper and action plan for administrative reform published in March 2000. The target for implementation of the reform is the second half of 2002. Significant achievements to date to improve financial management include:

- Measures to establish clear lines of responsibility for financial management, through job descriptions and training programmes and in particular clarifying the responsibility of operational staff for sound financial management.
- A review of internal control systems in each Directorate General (DG) and the creation of an audit capability within each DG to provide advice and assurance on the system.
- A central financial service was set up in May 2000 to introduce common standards of control across the Commission DGs and provide advice on sound financial management.
- An internal audit service has been operational since June 2000. The Head of Service was appointed in December 2000 and other staff are being recruited.
- The Commission brought forward a proposal for a complete "recasting" of the Financial Regulation applicable to the general budget of the European Communities, aimed at modernizing financial management procedures, in October 2000 (see below).
- The Commission brought forward a "fast track" proposal in May 2000 to allow the formal separation of the roles of financial controller and internal auditor within the Commission. This was adopted by the Council in March 2001.

(vii) Recasting of the Financial Regulation

57. The Commission's October 2000 proposal for an amended Financial Regulation has two main aims. The first is to simplify and clarify the text of the Regulation, which dates originally from 1977 but has been amended fourteen times since then. The second is to modernize the financial management systems of the Commission. Changes of substance are:

- a clear statement of the principles of budget law, setting out and explaining the seven principles of budget law given in the Treaty – unity, annuality, equilibrium, unit of account, universality, specification and sound financial management. Exceptions to these principles are eliminated unless there are compelling reasons to retain them;
- changes to procedures for implementing the budget. This includes a change to the role of the actors in the processes, in particular making it clear that the operational DGs are responsible for sound financial management; clarification of the circumstances in which implementation of the budget can be shared or decentralised; and revised rules governing commitments, payment times and recovery orders;
- clearer rules on procurement and inclusion of rules covering the award and supervision of grants for the first time;
- applying standards based on internationally accepted accounting principles and methods to the keeping and presentation of the accounts ;
- simplification and clarification of the management of external aid, including decentralisation of management, subject to proof of certain minimum standards of financial management.

58. The Commission's proposal has been considered by the Council, European Parliament and the European Court of Auditors. The European Parliament has not yet issued its opinion. In June 2001 the ECOFIN Council welcomed the broad principles of the Commission's proposals, made specific comments on certain areas and asked the Commission to bring forward a revised proposal by the end of September. This will allow the Council to give detailed consideration to the proposals with a view to agreeing an amended regulation during 2002.

(viii) Nice Inter-Governmental Conference

59. The Nice Inter-Governmental Conference agreed to a move from unanimity to qualified majority voting for amendments to the Financial Regulation, to take effect from 2007. This will mean that making necessary changes to update and modernize the Financial Regulation will in future be easier and quicker.

60. The Conference also agreed to changes to the Treaty articles relating to the European Court of Auditors. Article 247 relates to the composition of the Court, currently set at fifteen members. The change makes explicit the current practice that the Court shall be made up of one member per Member State. Article 248 will be amended to improve the functioning of the Court. The statement of assurance may be supplemented by a specific assessment of each of the Community's major areas of activity. The Court is now able to organize itself into chambers to adopt certain categories of Reports or Opinions. It is also made clear that the Court can draw up its own Rules of Procedure which will be approved by the Council acting by qualified majority.

61. These changes are subject to ratification of the proposed Treaty changes by all Member States.

62. Member States also made a declaration at the conference inviting the Court of Auditors and the national audit institutions to improve the framework and conditions for co-operation between them, while maintaining the autonomy of each, by means of a contact committee set up by the President of the Court of Auditors with the chairmen of the National Audit Institutions.

G Countering fraud against the EC budget

(i) The European Anti-Fraud Office (OLAF)

63. The European Anti-Fraud Office (known by its French acronym, OLAF) was set up on 1 June 1999 to replace the Commission's Unité de coordination de la lutte anti-fraude (UCLAF). There have been some delays with the recruitment of suitable staff for OLAF, but it still expects to have around 300 staff by the end of 2001 – more than double that of its predecessor.

64. OLAF has already been involved in some significant fraud cases:

- **Fraud in the importation of bananas**
  An OLAF analysis of information received revealed that vast quantities of bananas from Ecuador were being smuggled in via the Italian port of Catania. In June 1999 a joint operation by OLAF and the Italian Guardia di Finanza resulted in the arrest of the importer and the customs agent responsible for the fraud.

- **Fraud involving adulterated butter**
  From 1997 to 1999 a number of Italian-based companies manufactured "industrial butter" from animal fat and synthetic products, which they sold on as "butter" to clients in France and Belgium. The product attracted illegal export refund subsidies at the expense of the Community budget. OLAF was alerted by the Italian authorities and, following investigations, co-ordinated international searches in July 2000 which led to arrests in Italy and France.

- **Spanish flax**
  Following reports in the Spanish media about suspicions of irregularities or fraud in the subsidies paid for flax production in Spain, OLAF contacted the Spanish authorities. Both OLAF and the Spanish Fiscalia Anti-Corrupción opened inquiries and a report has been forwarded to the competent judicial and administrative authorities.

- **EU subsidies paid in Slovakia**
  OLAF has recently (April 2001) opened an investigation into allegations of fraud concerning the award of tenders for EU projects in Slovakia. The investigation will be carried out in close co-operation with the Slovak authorities.

(ii) The incidence of fraud against the Community budget

65. OLAF compiles the Commission's Annual Report on the Fight against Fraud. The eleventh Annual Report, covering 1999, was published on 8 November 2000. (Publication of the 1999, like the 1998 reports, was delayed from its normal May publication date during the transitional period while the new European Anti-Fraud Office (OLAF) took over from its predecessor, UCLAF.) The twelfth Annual Report, covering the year 2000, was published in May 2001.

66. The "Fraud Report" deals with both irregularities and fraud. "Irregularities", as defined by Council Regulation 2988/95, covers both simple omissions due to errors or negligence, which are likely to undermine the Community budget, and also intentional and deliberate acts. "Fraud", as defined by the Fraud convention, covers intentional acts or omissions, in respect of both expenditure and revenue, which involve the use or presentation of false, incorrect or incomplete statements or documents, or specific non-disclosure of information, or misapplication of funds or benefits.

67. It is worth noting that higher figures for detected fraud and irregularities do not necessarily indicate a growing problem, as improved detection or notification rates may have contributed. Also, the results of long-term investigations, involving cases covering several years may be counted in one year. However, the following table shows the amounts involved in cases, either investigated by OLAF or notified by Member States in 1998, 1999 and 2000:

	1998		1999		2000	
	Million euro	£million	Million euro	£million	Million euro	£million
Own Resources	538	361	337	222	1143	696
Agricultural Guarantee	420	282	287	189	577	352
Structural Funds	50	34	145	95	139	85
Direct expenditure	11	7	73	48	170	103
Total	1019	684	842	554	2029	1236

The table shows that, in 1999, the total amounts involved fell from the previous year, and that the own resources and Agricultural Guarantee sectors showed considerable improvement. However, fraud and irregularity in the Structural Funds almost trebled, and cases in the field of direct expenditure showed a big increase. In 2000, the Own Resources and Agricultural Guarantee sectors showed large increases – but these were almost entirely due to two significant cases (the New Zealand butter case in the UK, and the adulterated butter case in Italy). Irregularities reported in the Structural Funds showed a slight fall. Direct expenditure (that is, funds managed directly by the Commission such as for research) also shows a big increase and reflects the greater priority given by OLAF to this sector.

68. For the first time in the 1999 "Fight against fraud" report, the Commission attempted to distinguish between fraud and irregularity in the cases reported. However, since the Regulations do not require Member States to report cases classified into fraud and irregularity, Member States may not always agree with the Commission's classification (and the Commission has not repeated the exercise in the 2000 report – but has undertaken to carry out some further work on the definitions and classification). The following table shows how the cases were classified (and includes cases investigated by OLAF to facilitate comparison with the previous table):

	1999 – Million euro			
	Value of Suspected Fraud Member States	Value of Irregularity reported by States	Value of OLAF cases	Total
Own Resources	51	215	71	337
Agricultural Guarantee	115	117	55	287
Structural Funds	23	97	25	145
Direct expenditure	0	0	73	73
Total	189	429	224	842

The table provides a useful, if rough-and-ready, illustration of the relatively low incidence of suspected fraud – less than half the value of cases reported by Member States in the Agricultural sector and less than one fifth of cases reported in the Structural Funds and Own resources sectors.

(iii) Preventative measures to combat fraud

69. The main developments in the protection of the Community's financial measures were:

(in 1999)

- A new set of initiatives to restore confidence in the Community Transit system;
- An action programme for renewing the conditions under which preferential tariff arrangements are applied;
- An ad hoc Council Working Party on Tax Fraud, and a Commission inquiry into the functioning and effectiveness of administrative co-operation and mutual assistance in the VAT sector;
- A feasibility study on setting up a computerized system for the movement and control of excisable goods;
- Revision of the legislation in several Agricultural sectors (for example, wine products, flax and hemp, arable crops, olive oil, beef and veal);
- Approval of nine Regulations on Structural Fund management;
- Proposals to recast four Directives in the field of public procurement;
- Commission has taken 45 formal decisions to make financial corrections in Member States (financial corrections are "fines" imposed on Member States where the Commission considers funds have been mis-spent or mis-managed);
- Other measures resulting from the White Paper on Commission Reform (also in 2000).

(and in 2000)

- Computerization of customs transit procedures;
- Proposal to reinforce current legislative provisions to improve the operation of the VAT system in the internal market;
- Council Decision which will allow Member States to retain 25% of amounts recorded for Own Resources as collection expenses;
- New Regulation to strengthen controls of banana imports;
- Over 600 million euro recovered from Member States in the Agriculture sector, under the Clearance of Accounts procedure for 1996-1999;
- New proposals for Regulations to improve the financial management and control of the Structural Funds;
- Reform of the management of external aid.

70. Measures and initiatives to improve co-operation and partnership with the Member States, candidate countries and third countries include:

(in 1999)

- **With Member States** – protocol signed between OLAF and the Italian National Anti-Mafia Directorate, developing contacts to improve judicial co-operation, training activities;

- **With Candidate Countries** – setting up of a specialist organization to combat fraud and organized crime, within the Polish general customs inspectorate;

- **With third countries** – conclusion of agreements on mutual assistance in Customs matters with 33 third countries (all geographical neighbours or important trading partners), four agreements on trade in textile products with far Eastern countries.

(and in 2000)

- **With Member States** – co-operation with internal audit services in the field of traditional own resources, operational co-operation between OLAF and Member States' authorities in fraud cases, co-ordination of investigations in the Structural Funds;

- **With Candidate Countries** – administrative co-operation on the implementation of SAPARD (Special Accession Programme for Agricultural and Rural Development), operational co-operation in Poland;

- **With third countries** – draft agreement with Switzerland to strengthen co-operation against organized crime and fraud, mutual administrative assistance in customs matters with Russia.

(iv) Measures adopted by Member States with a view to protecting the Community's financial interests

71. Article 280 of the Treaty of Amsterdam, which came into force on 1 May 1999, requires Member States to "take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests". The Article also requires the Commission to submit an annual report to the Council and to the European Parliament on the measures taken by Member States and the Commission for the implementation of Article 280. The Commission decided to cover the period from 1 May 1999 to 31 December 2000 in the 2000 "Fight against Fraud" report. Member States were required to complete a detailed questionnaire describing legislative measures, changes in organization of controls, co-operation between competent authorities, recoveries and other issues, in the three major budget sectors managed by themselves (own resources, agriculture and structural funds). The results are tabulated in the 2000 "Fight against Fraud" report.

(v) Commission's overall strategy for the fight against fraud

72. In June 1999 the Helsinki European Council asked the Commission to present "a communication on the development of the overall strategy which should allow the financial interests of the Community to be protected", by June 2000. The Commission's response, dated 28 June 2000, gives the background to the current provisions and legal framework covering the protection of the Community's financial interests, and lays out the Commission's global strategy in the form of four challenges:

- An overall legislative anti-fraud strategy;
- A new culture of operational co-operation;
- An inter-institutional approach to prevent and combat corruption;
- Enhancement of the penal judicial dimension.

The Commission explains how it intends to meet these four challenges, and has since published an Action Plan covering the period 2001 to 2003, which sets out the measures proposed.

(vi) OLAF's first report on operational activities

73. The Director of OLAF published a report on OLAF's first year of existence on 23 May 2000. This report was described in last year's Statement. The next report is expected to be published in the second half of 2001, and will be covered in next year's Statement.

(vii) First report from OLAF's Supervisory Committee

74. In order to ensure OLAF's independence, the Regulation which set up the new Anti-Fraud Office also set up a Supervisory Committee, to monitor regularly its investigative function. The Supervisory Committee comprises 5 independent Members (including Raymond Kendall from the UK, the former Secretary-General of Interpol), is required to meet at least ten times a year, provides opinions on OLAF's activities and is required to make at least one report each year to the other institutions. The first report from the Supervisory Committee was published on 25 August 2000. The Committee criticized the delays in the transition from UCLAF to OLAF and concluded that one year of operation had led to no noticeable improvement in the protection of the Communities' financial interests. The difficulties and delays in recruiting suitable staff were also criticised, however the Committee praised the efforts made by the new Director of OLAF to improve transparency in the management of operational activities and to step up his monitoring of the opening of investigations and the transmission of files to disciplinary or judicial authorities.

(viii) Ratification of the Convention on the protection of the European Community's "Fraud Convention")

75. The UK began the formal process to ratify the Fraud Convention on 2 June 1999, following commencement of Part I of the Criminal Justice Act 1993 on 1 June 1999. Ratification was completed in September 1999. Eleven Member States have now notified the Commission that they have ratified the Convention.

76. The Fraud Convention specifies minimum rules which Member States should adopt through their criminal law to deal with fraud against the Community Budget. It also requires all Member States to ensure that such frauds are punishable with imprisonment and are extraditable. When all Member States have notified the Commission of the completion of the ratification process, the Convention and Protocols will enter into force.

(ix) Anti-fraud activities in the UK – HM Customs and Excise

77. **Vat fraud:** An ad hoc Council Working Party considered this area and produced a report which made recommendations to address identified weaknesses in Community/national legislation; in administrative procedures for co-operation and mutual assistance; and in inspection systems, all of which hamper efforts to tackle fraud. The Report was presented to ECOFIN in June 2000. The UK welcomes the report as a significant step forward in the fight against tax fraud and would like to see its recommendations taken forward by Member States. Although the UK is already doing much of what the report recommends, it has put together an action plan to address the recommendations.

78. Both the Commission's Standing Committee on Administrative Co-operation

(SCAC) and the Anti-Fraud Sub-Committee (SCAF) continue to address fraud issues. The SCAC is taking forward a number of the recommendations arising from the ad hoc Working Party's Report. At the November 2000 SCAF meeting the UK made a presentation on risk analysis and subsequently hosted a seminar for all Member States centred on its risk analysis model. During the April 2001 SCAF meeting, the UK presented its strategy to tackle Missing Trader-based Intra-Community VAT fraud.

79. In September 2000, the UK implemented a nationally co-ordinated strategy to tackle "missing trader-based intra-community VAT fraud". This is an EU-wide VAT fraud and the UK has been working closely with counterparts in other Member States to tackle it. The strategy continues to develop particularly to broaden the financial attack on the fraudsters both in the UK and in other Member States.

80. **Traditional Own Resources fraud:** During 2000 HM Customs & Excise has been developing a civil penalty regime for customs duty evasion and other regulatory offences. This has not been implemented yet and is being given further consideration during 2001. HMCE also introduced legislation for interest to be charged on customs debts which the UK hopes will help recovery in cases of fraud and irregularity. Co-operation and mutual assistance between Member States has continued to develop in 2000. There is a well-established mechanism and single point of contact in the UK through which Member States can deal. A dedicated customs intelligence team has been set up to develop intelligence in all areas of commercial customs fraud, including anti-dumping duty, under-valuation fraud and CAP frauds. It is also the liaison point for other European customs intelligence services.

(x) Eurojust

81. The European Council in Tampere in October 1999 agreed to set up a unit named Eurojust, composed of magistrates, prosecutors or police officers of equivalent competence to reinforce the fight against serious organised crime. The intention is to facilitate the proper coordination of national prosecuting authorities and to support criminal investigations in cases of serious crime which cross national borders.

82. Pending establishment of the full Eurojust, a Council decision establishing a provisional unit of Eurojust was adopted in December 2000. Each Member State has sent an experienced judge, prosecutor or magistrate to this unit. The provisional unit has two aims: to improve practical cooperation on a case-by-case basis and to gain experience of collective working which will inform the decision on setting up the final Eurojust body.

Table 1

Expenditure on the Community Budget
Commitments and Payments by Type of Expenditure

million euros

	Commitments						Payments					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
1. Common Agricultural Policy	**39108**	**40675**	**39937**	**40060**	**40994**	**43298**	**39081**	**40623**	**39937**	**40060**	**40994**	**43298**
2. Structural Operation	**28672**	**30082**	**33461**	**39001**	**32678**	**32720**	**24426**	**26059**	**28518**	**30425**	**31802**	**31574**
– Structural Funds	26228	27333	30590	35883	30019	30005	22554	23736	25869	27550	29002	28714
– Cohesion Fund	2444	2749	2871	3118	2659	2715	1872	2323	2649	2875	2800	2860
3. Internal Policies	**5355**	**5698**	**5765**	**5862**	**6027**	**6232**	**4545**	**4935**	**4946**	**5021**	**5675**	**5855**
– Other agricultural operations	139	177	146	148	52	55	98	154	121	132	82	108
– Other regional operations	22	22	17	17	15	15	43	36	22	22	20	15
– Social and education policies	817	797	777	812	909	949	695	740	725	741	773	864
– Energy and environment	193	185	190	235	211	168	172	180	182	19	188	193
– Internal Market and TENs	794	841	1077	1129	1106	1008	551	710	796	883	938	948
– Research and development	3314	3613	3491	3450	3630	3920	2939	3066	3048	2990	3600	3610
– Other Internal policies	76	65	67	70	104	118	47	49	51	55	74	117
4. External action	**5563**	**5459**	**5721**	**4674**	**4805**	**4929**	**3805**	**3992**	**4349**	**3328**	**3611**	**3927**
– Food aid and humanitarian aid	1268	1018	855	866	936	928	1006	1078	702	711	832	873
– Regional cooperation measures	0	3650	3981	3284	3348	3499	0	2141	2858	2140	2293	2558
– Other external actions	4295	773	855	497	474	466	2799	748	769	456	456	461
– CFSP	0	18	30	27	47	36	0	25	20	21	30	35
5. Administration	**4105**	**4215**	**4505**	**4502**	**4704**	**4904**	**3963**	**4129**	**4505**	**4502**	**4704**	**4904**
– Commission	2665	2761	2844	2923	3069	3217	2615	2699	2844	2923	3069	3217
– Other Institutions	1440	1454	1661	1579	1634	1687	1348	1430	1661	1579	1634	1687
6. Reserves and repayment	**936**	**1370**	**1275**	**1192**	**906**	**916**	**936**	**1370**	**1275**	**1192**	**906**	**916**
– Monetary Reserve	0	500	500	500	500	500	0	500	500	500	500	500
– Emergency Reserve	0	329	338	346	203	208	0	329	338	346	203	208
– Loan Guarantee Reserve	235	329	338	346	203	208	235	329	338	346	203	208
– Repayments	701	212	99	0	0	0	701	212	99	0	0	0
7. Pre accession aid	**0**	**0**	**0**	**1372**	**3167**	**3240**	**0**	**0**	**0**	**1053**	**1696**	**2095**
Total	**83739**	**87499**	**90664**	**96663**	**93281**	**96239**	**76756**	**81108**	**83530**	**85581**	**89388**	**92569**

1. Because of rounding the column totals do not necessarily equal the sum of the individual items.
2. Figures for 1996 to 2000 are taken from the 2000 EC Finances White Paper. Those for 2001 are taken from publications detailing the 2001 Budget

Table 1A

Expenditure on the Community Budget
Commitments and Payments by Type of Expenditure

£ million

	Commitments 1996	1997	1998	1999	2000	2001	Payments 1996	1997	1998	1999	2000	2001
1. Common Agricultural Policy	**31369**	**28032**	**26811**	**26369**	**24981**	**27022**	**31348**	**27997**	**26811**	**26369**	**24981**	**27022**
2. Structural Operation	**22998**	**20732**	**22459**	**25672**	**19913**	**20421**	**19593**	**17959**	**19145**	**20027**	**19380**	**19705**
– Structural Funds	21038	18838	20532	23619	18293	18726	14751	16358	17367	18135	17673	17920
– Cohesion Fund	1960	1894	1927	2052	1620	1694	4842	1601	1778	1894	1706	1785
3. Internal Policies	**4295**	**3927**	**3870**	**3859**	**3672**	**3889**	**3646**	**3401**	**3320**	**3305**	**3458**	**3654**
– Other agricultural operations	111	122	98	97	20	34	79	106	81	87	50	67
– Other regional operations	18	15	11	11	5	9	34	25	15	14	12	9
– Social and education policies	655	549	522	534	554	592	557	510	487	488	471	539
– Energy and environment	155	127	127	155	129	105	138	124	122	13	115	120
– Internal Market and TENs	637	579	723	743	419	629	442	489	534	581	572	592
– Research and development	2658	2490	2344	2271	2212	2446	2357	2113	2046	1968	2194	2253
– Other Internal policies	61	45	45	46	63	74	38	34	34	36	45	73
4. External action	**4462**	**3762**	**3842**	**3075**	**2928**	**3076**	**3052**	**2751**	**2920**	**2191**	**2200**	**2451**
– Food aid and humanitarian aid	1017	702	574	570	570	579	807	743	471	468	507	545
– Regional cooperation measures	0	2516	2672	2161	2040	2184	0	1476	1918	1409	1397	1596
– Other external actions	3445	533	574	327	289	291	2245	516	516	300	278	288
– CFSP	0	12	20	18	18	22	0	17	14	14	18	22
5. Administration	**3293**	**2905**	**3024**	**2963**	**2867**	**3061**	**3179**	**2846**	**3024**	**2963**	**2867**	**3061**
– Commission	2138	1903	1909	1924	1870	2008	2098	1860	1909	1924	1870	2008
– Other Institutions	1155	1002	1115	1039	996	1053	1081	986	1115	1039	996	1053
6. Reserves and repayment	**751**	**944**	**856**	**785**	**552**	**572**	**751**	**944**	**856**	**785**	**552**	**572**
– Monetary Reserve	0	345	336	329	305	312	0	345	336	329	305	312
– Emergency Reserve	0	227	227	228	124	130	0	227	227	228	124	130
– Loan Guarantee Reserve	188	227	227	228	124	130	188	227	227	228	124	130
– Repayments	562	146	66	0	0	0	562	146	66	0	0	0
7. Pre accession aid	**0**	**0**	**0**	**903**	**1930**	**2022**	**0**	**0**	**0**	**693**	**1034**	**1307**
Total	**67169**	**60302**	**60860**	**63629**	**56844**	**60063**	**61567**	**55898**	**56075**	**56335**	**54472**	**57773**

1. Because of rounding the column totals do not necessarily equal the sum of the individual items.
2. Figures for 1996 to 2000 are taken from the 2000 EC Finances White Paper. Those for 2001 are taken from publications detailing the 2001 Budget
3. Sterling figures are derived from the corresponding euro amounts in Table 1 converted at the appropriate annual exchange rate (see Glossary for further details).

Table 2

Community Budget Own Resources

million euro

	Agricultural and Sugar Levies						Customs Duties						VAT Contributions					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Belgium	98	86	94	99	99	89	888	963	1,047	1,004	1,000	1,054	1,072	1,005	978	969	1,030	1,075
Denmark	43	40	41	45	44	39	222	248	254	251	250	264	695	679	654	636	657	684
Germany	461	430	421	464	444	412	3,039	3,002	2,840	2,724	2,714	2,860	11,497	10,504	8,589	8,552	9,264	9,357
Greece	18	19	19	21	20	19	131	145	145	167	167	176	610	598	621	595	611	641
Spain	84	68	69	94	73	87	539	563	667	725	722	761	2,574	2,796	2,686	2,783	2,846	2,994
France	349	333	325	356	348	306	1,193	1,218	1,177	1,130	1,127	1,187	7,139	6,842	6,297	6,258	6,495	6,719
Ireland	13	11	11	13	11	11	194	214	186	162	162	170	342	272	445	450	421	466
Italy	135	131	166	187	174	168	912	989	1,102	1,092	1,088	1,146	4,997	3,880	4,512	4,340	4,439	4,675
Luxembourg	0	1	1	1	1	1	18	21	21	20	20	21	98	89	107	87	91	97
Netherlands	192	230	223	234	229	223	1,417	1,498	1,467	1,378	1,373	1,447	1,836	1,826	1,825	1,779	1,891	2,024
Austria	41	38	40	43	43	38	222	216	201	201	201	211	1,051	1,118	977	894	958	991
Portugal	33	37	43	42	43	41	103	118	135	143	142	150	514	570	496	531	527	556
Finland	18	13	15	14	16	13	134	131	124	114	114	120	500	515	501	518	529	556
Sweden	26	33	41	38	42	35	357	330	343	318	317	334	1,003	1,170	1,066	952	1,042	1,135
United Kingdom	309	456	447	501	451	487	2,392	2,588	2,445	2,278	2,270	2,392	2,521	2,367	3,394	1,821	3,247	1,497
Total	1,821	1,925	1,955	2,152	2,038	1,968	11,762	12,247	12,156	11,706	11,665	12,292	36,448	34,230	33,147	31,165	34,049	33,467

	Fourth Resource Contributions						TOTALS					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Belgium	685	918	1,012	1,122	1,114	1,261	2,743	2,972	3,131	3,194	3,244	3,478
Denmark	400	538	745	723	731	823	1,360	1,506	1,695	1,655	1,682	1,810
Germany	5,770	7,281	8,783	9,318	9,176	10,361	20,767	21,217	20,633	21,058	21,599	22,990
Greece	347	416	525	565	565	643	1,107	1,178	1,310	1,348	1,362	1,478
Spain	1,342	1,940	2,330	2,621	2,628	3,001	4,539	5,368	5,752	6,222	6,269	6,842
France	3,729	4,793	5,785	6,269	6,286	7,083	12,411	13,186	13,584	14,014	14,256	15,295
Ireland	162	190	343	430	389	468	710	687	985	1,055	983	1,115
Italy	2,890	3,666	4,802	5,116	5,104	5,770	8,935	8,667	10,582	10,734	10,805	11,759
Luxembourg	47	60	88	86	84	97	163	171	217	193	195	216
Netherlands	990	1,283	1,589	1,704	1,755	2,029	4,436	4,838	5,104	5,095	5,248	5,723
Austria	558	738	868	929	906	1,017	1,873	2,110	2,086	2,068	2,108	2,257
Portugal	257	353	431	511	486	557	906	1,078	1,104	1,227	1,198	1,304
Finland	310	405	505	568	559	639	961	1,064	1,146	1,214	1,219	1,327
Sweden	571	793	934	1,058	1,076	1,268	1,957	2,326	2,383	2,365	2,476	2,771
United Kingdom	3,006	3,516	6,252	6,493	6,945	8,230	8,227	8,926	12,537	11,092	12,913	12,607
Total	21,064	26,891	34,991	37,512	37,805	43,245	71,096	75,293	82,249	82,534	85,557	90,972

Notes:
1. Figures for 1996 to 1999 are taken from the Court of Auditors Report for the respective year. Figures for 2000 are taken from Supplementary and Amending Budget No. 2/2000.
   Figures for 2001 are taken from the Adopted Budget 2001.
2. Miscellaneous items of revenue and carry forwards of surpluses and deficits from previous years account for the differences between total budget expenditure given in Table 1 and the own resources figures in Table 2.
3. The figures for agricultural and sugar levies and customs duties are after the deduction of 10% collection costs.
4. The figures for VAT contributions are after abatement.
5. Because of rounding the column totals do not necessarily equal the sum of the individual items.

Table 2A

Community Budget Own Resources

£ million

	Agricultural and Sugar Levies						Customs Duties						VAT Contributions					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Belgium	78	59	63	65	60	55	712	664	703	661	609	658	860	692	656	638	628	671
Denmark	35	28	28	30	27	24	178	171	170	165	152	164	557	468	439	419	400	427
Germany	370	297	282	306	271	257	2,438	2,069	1,906	1,793	1,654	1,785	9,222	7,239	5,766	5,629	5,645	5,840
Greece	15	13	13	14	12	12	105	100	97	110	102	110	490	412	417	392	373	400
Spain	67	47	47	62	44	54	432	388	448	477	440	475	2,065	1,927	1,803	1,832	1,734	1,868
France	280	229	218	234	212	191	957	839	790	744	686	741	5,726	4,715	4,227	4,120	3,958	4,194
Ireland	10	8	7	8	7	7	155	147	125	107	98	106	274	187	299	296	257	291
Italy	109	90	111	123	106	105	732	682	740	719	663	715	4,008	2,674	3,029	2,857	2,705	2,918
Luxembourg	0	0	0	0	0	0	15	15	14	13	12	13	78	61	72	57	55	61
Netherlands	154	159	150	154	139	139	1,137	1,032	985	907	837	903	1,473	1,259	1,225	1,171	1,152	1,263
Austria	33	26	27	28	26	24	178	149	135	133	122	132	843	771	656	589	584	618
Portugal	26	25	29	28	26	26	82	82	91	94	87	94	412	393	333	350	321	347
Finland	14	9	10	9	10	8	107	91	83	75	69	75	401	355	336	341	323	347
Sweden	21	23	27	25	26	22	287	227	230	209	193	208	805	806	715	626	635	708
United Kingdom	248	314	300	330	275	304	1,918	1,784	1,641	1,499	1,383	1,493	2,022	1,631	2,279	1,199	1,979	934
Total	1,461	1,327	1,312	1,416	1,242	1,228	9,435	8,440	8,160	7,705	7,109	7,671	29,236	23,591	22,252	20,514	20,749	20,887

	Fourth Resource Contributions						TOTALS					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
Belgium	550	633	679	738	679	787	2,200	2,048	2,102	2,102	1,977	2,171
Denmark	320	371	500	476	445	513	1,091	1,038	1,138	1,089	1,025	1,129
Germany	4,628	5,018	5,896	6,134	5,592	6,466	16,658	14,623	13,851	13,861	13,162	14,348
Greece	278	287	352	372	344	401	888	812	880	887	830	922
Spain	1,077	1,337	1,564	1,725	1,601	1,873	3,641	3,699	3,862	4,096	3,820	4,270
France	2,991	3,303	3,884	4,127	3,831	4,420	9,955	9,087	9,119	9,225	8,687	9,546
Ireland	130	131	230	283	237	292	570	473	661	695	599	696
Italy	2,318	2,527	3,223	3,367	3,110	3,601	7,167	5,973	7,104	7,066	6,584	7,339
Luxembourg	38	41	59	57	51	61	131	118	146	127	119	135
Netherlands	794	884	1,067	1,122	1,070	1,266	3,558	3,334	3,427	3,354	3,198	3,572
Austria	448	509	583	611	552	635	1,502	1,454	1,400	1,361	1,284	1,409
Portugal	206	243	289	336	296	348	727	743	741	808	730	814
Finland	248	279	339	374	341	399	771	733	769	799	743	828
Sweden	458	547	627	696	656	792	1,570	1,603	1,599	1,557	1,509	1,729
United Kingdom	2,411	2,423	4,197	4,274	4,232	5,137	6,599	6,152	8,417	7,301	7,869	7,868
Total	16,896	18,532	23,490	24,692	23,038	26,989	57,027	51,890	55,216	54,327	52,137	56,776

Notes:

1. Sterling figures are derived from the corresponding euro amounts in Table 2 converted at the appropriate annual exchange rate (see glossary).

Table 3

United Kingdom contributions to and public sector receipts from the Community Budget

	Million euro						£ million					
	1996	1997	1998	1999	2000	2001	1996	1997	1998	1999	2000	2001
GROSS CONTRIBUTIONS												
Agriculture & Sugar Levies	312	459	448	502	497	489	250	316	301	331	303	305
Customs Duties	2,439	2,612	2,445	2,290	2,676	2,873	1,957	1,800	1,641	1,507	1,630	1,793
VAT Own Resources	5,538	5,292	5,597	5,956	6,734	5,805	4,442	3,647	3,758	3,921	4,104	3,623
Fourth Resource payments	3,103	3,880	5,238	6,698	6,966	6,254	2,489	2,674	3,516	4,409	4,245	3,903
VAT & Fourth Resource adjustments	–6	–647	1,302	183	388	–124	–4	–446	874	120	236	–77
United Kingdom Abatement	–3,007	–2,515	–2,052	–4,817	–3,421	–7,306	–2,412	–1,733	–1,378	–3,171	–2,085	–4,560
Total Contributions	8,379	9,080	12,978	10,812	13,839	7,991	6,721	6,258	8,712	7,117	8,433	4,987
PUBLIC SECTOR RECEIPTS												
EAGGF Guarantee	3,613	4,598	4,332	4,101	4,105	3,820	2,898	3,169	2,908	2,700	2,502	2,384
EAGGF Guidance	38	83	83	73	135	78	31	57	56	48	82	49
European Regional Development Fund	773	1,178	531	434	1,622	1,393	620	812	357	286	989	869
European Social Fund	1,002	893	1,167	660	1,081	1,129	804	616	783	434	659	705
Other Receipts	25	11	16	17	16	26	20	7	11	11	10	16
Total Receipts	5,451	6,763	6,130	5,285	6,959	6,446	4,373	4,661	4,115	3,479	4,241	4,023
NET CONTRIBUTIONS	2,928	2,317	6,848	5,527	6,880	1,545	2,348	1,597	4,597	3,638	4,192	964

Notes:
1. For all years sterling figures reflect payments made during the year, not payments in respect of particular budgets. The corresponding euro figures have been converted from sterling at the appropriate annual exchange rate (see glossary).
2. The figures for contributions of customs duties, including those on agricultural products, and sugar levies in 2001 are based on UK projections of our sterling payments to be made during the year.
3. The figures for 2001 are forecasts, those for earlier years are outturn.
4. Because of rounding the column totals may not necessarily equal the sum of the individual items.

Glossary

The Budget procedure

The Community's financial year runs from 1 January to 31 December.
The rules governing decisions on the Community Budget are set out in Article 272 of the Amsterdam Treaty. These rules have been built on by the Inter-Institutional Agreement. The timetable is as follows:

- establishment of the preliminary draft budget by the Commission, normally by end-April;
- establishment of the draft budget by the Council in late-July;
- first reading by the Parliament in late-October;
- second reading by the Council in mid-November;
- second reading by the Parliament and adoption of the budget in mid-December.

Inter-Institutional Agreement and Financial Perspective

The Inter-Institutional Agreement (IIA) is a political and legally binding, agreement, which clarifies the Community's budgetary procedure. Under the Treaty, the Council and the European Parliament have joint responsibility for deciding the Community Budget on the basis of proposals from the Commission. The IIA sets out the way the three institutions will exercise their responsibilities in accordance with the Treaty, and respecting the revenue ceilings which are laid down in the Own Resources Decision. In particular, it provides for the annual Community budget to be set in the context of a multi-annual financial framework.

Agenda 2000

The Agenda 2000 package included the new Inter-Institutional Agreement and financial perspective together with reforms to the CAP and structural and cohesion funds, and new pre-accession aid programmes. The main lines of the package were agreed at the Berlin European Council in March 1999. Agreement on the implementing legislation was reached between Council and Parliament in May 1999.

Commitment and payment appropriations

The Budget distinguishes between appropriations for commitments and appropriations for payments. Commitment appropriations are the total cost of legal obligations which can be entered into during the current financial year for activities which will lead to payments in the current and future financial years. Payment appropriations are the amount of money which is available to be spent during the year arising from commitments in the Budgets for the current or preceding years. Unused payment appropriations may, in exceptional circumstances, be carried forward into the following year.

Compulsory and non-compulsory expenditure

Community expenditure is regarded as either "compulsory" or "non compulsory". Compulsory expenditure is expenditure necessarily resulting from the Treaty or from acts adopted in accordance with the Treaty. It mainly includes agricultural guarantee expenditure including stock depreciation and the monetary reserve. The Council has the last say in fixing its total.

The Parliament has the last say in determining the amount and pattern of non-compulsory expenditure. The growth of this expenditure is governed by the "maximum rate". Article 272(9) of the Amsterdam Treaty provides a formula for determining this rate unless an alternative figure is agreed by the budgetary authority. Under the Inter-Institutional Agreement the Council and Parliament agree to accept the maximum rates implied by the financial perspective ceilings.

Agricultural Guideline

The agricultural guideline is a legally binding limit under which spending on agricultural market support can grow each year by no more than 74 per cent of the change in Community GNP.

Structural Funds

The Structural Funds include the European Regional Development Fund and the European Social Fund. The Cohesion Fund supports projects and infrastructure networks in those Member States with a per capita gross national product which is less than 90 per cent of the Community average. The Berlin European Council set out proposed commitment appropriations for these funds between 2000 and 2006.

Own Resources

The Own Resources Decision lays down four sources of Community revenue, or own resources:

- *Customs duties, including those on agricultural products*. These are paid on a range of commodities imported from non-member countries. Following the agreement on agriculture during the Uruguay GATT Round, most agriculture duties are now fixed. However, for some key commodities, they continue to vary in line with changes in world prices;

- *Sugar levies*. These are charged on the production of sugar to recover part of the cost of subsidising the export of surplus Community sugar onto the world market;

- *Contributions based on VAT*. Essentially, the VAT resource is the amount yielded by applying a notional rate of 1% to a VAT base assuming an identical range of goods and services in each Member State. Each Member State's VAT base is however subject to a cap of, currently, 50% of 1% of its GNP;

- *GNP-based contributions*. The amount due is calculated by taking the same proportion of each Member States' Gross National Product. Because the Community is not allowed to borrow, revenue must equal expenditure. The GNP resource is the budget-balancing item; it covers the difference between total expenditure in the Budget and the revenue from the other three resources, subject to the overall own resources ceiling.

Fontainebleau abatement

The UK's VAT contributions are abated according to a formula set out in the Own Resources Decision. Broadly this is equal to 66 per cent of the difference between what the UK contributes to the Community budget and the UK's receipts, subject to the following points:

- the abatement applies only in respect of spending within the Community. Expenditure outside the Community (mainly aid), amounting to some 7 per cent of total expenditure in 2001, is excluded;

- the UK's contribution is calculated as if the Budget were entirely financed by VAT; and

- the abatement is deducted from the UK's VAT contribution a year in arrears.

The sterling figures for 1996 to 2000 in this White Paper are based on actual sterling cash receipts or payments where these took place and are known: elsewhere the appropriate average annual sterling/euro exchange rate has been used to convert euro figures into sterling[5]. Generally the 2001 euro figures have been converted into sterling using the £/euro exchange rate on 29 December 2000, when the rate was £1= 1.6023 (regulations state that VAT and GNP payments will be made using the exchange rate on the last working day of the preceding year). However, there may be some exceptions, for example where figures have previously been published at a different exchange rate – but these are noted where necessary. Note too that euro has been used for consistency throughout the publication rather than ecu.

Discharge Procedure

The European Court of Auditors' annual report is subject to consideration by the budgetary authority (Council and European Parliament) under the "discharge procedure" set out in Article 276 of the Treaty. In particular, they consider how the budget for the year in question was implemented. The European Parliament, acting on a recommendation from the Council, considers whether to grant the Commission a discharge in respect of the budget in question, thus bringing the budgetary process for that year to a formal close. The Commission is obliged under Article 276 of the Treaty to take "all appropriate steps" to act on comments made by the European Parliament and by the Council during the discharge process. If so asked, it must also report back on its actions with such reports going to the European Court of Auditors.

[5] The annual average rate for 1996 is £1 = 1.2467 euro
The annual average rate for 1997 is £1 = 1.4510 euro
The annual average rate for 1998 is £1 = 1.4896 euro
The annual average rate for 1999 is £1 = 1.5192 euro
The annual average rate for 2000 is £1 = 1.6410 euro

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Technical Annex I

Determining the value of the Own Resources Elements

The budgetary process relating to revenue has to respect the rules governing the size and structure of Own Resources. It involves a chain of inter-related calculations. These can be summarised as follows:

- at the beginning of the budgetary process, which occurs in the year prior to the Budget in question, the amounts due from each Member State are assessed in that Member State's national currency, ie sterling for the UK;

- the initial process involves estimating the amounts due to be received in respect of the traditional own resources, the amount relating to VAT if it were applied at 1 per cent across the Community and the amount of 1 per cent of each Member State's GNP. These estimates rely on the Member States' estimates of their economic activity during the Budget year;

- the Member States national currency estimates are then converted into euro at a rate known as the "budget exchange rate" (this is the exchange rate at the time the estimates are being drawn-up – in recent years an early April exchange rate has been used;

- the amount of VAT and GNP each Member State has to pay to the Community Budget is then determined by the limits described above for these own resources, so that when added to the amounts for the traditional own resources the total does not exceed the value of the own resources required to fund the proposed Budget for the coming year, subject to ensuring that the value of these own resources does not also exceed the own resources ceiling for the year in question (eg 1.27% in 2001);

- the sum, in euro, produced is entered into the Preliminary Draft Budget (PDB) for the Community, in June usually, of the year preceding the Budgetary year;

- the sum entered in the PDB is adjusted as necessary during the remainder of the Budget process, essentially to reflect changes on the expenditure side of the Budget, but still on the basis of the budget exchange rate and still respecting the own resources ceiling;

- the sterling/euro exchange rate on the last day of quotation before the start of the Budget year is established as the rate by reference to which VAT and GNP-based own resources contributions will be paid in the Budget year, so the amount which a Member State has to pay over in respect of the third and fourth resources in the Budget year will be different from its original estimates if the last-day of quotation rate is different from the budget exchange rate;

- during the course of the Budget year, the UK pays its VAT and fourth resource contributions to meet its obligations as denominated in euro in the adopted Budget. These payments are made at the sterling/euro rate described above (because Member States hand over only what they collect, their traditional own resources payments are not determined by the euro amounts in the Budget);

- because there are generally differences between the sterling/euro exchange rates (a) used to set up the Budget and (b) to make VAT and fourth resource contributions to it, the UK will generally have paid either more or less in sterling than the amount established for them for the budgetary year in question. These differences were, up until 1998, adjusted in December of the year after the Budget year. That is, an adjustment had either to be paid by or to the Member States to reflect any over or under payment in the Budget year as described above. Thus the UK's gross contribution in the year after the Budget year were affected by these adjustments;

- because the system led to large variations in the Member States gross contributions between EC budgetary years, the Member States accepted a European Commission proposal that effectively led to their making the adjustments during the course of the budgetary year to which their contributions relate. Under the new arrangements, in place since 1998, Member States re-estimate their 1% VAT and GNP bases during the course of the budgetary year and the conversion of their national currency estimates is then carried out at the last day of quotation rate. The revised figures are then included in a S&AB to the budgetary year to which they relate. In practice, converting the revised figures to euro at the last day of quotation rate means that in-year contributions are no longer affected by exchange rate differences. Furthermore, re-estimating the value of the 1% bases using much later information means that any differences between these estimates and the actual outturn for the year are very much reduced. The Member States thus contribute in year virtually what they should on the basis of their national currency obligations. Thus in the year following the budgetary year, any adjustments to correct for any under or overpayment should, from 1998, be relatively small compared to the adjustments made in years prior to 1998.

- numerous small further adjustments are, however, required to be made over several years following the budget year, for example, to reflect later adjustments in the amount of GNP statistics.

Technical Annex II

Explanation of the Difference Between the Government's Cashflow Outturn for the UK for 1999 and the Figures in the ECA's Annual Report for that Year

- When converted at the average exchange rate for 1999 of £1=1.5192 euro, the figures in the ECA report break down as follows:

	euro (millions)	*(£ million)*
UK gross contribution before abatement	14,651	9,644
UK abatement	–3,568	–2,349
UK receipts	–5,793	–3,813
UK net contribution	5,290	3,482

- The Government's figure for the UK's net contributions in 1999 is £3,638 million.

- There appear to be a number of factors that, to a greater or lesser extent, contribute to the difference between these two figures. The probable main causes for the difference are as follows:

  – The UK figure includes only transactions between the Community Budget and the UK public sector, whereas the ECA figure includes private sector receipts. We estimate that this accounts for around £350 million of the difference;

  – The late adoption of S&AB No. 1/1998 and S&AB No. 5 /1999 meant that associated changes were not implemented until January 1999 and January 2000 respectively. The result of which leads to the Government's figures for 1999 being £272 million lower in respect of changes associated with S&AB 1/1998 and £2 million lower in respect of changes arising from S&AB No. 5/1999; and

  – The UK's outturn figure is based on cashflow within a calendar year, whereas we understand that ECA figures relate to transactions in respect of a particular Community Budget. Some payments to and receipts from a Community Budget for a given year take place in the early weeks of the subsequent year. These are scored in the UK to the year in which the transactions happened, and by the Community to the Budget for the previous year. It would appear that up to £61 million of Structural Funds payments to the UK in respect of the 1999 Budget may have been made in 2000. In addition, in February 1999 the UK paid £5 million to the Budget in respect of the Loan Guarantee Fund for 1998, and in February 2000 the UK paid £8 million to the Budget in respect of the Loan Guarantee Fund for 1999.

There may, of course, be other factors which cause the two sets of figures to differ.

The table below reconciles the two figures:

	£ (million)
UK Government cashflow outturn for 1999	**3,638**
Private sector receipts	–350
Loan Guarantee Fund payments:	
1999 in respect of 1998 Budget	–5
2000 in respect of 1999 Budget	+8
Late implementation, in January 1999, of Supplementary & Amending Budget No. 1 1998	+272
Late implementation, in January 2000, of Supplementary & Amending Budget No. 5 1999	+2
Structural Fund receipts from 1999 Budget which appear to have been paid in 2000 (assuming the maximum amount was thrown back)	–61
Structural Fund receipts from 1998 Budget which appear to have been paid in 1999 (assuming the maximum amount was thrown back)	0
UK cash flow figure adjusted to reflect main differences compared to ECA figure	**3,504**
ECA figure for 1999 outturn	**3,482**
Net difference due to other factors (such as exchange rate)	22

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