



HM TREASURY

# **European Community Finances**

Statement on the 2000 EC Budget and measures  
to counter fraud and financial mismanagement



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to counter fraud and financial mismanagement

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

**July 2000**

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# 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 twentieth in the series. It describes the Budget for 2000 as adopted by the European Parliament and the United Kingdom's gross and net contributions to the Community Budget over the years 1995 to 2000. 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 April, 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 - around 46% of the total expenditure in 2000 - and certain small items in other sections of the budget 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 2000 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 2000 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 underimplementation 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. The Council is in the process of adopting 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, also 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%.<sup>1</sup>

13. The Loan Guarantee Reserve ceiling, which is equivalent to 203 million or £228 million in the 2000 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 2000 Budget**

14. Table A sets out the amounts established for the 2000 Budget at each stage of the budgetary procedure - which ran from April 1999 to December 1999 - and relates these to the Financial Perspective ceilings.

15. The final adopted Budget amounts to 93.28 billion euro or £58 billion in commitment appropriations, which is 0.67 billion euro below the Financial Perspective ceiling. Total payment appropriations amount to 89.39 billion euro or £55.6 billion, or 1.11% of Community GNP, well under the Own Resources ceiling of 1.27%.

16. The 2000 Budget represents a decrease over 1999 of 3.5 per cent in commitment appropriations, and an increase of 4.4 per cent in payment appropriations.

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<sup>1</sup> As of 1 January 2000 (Council Regulation No. 1149/99)

**2000 EC Budget****Table A**  
**million euro**

	Financial Perspective Ceilings	Preliminary Draft Budget	Council's First Reading Draft Budget		European Parliament's First Reading Draft Budget		Council's Second Reading Draft Budget		Adopted Budget
			40,901	40,526	41,497	40,526	40,526	40,526	
Commitment appropriations									
Common Agricultural Policy	41,738	40,901	40,526	41,497	40,526	40,526	40,526	40,994	
Structural Operations	32,678	32,678	32,678	32,678	32,678	32,678	32,678	32,678	
Internal policies	6,031	5,937	5,809	6,027	5,933	5,933	5,933	6,027	
External Action	4,627	4,479	4,611	4,587	4,606	4,606	4,606	4,805 <sup>2</sup>	
Administration	4,798	4,716	4,665	4,702	4,704	4,704	4,704	4,704	
Reserves	906	906	906	906	906	906	906	906	
Pre-accession aid	3,174	3,167	3,167	3,167	3,167	3,167	3,167	3,167	
<b>Total Commitment appropriations</b>	<b>93,952</b>	<b>92,784</b>	<b>92,362</b>	<b>93,563</b>	<b>92,520</b>	<b>92,520</b>	<b>92,520</b>	<b>93,280</b>	
<b>Total Payment appropriations</b>	<b>91,312</b>	<b>89,663</b>	<b>87,946</b>	<b>91,289</b>	<b>87,909</b>	<b>87,909</b>	<b>87,909</b>	<b>89,387</b>	
<b>Payments as a percentage of Community GNP</b>		<b>1.11</b>	<b>1.09</b>	<b>1.13</b>	<b>1.09</b>	<b>1.09</b>	<b>1.09</b>	<b>1.11</b>	

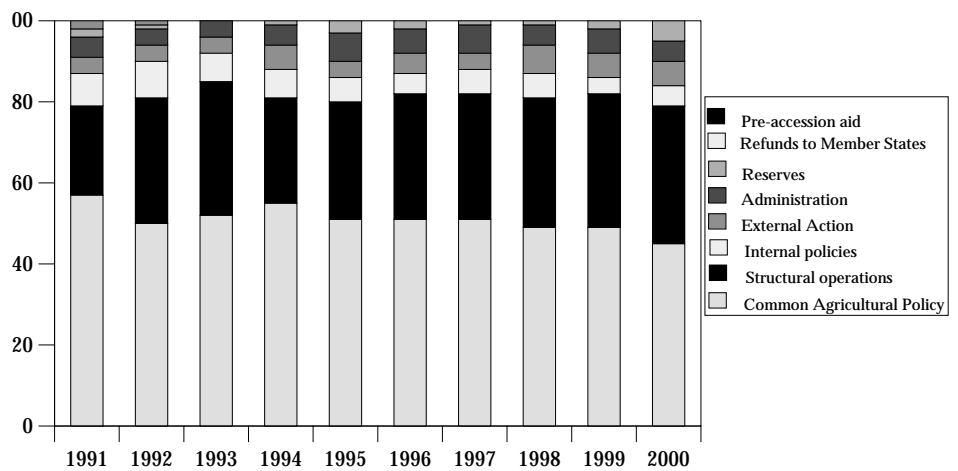
<sup>2</sup> Given the unforeseen, exceptional needs for Kosovo in 2000, the two arms of the budgetary authority, the Council and the European Parliament, agreed to make use of the Flexibility instrument (which has a maximum availability of 200 million euro per year) as set out in paragraph 24 of the Inter-institutional agreement on budgetary discipline of 6 May 1999.

**D. Developments in Community spending**

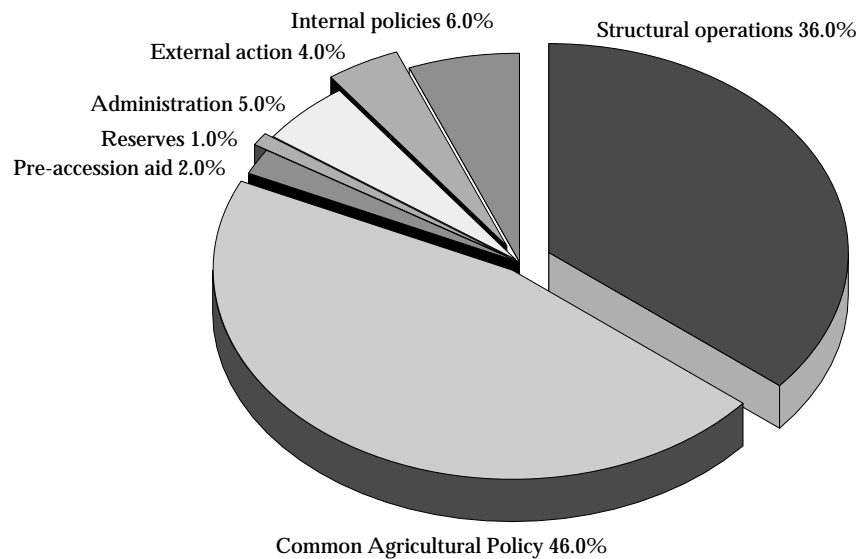
17. Chart B shows the developments in Community spending over the period 1991-2000. The two most significant trends are the reduction in the proportion of spending on agriculture which now forms under half the total budget - and the simultaneous increase in structural operations expenditure, which has increased to over one-third of the budget in 2000. Refunds to Member States have ceased, 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 (p. 21 & 22). These tables show commitments and payments for the years 1995-2000 in euros<sup>3</sup> and sterling. These tables show the main spending programmes broken down by Financial Perspective category.

**Developments in Community Spending 1991-2000**



**2000 EC Budget – Payment Appropriations**



<sup>3</sup> 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 expenditure 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 base is the amount yielded by applying a notional rate of 1 % to an identical range of goods and services in each Member State. Member States are, however, subject to a cap on their VAT contribution as a share of their Gross National Product. The cap on the VAT base is currently, 50% of 1 % of GNP for all Member States;
- 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 twelve 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 (p. 30 and 31)). If outturn expenditure is below the amount raised from Member States, excess contributions are refunded in a subsequent Budget, (a Supplementary and Amending Budget for the year).

(iii) *Community revenue in 2000*

24. Tables 2 and 2a (p. 23 and 24) show the estimated gross contributions, by Member States, to the EC Budget for the years 1995 to 2000. The key points to note are:

- in 2000 revenue from TOR is estimated to be £8.5 billion, of which the UK's share is some 19.9%. In 1999 revenue from this source was estimated to be £8.8 billion, of which the UK's share was 19.1%. The fall in the amount estimated to be raised from this resource in 2000 means that, all other things being equal, Member States will make, proportionately, higher fourth resource payments in 2000 than in 1999;
- total VAT contributions in the 2000 Budget are forecast to be around £21.2 billion. The UK's share of this total (after abatement) is 9.5 %. In 1999, total VAT contributions were estimated to be £20.4 billion, of which the UK's share (after abatement) was 6%;
- total GNP-based contributions in the 2000 Budget amount to some £23.5 billion, including a possible £0.6 billion contribution to Community reserves. The equivalent figure for 1999 was £24.7 billion, including £0.8 billion for the reserves (which were not all called up in 1999). The UK's share of the fourth resource in 2000 (including potential contributions to Community reserves) is 18.4% (in 1999 the equivalent share was 15.9%);
- the estimate of the UK's abatement in 2000 (in respect of our net contribution in 1999) is around £2.1 billion compared with £2.2 billion in 1999;
- the UK's share of total gross contributions (including potential contributions to the reserves, but after abatement) in 2000 is 15.1%. This compares with 25.2% for Germany, 16.7% for France and 12.6% for Italy. The equivalent 1999 figures are 12.7% for the UK, 26.4% for Germany, 17.3% for France and 13.1% 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 UK receipts, compared with UK contributions to the Community budget. In broad terms the UK receives an abatement of its gross contributions equal to 66 per cent of the difference between its unabated UK 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 6 per cent of total EC budget expenditure in 2000, 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 UK abatement is set out in the ORD and in a Working Methods Paper 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 in arrears, after which a final reckoning is made (known as the definitive calculation of the abatement in respect of a, specific, Community budgetary year).

28. Table 3 (p. 25) shows the UK's contributions to, abatement, and public sector receipts from, the Community Budget for the years 1995 to 2000. The figures for 2000 are estimates, those for earlier years are outturns.<sup>4</sup>

29. UK Public sector receipts in 2000, mainly from the Agricultural Guidance and Guarantee Fund (EAGGF) and the Social and Regional Development Funds, are expected to be around £4.3 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 2000 these payments are expected to be around £410 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 (p. 25), 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 2000 is estimated to be some £4 billion, compared with some £3.6 billion in 1999.

32. The UK's net contributions to the Community Budget 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 2000 and the 1999 net contribution are:

- (i) higher rate of growth in the UK economy compared to other Member States has increased our GNP and VAT payments in 2000; as a result of this, we expect a significant increase in our abatement in 2001;
- (ii) a lower abatement in 2000 (£2,085 million) compared with 1999 (£3,171 million), which included an upward correction of some £776 million to the 1998 abatement. Updates of earlier estimates of our abatement reflect improved estimates of the data for UK and other Member States' VAT and GNP which are used in the calculation;
- (iii) a higher estimate of UK public sector receipts (£4,325 million) in 2000 compared with the outturn for 1999 (£3,479).

33. The estimate of the UK's net contribution in calendar year 2000, shown in Table 3 (p. 25), differs from the estimate for the financial year 2000-01 contained in the Chancellor's Departmental Report (Cm 4615) for three main reasons:

- (i) first, the estimates relate to different time periods;
- (ii) second, the figure in Table 3 (p. 25) reflects the actual net contribution expected to be paid in 2000, whereas the figure, for 2000-01 in the Departmental report reflects the trend in the UK's net contribution; and
- (iii) the figures in Table 3 (p. 25) take into account information which was not available at the time the figures in the Departmental Report were prepared.

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<sup>4</sup> 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 Auditor's 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' annual report for the same year. This White Paper reports on the likely differences for the 1998 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 £505 million for 1998);
- (ii) the late adoption of Supplementary and Amending Budget No. 1 1998 meant that associated changes to contributions were not implemented until January 1999 and do not, therefore, appear in the Government's figures for 1998. These are some £272 million higher 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 1998 cash flow figure for the UK's net contribution up to some £26 million lower than that indicated by the figures for the UK in the Court of Auditors' report on the 1998 Community Budget.

36. Technical annex II (p. 32 and 33) provides a comparison between the two sets of figures.

## **II FINANCIAL MANAGEMENT AND ANTI-FRAUD**

### **F. Financial Management**

37. Financial management of the European Union budget, and measures to counter fraud against the budget, has had an extremely high profile since the European Parliament's postponement in 1998 of discharge of the 1996 budget, which led to its vote on a censure motion on the Commission on 14 January 1999. The Commission survived the censure motion, but the Parliament's Resolution calling for a Group of Experts to look at how the Commission deals with fraud, mismanagement and nepotism was agreed. The Committee of Independent Experts, popularly referred to as the "Wise Men", published its report on 15 March 1999. In response to the criticism in the report, the Commission decided, collectively, to resign.

38. The European Council, meeting in Berlin on 24-25 March 1999, nominated Romano Prodi as the new President of the Commission and called on the new Commission to put speedily into effect the necessary reforms, in particular for the improvement of its organisation, management and financial control. At the Cologne Council on 3-4 June 1999, Mr Prodi undertook to bring forward a detailed plan on reform of the Commission by February 2000. Neil Kinnock was appointed Vice-President of the Commission with special responsibility for reform. He set up a ten-member "Task Force for Administrative Reform" which

aimed to define the reform strategy and supervise its implementation. This has taken account of input from Member States and the European Parliament including a second report of the Independent Experts dealing with Commission reform. The Commission's White Paper ("Reforming the Commission" COM(2000) 200) setting out the Task Force's plans for reform was published on 1 March 2000.

39. The White Paper defined the reform strategy in three specific areas:

- Priority setting, allocation and efficient use of resources, including better planning and priority allocation, greater accountability and performance-related working methods;
- Human resources development, including a complete overhaul of policies on recruitment, promotion and career development, training, codes of conduct and ethical standards, and the rights and obligations of staff;
- Audit, financial management and control, including accountability, checking, control systems, setting up a professional Internal Audit Service and creating a new Central Finance Service to define and monitor financial rules and procedures.

40. The White Paper has been welcomed by the UK and the rest of the Council. It set out a detailed action plan and timetable for achieving reform by the second half of 2002. Meanwhile action has already been taken to reorganise directorates-general in order to increase efficiency and coherence, to rotate senior staff who have held the same post for many years, to introduce a code of conduct for Commissioners and Commission staff and to abolish a range of tax free privileges for Commissioners.

(i) *European Court of Auditors' Annual Report for 1998, Statement of Assurance and Special Reports*

41. 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 (formerly Article 188c) 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.

42. 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 Court of Auditors produces a separate annual report with its findings on the management of the Sixth, Seventh and Eighth 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.

43. 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.

44. 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 (formerly Article 206), 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 1998 budget*

45. The latest Annual Report and Statement of Assurance from the Court of Auditors relate to implementation of the budget for the 1998 financial year, and were published together (in a provisional version) on 16 November 1999. These were formally published in the Official Journal (C349 Vol 42) on 3 December. The Court of Auditors makes three main recommendations in its introduction to the report:

- the Commission should move away from the spending culture in which the extent to which appropriations have been utilised is the main indicator of performance;
- the Commission should continue and deepen the financial management reform process;
- the Commission must make fundamental improvements in its internal control system including greater accountability on the part of managers supported by improved human resource management systems.

46. Last year's White Paper explained that the Court of Auditors now published most of its detailed findings in the form of Special Reports. The Annual Report on the 1998 budget does not summarise the content of Special Reports published during the year but concentrates more on implementation of the budget and an analysis of the Statement of Assurance (see next paragraph) in each budget area. More emphasis has been given this year to following up action which has been taken in response to the Court's previous reports.

*European Court of Auditors' Statement of Assurance*

47. 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 1998 concluded that:

- the accounts for 1998 reliably reflected the revenue and expenditure for the Community for the year and the financial situation at the end of the year, with four areas of qualification. These concerned the inaccurate or incomplete disclosure of fixed assets, debtors, commitments and provisional payments;

- taken as a whole the transactions underlying the revenue entered in the Community accounts for 1998 were legal and regular subject to a number of limitations, in particular on the completeness of the figures;
- taken as a whole the commitment transactions for 1998 were legal and regular, with one exception where the Commission entered into binding obligations greater than the amounts provided for in the budget;
- there was an unacceptably high rate of errors which directly affected the payments made. Therefore for the fifth year in succession the Court declined to provide assurance that the transactions underlying payments were legal and regular.

48. The Court has suggested that the Commission should employ external professional expertise to improve the quality of its financial statements, a suggestion which the Commission has welcomed and intends to pursue.

49. The Court again found itself unable to issue a positive statement of assurance because of the high level of errors in payment transactions. The highest error rates found by the Court occurred in the Structural Funds and the Internal Policies (measures for training and culture, media, energy and environmental policies, transport, research and technical development etc) areas. The Court noted that the Agricultural accounts were generally reliable, although the rate of errors in payments was still too high. Changes in procedures and legislation have led to improvements in Agriculture and the Court expects similar changes to lead to improvements in the Structural Fund accounts.

50. 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.

*Council recommendation to the European Parliament*

51. The Council's recommendation to the European Parliament on the terms of the discharge to be granted to the Commission for implementation of the 1998 budget was discussed by ECOFIN on 13 March 2000. 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 based on the reasoning that it is more constructive to help the Commission to improve rather than punish it for its failures and it also reflects an awareness that the fault does not lie only with the Commission but with all those who have a part in the administration of the budget (i.e. including the Council and the European Parliament). The Council also wished to recognise the new Commission's intentions to take steps to improve financial management - on 11 February 2000 the Commission had produced a draft "Action Plan" for improving financial management, aimed at achieving "a substantial reduction in the errors reported by the Court of Auditors in the context of its Statement of Assurance". Most Member States felt that this Action plan, although far from perfect, was a commendable first step which should be welcomed. It would have been counter-productive to hold out for further progress before making the discharge recommendation.

52. However, the European Parliament has not always agreed with the Council's recommendation for discharge on the budget. The Parliament's refusal to grant discharge on the 1996 budget ultimately led to the resignation of the Commission led by Jacques Santer in March 1999. Discharge has in fact never been given for 1996 - the European Parliament eventually decided simply to "note" the accounts to allow the books to be closed. The resolution on discharge of the 1997 accounts was postponed throughout 1999 but was finally adopted by the European Parliament in January 2000.

53. Discharge of the 1998 budget was postponed by the European Parliament at its plenary session on 13 April 2000. The Parliament called on the Commission to provide a detailed response to various issues highlighted in its report by 15 May 2000. The Commission met this deadline and the response was discussed by the Parliament's Budgetary Control Committee, which made a recommendation to grant discharge. On 6 July the European Parliament voted comprehensively in favour of granting discharge.

*European Court of Auditors' special reports*

54. The Council also considered the Court of Auditors' Special Reports 1/99 to 4/99. These are listed in the Bibliography section of this White Paper. Further reports relating to the 1998 financial year were published by the Court of Auditors at the end of 1999 and the beginning of 2000, but because the process of obtaining the comments of the institutions concerned had not been completed, these reports were not included in the 1998 Annual Report.

*UK response to the European Court of Auditors*

55. 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. For the report on 1998, the Commission asked all Member States to respond to specified references to them in the Court of Auditors report. The UK's response was copied at the time to both Houses of Parliament. 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.

56. There were very few specific criticisms of the UK in the Court of Auditors report on 1998. Some of those highlighted by the Court of Auditors include:

- over-estimation of the value of a cow slaughtered under the programme to eradicate BSE (*the UK does not accept the Auditors view of this case; discussions are continuing*);
- inadequate keeping of livestock records (*standard registers have now been introduced*);
- the treatment of cheques issued to beneficiaries but not cashed (*the UK is seeking clarification and advice from the Commission on its standard practices*);

*(ii) NAO report on Court of Auditors' reports*

57. The National Audit Office produces an annual report to Parliament (published this year on 28 April) explaining the findings in the Court of Auditors' Annual Report and Statement of Assurance. This year it also included a section on the Commission's plans for reform.

(iii) *Sound and Efficient Management 2000 programme (SEM 2000)*

58. The Commission's SEM 2000 programme was launched in early 1995 in an effort to instil a better culture of resource management in the Commission's work. Phase III of the programme deals with relations between the Commission and Member States. The Commission is assisted by a Working Group of Personal Representatives of Member States' Finance Ministers (PRG). The Commissioner responsible for financial control and budgets (currently Michaela Schreyer) has presented regular PRG progress reports to the ECOFIN Council. The new Commission has decided to carry on with SEM 2000 programme, even though the original SEM 2000 programme has officially finished. Since last year's White Paper, reports have been made to the November 1999 and July 2000 ECOFINs, and have been deposited in both Houses of Parliament.

59. The major areas of work discussed by the PRG included:

- the results of an evaluation of the SEM2000 initiative undertaken by external consultants;
- the Commission's programme for administrative reform;
- shared responsibility between Member States and the Commission for management of the Structural Funds;
- the European Court of Auditors' Annual Report, and Member States' responses;
- the recasting of the Financial Regulation;
- the presentation of the Preliminary Draft Budget for 2001 in parallel "Activity-Based Budgeting" format;
- the Joint Audit Initiative (whereby the Commission's Budget Directorate-General would evaluate Member States' audits of their own control systems).
- Structural Funds implementation and financial control activities.

(iv) *Recasting the Financial Regulation*

60. The Financial Regulation of 21 December 1977 applies to the General Budget of the European Union. There have been a number of amendments to the Regulation since that date. In October 1998 ECOFIN adopted the 7th series of amendments, following a conciliation procedure with the European Parliament. The 7th series of amendments is part of the SEM2000 initiative to improve financial management and includes important changes which will allow more modern and effective financial management systems to be introduced.

61. An 8th series of amendments was proposed mostly relating to technical adjustments required to take account of the introduction of the euro on 1 January 1999, but also proposing a specific section of the general budget for the Ombudsman, previously included in section I of the budget (Parliament). Due to time constraints the series was split into two, with 8(a) relating to the introduction of the euro, and 8(b) related to the budget of the Ombudsman. The Council adopted 8(a) in November 1998 while 8(b) was not adopted by the Council until December 1999, mainly as a result of disruption caused by the resignation of the Commission in March 1999.

62. These amendments were the latest of a number of changes to the original text to take account of changes to the institutional structure and to tighten up the management of Community finances. Although these amendments were necessary to bring the Regulation up to date and introduce improvements in financial management, they have impaired the coherence and readability of the text. Following the 7th train of amendments the Commission produced a working paper which proposed a fundamental review of the Financial

Regulation. The resignation of the Santer Commission delayed publication of a formal proposal, and this has been further held in abeyance in order that it may take account of the new Commission's reform plans. The Commission has, however, brought forward a welcome proposal dated 30 May 2000 which deals exclusively with the urgent requirement to separate the function of internal auditor from the function of financial controller of the Commission.

**G Countering fraud against the EC budget**

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

63. Until 1 June 1999 the organisation responsible for investigating allegations of fraud within the European Union budget was the Commission's UCLAF (Unité de co-ordination de la lutte anti-fraude). The operation of UCLAF had been criticised by both the Court of Auditors and the European Parliament. In response to the criticisms, the Commission presented a proposal to establish a European Anti-Fraud Office as a separate body outside the Commission to the Vienna European Council on 11-12 December 1998. After consideration by the Council and the European Parliament, an amended proposal was made by the Commission in March 1999, which situated the new Anti-Fraud Office within the Commission but with operational independence including the right to initiate investigations, make recommendations and report to the European Parliament and the Council. This new proposal met the UK's requirements. Following further discussion, a joint Regulation of the European Parliament and the Council on the conduct of investigations by the Office was agreed under the co-decision procedures introduced by the Amsterdam Treaty at the Parliament's May plenary session and the 25 May ECOFIN. The new European Anti-Fraud Office (*Office Européen de Lutte Antifraude - OLAF*) was established by a Commission Decision on 1 June 1999.

64. The Director of OLAF, Franz-Hermann Bruener, took up office on 1 March 2000. He will bring forward a work programme and analysis of the resources required by the new office for consideration by the Council and European Parliament. The Commission are also developing a global strategy for fighting fraud against the EC budget as requested by the Helsinki European Council.

*Annual Report on the Fight against Fraud*

65. OLAF compiled the Commission's Annual Report on the Fight against Fraud, although it refers to work completed by OLAF's predecessor, UCLAF. The Tenth Annual Report, on 1998, was published on the Commission's internet site on 19 November 1999. The report was considered by the ECOFIN council of 28 November 1999.

(ii) *The incidence of fraud against the Community budget*

66. The "Fraud Report" explains that it 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 penal 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. 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. The following table (p. 19) shows the amounts involved in cases investigated by UCLAF (the Commission's former fraud investigation unit) or notified by Member States in 1997 and 1998:

	1997		1998	
	Million euro	£million	Million euro	£million
Own Resources	1,000	689	538	361
Agricultural Guarantee	317	218	420	282
Structural Funds	77	53	50	34
Direct expenditure	11	8	11	7
Total	1,405	968	1,019	684

Roughly half the cases were investigated as a result of notifications from Member States, the rest were new investigations opened by UCLAF. The total number of cases investigated appears to be stabilising, and the amounts involved have reduced by almost one third. However, UCLAF cautiously estimated that only one case in five investigated related to actual fraud (that is, warranting criminal law measures).

(iii) *Preventative measures to combat fraud*

68. The report states that the main developments in the protection of the Community's financial measures were:

- reform of the Community transit system (improving co-ordination between 22 countries);
- reform of the preferential tariff arrangements (implemented by the new Council Regulation 2820/98);
- recommendations and guidelines on indirect taxation (VAT fraud - the FISCALIS programme provides for exchange of information and closer contacts between Member States);
- reform of financial management (implementation of the Structural Funds regulation 2064/97), and guidelines for the application of financial corrections (fines imposed on Member States when irregularities are discovered);
- the Corpus Juris study (a detailed comparative study to evaluate the proposals set out in the *corpus juris* introducing penal provisions for the protection of the financial interests of the European Communities);
- the annual comparative analysis of the application of Article 280 of the Treaty (which 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.)

Measures and initiatives to improve co-operation and partnership with the Member States include:

- the ratification of the Convention on the protection of financial interests;
- close co-operation between the Commission and national services involved in the fight against fraud and criminality (eg between UCLAF and the Italian Carabinieri);
- entry into force of Article 280 of the Treaty of Amsterdam, which makes clear that responsibility to protect the Communities' financial interests is shared between the Member States and the Community;

- Judicial co-operation between Member States in trans-national investigations into fraudsters, and the role of OLAF in overcoming difficulties and slow procedures in these cases;
- preventive measures aimed to combat the threat of counterfeiting Euro notes and coins;
- the Customs Information System launched in 1998, which enables Member States to exchange information on customs fraud. cases quickly and securely;
- training provided by the Commission for national services involved in protecting the European Union's financial interests.

(iv) *OLAF's first report on operational activities*

69. The Director of OLAF published a report on OLAF's first year of existence on 23 May 2000. The report covers activities from 1 June 1999 to 31 May 2000 (although the statistical data in the report only covers the period until 31 March 2000). The report does not include an account of Member States' activities to counter fraud - this will feature in the next Commission Annual report on the Fight against Fraud, which is expected to be published in Autumn 2000. The report describes OLAF's activities in gathering and processing data, running administrative investigations, its roles in co-ordination and assistance and in monitoring results. It explains how priorities from the work of its predecessor UCLAF, have been taken over. OLAF analyses frauds uncovered by methods used, and categorises them within budget areas. Statistics show the numbers of reports submitted and the financial consequences. OLAF recognises its current limitations - resource problems, weaknesses in legislation, problems with co-operation - and suggests improvements. Planned developments include improvements in IT systems, a strengthening of resources (to 300 posts by 2002), re-organisation, improving the legal framework and more precisely-targeted priority setting.

(v) *Ratification of the Convention on the protection of the European Community's financial interests (the "Fraud Convention")*

70. 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. Ratification has also been completed by Germany, Austria, Spain, Finland and Sweden and is in progress in the other Member States.

71. This will enable the courts in the UK to take jurisdiction over certain offences of dishonesty where any relevant act takes place within the jurisdiction, and will satisfy the Convention's requirements for Member States to take jurisdiction where an offence takes place "in whole or in part" within its territory.

Table 1

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

	million euros											
	Commitments					Payments						
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
<b>1. Common Agricultural Policy</b>	<b>34,503</b>	<b>39,108</b>	<b>40,675</b>	<b>39,937</b>	<b>40,060</b>	<b>40,994</b>	<b>34,498</b>	<b>39,081</b>	<b>40,623</b>	<b>39,937</b>	<b>40,060</b>	<b>40,994</b>
<b>2. Structural Operations</b>	<b>24,511</b>	<b>28,672</b>	<b>30,082</b>	<b>33,461</b>	<b>39,001</b>	<b>32,678</b>	<b>19,292</b>	<b>24,426</b>	<b>26,059</b>	<b>28,518</b>	<b>30,425</b>	<b>31,802</b>
– Structural Funds	22,359	26,228	27,333	30,590	35,883	30,019	17,593	22,554	23,736	25,869	27,550	29,002
– Cohesion Fund	2,152	2,444	2,749	2,871	3,118	2,659	1,699	1,872	2,323	2,649	2,877	2,800
<b>3. Internal policies</b>	<b>5,117</b>	<b>5,355</b>	<b>5,698</b>	<b>5,765</b>	<b>5,862</b>	<b>6,027</b>	<b>4,004</b>	<b>4,545</b>	<b>4,935</b>	<b>4,946</b>	<b>5,021</b>	<b>5,675</b>
– Other agricultural operations	174	139	177	146	148	52	108	98	154	121	132	82
– Other regional operations	52	22	22	17	17	15	36	43	36	22	22	20
– Social and education policies	777	817	797	777	812	909	627	695	740	725	741	773
– Energy and environment policies	209	193	185	190	235	211	142	172	180	182	19	188
– Internal market and trans-European networks	738	794	841	1,077	1,129	1,106	519	551	710	796	883	938
– Research and Development	3,114	3,314	3,613	3,491	3,450	3,630	2,538	2,939	3,066	3,048	2,990	3,600
– Other internal policies	54	76	65	67	70	104	35	47	49	51	55	74
<b>4. External action</b>	<b>5,202</b>	<b>5,563</b>	<b>5,459</b>	<b>5,721</b>	<b>4,672</b>	<b>4,805</b>	<b>3,450</b>	<b>3,805</b>	<b>3,992</b>	<b>4,349</b>	<b>3,328</b>	<b>3,611</b>
– Food aid and humanitarian aid	1,288	1,268	1,018	855	866	936	931	1,006	1,078	702	711	832
– Regional cooperation measures	0	0	3,650	3,981	3,284	3,348	0	0	2,141	2,858	2,140	2,293
– Other external actions	3,914	4,295	773	855	497	474	2,519	2,799	748	769	456	456
– Common Foreign and Security Policy	0	0	18	30	27	47	0	0	25	20	21	30
<b>5. Administration</b>	<b>3,925</b>	<b>4,105</b>	<b>4,215</b>	<b>4,505</b>	<b>4,502</b>	<b>4,704</b>	<b>3,874</b>	<b>3,963</b>	<b>4,129</b>	<b>4,505</b>	<b>4,502</b>	<b>4,704</b>
– Commission	2,539	2,665	2,761	2,844	2,923	3,069	2,473	2,615	2,699	2,844	2,923	2,923
– Other Institutions	1,386	1,440	1,454	1,661	1,579	1,634	1,401	1,348	1,430	1,661	1,579	1,579
<b>6. Reserves and repayments</b>	<b>1,798</b>	<b>936</b>	<b>1,370</b>	<b>1,275</b>	<b>1,192</b>	<b>906</b>	<b>1,798</b>	<b>936</b>	<b>1,370</b>	<b>1,275</b>	<b>1,192</b>	<b>906</b>
– Monetary Reserve	0	0	500	500	500	500	0	0	500	500	500	500
– Emergency Reserve	0	0	329	338	346	203	0	0	329	338	346	203
– Loan Guarantee Reserve	251	235	329	338	346	203	251	235	329	338	346	203
– Repayments	1,547	701	212	99	0	0	1,547	701	212	0	0	0
<b>7. Pre-accession aid</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,372</b>	<b>3,167</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,053</b>	<b>1,696</b>
<b>Total</b>	<b>75,056</b>	<b>83,739</b>	<b>87,499</b>	<b>90,663</b>	<b>96,665</b>	<b>93,281</b>	<b>66,915</b>	<b>76,756</b>	<b>81,108</b>	<b>83,529</b>	<b>85,584</b>	<b>89,387</b>

1. Because of rounding the column totals do not necessarily equal the sum of the individual items.

2. Figures for 1995 and 1996 are taken from the 1998 EC Finances White Paper. Those from 1997 and 1998 are outturn figures taken from the Court of Auditors Annual Report. Those for 1999 and 2000 are taken from publications detailing the 2000 Budget.

Table 1A

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

£ million

	Commitments					Payments						
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
<b>1. Common Agricultural Policy</b>	<b>28,255</b>	<b>31,369</b>	<b>28,032</b>	<b>26,811</b>	<b>26,369</b>	<b>25,485</b>	<b>28,251</b>	<b>31,348</b>	<b>27,997</b>	<b>26,811</b>	<b>26,369</b>	<b>25,486</b>
<b>2. Structural Operation</b>	<b>20,073</b>	<b>22,998</b>	<b>20,732</b>	<b>22,459</b>	<b>25,672</b>	<b>20,315</b>	<b>15,799</b>	<b>19,593</b>	<b>17,959</b>	<b>19,145</b>	<b>20,027</b>	<b>19,771</b>
– Structural Funds	18,311	21,038	18,838	20,532	23,619	18,662	11,922	14,751	16,358	17,367	18,135	18,030
– Cohesion Fund	1,762	1,960	1,894	1,927	2,052	1,653	3,877	4,842	1,601	1,778	1,894	1,741
<b>3. Internal policies</b>	<b>4,191</b>	<b>4,295</b>	<b>3,927</b>	<b>3,870</b>	<b>3,859</b>	<b>3,747</b>	<b>3,279</b>	<b>3,646</b>	<b>3,401</b>	<b>3,320</b>	<b>3,305</b>	<b>3,528</b>
– Other agricultural operations	142	111	122	98	97	32	89	79	106	81	87	51
– Other regional operations	42	18	15	11	11	9	29	34	25	15	14	12
– Social and education policies	636	655	549	522	534	565	514	557	510	487	488	481
– Energy and environment policies	171	155	127	127	155	131	116	138	124	122	13	117
– Internal market and trans-European networks	604	637	579	723	743	687	425	442	489	534	581	583
– Research and Development	2,550	2,658	2,490	2,344	2,271	2,256	2,078	2,357	2,113	2,046	1,968	2,238
– Other internal policies	44	61	45	45	46	64	29	38	34	34	36	46
<b>4. External action</b>	<b>4,260</b>	<b>4,462</b>	<b>3,762</b>	<b>3,841</b>	<b>3,075</b>	<b>2,987</b>	<b>2,825</b>	<b>3,052</b>	<b>2,751</b>	<b>2,920</b>	<b>2,191</b>	<b>2,245</b>
– Food aid and humanitarian aid	1,055	1,017	702	574	570	581	762	807	743	471	468	517
– Regional cooperation measures	0	0	2,516	2,672	2,161	2,081	0	0	1,476	1,918	1,409	1,426
– Other external actions	3,205	3,445	533	574	327	294	2,063	2,245	516	516	300	283
– Common Foreign and Security Policy	0	0	12	20	18	29	0	0	17	14	14	19
<b>5. Administration</b>	<b>3,214</b>	<b>3,293</b>	<b>2,905</b>	<b>3,024</b>	<b>2,963</b>	<b>2,924</b>	<b>3,172</b>	<b>3,179</b>	<b>2,846</b>	<b>3,024</b>	<b>2,963</b>	<b>2,924</b>
– Commission	2,079	2,138	1,903	1,909	1,924	1,908	2,025	2,098	1,860	1,909	1,924	1,817
– Other Institutions	1,135	1,155	1,002	1,115	1,039	1,015	1,147	1,081	986	1,115	1,039	981
<b>6. Reserves and repayments</b>	<b>1,472</b>	<b>751</b>	<b>944</b>	<b>856</b>	<b>785</b>	<b>563</b>	<b>1,472</b>	<b>751</b>	<b>944</b>	<b>856</b>	<b>785</b>	<b>563</b>
– Monetary Reserve	0	0	345	336	329	310	0	0	345	336	329	311
– Emergency Reserve	0	0	227	227	228	126	0	0	227	227	228	126
– Loan Guarantee Reserve	205	188	227	227	228	126	205	188	227	227	228	126
– Repayments	1,267	562	146	66	0	0	1,267	562	146	0	0	0
<b>7. Pre-accession aid</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>903</b>	<b>1,968</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>693</b>	<b>1,054</b>
<b>Total</b>	<b>61,466</b>	<b>67,169</b>	<b>60,302</b>	<b>60,860</b>	<b>63,629</b>	<b>57,993</b>	<b>54,799</b>	<b>61,567</b>	<b>55,898</b>	<b>56,075</b>	<b>56,335</b>	<b>55,557</b>

1. Because of rounding the column totals do not necessarily equal the sum of the individual items.

2. Figures for 1995 and 1996 are taken from the 1998 EC Finances White Paper. Those from 1997 and 1998 are outturn figures taken from the Court of Auditors Annual Report. Those for 1999 and 2000 are taken from publications detailing the 2000 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							
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Belgium	103	98	86	94	154	99	901	888	963	1,047	985	1,000	1,209	1,072	1,005	978	942	1,017
Denmark	49	43	40	41	36	44	237	222	248	254	239	250	733	695	679	654	630	646
Germany	440	461	430	421	444	444	3,440	3,039	3,002	2,840	2,671	2,714	13,200	11,497	10,504	8,589	8,920	9,264
Greece	22	18	19	19	23	20	130	131	145	145	136	167	612	610	598	621	572	611
Spain	179	84	68	69	68	73	548	539	563	667	627	722	2,194	2,574	2,796	2,686	2,621	2,846
France	382	349	333	325	335	348	1,329	1,193	1,218	1,177	1,107	1,127	7,595	7,139	6,842	6,297	6,229	6,495
Ireland	14	13	11	11	17	11	214	194	214	186	175	162	334	342	272	445	355	421
Italy	199	135	131	166	227	174	987	912	989	1,102	1,038	1,088	3,641	4,997	3,880	4,512	4,122	4,342
Luxembourg	0	0	1	1	0	1	20	18	21	21	20	20	114	98	89	107	89	91
Netherlands	171	192	230	223	216	229	1,493	1,417	1,498	1,467	1,380	1,373	1,982	1,836	1,826	1,825	1,736	1,891
Austria	16	41	38	40	50	43	206	222	216	201	189	201	1,162	1,051	1,118	977	938	958
Portugal	91	33	37	43	38	43	115	103	118	135	127	142	514	514	570	496	505	527
Finland	15	18	13	15	14	16	123	134	131	124	117	114	558	500	515	501	492	525
Sweden	17	26	33	41	47	42	334	357	330	343	322	317	945	1,003	1,170	1,066	879	1,036
United Kingdom	247	309	456	447	252	451	2,432	2,392	2,588	2,445	2,300	2,270	4,394	2,521	2,367	3,394	1,877	3,247
Total	1,945	1,821	1,925	1,955	1,921	2,038	12,509	11,762	12,247	12,156	11,434	11,665	39,187	36,448	34,230	33,147	30,906	33,918

	Fourth Resource Contributions					TOTALS						
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Belgium	468	685	918	1,012	1,161	1,125	2,680	2,743	2,972	3,131	3,241	3,242
Denmark	276	400	538	745	759	741	1,295	1,360	1,506	1,695	1,664	1,681
Germany	4,244	5,770	7,281	8,783	9,586	9,163	21,324	20,767	21,217	20,633	21,620	21,586
Greece	221	347	416	525	568	564	985	1,107	1,178	1,310	1,299	1,362
Spain	724	1,342	1,940	2,330	2,600	2,624	3,645	4,539	5,368	5,752	5,916	6,265
France	2,570	3,729	4,793	5,785	6,503	6,277	11,877	12,411	13,186	13,584	14,175	14,247
Ireland	103	162	190	343	353	388	665	710	687	985	900	983
Italy	1,587	2,890	3,666	4,802	5,382	5,194	6,414	8,935	8,667	10,582	10,769	10,797
Luxembourg	34	47	60	88	88	84	168	163	171	217	198	194
Netherlands	704	990	1,283	1,589	1,723	1,753	4,350	4,436	4,838	5,104	5,055	5,246
Austria	379	558	738	868	965	905	1,763	1,873	2,110	2,086	2,142	2,107
Portugal	146	257	353	431	501	486	865	906	1,078	1,104	1,172	1,198
Finland	192	310	405	505	568	563	888	961	1,064	1,146	1,190	1,218
Sweden	362	571	793	934	930	1,080	1,658	1,957	2,326	2,383	2,178	2,475
United Kingdom	2,179	3,006	3,516	6,252	5,958	6,935	9,252	8,227	8,926	12,537	10,388	12,904
Total	14,188	21,064	26,891	34,991	37,646	37,882	67,828	71,096	75,293	82,249	81,907	85,504

## Notes:

- Figures for 1995 to 1998 are taken from the Court of Auditors Report for the respective year. Figures for 1999 are taken from Supplementary and Amending Budget No. 3/1999. Figures for 2000 are taken from the Preliminary Draft Supplementary and Amending Budget No. 1/2000.
- 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.
- The figures for VAT contributions are after abatement.
- The figures for agricultural and sugar levies and customs duties are after the deduction of 10% collection costs.
- 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							
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Belgium	84	78	59	63	101	62	738	712	664	703	648	622	990	860	692	656	620	633
Denmark	40	35	28	28	24	27	194	178	171	170	157	155	600	557	468	439	415	402
Germany	361	370	297	282	292	276	2,817	2,438	2,069	1,906	1,758	1,688	10,810	9,222	7,239	5,766	5,871	5,759
Greece	18	15	13	13	15	12	107	105	100	97	90	104	501	490	412	417	377	380
Spain	147	67	47	47	45	45	449	432	388	448	413	449	1,797	2,065	1,927	1,803	1,725	1,769
France	313	280	229	218	221	216	1,089	957	839	790	729	700	6,220	5,726	4,715	4,227	4,100	4,038
Ireland	11	10	8	7	11	7	176	155	147	125	115	100	274	274	187	299	234	262
Italy	163	109	90	111	150	108	808	732	682	740	683	676	2,982	4,008	2,674	3,029	2,713	2,699
Luxembourg	0	0	0	0	0	0	16	15	15	14	13	12	93	78	61	72	59	56
Netherlands	140	154	159	150	142	142	1,222	1,137	1,032	985	908	854	1,623	1,473	1,259	1,225	1,143	1,176
Austria	13	33	26	27	33	27	169	178	149	135	125	125	952	843	771	656	617	596
Portugal	75	26	25	29	25	27	94	82	82	91	84	88	421	412	393	333	332	328
Finland	12	14	9	10	9	10	100	107	91	83	77	71	457	401	355	336	324	326
Sweden	14	21	23	27	31	26	273	287	227	230	212	197	774	805	806	715	578	644
United Kingdom	202	248	314	300	166	280	1,992	1,918	1,784	1,641	1,514	1,411	3,598	2,022	1,631	2,279	1,236	2,019
Total	1,592	1,461	1,327	1,312	1,265	1,267	10,244	9,435	8,440	8,160	7,526	7,252	32,092	29,236	23,591	22,252	20,344	21,087

	Fourth Resource Contributions					TOTALS						
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
Belgium	383	550	633	679	764	700	2,195	2,200	2,048	2,102	2,133	2,016
Denmark	226	320	371	500	500	461	1,061	1,091	1,038	1,138	1,095	1,045
Germany	3,475	4,628	5,018	5,896	6,310	5,697	17,463	16,658	14,623	13,851	14,231	13,420
Greece	181	278	287	352	374	350	807	888	812	880	855	847
Spain	593	1,077	1,337	1,564	1,711	1,631	2,985	3,641	3,699	3,862	3,894	3,895
France	2,105	2,991	3,303	3,884	4,281	3,903	9,726	9,955	9,087	9,119	9,330	8,857
Ireland	84	130	131	230	232	241	544	570	473	661	593	611
Italy	1,299	2,318	2,527	3,223	3,543	3,229	5,252	7,167	5,973	7,104	7,089	6,713
Luxembourg	28	38	41	59	58	52	137	131	118	146	130	121
Netherlands	577	794	884	1,067	1,134	1,090	3,562	3,558	3,334	3,427	3,328	3,261
Austria	310	448	509	583	635	562	1,444	1,502	1,454	1,400	1,410	1,310
Portugal	119	206	243	289	330	302	708	727	743	741	771	745
Finland	158	248	279	339	374	350	727	771	733	769	783	757
Sweden	296	458	547	627	612	671	1,358	1,570	1,603	1,599	1,433	1,539
United Kingdom	1,785	2,411	2,423	4,197	3,922	4,312	7,576	6,599	6,152	8,417	6,838	8,022
Total	11,619	16,896	18,532	23,490	24,780	23,551	55,547	57,027	51,890	55,216	53,914	53,157

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					
	1995	1996	1997	1998	1999	2000	1995	1996	1997	1998	1999	2000
<b>GROSS CONTRIBUTIONS</b>												
Agriculture & sugar Levies	248	312	459	448	502	551	203	250	316	301	331	343
Customs Duties	2,461	2,439	2,612	2,445	2,290	2,461	2,016	1,957	1,800	1,641	1,507	1,530
VAT Own Resources before Abatement	5,659	5,538	5,292	5,597	5,956	6,601	4,635	4,442	3,647	3,758	3,921	4,104
Fourth Resource payments	2,002	3,103	3,880	5,238	6,698	6,804	1,639	2,489	2,674	3,516	4,409	4,230
VAT & Fourth Resource adjustments	484	-6	-647	1,302	183	403	396	-4	-446	874	120	251
United Kingdom Abatement of VAT	-1,473	-3,007	-2,515	-2,052	-4,817	-3,353	-1,207	-2,412	-1,733	-1,378	-3,171	-2,085
<b>Total Contributions</b>	<b>9,381</b>	<b>8,379</b>	<b>9,080</b>	<b>12,978</b>	<b>10,812</b>	<b>13,467</b>	<b>7,682</b>	<b>6,721</b>	<b>6,258</b>	<b>8,712</b>	<b>7,117</b>	<b>8,372</b>
<b>PUBLIC SECTOR RECEIPTS</b>												
EAGGF Guarantee	2,921	3,613	4,598	4,332	4,101	4,623	2,392	2,898	3,169	2,908	2,700	2,874
EAGGF Guidance	60	38	83	83	73	117	49	31	57	56	48	73
European Regional Development Fund	533	773	1,178	531	434	1,073	436	620	812	357	286	667
European Social Fund	923	1,002	893	1,167	660	1,062	756	804	616	783	434	660
Other Receipts	39	25	11	16	17	82	32	20	7	11	11	51
<b>Total Receipts</b>	<b>4,476</b>	<b>5,451</b>	<b>6,763</b>	<b>6,130</b>	<b>5,285</b>	<b>6,956</b>	<b>3,665</b>	<b>4,373</b>	<b>4,661</b>	<b>4,115</b>	<b>3,479</b>	<b>4,325</b>
<b>NET CONTRIBUTIONS</b>	<b>4,906</b>	<b>2,928</b>	<b>2,317</b>	<b>6,848</b>	<b>5,527</b>	<b>6,510</b>	<b>4,017</b>	<b>2,348</b>	<b>1,597</b>	<b>4,597</b>	<b>3,638</b>	<b>4,047</b>

*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 agricultural and sugar levies, and customs duties, in 2000 are based on UK projections of our sterling payments to be made during the year.
3. The figures for 2000 are forecasts, those for earlier years are outturn.
4. Because of rounding the column totals do 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 - the financial perspective.

## **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 preaccession 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.

### **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 base is the amount yielded by applying a notional rate of 1% to an identical range of goods and services in each Member State. Member States are, however, subject to a cap on their VAT contribution as a share of their Gross National Product. The cap on the VAT base is currently, 50% of 1% of GNP for all Member States; and
- *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 system**

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 6 per cent of total expenditure in 2000, 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.

## **Sterling Figures**

The sterling figures for 1995 to 1999 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<sup>5</sup>. Generally the 2000 euro figures have been converted into sterling using the £/euro exchange rate on 30 December 1999 when the rate was £1= 1.6085 (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.

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<sup>5</sup> The annual average rate for 1995 is £1 = 1.2211 euro  
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

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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 2000);
- 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 Supplementary and Amending Budget 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 1998 and the figures in the Court of Auditor's Annual Report for that year*

- When converted at the average exchange rate for 1998 of £1=1.4896 euro, the figures in the Court of Auditors report break down as follows:

	euro (millions)	£ (millions)
UK gross contribution before abatement	15,707	10,544
UK abatement	-3,170	-2,128
UK receipts	-6,878	-4,618
<b>UK net contribution</b>	<b>5,659</b>	<b>3,799</b>

- The Government's figure for the UK's net contributions in 1998 is £4,597 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 £505 million of the difference;
  - The late adoption of Supplementary and Amending Budget No. 1 1998 meant that associated changes to contributions, and the UK abatement, were not implemented until January 1999. These do not, therefore, appear in the Government's figures for 1998 which are some £272 million higher as a result.
  - 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 cashflow for the year in which the transactions happened, and by the Community to the Budget for the previous year. It would appear that up to £28 million of Structural Funds payments to the UK in respect of the 1997 Budget may have been made in 1998. In addition, in February 1998 the UK paid £7 million to the Budget in respect of the Loan Guarantee Fund for 1997, and in February 1999 the UK paid £5 million to the Budget in respect of 1998; and

- sterling weakened during 1998 (from £1 = 1.4994 euro at the beginning of 1998 to £1 = 1.4175 euro at the close of the year). Exchange rate movements will, therefore, have had an effect during 1998 (ie, individual transactions would have taken place at the rate prevailing at the time, which will differ from the average rate for the year used for this comparison) - and for which the net effect may mask larger differences for individual elements which go to make up the UK's contributions and receipts).

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

- The table below reconciles the two figures:

	<i>£ (million)</i>
<b>UK Government cashflow outturn for 1998</b>	<b>4,597</b>
Private sector receipts	-505
Loan Guarantee Fund payments: 1998 in respect of 1997 Budget 1999 in respect of 1998 Budget	-7 +5
Late implementation, in January 1999, of Supplementary & Amending Budget No. 1 1998	-272
Structural Fund receipts from 1998 Budget which appear to have been paid in 1999 (assuming the maximum amount was thrown back)	—
Structural Fund receipts from 1997 Budget which appear to have been paid in 1998 (assuming the maximum amount was thrown back)	+28
Estimate of likely net effects of exchange rate, and timing, differences for the UK's net payments and receipts not otherwise taken into account in the above figures	-45
<b>UK cash flow figure adjusted to reflect main differences compared to ECA figure</b>	<b>3,801</b>
<b>ECA figure for 1998 outturn</b>	<b>3,799</b>
Net difference due to other factors (such as differences due to rounding)	-2



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