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The UK's negotiation of its EU budget rebate

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Abstract

This thesis is an investigation of Britain's negotiations of its EU budget rebate. It attempts to answer the main question of why Britain decided to reduce its rebate in the 2005 financial negotiation for the financial perspective for 2007-2013, instead of defending the rebate. What motivated Britain's behaviours in the rebate negotiations?

Drawing upon European integration theories, particularly Liberal Intergovernmentalism (LI), this thesis challenges LI's lack of explanation of the role of domestic political parties in shaping the formation of a national preference, member states' behaviours in inter-state bargaining, and the role of the presidency of the Council in EU institutions. This thesis emphasises the role of domestic political parties in shaping member states' approach on European integration which affects member states' behaviours within decision-making. In Britain, the governing parties' ideologies are not only a lens to evaluate European integration but also bring about intra-party factions and cross-party factions in shaping Britain's approach. In contrast to LI's explanation of member states' behaviours, this thesis adopts the constructivists' argument of a 'logic of expected consequentialism' and a 'logic of appropriateness' in order to explain Britain's behaviours in financial negotiations and argues that the governing party's attitude is a decisive factor for Britain in choosing its behaviour from the two logics above. In addition, with regard to the debate between rational choice institutionalists and sociological institutionalists on the role of the presidency of the Council in EU decision-making, Britain is able to choose its behaviour in the role of the presidency as decided by the governing party's approach. When Britain has pro-European approach and its preferences are a central issue in blocking a financial agreement, it may be that the UK presidency's appropriate behaviour makes extraordinary concessions on their preferences to secure deals that will enhance their reputation as presidency. Since the time of Britain's initial membership negotiations, this behavioural logic has been evident in the EU's budgetary decision-making. In the 2005 financial negotiation, the UK presidency's pro-European approach recognized that its rebate was a central issue in blocking the negotiation. Consequently, after lengthy and difficult negotiations, the UK presidency decided to make a concession about the reduction of the rebate in order to achieve the financial agreement.

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In December 2005, I frequently heard news about the Blair government's decision to reduce the UK's rebate, which was criticised by the opposition parties. These debates aroused my curiosity about the UK's behaviour in the EU and politics of the EU's budgetary decision-making process. This was the start of my PhD process, during which I faced two problems. First of all, I had to become much more familiar with the history of the EU, as my background was not on European integration, and then understand the intricacies of the EU budget politics. Secondly, I had to work really hard to find a coherent explanation for the UK's behaviour in the various EU budgetary negotiation rounds. This further complicated by the fact that budgetary negotiations, often, involve economic as well as political considerations. Eventually, I understood that the UK's behaviour has been affected by the ideology of the governing party, which in turn affects its approach to European integration.

With regard to this process, my deepest gratitude goes to my excellent supervisors, Professor Maurizio Carbone and Professor Alasdair Young. Without their invaluable guidance, encouragement, and appropriate pressure, the completion of this thesis would have been impossible. In particular, my first supervisor, Professor Maurizio Carbone, provided a role model as a scholar: be precise and critical, but always be aware of one's own limitations and the possibilities for improvement. I also wish to express appreciation to my anonymous interviewees in the UK and in Brussels; their insights have helped me develop my argument. I also want to thank the Department of Politics at the University of Glasgow for supporting my research and professional development throughout. I would like to sincerely thank my colleagues, particularly Ahmed Ben Aessa, Scott A.W. Brown, Arantza Gomez Arana, Ali Solf, for their encouragement and for sharing the burden of PhD hoods. I would also like to express my sincere gratitude to a number of my friends, particularly Jae Ho Choi, Rev. Hwang, Hand-Deok, Sun-Ok, Young Boo, Eun Jin, Ga Bin, and Jun-ho.

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Author's declaration

I declare that, except where explicit reference is made to the contribution of others, that this thesis is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature:

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List of Abbreviations

AES	Alternative Economic Strategy
BATNA	Best Alternative to Negotiated Agreement
CAP	Common Agricultural Policy
CDU	Christian Democratic Union
CEEC	Council for European Economic Co-operation
CEECs	Central and Eastern European Countries
CET	Common External Tariff
CFSP	Common Foreign and Security Policy
CoR	Committee of the Regions and Local Authorities
Coreper	Committee of Permanent Representatives
CSU	Christian Social Union
DG	Directorate General
EAs	European Agreements
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Communities
ECB	European Central Bank
ECJ	European Court of Justice
Ecofin	Economic and Financial Affairs Council
ECSC	European Coal and Steel Community
EDC	European Defence Community
EDF	European Development Fund
EEC	European Economic Community
EFTA	European Free Trade Association
EMS	European Monetary System
EMU	Economic and Monetary Union
EP	European Parliament

EPC	European Political Cooperation
ERDF	European Regional Development Fund
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
ESF	European Social Fund
ETI	European Technology Institute
EU	European Union
Euratom	European Atomic Energy Authority
FIFG	Financial Instrument for Fisheries Guidance
GAF	Globalisation Adjustment Fund
GDP	Gross Domestic Product
GNP	Gross National Product
JHA	Justice and Home Affairs
ICT	Information and Communication Technologies
IGC	Intergovernmental Conference
IIA	Interinstitutional Agreement
IMF	International Monetary Fund
IPE	International Political Economy
IR	International Relations
LI	Liberal Intergovernmentalism
MPs	Member of Parliaments
NATO	North Atlantic Treaty Organisation
NEC	National Executive Committee
OMC	Open Method of Coordination
QMV	Qualified Majority Voting
R&D	Research and Development
SEA	Single European Act
SEM	Single European Market
SFP	Single Farm Payment
SPD	Social Democratic Party
TEU	Treaty on European Union

UK	United Kingdom
US	United States
VAT	Value Added Tax
WEU	West European Union
WTO	World Trade Organisation
WWII	World War II

Chapter 1

Introduction: the politics of the UK's budget rebate

1. Introduction

The negotiations for the European Union's financial perspectives for 2007-2013 were very tense. Unsurprisingly, one of the most contentious issues was the British budget rebate, which the Conservative government headed by Margaret Thatcher had obtained at the Fontainebleau European Council in June 1984 and that has since been preserved by subsequent governments despite strong pressure from the European Commission and other member states. In the first half of 2005, whilst the rotating presidency of EU was held by Luxembourg, several member states demanded that the UK took responsibility as a wealthier country and shared the increased financial burden by giving up its rebate. Requests to revoke the rebate were resisted and Prime Minister Tony Blair (during the Luxembourg Presidency, which was held in the first half of 2005) said that any attempt to scrap the rebate would be vetoed. The UK was to hold the Presidency of the EU for the second half of 2005 which was regarded as an opportunity for the re-elected Labour Government to retain the rebate. Prime Minister Tony Blair then surprised a number of people by agreeing to a 20 per cent reduction in the rebate. Why did the UK change position over its rebate? To answer this first question, this thesis points to the general change of approach towards European integration by the Blair government vis-à-vis the previous Conservative governments, but also

reviews the main elements underpinning the UK's negotiations of the EU budget over the past forty years. For this, the second research question of this thesis is the following: what factors have shaped the behaviour of the UK in EU budgetary policy making?

By answering these questions, this thesis seeks to provide a better understanding of both the EU's budgetary politics and the UK's approach to European integration. Its ambition is to fill a gap and offer new insights to two different literatures. On the one hand, existing studies on the EU budget have provided good overviews of the decision-making process and the 'various rounds' of negotiations. They have however failed to fully explain the behaviour of individual member states over time. Of course, they analyse the role of the UK, paying particular attention to the 1984 and 2005 agreements, but only in the context of general discussions (Denton, 1984; Vanden Abeele, 1982; Shackleton, 1990; Laffan, 1997; Lindner, 2006; Schild, 2008; Dür and Mateo, 2010). On the other hand, the studies assessing the behaviour of the UK in the EU have not adequately discussed how and why its preferences on the budget vis-à-vis other member states and the general EU context have evolved since membership (George, 1998; Young, 2000; Forster, 2002b; Geddes, 2004; Jones, 2007; Wall, 2008).

The basic argument of this thesis is that the UK's behaviour in the EU budget negotiations, and particularly the rebate issue, has been affected by domestic political parties' ideologies and their approach to European integration. This does not necessarily mean being favourable to a more supranational or a more intergovernmental European Union, but more taking account whether the EU's multi-annual budgetary plans incorporated ambitious European integration projects. If so, the governing party would be able to negotiate the budget without worrying too much about potential criticism from opposition parties and public opinion. Taking a pro-integration approach, however, meant accepting the principle that holding the rotating presidency implied a potential change of position and in some cases acceptance of unfavourable compromises. These issues are briefly discussed in the remainder of this introduction, which also touches upon the research methodology and provides an overview of the other chapters.

2. Understanding budgetary negotiations

The European Economic Community (EEC) was established by Belgium, France, Italy, Luxembourg, West Germany and the Netherlands in 1957. The UK decided not to join at this stage due to its traditional idea of national sovereignty and the special relationships it held with the Commonwealth countries and the US. Due to the success of the European Community (EC) and a weakening of the UK's special relationships its views changed. After two failed attempts in 1961 and 1967, it became a full EC member in 1973, with Ireland and Denmark. During the negotiations regarding the terms of Britain's membership to the EC the issue of its financial contributions proved a sticking point. In fact, at The Hague summit in 1969, the six founding member states had agreed to the establishment of the so-called 'own resources system', which meant that revenues would flow automatically to the EC budget rather than through agreement of the national parliaments, as had been the case until then.

Table 1.1 The 'own resources' mechanism

Customs duties collected on imports from the rest of the world
Agricultural levies
Payment based on the VAT base of the Member States

<Source: Europa 'Own resources' mechanism;
http://europa.eu/legislation_summaries/budget/l34011_en.htm>

This system brought about a disproportionate contribution by the UK, whose trade structure on industrial goods and agricultural products was heavily linked to non-EC countries. Moreover, the fact that about 70 per cent of the budget was used to finance the Common Agricultural Policy (CAP) and that the UK had a small agricultural sector meant that the UK gained few receipts under the EC's redistributive policies. Britain's late joining of the Community thus caused a

financial imbalance between its contributions to and its receipts from the EC budget. Nevertheless, for the Conservative government of the time (under Prime Minister Edward Heath), Britain's interest in joining the EC was greater than the matter of its financial imbalance. After accession, the UK continuously raised the financial problem with the other member states, until when at the Fontainebleau European Council, June 1984, Prime Minister Margaret Thatcher successfully managed to secure a rebate system for the UK.

Following the reform of the EC budgetary system in 1988 which introduced the idea of multi-annual budget plans, the European Commission proposed the financial perspective for 1988-1992 (Delors I package), taking into account two integration projects, both deepening (through the single market) and widening (enlargement with some Mediterranean countries) the Community. In the financial perspectives for 1993-1999 ('Delors II package'), the European Commission took into account the implementation of Treaty on European Union (TEU), notably the introduction of the Economic and Monetary Union (EMU) and the associated Cohesion Fund providing financial support to those member states (Greece, Spain, Portugal, and Ireland) that would face difficulties in meeting the economic convergence criteria (Laffan and Shackleton, 2000). In the financial perspectives for 2000-2006 ('Agenda 2000'), the European Commission proposed a stabilization in the size of the budget, in that pre-accession aid for the upcoming enlargement to the Central and Eastern European Countries (CEECs) would be partially compensated by the increased number of net contributors through the 1995 enlargement (Laffan and Lindner, 2005). The negotiations of all these multi-annual budgets brought about various types of disputes between net contributors and net beneficiaries on the size of the budget, and between the UK and other net contributors on sharing the financial burden. In these disputes, net beneficiaries put pressure on net contributors to increase the size of the budget and even threatened not to sign the packages. To facilitate the agreement of the various European integration projects, the net contributors accepted the net beneficiaries' demands, but this brought about conflicts between the UK and other net contributors, since the UK was asked to forfeit her rebate and share the financial burden more equally.

In the financial perspective for 2007-2013, the European Commission had to face the costs of the Lisbon strategy – meant to boost the EU’s competitiveness in the global market, foster economic growth, and create more jobs in the face of the challenges of globalisation – and the costs of the eastern enlargement, particularly increased regional aid. For this, it proposed a reduction of the UK’s rebate and an increase in EU revenues (Dion, 2005; Mundschenk *et al.*, 2006; Laffan and Lindner, 2010). The 2007-2013 financial perspectives were discussed at two European Councils in June and December 2005. In the first negotiation round, conducted under the Luxembourg Presidency, the UK strongly argued for a radical reform of the EU’s redistributive policies, particularly the CAP, but also suggested a reduction of both its rebate and CAP expenditures with the aim of achieving an agreement. France opposed the UK’s proposal and the negotiations continued under the UK Presidency. Facing the CEECs’ pressure to achieve agreement which would allow them to modernise their economies, the net contributors’ demand to reduce the size of EU revenue, and accepting the principle of a ‘responsible’ presidency, at the Brussels European Council in December 2005 the Blair government conceded the reduction of the UK’s rebate by €10.5 billion.

3. Research design and methodology

This study seeks to investigate the impact of political parties’ ideologies on the UK’s behaviour in EU budgetary negotiations. It concludes that party ideologies played a significant role, much more than it is generally acknowledged, and that the change of governing party can result in a change of Britain’s behaviour during negotiations. The selection of the UK as a case study is particularly significant not only because its budget negotiations can be seen as a subset of its overall EU policies, but also because its rebate has been one of the most controversial issues in the evolution of the EU budget. Various governments, headed by both Conservative and Labour leaders, have invested much effort in retaining it throughout 20 years of difficult negotiations, the decision by the Labour government decided to substantially reduce it in 2005. In order to explain the

behaviour of the UK in budget negotiations through the years, this thesis draws on and contributes to three strands of literature: EU integration theory, the role of the UK in the EU, and EU budgetary politics.

To explain the role of the member states in the European Union, the obvious starting point is Liberal Intergovernmentalism (LI). LI argues that national governments drive the integration process forward and their preferences are shaped by domestic economic groups. More especially in the case of the financial perspectives, it may be expected that, following a rationalist logic, member states undertake strategic behaviours, for instance using ‘threatening veto power’ and ‘side-payments’, to secure their preferences (Hoffman, 1995; Moravcsik, 1998). This thesis, in line with other approaches that draw on comparative politics (Dimitrakopoulos and Kassim, 2004; Gaffney, 1996; Raunio, 2002; Marks and Wilson, 2000; Ladrech, 2002; Geddes, 2008), argues that national preferences and overall behaviour in the EU are significantly affected by domestic political parties. In fact, political parties not only provide elected officials to the offices in the government but on the basis of their ideology they take pro- or anti-European stances.

Moreover, in line with constructivist explanations (Adler, 1997; March and Olsen, 1998; Rosamond, 2000; Knutsen, 1997), it is argued here that member state behaviour may be affected by norms and the desire to behave ‘appropriately’. In other words, in a given situation member states may decide to do the ‘right thing’ and pursue the common good rather than their own individual interests (Checkel, 2001). This thesis will show how Britain’s EU ‘membership identity’ – which is derived by accumulating member states’ behaviours on European integration (Marcussen *et al.*, 2001) – has gone through different phases, involving both periods in which it was an ‘awkward partner’ and periods of ‘constructive engagement’ (Bache and Jordan, 2008). These differing ‘membership identities’ also have an impact on the rotating Presidency of the EU: while rationalists argue that member states use it to achieve agreements which are as close as possible to their preferences, for sociological institutionalists member states act appropriately and may make extraordinary concessions in order to achieve the common good (Elgstrom, 2003; Tallberg 2004; Quaglia and Moxon-

Browne, 2006; Warntjen 2008). This applied to the UK in December 2005, when the pro-integration approach implied acceptance of the principle of a ‘responsible’ presidency.

Surprisingly, the academic literature on EU budgetary politics is extremely limited; for this, I tried to compensate by drawing on the much larger literature on the role of the UK in the EU. More importantly, I relied on different types of primary sources, with the view to ensuring triangulation (Brunham *et al.*, 2004). I analysed official documents produced by the European Commission and the Council, memoirs of political leaders (e.g. Edward Heath, Harold Macmillan, Margaret Thatcher, Tony Blair.), speeches in various contexts (e.g. European Parliament, House of Commons, universities), written and oral interviews, manifestos of both Labour and Conservative parties, and a small number of semi-structured interviews (lasting between 30 and 90 minutes), conducted between November 2009 and February 2010, with senior officials in the UK government in London and the permanent representation in Brussels.

I also used various newspapers sources, which concentrate on EU issues or cover more general issues. *Agence Europe* (published by an international press agency), *The European Report* (a daily newspaper published by the EU as a part of its European Information Service), and *The European Voice* (an independent weekly), provided useful information on the negotiation process and on member states’ positions. I also used *The Financial Times*, *The Guardian*, and *The Times* to acquire additional information about the UK domestic debate during the various financial negotiations. Had I been able to read other European member states’ languages, I could have obtained more information on other member states’ positions on the budget; due to my linguistic limitations, I focused on newspapers in English.

4. The structure of the thesis

This thesis consists of: an introduction, a theoretical framework, three empirical chapters, and a conclusion. Following this introduction, Chapter 2 introduces the theoretical framework. It challenges both Liberal Intergovernmentalism for over-

emphasising the role of economic groups and treating member states as rational actors, and the characterisation of the UK as an ‘awkward partner’ in the EU. In contrast, it emphasises the role of domestic political parties in shaping national preferences and member states’ behaviour in EU negotiations. It shows that member states act ‘appropriately’, particularly when they take a pro European approach and also hold the presidency of the Council. Finally, it points to the UK’s membership identity as that of ‘constructive engagement’, in addition to ‘awkward partner’, depending on the governing party.

Chapter 3 discusses the main reasons behind the establishment of the rebate in 1984. The first section shows why the UK’s decision not to join the EU resulted in being strongly penalised in the budget. It points to the fact that in the 1950s and in the 1960s the Conservative and Labour parties shared similar views about British national sovereignty, the role of the UK in the world, and its special relationships with the US and Commonwealth countries. When both parties witnessed the economic successes of the EC vis-à-vis their weakened benefits from their special relationships, they changed their view on European integration and supported an application for membership. This chapter also shows that before the UK became a member of the EU in 1973 an ‘own resources’ system had been established at The Hague Summit in 1969. The second section focuses on the negotiations for the settlement of the UK’s rebate system in the early 1980s: Britain had a financial problem and in order to solve it. The Thatcher government adopted obstructive behaviour (particularly on the reform of the CAP) in spite of its support for European economic integration in line with its neo-liberal ideology and in response to criticism from the Labour party and the right wing in the Conservative party. The chapter, thus, explores the negotiations before and at the Fontainebleau European Council in 1984, which eventually led to the establishment of the rebate system.

Chapter 4 focuses on the UK’s success in retaining its rebate in three EU budgetary negotiation rounds: 1987-88, 1993, and 1998-99. In each of these negotiations, the multi-annual budget plan was linked to a major ‘European project’, respectively: the Single European Market (SEM) and the Single European Act (SEA); the Treaty on European Union (TEU) and the Economic and

Monetary Union (EMU); and the enlargement to Central and Eastern European Countries (CEEC). In the negotiations for the 1988-1993 financial perspectives, although the Conservative government had a pro-European approach on the SEM, it was unwilling to support the SEA beyond economic integration and to agree the reduction of its rebate. Britain's behaviour in the negotiations for the 1993 – 1999 financial perspectives changed as a result of the then Conservatives government change of opinion from pro-European to an anti-European approach. Although the UK held the presidency of the Council in the second half of 1992, the anti-European approach prevailed and the Conservative government itself blocked the reduction of the rebate. In the negotiations for the 2000-2006 financial perspectives, although the new 'New Labour' government took a pro-European approach and held the presidency in the first half of 1998; the UK refused the reduction of the rebate. The central issue for negotiation had been Germany's unacceptable demands which together with the enlargement of the EU in 1995 meant the reduction of the UK's rebate was not an essential condition required to achieve agreement.

Chapter 5 addresses the negotiations for the 2007-2013 financial perspective in which the UK decided to reduce its rebate. Initially, the new 'New Labour' government headed by Tony Blair which took a pro-European approach, placed significant emphasis on the reform of traditional EU spending, particularly the CAP, with the view to modernising the EU in the face of the challenges of globalisation. Yet, it strongly opposed the reduction of the rebate, which resulted in a failure to achieve a compromise under the Luxembourg Presidency in the first half of 2005. Pressure mounted on the Blair government through the new member states that sought an increase of the budget to regenerate their economies and urged the other member states to obtain a financial agreement as soon as possible; and by the fact that the UK held the rotating presidency in the second half of 2005 and hoped to achieve a compromise before the end of its term. In fact, at the Brussels European Council in December 2005, the British presidency announced the positive conclusion of the negotiations, which resulted in a substantial cut in to the UK rebate.

Finally, the conclusion in Chapter 6 reviews the main findings of the

thesis and looks at the future of Britain's rebate negotiations. In particular, it shows how the pro- and anti-European approaches of the two main parties affected the UK's behaviour during budget negotiations. For instance, in 1984 the Thatcher government initially had a positive attitude towards the EC particularly on the advantages of the single market, but eventually took a more critical approach due to Britain's budgetary imbalance in order to prevent political attacks from the Labour party and the Conservative party's 'anti-Marketeters'. During the UK Presidency of 1998 the Labour government opposed any change to its rebate during negotiations. At this time the existence of the Lisbon Agenda (Strategy) and the responsibility for the 2004 enlargement played a decisive role. By contrast in 2005 Labour took a pro-European approach and were more willing to sacrifice the rebate to see more progress on the modernisation of the EU. Moreover, the chapter reviews the politics of budget negotiations in the EU, looking at the role of the UK in a broader context. In particular, it identifies a number of clashes that have occurred between member states over the years, most notably between net beneficiaries and net contributors on the size of the budget, and between the UK and other net contributors on burden sharing. The last section of this chapter discusses Britain's position in future rebate negotiations which will commence in 2013. The expectation is that due to the existence of a coalition government, where the two parties do not fully share the same views on European Integration, will significantly affect the UK's behaviour during the EU's budget negotiations and any preference formation for the country.

Chapter 2

Setting the framework: domestic politics, budgetary negotiations, and the UK's approach to European integration

1. Introduction

This thesis examines the issue of the UK's behaviour in its rebate negotiations as part of EU budgetary politics. The UK rebate was a politically symbolic issue in the national discourse, epitomising the costs and benefits of EU membership. Since the 1988 budgetary reform, the increased size of the budget due to the incorporation of European integration projects and poorer countries through several enlargement rounds (with the exception of the one in 1995) brought about a number of clashes between the UK and other net contributors on sharing the financial burden. The purpose of this chapter is to propose a framework which can help explain the behaviour of the various British governments in the negotiations of the EU's multi-annual budget plans over the years.

This chapter consists of three main sections. The first section draws on the literature on the EU's decision-making process, challenges the main tenets of Liberal Intergovernmentalism (LI) by stressing the importance of domestic political parties, norms and identity, and the presidency of the Council. The second section explores the role of the UK in the EU, emphasising the role of political parties in shaping Britain's EU policies, and the identity of Britain's EU

membership as an ‘awkward partner’ and a ‘constructive partner’. Finally, the third section sketches the EU’s budget policy process.

2. Member states and decision-making in the EU

The role of the member states in the EU has been the object of numerous studies (Kassim *et al.*, 2001; Bulmer and Lequesne, 2005; Zeff and Pirro, 2005; Piper, 2005; Carbone, 2010). The starting point, generally, is Liberal Intergovernmentalism (LI) which sheds light on member states’ behaviour in inter-state bargaining but also investigates what factors and actors affect preference formation. However, LI does not pay adequate attention to the role of political parties, does not consider the (potential) effects that norms and identity have on member states’ behaviour in inter-state negotiations, and underplays the ‘responsible’ behaviour of the rotating presidency of the Council.

2.1. Liberal Intergovernmentalism

The core assumption of liberal intergovernmentalism is that member states are the main actors in EU integration. EU member states’ preferences are influenced and shaped by the demands of domestic economic groups. Governments bring national preferences to Brussels in order to shape EU policies towards their favoured outcomes. Andrew Moravcsik (1991, 1993a, 1995, 1998, – see also Moravcsik and Nicolaidis, 1999) identified three stages in the EU’s decision making process, the first two of which have more direct relevance for this thesis: (1) preference formation, (2) inter-state bargaining, and (3) delegation of authority to international institutions.¹

The first step concerns preference formation. Governments identify and aggregate national preferences, which are constrained by shifting pressure based on competition amongst dominant interest groups: economic producers put pressure on national governments to cooperate in the EU in order to obtain

¹ In line with the ‘two-level game’ metaphor, while negotiating at the international level governments take into account the domestic level and act in a way to gain further support when they return back at home. See Putnam (1988).

economic benefits in response to the international globalised economy. This however does not mean that they play an independent role, going beyond national governments. Moreover, LI does not ignore the role of partisan politics: ‘an understanding of domestic politics is a precondition for, not a supplement to, the analysis of the strategic interaction among states’ (Moravcsik, 1993a: 481). In fact, the primary interest of governments is to remain in power and to do so they need the support of domestic voters. But, as argued by Quaglia (2010: 91), ‘Although Liberal Intergovernmentalism does not make this point explicitly, foreign and security policies largely remain the domain of core executives and, consequently, the formation of national preferences is unlikely to be the outcome of pluralistic politics’.

The second stage concerns inter-state bargaining. Governments bring national preferences to the negotiating table in Brussels, and engage in hard bargaining in order to pursue their interests. Outcomes in intergovernmental negotiations are dependent on each member state’s bargaining power and strategies and are not influenced, or little influenced, by EU institutions. Outcomes are selected in the ‘bargaining space’, which is formed out of possible areas within issues for mutually beneficial exchanges in intergovernmental negotiations. EU member states often have different preference intensities on policies: some issues and agreements are more important to some than to others. As a result of asymmetric interdependence, agreements requiring unanimity depend upon recalcitrant states. Negotiations, thus, are a process of seeking possibilities for coalition-building through negotiation strategies. Decisions reflect the relative power of member states and integration proceeds mainly when there is a convergence of interests between the three most powerful member states, that is; France, Germany, and the UK. These countries can adopt various strategies – such as ‘issue linkages’, ‘threats of exclusion’, ‘package deals’ and ‘side-payments’ – to obtain concessions by other recalcitrant member states (Moravcsik, 1993, 1998; Moravcsik and Nicolaidis, 1999; Schimmelfenning, 2007).

The third stage concerns the choice of institutions. EU member states pool or delegate sovereignty to European institutions in order to reduce conflicts, to effectively achieve agreements in intergovernmental negotiations, and to

increase the credibility of their mutual commitments (Moravcsik, 1998; Pollack, 2005; Schimmelfenning, 2007).

2.2. Domestic politics and the role of political parties

Liberal Intergovernmentalism has been criticised on many accounts. One of the central reasons for criticism is that it does not adequately acknowledge the role of domestic politics. In fact, beyond economic groups there are a number of other factors and actors that affect preference formation and decisions in the EU (Dimitrakopoulos and Kassim, 2004; Kassim, 2004; Forster, 1998). This thesis, in particular, points to the role of domestic political parties.

In a democratic system, political elites who share similar ideas about political and economic issues get organised within a political party, and try to win elections so that they can turn their ideas into government policy. A political party sets out its position on the future direction of government in manifestos based on that party's ideology. A manifesto serves to inform voters of policies and to entice them to vote for that party. Political parties' ideologies, thus, are not only lenses to see intra- and extra-phenomena but also a tool to design a party's approach regarding those phenomena. At elections, voters consider all the parties and then vote for whichever party better represents their interests: politicians and voters, thus, have an interdependent relationship for mutual benefit. Following an election, the majority party provides elected officials to form a government and formulate policies (Caul and Gray, 2000; Dalton and Wattenberg, 2000; Strøm, 2000).

With regard to the democratic system, there are two important factors: the roles of public opinion, and the role of political parties in shaping government policy. First, scholars, who emphasise upon the role of public opinion in member states' EU policy-making, argue that policy-makers in member states paid close attention to public opinion in shaping their positions on European integration for their survival in power (Anderson and Kalternthaler, 1996; Trumbore, 1998; Hix, 2005; Usherwood, 2002). Anderson and Kalternthaler (1996), and Trumbore (1998) argue that citizens consider their economic benefits/performance from the integration process when forming their views whether favourable or sceptical. In a

'bottom-up' approach, the citizens' position has a distinct impact on member states' policy-making through elections and ratifications. In general, elections are a prominent linkage between the public opinion and the member states' policy-making. Elections not only allow voters to choose the members of the Parliament (MPs) who will represent their opinions in shaping their member states' EU policies, but also have the power to judge their MPs' performances (Hix, 2005; Trumbore, 1998).

Second, in the role of a political party in the democratic system, a number of scholars emphasise upon the role of a party ideology in shaping a political party's attitudes and policies. In particular, in the action-orientation model, ideology is an action-related idea which provides guidelines for the party's direction towards achieving its political ideal (Budge, 1994; Nice, 1985; Schonhardt-Bailey, 2003; Entman, 1983; Sainsbury, 1981). Ideology shapes the party's policies and attitudes, and constrains the scope of a party's activity in choosing their political strategies from the motivations of increasing their popularity with voters (Schonhardt-Bailey, 2003: 586). Ideology does not allow a party to form their political identity in line with only focusing on their political popularity to have power in domestic politics (Sainsbury, 1981: 284). The ideology's constraint often results in conflicts with the party's demand to alter its attitude and policies in a way that would appeal to voters in order to win a general election.

Sainsbury (1981) points out endogenous and exogenous strains in analysing conflicts between ideology and a party. When a party is faced with these two strains, members of that party draw fierce resistance to their party's incumbent position and policies which are shaped based on its ideology. First of all, an endogenous strain can be indicated by that party's electoral defeats. Members of the party demand the leader group to re-consider its ideology, and to revise the party's attitude and policies in accordance with voters' preferences. Secondly, an exogenous strain explains disparities between the party's ideology direction/expectation and external reality. When the unexpected happens, the leader group re-considers its ideology, attitude and policies: whether the party continues its position or changes its position with regard to a re-interpretation of

its ideology in response (Sainsbury, 1981: 274). Furthermore, if members of the party have a disagreement with the leader group's decision on the party's position and policies, the members use the party's conferences and conventions to challenge the leader group's decision. During party conferences and conventions, the members and the leader group have a serious debate on the leader group's decision whether the leader group appropriately re-interpret the ideology in shaping the party's policies and attitude, and which direction the party's policies and attitude should take taking into account endogenous and exogenous strains. The challenge pressures the leader group to change the attitude. Sometimes the leader group has enough power to suppress the members' opposition, and continue with their decision. Sometimes these challenges can drag a group down from a position of power within a party. A change of the leader or the leader group can come about with a new version of the party's ideologies and a change of the party's attitudes and policies (Budge, 1994: 455).

There is another point of view regarding the change of a party's attitude. Factionalists, more specifically, point out the clashes between the groups. They argue that the change of the party's policies result from a division of a party between sub-groups whose aim is regarding structural incentives (power) (Hine, 1982; Boucek, 2009; Duveger, 1964; Panebianco, 1988; Sartori, 1976, 2005). Endogenous and exogenous strains provide a chance for sub-groups to challenge the leader group's leadership and policies which may have disagreements with sub-groups over the party's attitudes, strategy and policies in response to the change of environment (Panebianco, 1998: 242-242; Harmel and Janda, 1994: 261, 265; Deschouwer, 1992: 12). These disagreements bring about conflicts between the sub-groups and the leader group trying to gain power or representing their members in the party's decision-making bodies and in the government for making their ideas determine the party's attitude and policies (Boucek, 2009). Harmel and Janda (1994) analyse the change in a party such as policies and attitude, and argue that, as a result of the conflicts, the change of the party's attitude and policies is primarily the result of clashing between the groups, and the leader and their respective followers in the party.

European integration has become a salient issue in a party's fight in

domestic politics and elections. It has encouraged the emergence of a new dimension that indicates that party's position regarding anti- and pro-European approaches. A party's attitudes can be an important issue to campaign during a general election (Hix, 1999). On the basis of its ideology, a political party takes its approach on European integration, which if successful in the election becomes the official position of their country (Gaffney, 1996; Hix, 1999; Mair, 2000; Marks and Wilson, 2000; Ladrech, 2002; Raunio, 2002). More generally, positions on European integration can be placed along a continuum, from anti- to pro-European. However, the attitude of a party is flexible when faced with the emergence of EU issues that deviate from those they anticipated after electoral defeats or during the process of integration. The leader group in the party re-considers their ideology and approach: whether the party continues with their existing position or changes its approach and decides a new approach for the party. Furthermore, the decision often brings about a conflict in the party. Both anti- and pro-Europeanists in the party disagree whatever the leader group decides and challenge the group's decision which is based on a new interpretation of their ideologies in view of the new circumstances. Sometimes, these pressures can result in re-shaping or changing the party's attitude on European integration in order to reinforce their appeal in domestic politics (Ladrech, 2002; Szczerbiak and Taggart, 2011).

2.3. Inter-state negotiations, norms and identity

One of the central tenets of Liberal Intergovernmentalism is that in inter-state bargaining, national governments have little flexibility to make concessions – the assumption, thus, is that preferences are fixed. This does not take into account that during negotiations, national governments can learn about other member states' preferences and this information is a basis upon which to devise negotiation strategies for securing their interests or pursuing common interests. Having such information, thus, may require them to revise or re-order their preferences with the view to fostering coalition-building and achieving an agreement (Dimitrakopoulos and Kassim, 2004; Forster, 1998).

The constructivist turn in international relations has also had an impact on

the study of the member states in the EU. Constructivism is an intersubjective approach which emphasises the mutual constitutiveness of structure and agency. Basically, humans do not exist independently from their social environment and their interactions generate the idea of community, a sense of 'us', which imposes restrictions of individuals' behaviours. Interests are also socially constructed and membership of a community also implies responsibilities (Wendt, 1992; Adler, 1997; Rosamond, 2000; Risse, 2007).

More specifically to our study, constructivists emphasise EU membership identity and the role of norms. Preference formation is not exogenous but is affected by the interaction between actors and their environment. Norms, which can also be socially constructed, play an important role in inter-state negotiations by not only restricting EU member states' behaviours but also facilitating the achievement of agreements. EU member states, therefore, do not necessarily act purely on the basis of strategic calculations for securing their preferences. Rather, they seek a consensus to produce or reproduce norms (Knutsen, 1997; Dimitrakopoulos and Kassim, 2004; Checkel, 2006; Rosamond, 2000). Checkel (2001: 53) talks of social learning, in which member states recognize and build up a common interest, 'what should we do', rather than simply pursuing their own interests.²

This would therefore suggest that member states do not (always) adopt the 'logic of expected consequentialism' but may also adopt the 'logic of appropriateness'. The logic of expected consequentialism argues that member states take strategic behaviours to secure their preferences according to fixed, given preferences derived from domestic interests. The logic of appropriateness argues that EU member states behave with regard to the appropriate rule in a given social situation (March and Olsen, 1998). Marsussen *et al.*, (2001) argue that member states' EU identity affects their behaviour in choosing between the two logics. The level of member states' EU membership identity depends upon member states' approaches to European integration, falling between anti-and pro-

² In discursive practices, there is a debate between advocates of the arguing-deliberation and persuasion perspectives. The former, drawn upon Habermas' theory of communicative action, focuses on argumentative rationality (while the latter emphasises persuasion and social learning (Lynch, 1999, 2002; Risse, 2000; Johnston, 2001; Checkel, 2003, 2005; Zürn and Checkel, 2005).

European stances. A member state which takes a pro-European approach has a strong EU membership identity, and tends to adopt the logic of appropriateness. A member state which has an anti-European approach has a weak EU membership, and tends to adopt the logic of expected consequentialism.

2.4. The Presidency of the Council

Another important criticism of Liberal Intergovernmentalism is the limited role assigned to European institutions. Of particular interest for our analysis is the role of the ‘Presidency of the Council’; this role is able to significantly affect outcomes during inter-state negotiations. In this thesis, literature on the EU Presidency is divided into two categories. First, there are a number of studies that focus on important questions and issues regarding the role of the EU Presidency (Tallberg, 2006; Brummer, 2011; Hayes-Renshaw and Wallace, 2006; Metcalfe, 1998; Elgström, 2003b; Metcalf, 1998; Thomson, 2008; Schalk *et al.*, 2007). Second, numbers of scholars point out the impact of (Presidency) norms on the Presidency’s ability in achieving outcomes (Wallace, 1985; Elgström, 2003b; Bercovitch, 1992; Hopmann, 1996; Stenelo, 1972; Niemann and Mak, 2010).

The six-month rotating Council Presidency³ was established to solve collective-action problems, as member states conceal their true preferences. In order to avoid deadlocks and to introduce compromises between member states’ different preferences, it was given several tasks in order to identify areas of potential agreement (Lewis, 2007; Bache and George, 2006; Tallberg, 2006; Hayes-Renshaw and Wallace, 2006). Drawing on general bargaining theory, there are the different views between a ‘responsibility with power’ and a ‘responsibility without power’ in defining the role of the presidency and whether the role enables the Presidency to advocate the direction of the decision-outcomes in line with their national interests when they hold the Presidency. Advocates of the ‘responsibility with power’ argue that the Presidency has a power to affect the outcomes in negotiations for gaining its national interests by brokerage resources:

³ At the Paris summit in 1974, EU member states were concerned about possible failures of negotiations amongst themselves for further European integration and, thus, agreed to create the Council presidency with delegating powers to control EU decision-making to mitigate collective-action problems. See Tallberg (2006) and Nugent (2006).

accessing information⁴ and controlling the EU decision-making process⁵ (Thomson, 2008; Schalk *et al.*, 2007; Tallberg, 2004, 2006; Stubb, 2000; Bjurulf and Elgström, 2004). By contrast, advocates of the ‘responsibility without power’ view argue that the Presidency is heavily constrained in its power in shaping decision-outcomes in line with their national interests (Hayes-Renshaw and Wallace, 2006; Metcalfe, 1998; Elgström, 2003b). They not only point out structural constraints: the short time frame of six months, the inheritance of dossiers from previous Presidencies⁶, external and internal events⁷ and a lack of expertise or skill⁸; but also focus on normative constraint: the norms of impartiality/ neutrality and effectiveness, on the Presidency’s behaviours to advance its national interests.

In particular, a number of scholars emphasise upon normative constraint (norms) on the Presidency’s ability in EU decision-making (Wallace, 1985; Elgström, 2003b; Bercovitch, 1992; Hopmann, 1996; Stenelo, 1972; Niemann and Mak, 2010). Norms constrain the Presidency’s calculation of maximising its gains in negotiations. It guides the Presidency towards ‘appropriate behaviour’: impartiality/ neutrality and effectiveness which not only reduces the costs of

⁴ ‘Confessionals’ are a privilege of the Presidency to obtain information about other member states’ preferences and how to gain acceptance during negotiations. Such information not only enables the Presidency to prepare a compromise that is acceptable to other member states but also provides some room for manoeuvre to influence decision-outcomes in line with its own favoured positions. See Thomson (2008).

⁵ Thomson (2008: 598) argues that Procedural control is an influential factor which enhances the power of the Presidency. The Presidency can control negotiation pace, meeting schedules, and shaping the agenda which enables the Presidency to put pressure on other member states to draw concessions from other member states to achieve agreement and shape decision-outcomes in accordance with their policy preferences.

⁶ Term of the Presidency constrains the Presidency’s ability to set up a new agenda. Rather, the Presidency tends to deal with the inheritance of agendas from previous Presidencies. See Elgström (2003a).

⁷ The Presidency is constrained by internal event, for example ratification failure of EU treaties, and external events, such as the outbreak of conflict or wars, in its control on the process of its original purposes. See Brummer (2011), and Hayes-Renshaw and Wallace (2006).

⁸ Metcalf (1998: 422) points out ‘expertise’ in constraining the Presidency’s behaviour. The Presidency depends on the Council Secretariat in outlining problems and sticking points in negotiations. Secretariat officials not only have a great deal of experience and professional skill but also take impartial position.

violation but also expands the range of other member states' acceptable behaviour in negotiations (Niemann and Mak, 2010: 730; Tallberg, 2004: 1002; Metcalfe, 1998: 420). In its role of broker, the Presidency concerns the norms of impartiality/ neutrality and effectiveness. The former has received most attention and has been emphasised by the Council secretariat's handbook for Presidencies⁹. The impartiality norm intensely underlines evenhanded behaviour of the Presidency when the Presidency takes the *Tour de Table* and the *Tour des Capitales* to gather information. During the Tours, the Presidency has to listen patiently to the views of all member states in order to expand the Presidency's room for manoeuvre in proposing its compromise which focuses on mediating conflicts between member states for achieving agreements and carrying any negative reputational consequences in order to avoid criticism from media attention, other member states and academics (Niemann and Mak, 2010: 731; Metcalfe, 1998: 420). The latter: norms of effectiveness emphasises upon the Presidency's basic duty which significantly concentrates on achieving conclusion by using all the brokerage resources available to it (Westlak, 1999; Elgström, 2003a). The norms of effectiveness very often bring about conflict with the impartiality norm. When this occurs, the Presidency tends to follow the majority position in proposing its compromise for effectively pushing negotiations towards the direction of the most favourable outcomes. Nevertheless the outcomes may be unfair (Metcalfe, 1998: 421; Niemann and Mak, 2010: 731; Tallberg, 2004; 1007).

Furthermore, the Presidency norms bridges between rational choice institutionalism and sociological institutionalism (March and Olsen, 1998; Elgström, 2003b; Tallberg, 2003, 2004, 2006; Quaglia and Moxon-Browne, 2006; Warntjen, 2008). Rationalists argue that the Presidency takes advantage of its term to reach agreements which are as close as possible to its national preferences. For this, it tends to strategically use the brokerage resources to facilitate concessions and present compromises with time constraints, in order to better pursue its national interests (Tallberg, 2004: 1003-1005). By contrast, sociological institutionalists point to the appropriate behaviour of the Presidency which is

⁹ The Council Secretariat's handbook states that 'the Presidency must, by definition, be neutral and impartial' (General Secretariat of the Council, 1997: 5).

determined through its belief of appropriateness in a given situation with regard to the Presidency norms rather than by cost-benefit calculations (March and Olsen, 1998: 951-952). The two logics argue that, depending on individual member states' degree of awareness on the Presidency norms, member states take different behaviours.

Scholars have begun to research conditions under which the Presidency is constrained by the norms in playing the roles of the Presidency: as disinterested leadership (Metcalf, 1998; Dür and Mateo, 2008), size of member states (Quaglia and Moxon-Browne, 2006), and the Presidency reputation (Finnemore and Sikkink, 1998; Elgström and Tallberg, 2003; Manners, 2003; Schout and Vanhoonacker, 2006). First, the Presidency concerns the impartiality norm in playing its roles in negotiations if it does not have to secure particular interests (Metcalf, 1998: 421). Second, due to a lack of bureaucracies and human resources, and a weakening of domestic constrain, small member states holding presidency tend to work closely with European institutions, in particular, the Council Secretariat which not only have professional skill but also takes an impartial position. Depending on the Council Secretariat's position, the Presidency also concerns the impartiality norm. By contrast, big member states act differently to small member states when they hold the Presidency (Quaglia and Moxon-Browne, 2006: 352-354). Finally, when member states, which are insecure about their reputation and hold the Presidency, the Presidency is constrained by the impartiality norm. In particular, new member states or new governments tend to focus on making a good impression and on strengthening their European credentials (Elgström and Tallberg, 2003: 201). Furthermore, occasionally, it has been the case that big member states (France, Germany, and the UK) holding Presidency have also made extraordinary concessions to preserve their reputations: for this, they present their compromises through making extraordinary concessions to get deals in order to be perceived as the norm of effectiveness, especially when their own preferences are a central factor to block an agreement (Dian, 1999; Kirchner, 1992; Christiansen, 2006).

3. The role of the UK in the EU

This section proposes to explore the role of the UK in the EU, concentrating on the general attitudes of the various governments¹⁰ that have alternated in power since the end of the World War II. The aim is to challenge the view that the UK has been an ‘awkward partner’, and has taken an obstructive behaviour on the development of European integration beyond economic integration. The concept mainly refers to Britain’s traditional ideas on national sovereignty and the special relationship with the US and the Commonwealth countries, which not only hindered Britain’s accession to the European Economic Community (EEC) in the 1950s but also became a basic consideration for political parties’ approaches on European integration. Based upon various analyses (Wallace, 1997; George, 1998; Forster and Blair, 2002; Piper, 2005; Geddes, 2008, 2004), it can be argued that since the terms of the British entry into the European Economic Community in 1973 were set, Britain’s behaviour with regard to European integration have not been consistent. This inconsistent behaviour, one of the arguments of this thesis, is the result of the domestic political parties’ approach towards European integration. The two main parties, in fact, have their own ideologies as a lens through which they view European integration and which shape their (an anti- or a pro-European) approaches (Geddes, 2008).

Table2.1 List of parties and Prime Ministers in the United Kingdom (1947-2007)

Term of office	Party in Government	Prime Minister
July, 1945-October, 1951	Labour	Clement Attlee
October, 1951-April, 1955	Conservative	Sir Winston Churchill
April, 1955-January, 1957	Conservative	Sir Anthony Eden
January, 1957-October, 1963	Conservative	Harold Macmillan
October, 1963-October, 1964	Conservative	Alec Douglas-Home
October, 1964-June, 1970	Labour	Harold Wilson
June, 1970-March, 1974	Conservative	Edward Heath

¹⁰ In Britain, from 1945 to 2010, the British political system can be characterised by ‘two-party systems’ which describes a dominance of two political parties in the domestic politics, and a single government system. Both the Labour and Conservative parties alternatively won general election with a comfortable overall majority in the parliament and, thereby, formed a single party government. See. Leach et al., (2011) and Garner and Kelly (1993).

March, 1974-April, 1976	Labour	Harold Wilson
April, 1976-May, 1979	Labour	James Callaghan
May, 1979-November, 1990	Conservative	Margaret Thatcher
November, 1990-May, 1997	Conservative	John Major
May, 1997-June, 2007	Labour	Tony Blair

Source: George (1998); Piper (2005); Bulmer and Buch (2009)

3.1. Shared views

Between the 1950s and the late 1970s, Britain's membership became a dominant issue not only in Britain but also in the European Community. Britain's late membership has been to Britain's great cost and resulted from the setting of the rules of integration in line with the founding member states' preferences. Many studies about Britain in Europe search for the cause of Britain's late membership and look at Britain's traditional idea of its national sovereignty, the remnants of its Empire, and its special relationship with Commonwealth countries and the US (Young, 1993; George, 1998; Ellison, 2000; Gamble, 2003). During this time, the Labour and Conservative parties shared a similar approach to European integration, which was enhanced with the concept of the 'awkward partner' (Young, 1993; George, 1998). Ellison (2000) and Gamble (2003) argue that, at that time, Britain concentrated on its special relationship due to perceived economic benefits which (it is thought) were greater than Europe that had suffered economically since World War II. This 'special relationship' also saw Britain ranked second in the league of world powers. This position of power strongly influenced Britain's hostility to an initial stage of European integration.

The Labour government, under Attlee (1945-1951), regarded the creation of the European Coal and Steel Community (ECSC) in April 1951 as a supranational co-operation effort which would threaten Britain's national sovereignty, its world power status, and 'special relationships'. The six founder member states encouraged British membership of the ECSC, but the Labour government at the time was not of the same opinion (Geddes, 2004). The Conservative party also considered the traditional ideas of national sovereignty, world power status and 'special relationships' in shaping its approach to the creation of the EEC in 1957, and as a result took a hostile approach towards supranational integration in Europe. The Conservative government of Macmillan

government (1957-1963) not only declined membership of the EEC but also established an intergovernmental economic co-operation body, named the European Free Trade Association (EFTA) instead of joining the EEC (Young, 1993; Young, 2000).

In the 1960s, Britain's hostility on membership was changed to a more positive position. Pilkington (1995) points out the economic success of the EEC and the weakened 'special relationship' to explain the change of Britain's approach. Both political parties thought that Britain's membership would replace the special relationship in securing Britain's interests. Despite this, both parties continuously adhered the traditional ideas in shaping their attitudes on European integration. The Conservative government (1957-1963) led by Macmillan and the Labour government (1964-1970) headed by Wilson applied for membership but they favoured intergovernmental rather than supranational co-operation, in order to preserve Britain's national sovereignty (Geddes, 2004; Pilkington, 1995). The Conservative government (1970-74) under Heath secured membership in 1971, but was faced with a financial problem, which resulted from the establishment of the EEC's 'own resources' system in 1970 before British accession to the EU in 1973 (Preston, 1997; Kitzinger, 1973).

The Labour governments under Wilson (1974-76) and Callaghan (1976-1979) were dominated by the left wing which criticised the former Heath (Conservative) government's decision on accession (and supranational European integration). Their concern was that EC would threaten the role of the government in the Labour party's state-directed capitalism. Thus, the Wilson government not only called for the national referendum to decide whether the UK should withdraw from the EC but also required the renegotiation of Britain's EC membership in the light of the financial problems. The British people, however, in the referendum supported British membership (Jowell and Hoinville, 1976; Bilski, 1977; George, 1998). In March 1976, following Wilson's resignation, James Callaghan, a left wing member of the Labour party, became Prime Minister. Since the outcome of the referendum meant that there was no question regarding membership, attention shifted to Britain's financial problem and the 'own resources system' (George and Bache, 2001; Lindner, 2006).

3.2. The Conservative Party and the UK as an awkward partner

The role of the Margaret Thatcher is particularly relevant for this thesis. During Margaret Thatcher's time as Prime Minister, the 'Awkward Partner' was the academic interpretation of Britain's relations with the European Union. George (1998) analyses Britain's behaviour on European integration, and defines that the 'Awkward Partner' characterises the Thatcher government's Eurosceptical behaviours which obstructed the process of the integration. In Taggart's study (1998), he states that Euroscepticism is the anti-integration position of those who totally oppose the idea of European integration, and have sceptical views on the integration because the integration is too inclusive or too exclusive. He emphasises the role of political parties in shaping member states' Euroscepticism. Political parties' ideologies clearly are a component in explaining their opposition. Ideologies lead or conduct the parties to shape anti-European attitude due to facing a difference with the direction of the integration (Taggart, 1998: 367, 378).

Baker *et al.*, (2002) introduces 'hyperglobalism' in order to identify the Conservative party's ideology, under Thatcher's leadership. They argue that the party's ideology in shaping its attitude on the integration was built on 'hyperglobalism'. They identify that 'hyperglobalism' was derived from the emergence of globalisation, which has diminished national governments' power in controlling capital mobility and commercial flows in a global economic context. A stream of globalisation pressured the governments to leave Keynesian economic management which emphasises the role of government in protecting and subsidising the national economy as well as increasing the level of employment. Globalisation provided the governments' new priorities of controlling inflation and fiscal balance, and removing all forms of regulation in shaping their economic policies. However, 'hyperglobalism' grants national sovereignty which enables a government to design the economic programmes: low taxation, low government spending, deregulation and privatisation in line with globalisation.

Since the Thatcher leadership in 1979, the Conservative party not only recognised the movement of globalisation but also used it to design 'Thatcherism'. After victory in the 1979 general election, the Thatcher government adopted Thatcherism to shape its attitude on integration. Her approach to European

integration and EU policies, 'Thatcherism', was a combination of neo-liberalism, which stressed the central role of the free market in the economic, and neo-conservatism, which emphasised national sovereignty. The Thatcher government mainly focused on two issues: liberalising the European market and defending British national sovereignty in shaping its approach on the integration (Norton, 1990).

The Thatcher government initially adopted a general pro-European approach and supported economic liberalism, particularly the project of Single European Market (SEM). Despite this, the government changed its approach from the pro- to an anti-European approach. Many scholars point out that the Single European Act (SEA), and the European Monetary Union (EMU) and the social chapter in the Treaty on European Union (TEU) were just too inclusive to the Thatcher government. As a consequence, the government not only had a sceptical view on the integration but also obstructed the pace of the integration (Norton, 1990; George, 1998; Buller, 1995; Sowemimo, 1996; Baker, 2005; Nugent and Mather, 2006; Falkner, 2007; Garry, 1995; Phinnemore, 2007).

First of all, the SEM project brought about institutional reforms through the SEA in order to effectively achieve the SEM by 1992. The SEA focused on the reform of the institutional system in the decision-making procedures, particularly the increase of the European Parliament (EP)'s involvement (Nugent, 2006: 80). Forster (2002: 66) argues that Thatcher hesitated to agree the SEA which would endanger Britain's sovereignty. In particular, the EP would replace Britain's sovereignty on the SEM measures. Secondly, the post-SEA issues: the EMU and the social chapter in the TEU focused on eliminating the cost of currency conversion and preventing 'social dumping' in the SEM respectively (Falkner, 2007; Garry, 1995; Phinnemore, 2007). Hale (1999: 101) argues that Thatcher's sceptical view was beyond just the economic integration. In Thatcher's Bruges speech in 1988, Thatcher explicitly announced the change of the government's approach on European integration. She asserted that the EMU would represent an erosion of national sovereignty in controlling currency, and that the social chapter would counter the Conservative government's economic policy (Forster, 2002: 64; Geddes, 2006: 129-130).

Although the change in the Thatcher government's approach brought a challenge to the pro-Europeans within the Conservative party John Major became Prime Minister, Thatcherism continued to have its dominant role in the party in shaping Britain's approach on the EMU and the social chapter (Gamble, 1993). During the Major government (1990-97) Britain's approach to European integration did not change despite Major being a member of a pro-European group and supporting European integration. This was due to strong criticism from the Thatcherite backbench MPs and the Labour party. Thus, it blocked British membership of the post-SEA issues (Gamble, 1993; George, 1998; Forster, 2002). Meanwhile, there was a substantial change within the Labour party in the late 1980s, which shifted from an anti- to a pro-European approach on European integration. In the campaign for the EP election in June 1989, due to its change of its approach, the Labour party argued that the Conservative government's European policies had undermined Britain's social benefits (Daniels, 1998).

3.3. The Labour Party and the UK as constructive partner

In 1980s, Labour slowly changed its attitude on Britain's EC membership from outright opposition towards an unenthusiastic acknowledgement that shifted away from its withdrawal argument. The change of the Labour party's attitude provided a chance for the new Labour government¹¹, under Blair, to take a positive attitude, characterised 'constructive engagement'. This new approach broke away from 'awkward partner' in an image of Britain's EU membership (Baker, 2005; Fella, 2006). Daniels (1998) points out four elements: the pressures of domestic political competition, the dynamic of the European integration process, a change in trade union attitudes on Europe, and a consideration of economic policy change, which were crucial factors to influence Labour's conversion towards a pro-membership. The issues pressured the party to re-interpret their ideology in designing the party's policies, particular its EU attitude.

First, the Labour party considered domestic political situations: internal party politics and the domestic political context. Due to defeats in both the 1983

¹¹ In the 1997 general election, the Labour party, under Blair leadership, won 418 seats and took office. See Smith (2005).

and 1987 general elections¹², the party needed to reform its programme to try and recover from those defeats. The party considered the change of its attitude on the membership that was symbolised by the party shifting away from its anti-European approach. Furthermore, Thatcherites' growing hostility to the European project brought about her successor, Major's problems of party management overtaking his pro-European attitude. In the adversarial political system, the change of the Conservative party's attitude offered a possibility for Labour to change (Daniels, 1998; Forster, 2002a). Second, the party recognized an ideological similarity between its socialism and the direction of European integration. In particular, the social chapter in the TEU represented the idea of a 'Social-Europe'(Jeffrys, 1993; Daniels, 1998; Geddes, 2003; Fella, 2006). Third, the party acknowledged Britain's growing economic interdependence with European economies: the mobility of capital and trade (Daniels, 1998: 83). Fourth, the party recognised the extension of global market. It considered changing its economic policy that would focus on a stabilisation of deflation rather than a nationalisation for protecting national industries and Keynesian spending programmes in the direction of modernising the party (Daniels, 1998; Baker, 2005).

For these causes, members of the Labour party demanded the leader group (the left wing), to re-interpret their ideology in order to re-design their policies and their attitude on the membership. Between 1989 and 1991, the party, under the Kinnock leadership, presented the 'policy review' which focused on the modernisation of all of the Labour party's policies (Fella, 2006; Redgrave, 2008; Forster, 2002a). In shaping its European policies, the review not only considered its new economic policies: acceptance of the market economy, deflationary policies, monetary and fiscal policies, and Britain's full participation in global

¹² In the 1983 general election campaign, the Labour party, under the left wing's dominance, argued for a withdrawal of Britain's EC membership. Subsequently, Labour faced its worst defeat in its history. Due to the defeat, Michael Foot, who was the leader of left-wing and the party, resigned his position. His successor, Neil Kinnock stood as leader in the 1987 general election and slightly changed the party's position from the withdrawal option to the reform of the EC, particularly reducing the role of the EP, the reform of the CAP and a reduction of Britain's budgetary contributions. However, the party was defeated once again in the general election. See Daniels (1998) and Fella (2006).

economy but also focused on the post-SEA issues. The review took a positive position on the EMU¹³ and the social chapter in the TEU, and changed the Labour party's stance to a pro-European stance. This review formed the foundation of the Blair government's pro-European approach, named 'constructive engagement' (Forster, 2002a: 707, 718; Redgrave, 2008: 424).

Redgrave (2008) describes the new Labour government's 'constructive engagement' which characterised its pro-European approach. The approach resulted from the government's recognition of the growing synthesis between Britain's national interests and the interests which would be maximised at the heart of European integration. To secure Britain's national interests, the new Labour government started its engagement with the EU. Shortly after taking government, the new Labour government participated the Amsterdam European Council in 1997. It not only signed the Treaty of Amsterdam¹⁴ but also signed up to the social chapter of the TEU which the previous Conservative government refused to do (Baker, 2005: 25-26, Fella, 2006: 626). Furthermore, the government played a leading role on the enlargement of Central and Eastern European Countries (CEECs) and the setting up of the Lisbon strategy which was aimed at the modernisation of the EU economy toward the development of a knowledge-based economy in order to strengthen innovation and competition in a rapidly changing global economy (Begg, 2008; Dion, 2005; Jones, 2005; Collignon, 2008; Chadwick and Heffernan, 2003). In 2005, the government also sacrificed its rebate in order to achieve the financial agreement on time which would financially support the Lisbon strategy (Whitman and Thomas, 2007: 71).

Despite this, some scholars point out the limit of the new Labour

¹³ The review saw that the EMU would have the right function on price stability in trade in the single market. In particular, Britain's membership of the EMU would secure lower levels of inflation and interest rates, and the elimination of exchange rate uncertainty. See Gamble and Kelly (2000).

¹⁴ The Treaty of Amsterdam stipulated the reform of the EU institutions: extension of Qualified Majority Voting (QMV), further strengthening the role of the EP, new rules on transparency and new human rights, and anti-discrimination provisions which dealt with the enlargement of Central and Eastern European Countries (CEECs). The new Labour government's agreement on the Treaty indicated its pro-European approach beyond just economic integration. See Smith (2005), Sherrington (2006), and Bulmer (2008).

government's pro-European approach thanks to its traditional ideas of national sovereignty and the special relationship with the US, and the definition that Britain is 'defensive engagement' or a 'semi-detached partner'. They focus on Britain's non agreement on the EMU¹⁵, the creation of the European Defence Agency¹⁶, and the reform of the EU institutions¹⁷ in the negotiation for establishing the Constitutional Treaty in 2003-4. However, they do acknowledge the change of Britain's approach which shifted away from its image of 'awkward partner' (Oppermann, 2008; Bulmer, 2008; Baker, 2005; Smith, 2005; Redgrave, 2008; Bach and Jordan, 2008).

4. A note on the EU's budgetary policy process

Since its inception in 1951, the EC/EU budget has been seen as collective attempt to financially support European integration projects. Before the 1988 budgetary reform, it was implied that due to the size of the budget the development of EC policies was practically insignificant (Nugent, 2006: 430). During that time,

¹⁵ In the first term of the Blair government (1997-2001), the government had a pro-European approach regarding the membership of the EMU. However, Chancellor Gordon Brown moved from favouring the membership to being hostile towards it, Blair had to agree Brown's suggestion which would take five economic tests. Due to fails of the tests in 1997 and 2003, the government postponed its membership and promised to have a Parliamentary vote and a referendum of the British people on the issue. See Smith (2005).

¹⁶ After the war in Kosovo (1998-1999), the EU discussed an extension of the EU's foreign and defence policy. The Blair government supported the extension in order to increase the EU's military capabilities in international conflicts. In December 1998, the Blair government engaged with France for the establishment of the St Malo Declaration for European defence. However, Britain's special relationship with the US in the US military action in Afghanistan and the US invasion of Iraq in 2003 cast a shadow over the St Malo Declaration on the EU's foreign security policy. See Baker (2005), Smith (2005) and Nugent and Mather (2006).

¹⁷ In the second term (2001-2005), the Blair government dealt with the institutional reform at the Nice Intergovernmental Conference (IGC) in 2001, the convention on the future of Europe from 2002 until 2003 and the 2003-2004 IGC for establishing the Constitutional Treaty. The New Labour was very instrumental to safeguarding national sovereignty far more effectively than the previous Thatcher and Major (Conservative) governments in order to secure Britain's national interests in response to the enlargement of CEECs. In particular, it rejected the extension of QMV in the areas of taxation, criminal justice, foreign and security policy, social policy. This decision found Britain isolated from other EU member states. See Fella (2006) and Smith (2005).

budgetary politics concentrated on solving the problem which some member states had concerning the imbalance between their contributions and their receipts. When the EC financial system was established in 1970 France benefited most and this had been to gain its support for the first enlargement. Agricultural subsidies accounted for over 70 per cent of the EC funds. But the political linkage between the new budget system and France's acceptance of the enlargement is at the origin of Britain's budget problem (Heath, 1998). For over 10 years the UK demanded a reduction of its contributions, which culminated in the agreement of the UK's rebate system at the Fontainebleau European Council in June 1984. The EU budget increased significantly with the acquisition of new competences and the accession of some poorer countries – the Mediterranean enlargement in the 1980s followed by the accession of 8 Countries of Central and Eastern European countries in 2004, and further countries in 2007. The aim of the enlargement was to reduce economic disparities across Europe and further complete the unification of Europe (Denton, 1984; Laffan, 1997). The agreement of the financial perspectives is a highly political issue – what Peterson and Bomberg (1999) term 'history-making' decisions¹⁸ – and is dealt mainly by the European Council. Member states are pivotal players, but other institutions (the European Commission and the European Parliament) also play a role.

The European Coal and Steel Community was created at the 'Treaty of Paris' 1951. Also established at the Treaty was a type of financial system which gave budgetary power to the ECSC High Authority to impose levies on coal and steel products in order to finance housing, mobility and resettlement subsidies for coal and steel workers. The budget comprised mainly of the Member States' financial contributions and as such their national parliaments wielded the most power regarding budgetary decision-making. After the Treaty of Rome in May 1957, the European Economic Community (EEC) recognized the need to replace national contributions with a new system which would allow overcoming the national authorities' approval process. In fact the parliaments had to consider their domestic situations rather than that of the EEC when they approved the size of

¹⁸ Peterson and Bomberg (1999) identify three different types of EU decision-making: history-making decisions, systemic level decisions, and sub-systemic level decisions.

their contributions to the EEC. This meant that it was very difficult to increase the size of the EEC budget. At The Hague summit in December 1969, the six founders agreed to establish a new financial system before the first enlargement in order to shift the financial burden onto the new member states as a 'charge' for membership of the EC (Shackleton, 1990; Laffan, 1997).

These considerations came to fruition in the Budget Treaties of 1970 and 1975, which created the 'own resources' system. The Treaties stipulated autonomous 'own resource' base-customs duties on extra-EC trade, agricultural levies, Value Added Tax (VAT) which was limited to 1 per cent and an annual budgetary decision-making process. The 'own resources' system was significant in that it further shifted fiscal authority from national parliaments to the EC (Schreyer, 2001). In budgetary decision-making, the European Parliament was granted new power, and was able to reject, amend 'non-compulsory' expenditure, and discharge the budget (Shackleton, 1990; Laffan, 1997). The 1975 Treaty created the Court of Auditors, which was tasked to examine all EU revenue and expenditure accounts in the EU budget, and to correct significant irregular and unlawful transactions.¹⁹

The Budget Treaties established the annual budget system and this has remained the decision-making process until now. The process is divided into three steps: a draft budget, a first reading, and a second reading. First, the European Commission initiates the financial decision-making process by presentation of a preliminary draft budget to the Council. Under the supervision of the Budget Commissioner, the draft is prepared by the Budget Directorate General (previously DG XIX) in consultation with the other services of the Commission by 1 September of each year. The Budget DG has a meeting with representatives of the Council and the European Parliament (EP) to discuss the draft. Once the Commission agrees the preliminary draft budget, the draft is sent to the Council of Ministers. Second, the Council and the European Parliament have a first reading of the budget. In this step, the Budget Committee of the Council, consisting of

¹⁹ The Court of Auditors replaced the two existing Community audit bodies, the Audit Board of the EEC and the European Atomic Energy Community (Euratom), and the ECSC auditor (Nugent, 2006).

representatives from financial ministries, does most of the detailed work. Furthermore, the Council informally meets with the Parliament's Budget Committee in order to resolve problems at an early stage. The draft budget is then sent to the European Parliament for a first reading which has to be completed within forty-five days. The European Parliament can simply approve or propose modifications to the compulsory expenditure. However, it has the right to amend non-compulsory expenditure by an absolute majority vote. After a first reading, unless approved by the EP the draft budget goes back to the Council for the third step. Third, the Council has fifteen days to complete its second reading of the draft budget, which may be amended by the European Parliament on non-compulsory expenditure. The Council has the final word on compulsory expenditure and also indicates its position on non-compulsory expenditure. The draft budget is then returned to the European Parliament, which has fifteen days to have the final word on non-compulsory expenditure. The European Parliament then adopts or rejects the draft budget. If adopted, the EP President signs it into law. If rejected by the beginning of January, the European Community is then operated by a system of month-to-month financing, known as 'provisional twelfths', until agreement between the two arms of the budgetary authority is reached (Laffan, 1997; Lindner, 2006; Laffan and Lindner, 2010).

The multi annual budgetary plan was established during the 1988 reform rather than changing the process of annual budgetary decision making. This strengthened the heads of government and member states' involvement in decision-making. Since the Budget Treaties, annual budgetary decision-making has required an institutional agreement rather than the agreement of the European Council. The European Council informally discussed and negotiated budget issues, particularly the size of the Common Agricultural Policy (CAP) expenditure in 1980 and 1982, and the UK's financial problem in 1984 (Peterson and Bomberg, 1999). Following the 1988 reform, the European Council has become formally involved in budgetary decision-making. The financial perspective referred to a package between the Commission's multi-annual financial plans for 5-7 years and European integration projects. The multi-annual financial plans not only focused on a balance between revenue and expenditure in the financial period in order to

avoid the EC budget falling short, but also proposed financial support to the European integration projects. The multi-annual budget has no treaty basis which requires political agreement between member states. The European Council formally negotiates the financial perspectives, which subsequently are translated into a binding structure for annual budgets. The multi-annual budget plan focuses on balancing the maximum amounts of total annual expenditure with the overall revenue ceiling (Laffan, 1997; Lindner, 2006).

The European Council is the central actor in the negotiations of the financial perspectives, and is supported by the Council of Ministers and the Committee of Permanent Representatives (Coreper).²⁰ Coreper II prepares upcoming Council meetings through pre-negotiations between them. Although Coreper II cannot formulate conclusions of financial perspectives, its discussions and outcomes are used in pre-negotiations to advise national governments at the European Council. Within the Council of Ministers, the Economic and Financial Affairs Council (Ecofin) there are representatives from finance ministries. The Ecofin plays a central role in the negotiations of the EU's expenditure policies and revenues. The Council of Ministers in other sectors focuses on securing the budget in their own areas. For example, the Agricultural Council concentrates on keeping agricultural spending high. The Council presidency plays a central role in that it generally proposes compromises between the Commission's original proposal and member states' complaints with the view to achieve a solution agreeable to everybody. The European Commission, whose most important role is that of initiating the process by proposing the initial draft, may be active also at the decision-making stage where it tries to defend its proposal. The achievement of compromise may be

²⁰ The European Council, which consists of the Heads of State or Government and the President of the European Commission, generally meets twice a year, at the end of each six month Council presidency in June and December, and is held over a two-day period. The Council of Ministers initially had over 20 formations in order to deal with different policy areas. At the Helsinki European Council in December 1999, the number of formations was reduced to 16 in order to improve consistency and coherence of the Council's tasks. Since 2002, the number of Council formations has been reduced to 9. Coreper is split into two: Coreper I and II. Coreper I has a responsibility for the internal market and other more technical sectors. Coreper II prepares all meetings of the European Council, General Council Affairs, Development, Economic and Financial Affairs and Budget (Ecofin) and Budget Council meetings.

facilitated through the activities of the EC. Since the reform of budgetary decision-making in 1988, the European Parliament retains its power in the annual budgetary decision making but has no formal power in the negotiations of the financial perspectives (Peterson and Bomberg, 1999; Hayes-Renshaw, 2006; Lewis, 2006; De Schoutheete, 2006; Laffan and Lindner, 2010).

Chapter 3

Securing the rebate: the road to Fontainebleau (from the 1950s to 1984)

1. Introduction

This chapter explores the origin of the British problem in relation to its contribution to the EC's budget and points to the late membership as one of the central reasons. The six founder member states, in fact, agreed the Community's own resources system in 1970, which gave them bargaining power to fix the size of the British contribution. This brought about an imbalance between the UK's significant payment to the EC budget and the scanty benefits it received from it. In the following decade, several governments facing financial difficulties demanded a reduction of their contribution to the Community budget. This generated a number of conflicts between the UK and the other member states, which sought to prevent an increase of their contribution to the EC budget. Eventually, the Thatcher government secured the settlement of the UK's rebate system at the Fontainebleau European Council on 25-26 June 1984

To explain all these events, this chapter is divided into four sections. The first section discusses the reasons behind the UK's choice not to join the EEC in the 1950s and its change of approach in the 1960s. The second section explores the establishment of the own resources system and its penalizing effects on British accession negotiations, conducted by the Conservative government under Heath. The third section focuses on how two Labour governments – headed by Wilson

and by Callaghan – dealt with the issue. The fourth section concentrates on the approach taken by Conservative government headed by Margaret Thatcher, paying particular attention to the ‘May Mandate’, the initial failed attempts to reach an agreement, and the settlement of the UK’s rebate system at the Fontainebleau European Council.

2. The UK and the European Community (1940s-1970s)

This section focuses on defining the causes of the UK’s late joining of the EC: why the UK did not join the EC at its inception, subsequent change of position in the 1960s with two membership applications which were both rejected. Eventually the six founder member states embarked upon the negotiation of British membership, but required a high financial contribution from the UK as a cost of the membership under the ‘own resources’ system.

2.1. Early steps in European integration

After the Second World War, some countries in West Europe established a Council for European Economic Co-operation (CEEC) in Paris in July 1947 to co-operate in the restoration of the economy through the Marshall Plan.²¹ Initially, ‘Marshall Aid’ was a strategy adopted by the US to support Europe to adopt capitalism and liberal-democratic political systems as a means to expand the US’s trade areas, and to defend against the expansion of Soviet communism in Europe. Eastern European countries rejected the offer of ‘Marshall Aid’, which effectively divided Europe into two blocks: Western liberal democratic countries and Eastern communist countries. In March 1948, with the Treaty of Brussels, the UK, the Benelux countries (Belgium, the Netherlands, and Luxembourg), and France pledged to organise mutual military and economic co-operation against the communist block in Europe. In April 1949, with the Treaty of Washington, they established the North Atlantic Treaty Organization (NATO) under the US’s

²¹ The Secretary of State of the US, George C. Marshall, proposed a economic plan to rebuild West European economies with around \$ 13 billion of aid between 1948 and 1952. See Geddes (2004).

aegis.²²

In the early 1950s, there were movements toward further European integration: the European Coal and Steel Community (ECSC) and then the European Defence Community (EDC). Firstly, the French foreign minister Robert Schuman proposed the creation of the ECSC in the Treaty of Paris in April 1951. The ECSC was a common market in the basic raw materials of coal and steel for the industrial community in Europe. Secondly, the proposal to cooperate in the field of defence policy was never ratified. As an alternative to this, in order to hamper the rearmament of Germany, the UK and the six ECSC members agreed to the establishment of the West European Union (WEU), which incorporated defence policy. At the Messina conference of ECSC in June 1955, the Belgian foreign minister Paul-Henri Spaak proposed the European Economic Community (EEC). Spaak's proposal was accepted and the agreement signed by six member states: Belgium, France, Italy, the Netherlands, Luxembourg and West Germany in the two 'Treaties of Rome' in March 1957, which also saw the establishment of the European Atomic Energy Authority (Euratom).²³

2.2. Initial British approaches to European integration

In the early movement towards European integration, the then Labour government's ideas about British leadership in Europe played a central role in shaping the government's behaviour. The Attlee government (1945-51) considered that after World War II, the UK was ranked second in the league of world powers, due to its relatively modest degree of damage incurred during World War II compared to continental Europe, and its special relationships with the Commonwealth and the US.²⁴ The Attlee government initially supported and encouraged Western European unity. It understood its responsibilities were to build economic prosperity in Europe based on a liberal, capitalist order, and to defend Europe against the expansion of communism. For this, it played a leading role in establishing intergovernmental co-operation in the CEEC in 1947, as well

²² For a thorough analysis of Europe in the post-war period, see Milward (1984).

²³ For an analysis of the the road to the Treaties of Rome, see Dinan (2007).

²⁴ For a different view, arguing that the views of British elites should be seen as a 'delusion of grandeur'. See Porter (1987).

as in establishing NATO. However, it hesitated to support the development of European integration towards supranational co-operation. In fact, the Attlee government did not oppose the creation of the ECSC and the EDC, but did not support British membership of them. The government's sceptical thinking on membership resulted from its ideologies of socialism and imperialism which strongly tied up with its view of national sovereignty, and the special relationship with the US and the Commonwealth countries for continuing its social policies and historical global power respectively (George and Haythorne, 1996: 112; Forster, 2002: 17). The government argued that supranational European integration would undermine national sovereignty, compromise British world leadership and damage its special relationships with the Commonwealth and the US (Jowell and Hoinville, 1976; Ellison, 2000; Gamble, 2003; Geddes, 2004).

The Conservatives came to power in government from 1951 through until 1964. They also had the opinion that Britain should be hostile towards the supranational integration of Europe, and preferred European security on an Atlantic basis. The Churchill government (1951-55), joined the six ECSC member states to agree on the WEU based on the intergovernmental pillar of NATO to establish a collective defence structure for Western Europe in 1954 (Young, 1993). It was another Conservative government, led by Macmillan (1957-63), which refused to join the EEC in 1957. The Macmillan government demanded trade liberalisation in intergovernmental structures of European integration without supranational pretensions: pooling sovereignty as part of political integration in the EEC was not acceptable in traditional British politics. This approach was also influenced by the Macmillan government's preconceptions about Britain's role and identity: in its view the UK was the third force between the US and European integration in the liberal democratic world (Frankel, 1975). The UK's position was enhanced through its special relationship with the US and the Commonwealth. Economically, British trade with the Commonwealth and the US had brought about Britain's economic prosperity and historical leadership (Northedge, 1983). Politically, the Anglo-American alliance allowed the UK to play a leading role in the international arena but was still dependent on the US (Carrington, 1988). The Macmillan government concentrated on its leadership of Europe rather than

membership in a supranational structure of European integration (Jowell and Hoinville, 1976). Thus, its decision to establish the EFTA was seen as a form of intergovernmental co-operation which preserved national sovereignty and its special relationship. With EFTA, the UK aimed to establish a free trade area in Europe to abate national trade barriers between member states and with the EEC (Young, 2000; Geddes, 2004; Lam, 1999; Gamble, 1990).

Due to the weakening of special relationships out with Europe, and the economic success of the EEC, the Macmillan government, eventually, changed its opinion on European integration, with a view to keeping up Britain's rank in the international arena and preserving its economic interests. The Suez crisis in 1956 stood as testament to Britain's dependency on the US in world affairs, which implied that Britain's time as an imperial world power was over (Ramsden, 1996).²⁵ The Macmillan government assumed that the UK-US connection would ensure success of the EFTA, but actually the US demanded a stronger commitment to European integration for its own economic growth and security (George, 1998). In 1961, President Kennedy privately expressed the US disappointment on the division of Europe between the EEC and the EFTA, and decided to support the EEC (Pilkington, 1995). The Macmillan government was anxious about the potential success of the EC in political co-operation, which could pave the way to a new connection between the US and the EC, thus displacing Britain in Europe (George, 1998). Following the withdrawal of South Africa from the Commonwealth in 1961, the Conservative government also started recognising the dilution of the British leadership vis-à-vis the Commonwealth. Furthermore, the Conservative government faced up to the reality of EC economic success and felt that the UK's EC membership was necessary for obtaining economic benefits and recovering its political influence in the world (Camps, 1964; Pilkington, 1995). At the end of July 1961, Macmillan announced that the British government would submit its first application for full membership. This application was rejected by de Gaulle, who arguing that he was

²⁵ In 1956, there was a Franco-British joint operation to repossess the Suez Canal from Egypt, which was met with US opposition. Due to US pressure, the UK disbanded the operation and bowed to the US position on the Suez.

trying to prevent the expansion of Anglo-American dominance in Europe (Jowell and Hoinville, 1976; Young, 2000).

The Labour party opposed Britain's EC membership, which was regarded as sacrificing British imperial heritage (Pilkington, 1995). In particular, in 1962, Hugh Gaitskell, the leader of the Labour party, castigated the Macmillan application of 1961, arguing that it would end 'a thousand years of British history' (Young, 2003: 142).²⁶ After Hugh Gaitskell's death in 1963, Harold Wilson took the leadership of the Labour party and became the governing party after the 1964 general election with a slim majority²⁷. Wilson and his followers' pro-European attitude brought about a major turning point in shaping the Labour government's approach on European integration. Britain was confronted with an economic problem because of declining British trade with the Commonwealth and thus had to do something to improve Britain's trade position. Although Britain's economy depended upon US loans, the Labour party wanted to keep the US at distance. This dependency prevented the UK from articulating opposition to American's military involvement in Vietnam. The party also acknowledged that although capitalism was dominant, it was weaker in the EC than in the US. Thus, it averted its eyes from the US to look towards the EC, to try and avoid any penalty of being excluded from the economic success of the EC (Jowell and Hoinville, 1976; Pilkington, 1995). The Labour party manifesto for the 1966 general election was clear:

Britain is a member of the European Free Trade Association, which is a thriving organisation beneficial to us and to our partners. The Labour Government has taken the lead in promoting an approach by E.F.T.A. to the countries of the European Economic Community so that Western Europe shall not be sharply divided into two conflicting groups. Labour believes that Britain, in consultation with her E.F.T.A.

²⁶ The Labour party, under Hugh Gaitskell's leadership, thought that the UK had a responsibility to support the development of the Commonwealth countries which owed allegiance to the Queen (Jowell and Hoinville, 1976).

²⁷ Under Wilson, the Labour party won two general elections. In 1964, it defeated the Conservative party but the size of majority in parliament was an unworkably small majority of only 4 MPs. The Wilson government returned to office with a larger majority after the general election in 1966. See Pilkington (1995).

partners, should be ready to enter the European Economic Community, provided essential British and Commonwealth interests are safeguarded (1966 Labour Party Election Manifesto 'Time for Decision' ____www.labour-party.org.uk/manifestos/1966/1966-labour-manifesto.shtml).

In designing the manifesto, the Wilson's government's pro-European approach was confronted with anti-Marketeters' position which argued that Britain's membership would see them losing national sovereignty. After victory at the 1966 general election, the Wilson government demoted anti-Marketeters from the government and persuaded anti-Marketeters in the party to change their position on Britain's membership (Forster, 2002: 21; George and Haythorne, 1996; 114; Young, 2000: 85). On 2 May 1967 the Wilson government announced its application for EC membership (Central Office of Information 1983: 6). This second application was once again vetoed by De Gaulle in November 1967, for the same reason as the first application had.

The Conservative party, under Heath's leadership, won the general election in June 1970. Heath had been the chief negotiator in the Macmillan government's application for EC membership and a member of Jean Monnet's Action Committee for the United States of Europe. This meant that the Heath government inherited its ideas about EC membership from the Macmillan. The Heath government, thus, fully committed itself to EC membership and put the common market at the centre of British foreign policy. The six member states now looked at EC enlargement more favourably, arguing that the UK's membership would make the EC stronger economically and politically. The negotiations were successfully with the conclusion that Britain had to trade off membership with an agreement over the own resources system (Young, 1973; Jowell and Hoinville, 1976 George, 1994; Young, 2000).

2.3. Member states' initial responses to the UK's accession

The UK's accession into the EC in the 1960s caused some disagreement amongst the six founding members. The 'Friendly Five' (Germany, Belgium, Luxembourg, the Netherlands, and Italy) welcomed the UK's applications for EC membership, which would keep France's dominance in European integration in check. France,

which was the chief instigator in the rejections of Britain's EC membership applications in 1961 and 1967, had a more cautious attitude. In particular, President De Gaulle believed that Britain's EC membership would imply a penetration of Anglo-American dominance into Europe. He also feared that the UK with its special relationships would become a rival to thwart his desire to place France at the centre of European integration (Macmillan, 1973; Castle, 1984; Pilkington, 1995).

The British application for EC membership went under a new phase after the resignation of President de Gaulle in April 1969. The government led by Georges Pompidou was less sceptical than his predecessor over the UK's commitment to Europe. However, for Pompidou, the creation of the own resources system represented a turning point of his position on the British membership. The Pompidou government's acceptance of the UK's EC membership after the creation of the EC financial system implied that France wanted the UK to be a net contributor to the Community budget which was predominantly allotted to CAP expenditures (Heath, 1998).²⁸ For this, it argued that the UK would have to accept the EC budget system as the *acquis communautaire* if it wanted to join the EC. Once the UK accepted to pay its contribution to the Community budget which would benefit the French national interest, the Pompidou government ended French opposition to Britain's EC membership (Heath, 1998).

3. The establishment of the own resources system

This section reviews the negotiation of the Community's own resources system, which affected the UK's accession. The own resources system was designed by the European Commission to reduce the difficulty of securing national parliaments' approval on the size of the EC budget, which was destined to

²⁸ The CAP, largely based on a French idea, worked by restricting agricultural imports and setting a common 'target price' for agricultural produce, so as to guarantee farmers' income. Over 80 per cent of the Community budget was allocated for spending on the CAP. See Fougère (2007).

significantly increase with the upcoming enlargement.

3.1. The Commission's proposal for the Community own resources system

In the initial stage of European integration, the European Coal and Steel Community decided to finance community activities and to raise loans to support coal and steel workers for resettlement and houses (Laffan, 1997). The ECSC's financial scope was regulated by article 49 of the ECSC Treaty, which empowered the High Authority to directly procure financial resource through levies on the coal and steel industries (COM, 1969a: 13; Laffan, 1997: 2). The establishment of the EEC in 1957 brought about an increase of the EEC budget due to the creation of the European Social Fund (ESF) and the European Development Fund (EDF).²⁹ The Treaties of Rome created a financial system which stood on the basis of the EEC member states' contribution and also enacted Article 201 (EEC) to collect the revenue from customs duties and Article 173 (Euratom) to collect levies for the Euratom with the view to partially replacing the national contribution by 'own resources' of the communities (COM, 1969a: 13).

In 1960, an agreement of the CAP framework affected the shaping of the community's budget. The CAP was intended to establish a common agricultural market which required the Community's financial support for single prices and for a Community farm policy. In April 1962, the Council agreed Council Regulation No. 25 which created the European Agricultural Guidance and Guarantee Fund (EAGGF) for the EEC's financial responsibility regarding the CAP (Official Journal of the European Communities, 1962; COM, 1965a). For the implementation of Council Regulation No. 25, the Council required a Commission's proposal to be made before 1 April 1965. On 31 March 1965, the Commission submitted its proposals to the Council, which consisted of two financial regulations: arrangements for replacing the financial contribution of the EEC member states with the Community's own resources, and amendments to Article 203 of the EEC Treaty to increase the power of the European Parliament

²⁹ The European Social Fund was established for supporting coal and steel workers' training and mobility. The European Development Fund aimed to finance development activities in European overseas territories and later former colonies in Africa, Caribbean and Pacific (ACP).

on approval of the community budget (COM, 1965b). The Commission proposed that agricultural levies be added to the EC's own resources. The EC budget would be collected from the agricultural levies and from customs duties (Official Journal of the European Communities, 1962; Ehlermann, 1982). The Commission's proposal specified that the EC's own resources – agricultural levies and custom duties under the Common External Tariff (CET) – should start from July 1967, which would be the completion date for the customs union for industrial products, and also the commencement date for financing common prices for agricultural products (COM, 1969a).³⁰ National officials in the EC member states would collect custom duties under the CET and the levies on agricultural products in trade with countries outside of the EC, and then would hand these over to the EC, after the deduction of a 10 per cent service charge. Furthermore, the European Commission proposed an amendment of Article 203 to increase the European Parliament's power over its approval of the EC budget procedure with the aim of removing national parliament's control over the EC budget (Bache and George, 2006).

In its 1965 proposal, the European Commission linked the idea of the EC's own resources with a proposal for an increase of the European Parliament's powers over the EC budget. This package deal was confronted with opposition from the de Gaulle government, which did not want to strengthen the powers of the EP. On the issue of the amendments to Article 203 in the EEC Treaty, although on the surface France's opposition was due to a weakening of national authority in accordance with the increase of supranational institutional power, in substance the French opposition was bound up with concerns over loss of control of the EEC expenditure plan. France's position on the package deal was isolated given that other EEC member states consented to it (Lambert, 1966).³¹ When the package deal became deadlocked, President de Gaulle, and thus France, boycotted all

³⁰ On 12 May 1960, the Council agreed the Commission's proposal on the procedure of the customs union which would progressively dismantle internal customs barriers and would erect a common external tariff from 1959 to 1967. See Egan (2007).

³¹ The EEC member states, apart from France, advocated strengthening the budgetary power of the European Parliament in the Commission's package deal to secure an overall fairness of community expenditure. See Lambert (1966).

'Council of Ministers' meetings from June 1965, a period subsequently termed the 'empty chair crisis' (Bache and George, 2006). In a series of Special Council meetings in Luxembourg in May 1966, the EEC member states achieved an agreement on financing the CAP which stipulated that, from 1 January 1970, all agricultural expenditure would be financed by the Community budget (COM, 1970e: 1).³² The six EC member states agreed to discuss the EC's own resources system at The Hague summit of 1 and 2 December 1969 (COM, 1966: 5-11).

Prior to The Hague summit, the Commission repeatedly proposed the communities' own resources system and an increase in the EP's budgetary power. For the own resources system, the proposal stipulated collecting three sources of revenue: two 'traditional' resources (agricultural levies and customs duties), and a maximum of 1 per cent of Value Added Tax (VAT) (COM, 1969a: 15). The European Commission proposed agricultural levies on import in agricultural and sugar trades immediately. On custom duties, it proposed a progressive allocation by which, under the CET on imports from outside of the communities, two-thirds of customs duties would transfer to the communities on January 1971, this would increase to three quarters of custom duties on January 1972, and full custom duties would be in effect before January 1973. The Commission perceived that the traditional resources would not be sufficient to finance the EC budget. Thus, it added a maximum of 1 percent of the VAT into the own resources system (COM, 1969a: 14-15).

3.2. The budget settlement at The Hague summit

For The Hague summit on 1-2 December 1969, the European Commission, supported by the 'Friendly Five', proposed a package deal which included the Communities' own resources system and the UK's accession into the EC in order to induce French concession on the British membership (COM, 1969d: 488, 1970a: 9, 1970b: 23, 1970d: 258; Financial Times, 11 November 1969). The

³² From 1 July 1962 to 30 June 1965, the European Community stipulated that the EC budget covered one sixth of eligible agricultural expenditure for the common market and prices policies and then increased the size of expenditure to two sixths and finally three sixths. The agreement of 11 May 1966 stipulated full support of the CAP from EC expenditure from 1 January 1970. See COM 1(1970e) and Ludlow (2006).

Friendly Five were more interested in British membership rather than in the own resources system. Their position on British accession was positive for three reasons (George and Bache, 2006). Firstly, they foresaw that with British net contributions to the Community budget there would be an easing of their own financial burden (Laffan, 1997). Secondly, they saw in the UK's accession a potential counterweight to the French dominance of the pace of European integration – particularly in the light of the 'empty chair' crisis and France's attempt to withdraw from NATO (Pilkington, 1995). Thirdly, they expected that the British membership would invigorate the EC economies against the economic recession of the late 1960s, through the opening of the British domestic market to the EC (George and Bache, 2006). On the contrary to this, France was more interested in the agreement of the EC's own resources system than discussing British membership. The own resources system was designed to finance EC expenditures which heavily converged upon financing the CAP. France supported the agreement of the own resources system in order to become a net beneficiary (Financial Times, 10 and 11 November 1969; George and Bache, 2006).

The Friendly Five, in particular The Netherlands and Italy, opposed the own resources system. The Dutch government argued that, since The Netherlands was a major importing state the own resources system would disproportionately increase the Dutch contribution to the EC budget through custom duties. The Italian government was displeased about its contribution because the EC expenditure on the CAP was not commensurate with financial benefits for the Italians (Financial Times, 9 December 1969).³³ The Friendly Five threatened France and demanded a concession on the British membership for agreement on the own resources system (Financial Times, 2 December 1969).

In the negotiation, the Pompidou government faced strong pressure from French farmers on the domestic front. France considered the merits of the Community's financial support on the CAP and concentrated on achieving the agreement of the own resources system (Financial Times, 2 December 1969). After being threatened by the Friendly Five the Pompidou government saw that

³³ Italy had a plan to finance its agricultural industry. The Italians' major products, wine and tobacco, were not supported by the CAP (Financial Times, 9 December 1969).

the British membership would increase the number of budget contributors for the EC's budget and boost the European economies. Firstly, with the financial system the Community budget would increase by approximately 50 per cent vis-à-vis its level in the 1960s; this meant that the UK would become a budget contributor. Through the UK becoming a budget contributor the financial burden of the Friendly Five would be lowered (the Friendly Five's views on financial burden sharing). Secondly, France believed that British membership could potentially lead to the creation of a large European economic entity which due to a better division of labour and a greater economic scale would bring significant benefits to its own economy also (Financial Times, 20 December 1969).

Consequently, France made a deal with the Friendly Five regarding British membership in exchange for an agreement of the own resources system. The agreement reflected the six founder member states' common position on British membership which would involve sharing the financial burden of the EC budget. Therefore, the six states agreed to adopt a financial treaty for the Community's own resources system to replace national contributions on 21 April 1970 before negotiations began with the candidates for the first EC enlargement in 1971: Britain, Ireland, Denmark and Norway (Young, 1973: 28). Due to this the new member states' contributions was regarded as a cost of their EC membership. The agreement clearly stated that the new member states' inclusion in the first enlargement must be on the basis of acceptance of the complete *acquis communautaire* (Financial Times, 2 December 1969; Preston 1995).

4. Negotiations of the UK's membership

This section focuses on the accession negotiations between the UK and the six EC member states. Britain's contribution to the budget was a main point of conflict: the UK tried to keep her contributions as low as possible, whilst the six founding members sought to impose higher level contribution on the UK in order to maximize their benefits from the British membership.

4.1. The UK's financial problems

An imbalance between the UK's contributions and benefits was generated through the agreement at the Hague summit (December 1969) and the creation of the own resources system (1970). Firstly, Britain's trade structure for industrial goods was heavily linked to non-EC countries, particularly Australia, Canada, New Zealand rather than the EC member states. The British trade structure would result in a large payment for custom duties under the CET (Young, 1973). Secondly, the UK was a relatively large agricultural importer of cheap foodstuffs from outside of the EC. In particular, the UK's trade in butter and sugar would cause a large contribution into the EC budget through agricultural import levies (Denton, 1984).³⁴ Finally, the VAT contribution was related to the EC member states' GNP. The Commission expected that high-GNP member states would have a high rate of VAT which was charged only on goods sold for the purposes of consumption. The VAT instrument was such that rich EC member states would contribute more than poor member states (Young, 1973). However, Britain had a relatively high ratio of private consumption compared to its GNP rate. This would mean that the British would contribute relatively high VAT payments compared to other member states (Denton, 1981).

Although under the own resource system Britain would expect to become the second-largest contributor after West Germany; due to the British trade dependency on non-EC countries and its consumption pattern on the expenditure side it would receive few benefits (Laffan and Lindner, 2005). Under the agreements of Council Regulation No. 25, about three-quarters of the EC budget would be allocated for financing the CAP in order to increase agricultural productivity, to support the living standards of the agricultural community, and to support farm prices (Young, 1973: 64-65; Godley, 1980: 74). However, Britain's small agricultural sector, and the small numbers employed in agricultural industries, would bring about British problems in terms of too few benefits from

³⁴ Since 1962, the UK had guaranteed the British butter import quota to New Zealand. The quota represented roughly 440,000 tons of butter, about 85 per cent of New Zealand's products in a year (Pisani, 1969; O'Neill, 2000). Moreover, under a Sugar Agreement with the Commonwealth countries, the UK had promised to purchase a specific quantity of sugar at a special price which was fixed over a three-year period (Pisani, 1969).

CAP expenditure. In Britain, in 1967 the total size of agricultural holdings was about 17,500,000 hectares (about 1 per cent of total UK land area) and only 3 per cent of the total British population (about 750,000 people) were employed in agricultural industries. This would mean that Britain was a long way from being a net beneficiary of CAP expenditure (Pisani, 1969).

Table 3.1 The expectation of the British net balance in 1978, million of £

	Britain	The Six	Other Three Applicants	Total
Total payment	572.9	1,202	100	1,875
Levies	183.3	208.3	50	990
Duties	291.6	545.8	130	2,140
VAT	97.9	447.9	25	570.8
The Community repayment	104.1	1,597.9	89.5	1,791.6
Net balance	-468.7	+395.8	-10.4	+83.3

Source: White Paper 1970: Britain and the European Communities. An Economic Assessment (H.M.S.O)

The British government's White Paper in 1970, as shown in Table 3.1, clearly set out the expectation that there would be a UK imbalance between contribution and benefits in 1978.³⁵ With regard to British contributions, due to imports of agricultural products from non-EC countries, the British government presumed that agricultural levies in the UK would be £ 183.3 million despite the six founder EC member states paying £ 208.3 million. The paper expected that although the British trade structure with the outside of the Community on industrial products would progressively diminish, and the UK's intra-EC trade would increase, British trade with non-EC countries would still be retained. Thus, the paper

³⁵ The financial treaty in April 1970 stipulated a schedule for the EC's own resources system. Agricultural levies and custom duties would start from 1975 and during 1970-1975 the national contribution would finance a shortage in the Community budget. From 1975, the national contribution would be progressively replaced by VAT and, in 1978, the own resources system would completely replace the national contribution. See COM (1970f).

expected that Britain's payments on custom duties would be £ 291.6 million compared with 'the Six's' payment of about £ 545.8 million. Furthermore, the paper considered the British consumption pattern and predicted that on VAT, Britain would contribute £ 97.0 million compared to 'the Six's' £ 447.9 million, approximately. The total of the British contribution to the EC budget would be £572.9 million whilst the contribution of the six founder EC member states would be £ 1, 202 million, that of other applicants would be £ 100 million, and the total of the Community budget would be £ 1, 875 million. The figures in the White Paper distinctly indicated that, under the own resources system, Britain's contribution would be much higher than that of other EC member states (Young, 1973; Begg and Grimwade, 1998; Gowland and Turner, 2000).

On the Community expenditure side, the EC would allocate £ 1, 562.5 million for CAP expenditure and would add £ 104.1 million to cover the wine policy. £ 208.3 million would be due for non-agricultural expenditures. Regarding the Community's expenditure plan, Britain would receive £ 104.1 million, whilst the six founder member states would obtain £ 1, 597.9 million and other applicants would be supported to the tune of £ 89.5 million. Thus, the UK's net balance would be £ - 468.7 million while 'the Six's' would be £ 395.8 million and 'other applicants' would be -£10.4 million (Young, 1973: 38-40). The White Paper clearly envisaged that there would be little benefit from the Community budget expenditure while it would pay a high proportion of the Community budget contribution under the own resources system. Therefore, the UK had a problem with the imbalance between net contributions and receipts in the EC budget.

4.2. Negotiations of the British membership

Negotiation for British membership between Britain and the six founder EC member states opened in June 1970 and an agreement was reached regarding British accession in June 1971. In negotiations, the Heath government concentrated on the UK's large payment to the EC budget, the length of transitional period and the Commonwealth question (Preston, 1997; Kitzienger, 1973).

In the opening negotiation in June 1970, the Heath government

complained about the British financial contribution. The government argued that the UK would contribute about 21.5 per cent (or up to 25 per cent) of the total EC budget based on the 1970 White Paper, and required a lightening of its contribution. The six founder member states, particularly France, specifically argued that the British contribution was not negotiable (Preston, 1997). After the rejection of the reduction of the overall British contribution, Britain changed its approach which paid attention to the issues of the transitional period and questions about the Commonwealth for reducing its contribution instead of directly focusing on the size of the contribution.

First of all, in the autumn of 1970, the Heath government issued an extension of the length of the transition period in order to have sufficient time to change the British trade structure to fit into the own resources system and to delay full payment of its contribution (Lord, 1993). Initially, the Council stipulated a 5-year transitional period for all the applicants to adopt the new rules of the EC (COM, 1970b; COM, 1970d). During the transitional period, Britain's contribution would be 10-15 per cent of the EC budget in the first year and would steadily increase by 2.5 per cent each year. The UK's full payment would reach about 20-25 per cent of the EC budget at the end of the transitional period. The Heath government, however, demanded an 8-year transitional period, comprising a 3 years for the introduction of industrial free trade and 5 years for the adoption of the CAP. The government also argued that Britain wanted to contribute just 3 per cent of the EC budget for the initial British payment during the transitional period. At the end of an 8-year transitional period, the full British payment would be achieved but it would be smaller than the Commission's expectation (Lord, 1993; Preston, 1997).

Secondly, during negotiations in January 1971, the Heath government required a concession from the six founder member states on its special relationship with the Commonwealth countries in agricultural trade in order to stabilize agricultural prices in the British domestic market and to reduce its contribution under the own resources system. The government argued that Britain's disproportionate payment for the EC budget derived from the British trade structure with non-Community countries. In particular, over 40 per cent of

British trade depended on cheap agricultural imports from Commonwealth countries (Northedge, 1983). Even though Britain's importing of agricultural products caused the increasing of the UK's contribution through agricultural levies, it would be difficult to change the British trade with the Commonwealth countries to stabilise the agricultural price in the domestic market (Young, 1973). The Heath government, particularly, demanded a special agreement to exclude its trade in dairy products with New Zealand and in sugar with the Commonwealth countries from inclusion in agricultural levies (Lord, 1993).

For the six founder EC member states, it was very difficult to accept the British demands, because that would dilute the purpose of the six founding member states' acceptance of the British membership, that of imposing the British financial contribution. The six founder member states had different opinions regarding the large imbalance between the UK's contributions and benefits. On the extension of transitional period, the European Commission and France defined the purpose of the transitional period as giving time to new applicants to adjust to the new Community rules, but time was limited. Thus, they argued that they would not accept any extension of the length of the transition period for the UK beyond a 5-year span and that the length of the transition period must be the same for all the applicants (COM, 1970b; COM, 1970; Lord, 1993). By contrast, the Friendly Five, in particular Italy and the Netherlands, understood the British financial problems and supported the 8-year transitional period (Preston, 1997). Furthermore, on the issue of the rate of the British payment during the transitional period, France's position was that the UK would have to immediately pay its full contribution as soon as it became a full member of the EC. Belgium, Italy and the Netherlands were agreeable to a low starting-point. In particular, the Netherlands suggested a starting rate at 5 per cent of the EC budget and increasing to 17.5 per cent. Belgium suggested starting at 7.5-9.5 per cent and increasing to 17.5-19.5 per cent. Finally, the Friendly Five agreed on a suggested starting rate of 5-10 per cent (Young, 1973).

On the British demand for a special agreement on trade, the six founder member states did not allow any concession on dairy products and sugar. They pressured Britain to change the structure of Britain's trade from non-EC countries

to the EC member states. The European Commission shared the opinion of the six EC founders and argued that the UK should progressively reduce its special arrangement with the Commonwealth countries during the transitional period if it wanted to reduce its contribution (Lord, 1993).

It was difficult to achieve an agreement in the negotiation of the British membership without concession by Britain or the six founder member states over the British contribution. In particular, Britain and France's positions brought about anxiety that the negotiation of the British membership might fail as it had done twice before. The two governments agreed to arrange a bilateral summit between Heath and Pompidou on 11-12 May 1971. During the bilateral summit, the Heath government made a significant concession by accepting to immediately open the British domestic market to EC agricultural products if the negotiation of the British membership successfully came to an agreement. The Pompidou government also agreed to reduce the starting rate of the UK's contribution to around 10 per cent of the EC budget (Kitzinger, 1973; Lord, 1993).

Finally, on 23 June 1971, after marathon negotiations, the new applicants and the six founder EC member states announced the increase in number of EC member states from 1973 through the first enlargement: Britain, Denmark and Ireland. The agreement stipulated that all new member states were to be given a 5-year transitional period in order to adopt the Community rules and financial system. During the transitional period, the UK would pay 8.64 per cent of the EC budget in 1973 and the British contribution would gradually increase to 18.92 per cent in 1978. Moreover, Britain agreed to reduce its agricultural trade with non-Community countries during the transitional period (Paxton, 1976). Regarding the outcomes of the negotiation of the British membership, it could be said that the Heath government reduced the British contribution but the contribution was much higher than the level of British benefits. The British problem still remained due to Britain's imbalance between its large payment to the EC and few benefits from EC expenditure. In the negotiations over the UK's imbalance, the Heath government concentrated on its membership for his political ambition³⁶ rather

³⁶ The Heath government's political ambition consisted of two factors: seeking a new market and finishing a political debate on Britain's membership. First of all, the government's pro-

than reducing Britain's financial imbalance contribution, as confirmed by Sir Con O'Neill (cited in Lindner, 2006: 117), who was the senior official in the negotiating term:

The British Prime Minister Edward Heath, who had been chief negotiator during Britain's failed bid for EEC membership in the early 1960, put British accession high on the political agenda of the Conservative government that took office in 1970. He attached much personal political capital to this mission and was determined to complete the negotiation rapidly. He believed that Britain's bargaining position would be much improved once it became a full member. He was willing to accept temporary agreements and to defer problems to later negotiations.

At the time, most of the EC budget was used to finance the CAP and could be said that there were no EC expenditure policies to visibly support the UK. However, at The Hague summit in 1969, the European Commission had proposed the creation of the European Regional Development Fund (ERDF), but this was not actually created until 1973. The expectation was that the UK would receive financial benefits from the ERDF, but there was some uncertainty regarding this.

5. The British financial problem under Labour governments

Although Edward Heath considered Britain's EC membership a political success, the British financial problem continued to cause political conflicts between the UK and other EC member states. This section sheds light on the behaviour of the two Labour governments that followed the Heath government. The Wilson and Callaghan governments concentrated on the British financial problem through a renegotiation of Britain's EC membership terms, which constituted an initial stage of the settlement of the subsequent UK rebate (Baker and Seawright, 1998).

European approach was based on its economic liberalism which sought a new market of Europe. Secondly, the government demanded to finish a long political debate on the membership. Due to the political ambition, Heath said that the membership was the party's goal which could change with any political price. See Morris (1996).

5.1. Renegotiation in the Wilson Government (1974-1976)

The Labour party, under Harold Wilson's leadership, won two general elections in February and October and 1974.³⁷ Ironically, although in the first term (1964-1970) as Prime Minister Wilson was a strong supporter of European integration and had attempted to apply for Britain's EC membership in 1967; in his second term of government he was lukewarm towards European integration (George, 1998; Geddes, 2004). This change of attitude was mainly due to the left wing's dominance in the Labour party of the government.³⁸ The dominance of the left wing had been evident since the defeat of the 1970 general election. The left wing, which consisted of anti-Marketeters, held pro-Marketeters to account on losing the government and entered the leadership group of the party (George and Haythorne, 1996: 114; Forster, 2002: 28-29). The left wing criticised membership of the EC as being an implicit retreat from socialism, which was the Labour party's main ideology. The common market, and further supranational European integration on economic and monetary issues, would threaten the British government's power over the economy, which was seen as an essential condition of the Left's state-directed capitalism. The members of the left wing occupied many leading positions in the Wilson government and contributed to Britain's EC policies.³⁹ They opposed British membership and criticized Wilson and the right-wing's ideas about European policies within Labour (Bilski, 1977; George, 1998). The Wilson government saw in the left wing an attempt to politically ally with the Conservative anti-Marketeters, who aimed to pressure the Wilson government to change its EC policies (Forster, 2002b).

³⁷ There were two general elections, in February and October 1974. On 28 February 1974, the Labour party won 301 seats which was 17 seats fewer than an overall majority. The Labour party joined up with the Liberals under Jeremy Thorpe to form a coalition government. Wilson returned for a second term as Prime Minister. The Wilson government called the general election on 10 October 1974 and won a tiny majority of three.

³⁸ In the 1960s and 1970s, on the issue of Britain's EC membership, the Labour party was divided along left-right lines. The left wing consisted of the anti-Marketeters who opposed membership and the right wing was a group of pro-Marketeters who supported membership. See Bilski (1977).

³⁹ The left-wingers Callaghan and Shore were appointed Foreign Secretary and Secretary of State for Trade respectively (George, 1998).

The Wilson government called a national referendum on Britain's EC membership: a successful referendum would imply not only a clear endorsement of British membership of the EC but would also represent a method to prevent a division of the Labour party between right wing and left wing regarding Britain's EC policies. Furthermore, it attempted to use the national referendum to pressure the EC to arrange a renegotiation of Britain's financial contribution to the EC budget whilst at the same time planned to use the renegotiation as a part of the referendum campaign. It assumed that if the renegotiation failed, the British people would vote for a withdrawal of the UK from the EC, which in turn would put significant pressure on the EC to resolve Britain's financial problem. If other EC member states conceded to reducing the Britain's imbalance on the budget, the renegotiation would help persuade the public and eurosceptic members of the left wing in the Labour party and anti-Marketees in the Conservative party (Bilski, 1977; Ørstrøm, 1982; George, 1998; Forster, 2002; Gowland *et al.*, 2010).

The Wilson government appointed the Foreign Secretary, James Callaghan, to play a leading role in the renegotiation. Callaghan was a left-winger who supported Atlanticism and criticised European integration. He identified several issues which generated discussions on the UK's EC membership within the Labour party, the most important of which was the size of British contribution to the EC budget.⁴⁰ In June 1974, the Wilson government argued that the British financial contribution would become unacceptably high at the end of the transitional period, and proposed to reduce its budget contribution (Denton, 1982). This argument was based on a paper which was produced by the British Treasury in May 1974. Although the left wing demanded emphasis on the British financial imbalance in the Community budget, the Treasury only calculated the UK's contribution compared to Britain's percentage share of GNP in the Community in order to avoid difficulties in the renegotiation with other EC member states (Command paper, 1975: 14; Emerson and Scott, 1977; George, 1998). The paper envisaged that, under the own resource system, the British contribution would

⁴⁰ The four issues were: allowing accession of Commonwealth countries' products, the freedom for the British government's to provide aid to national industry and to the regions without any 'interference' from Brussels, reform of the CAP, and the size of British contribution.

increase from 11 per cent of the Community budget in 1974 to around 18.92 per cent in the transitional period, at the end of the period in 1978, and then would be increased to 21 per cent by 1979, and further increase to 24 per cent in 1980, even though Britain would share only 14 per cent of the Community's GNP (see Table 3.2.). The conclusion was that the UK's contribution was too high with regard to Britain's economy (Emerson and Scott, 1977: 212).

Both the European Commission and France openly opposed the Wilson government's argument on the British contribution. In November 1974, in response to the UK's argument, the European Commission presented its own paper, arguing that the Wilson government's predictions, based on data from 1973 or 1974, could not provide accurate figures of the British contribution in 1979-1980 (see Tables 3.3 and 3.4). France, under President Giscard d'Estaing, argued that the British calculation was flawed because it counted all Community resources including agricultural levies, customs tariffs and VAT as part of the British contribution. He said that agricultural levies and customs tariffs were the Community's own resources, and thus, the national contribution was only represented by VAT revenues (Dodsworth, 1975; Emerson and Scott, 1977; Jenkins, 1980).

Table 3.2 Simulated breakdown of the financing of the budget under the definitive own resources system, 1973 and 1974

		Agricultural levies and sugar contributions		Customs duties		VAT		Total	
		million u.a.	%	million u.a.	%	million u.a.	%	million	%
Denmark	1973	5	0.9	39	1.9	65	2.8	109	2.2
	1974	7	2.0	50	2.0	64	2.9	120	2.4
Germany	1973	144	26.6	621	30.7	749	32.4	1514	31.0
	1974	118	35.4	711	29.0	679	30.8	1509	30.2
France	1973	87	16.1	329	16.3	481	20.8	897	18.4
	1974	72	21.5	371	15.1	466	21.1	908	18.2
Ireland	1973	3	0.7	10	0.5	18	0.8	32	0.7
	1974	3	1.0	8	0.4	18	0.8	30	0.6
Italy	1973	127	23.4	236	11.7	305	13.2	668	13.7
	1974	53	16.0	307	12.5	302	13.7	662	13.2
Netherlands	1973	94	17.4	197	9.7	134	5.8	425	8.7
	1974	22	6.7	239	9.7	128	5.8	389	7.8
Belgium- Luxembourg	1973	30	5.5	130	6.4	104	4.5	264	5.4
	1974	17	5.2	164	6.6	97	4.4	278	5.6
United Kingdom	1973	51	9.4	461	22.8	456	19.7	968	19.9

	1974	41	12.2	606	24.7	452	20.5	1099	22.0
Community	1973	541	100	2023	100	2312	100	4877	100
	1974	333	100	2456	100	2206	100	4995	100

<Source: the Command of Her Majesty 'Membership of the European Community: Report on Renegotiation' Her Majesty's stationery office (March 1975)>

Table 3.3 Simulated distribution of relative shares in the Community budget and GDP, 1973 and 1974

	Total budget contribution In million u.a.		Relative share In budget %		Relative share in Community (GDP)	
	1973	1974	1973	1974	1973	1974
Denmark	109	120	2.2	2.4	2.6	2.8
Germany	1514	1509	31.0	30.2	33.0	33.6
France	897	908	18.4	18.2	23.9	23.2
Ireland	32	30	0.7	0.6	0.6	0.6
Italy	668	662	13.7	13.2	13.2	13.2
Netherlands	425	389	8.7	7.8	5.8	6.0
Belgium- Luxembourg	264	278	5.4	5.6	4.5	4.7
United Kingdom	968	1099	19.9	22.0	16.4	15.9
Community	4877	4995	100	100	100	100

Source: Commission 'inventory of the Community's economic and financial situation since enlargement and survey of future developments' Bulletin of the European Communities (supplement 7/74)>

Table 3.4 Relative shares in resources derived from VAT, 1973 and 1974

Year	Denmark	Germany	France	Ireland	Italy	Netherlands	Belgium- Luxembourg	United Kingdom
1973	2.8	32.4	20.8	0.8	13.2	.8	4.5	19.7
1974	2.9	30.8	21.1	0.8	13.7	5.8	4.4	20.5

<Source: Commission 'inventory of the Community's economic and financial situation since enlargement and survey of future developments' Bulletin of the European Communities (supplement 7/74)>

The corrective mechanism

At the Paris summit in December 1974, the UK tried to negotiate a solution to its financial problem with other EC member states. The Wilson government argued that the UK might have to withdraw from the EC, unless other EC member states engaged in the renegotiation of its contribution to the budget – in fact, this was an important issue in influencing the British public about EC membership in the national referendum (Emerson and Scott, 1977). While France strongly opposed reducing the British contribution, other EC member states seemed more sympathetic and appreciated the political difficulties that the Wilson government had to face on the domestic front. In particular, the Chancellor of Germany,

Helmut Schmidt, was seriously concerned about withdrawal of the Labour government's EC membership, which would imply losing one of his socialist allies in the EC (George, 1998). Schmidt not only argued that Britain's demand on a balance between its contribution and receipts was reasonable but also attempted to persuade other member states to agree devising a 'corrective mechanism' in order to mitigate the financial burden of member states which were struggling with high budgetary contributions. This was a difficult task, particularly with France, but he was eventually successful. The Council, therefore, asked the Commission to produce a paper before the Dublin summit in March 1975 (Laffan, 1997).

In February 1975 the European Commission published a complex formula for a 'corrective mechanism', in which it stipulated three conditions to qualify for a rebate. First of all, the rebate would apply only to net contributors – Ireland and the Netherlands did not fulfil this condition because both were net beneficiaries through the CAP. Secondly, the rebate would apply to member states whose GNP growth rate was below 120 per cent of the Community average. Thirdly, the rebate would apply to member states which experienced a deficit on their balance of payments – a reference point was designed in which a gap between a member state's percentage share of budgetary payments and the Community average GNP would have to exceed 10 per cent of the share of the Community average GNP (COM, 1975). The Commission designed the second and third conditions in order to prevent prosperous member states from applying for a rebate. If a member state qualified on the three conditions, its rebate would be calculated with reference to the gap between its total payments and its percentage share of the EC's average GNP, but would not exceed the member state's VAT contributions (Denton, 1982; George, 1998).

At the Dublin summit on 10-11 March 1975, the EC member states agreed the 'corrective mechanism', which for most implied an increase of their contributions. The member states made financial sacrifices in order to prevent the withdrawal of the British membership (George, 1998: 86; Emerson and Scott, 1977: 217). The UK met the three conditions of the 'corrective mechanism' and obtained its rebate. It was a net contributor and the British growth rate of GNP

was below 120 per cent of the Community average. It contributed 21 per cent of the Community budget, but represented 15.9 per cent of the EC's GNP. The gap between the British percentage share of budgetary payments (21 per cent) and the Community average GNP (15.9 per cent) exceeded 10 per cent of the British percentage share of the EC's GNP. Therefore, the British rebate was accounted at £125 million, considering the size of the gap between the British percentage share of budgetary payments and the community average GNP in 1975 (Emerson and Scott, 1977; Strasser, 1981). The corrective mechanism had a positive effect on the referendum held on 5 June 1975: 17,378,581 people voted for continued British membership (67.2 per cent) against those who voted for a 'withdrawal' 8,470,073 (32.8 per cent).

5.2. Britain's budget deficit in the Callaghan Government (1976-1979)

James Callaghan, who was the Foreign Secretary in the Wilson government, became Prime Minister when Wilson resigned in March 1976. Although Callaghan was a member of the left wing in the Labour party, due to the outcome of the British referendum in 1975, it was politically difficult to repeatedly question Britain's EC membership. However, the Callaghan government could not overlook the problem of Britain's financial contribution: the Wilson government had obtained a cash rebate which reduced Britain's sizeable payment to the EC budget, yet the Callaghan government experienced a significant budget deficit in the late 1970s. In 1976 and 1977, even though the UK received about £125 million of cash rebate per year, Britain's budget deficit amounted to about £423 million per year. The Economic Policy Committee of the EC envisaged that in 1980, the UK would have a deficit of around £800 million, in spite of the cash rebate of about £160 million (George, 1998; Forster, 2002; Geddes, 2004).

The Callaghan government argued that one of the causes of the UK's budget deficit was the imbalance between its GNP and its payments to the EC budget, which was still considered to be too great, despite the fact that the UK now received a cash rebate (Lindner, 2006: 119). At the annual Lord Mayor's banquet

in the Guildhall in London⁴¹ on 13 November 1978, Callaghan stated that under the own resource system, the UK's percentage share of the Community budgetary payment showed the third highest figure behind West Germany and Belgium in 1976 and the second highest figure just behind West Germany in 1977, and that by 1980 the UK would become the largest net contributor to the EC budget. By contrast, the UK was ranked seventh of the nine EC member states in terms of economic growth. These figures indicated the size of Britain's financial imbalance, which caused the significant budget deficit (The Times, 14 November 1978).

The reasons behind Britain's large contribution to the EC budget were mainly two: its trade relationship with Commonwealth countries and the high ratio of VAT revenue. Firstly, the UK continued to depend on the Commonwealth countries for its agricultural products. Although Britain's trade with EC member states was predicted to increase from 25 per cent of British total trade in 1973 to about 43 per cent in 1979, the percentage of Britain's trade had been consistently below the average percentage (about 50.8 per cent) of the founding member states (Vanden Abeele, 1982). The high percentage of British trade with Commonwealth countries caused an increase in the UK's contribution through agricultural levies (Young, 2004; Donoghue, 1987). Secondly, the high ratio of VAT revenue was another reason for the high British contribution to the EC budget. The existence of North Sea oil in the UK not only provided a windfall profit to the British Treasury, which maintained a low level of personal direct taxation, but also kept the pound's value high, which caused low prices for imports entering the British domestic market. These factors led to high expenditure by British consumers, which in turn increased Britain's contribution through VAT revenues. In comparison, the UK's economic growth was not enough to support Britain's large payment (The Times, 14 November 1978; George, 1998; Forster, 2002; Young, 2004).

When the Labour party won the general election in February 1974, the UK was still experiencing economic difficulties in recovering from the recession which resulted from the increase in oil prices since 1973, despite the existence of

⁴¹ The annual Lord Mayor's Banquet at the Guildhall is a traditional location for the Prime Minister to make a speech about a major foreign policy initiative. It is also an opportunity for the Lord Mayor of London to plan the city's policies following Britain's foreign policy.

North Sea oil. Under the Wilson government, in March 1974, the Treasury believed that the devaluation of the pound would boost the competitiveness of British products in the international market. The Treasury initially planned to devalue the pound by 5 per cent, but the devaluation not only boosted price competition in the international market, but also brought about an economic recession which in turn necessitated Britain's application to the International Monetary Fund (IMF) for a loan of £3.9 billion in December 1976. The Callaghan government struggled to overcome Britain's economic recession (Harmon, 1997; George, 1998). On 14 November 1978, it was the Foreign Secretary David Owen who described the Callaghan government's position on Britain's financial problem. He said that Britain was already the second highest net contributor even though it had the third lowest economic growth in the Community. For this, the UK's contribution was unacceptable (The Times, 14 November 1978).

At the Paris summit in March 1979, the Callaghan government focused on the change of existing rules to correct Britain's financial imbalance. The agreement in 1975 was a correction of the UK's imbalance in the *gross-contribution*,⁴² but did not solve the UK's large payment to the EC budget, which ultimately generated a budget deficit. Hence, in order to reduce the UK's contribution, the Callaghan government asked for a correction of Britain's imbalance between its sizeable contribution and few receipts from the EC budget, i.e. the *net-contribution* (Lindner, 2006: 120). The government particularly pointed at CAP expenditure, which in 1979 accounted for two-thirds of the EC budget. Although British farmers also received benefits from the CAP, the numbers of farmers benefitting from it in the UK were smaller than in other member states (Jenkins, 1980: 496). Furthermore, because Britain was not an exporter of agricultural products to the international market, the UK could not receive large benefits from the export subsidies in the CAP which aimed to compensate farmers for the difference between the international market price and the guaranteed price (Donoughue, 1987: 63). The Callaghan government argued

⁴² The *gross-contribution* is the gap between EC member states' GNP and contribution. The *net-contribution* is the gap between contributions and receipts from the EC budget (Lindner, 2006).

that the reduction of the CAP expenditure in the EC budget would be able to satisfy Britain's demands (Werts, 1992: 268).

These proposals met with opposition from the other EC member states, which ultimately wanted to prevent an increase in their financial contribution to the EC. France argued that the British deficit had nothing to do with the EC, but actually resulted from Britain importing products from the Commonwealth instead of from the European Community. Furthermore, the British VAT payment was caused by the UK government's poor financial control. Therefore, France argued, if the UK wanted to reduce its contribution, it would have to change its trade patterns and pay more attention to its finances rather than demanding a reduction of its financial contribution to the EC (George, 1998: 134).

Although the Callaghan government had threatened to block the price-setting of the CAP, this never reached the EC negotiating table due to his defeat at the 1979 general election. In the election campaign, both the Labour and Conservative parties had some provisions on the Britain's financial problem and the creation of the Exchange Rate Mechanism (ERM)⁴³ in their manifestos. Both parties had a similar approach, sharing the view that the UK's financial contribution needed to be cut (Gowland *et al.*, 2010: 88-89). However, while the Conservative party supported the ERM in line with its economic liberalisation approach, the Labour party was much more sceptical, arguing that the ERM would threaten Britain's national economic sovereignty and ultimately lead to the creation of a 'federal Europe' (Gamble, 1998). In the election, the Labour government was beaten and the EC budgetary problem was handed over to the new Conservative government (Denis and Derbyshire, 1988).

6. The settlement of the UK's rebate in the Thatcher government

This section proposes to examine the progress of the settlement of the UK's

⁴³ The collapse of the Bretton Woods system in 1971 resulted in the EC's design of the EMS for promoting monetary stability within the EC. At the Copenhagen European Council in April 1978, the Commission proposed the floating exchange rate arrangements. See Gowland (2010).

budget rebate under the Thatcher government. In the early stages of Thatcher's premiership, this was a very prominent issue, which was raised in several European summits. At the Fontainebleau European Council in June 1984, a rebate mechanism was introduced through agreement with the member states. This section concentrates on the Thatcher government's negotiations on the settlement of the UK's rebate in terms of political dynamics rather than providing a technical explanation of the rebate mechanism.

6.1. Economic recession and financial imbalance

Margaret Thatcher became the leader of the Conservative party in January 1975. Under her party leadership (1975-1979), the Conservative party opposed the then Labour government's EC policies, particularly the renegotiation of Britain's EC membership (Heffernan, 2000).⁴⁴ These views were clearly expressed by Thatcher (cited in Wall, 2008: 5) during their electoral campaign for the 1979 general election:

It is wrong to argue, as Labour do, that Europe has failed us ...what has happened is that under Labour our country has been prevented from taking advantage of the opportunities which membership offers.

When the Conservative party won the general election in May 1979, the heads of the EC member states expected that the new government would adopt more pro-European policies than its predecessor and that it would not raise the issue of Britain's financial contribution to the EC budget (Lindner, 2006: 120). However, Thatcher's European approach was different from that of her Conservative predecessor Heath, who had accepted a budgetary imbalance in 1971 in order for

⁴⁴ Under the Wilson government, political parties had a chance to express their positions about Britain's EC membership in a vote in Parliament on 9 April 1975 prior to the national referendum on 5 June 1975. The outcome of the vote was that a 396 majority voted in favour of acceptance of membership against 172 voting for a withdrawal of Britain from the EC. Under the Thatcher leadership, eight out of 275 Conservative MPs voted in favour of acceptance. The Conservative party's vote was the result of its opposition to the Wilson government, in line with the adversarial British political system, and general attitudes of the party's pro-European approach which was based on its neo-liberalism. See George (1998) and Norton (1990).

the UK to become a member of the EC, and from that of the Labour Party; and she expressed this very clearly (cited in Wall, 2008: 10):

That is our money which the previous government would have left us to pay to Europe but for our negotiations. They talked a lot about it but did absolutely nothing... We regard it as urgent to achieve a full and satisfactory solution.

The UK's financial problem was soon raised to the EC and they were left in no doubt as to the new government's attitude. The Thatcher government had to urgently solve Britain's financial problems in the EC for two main reasons. First of all, there was criticism on the Thatcher government's pro-European approach from anti-Marketeters in the Conservative party, as well as the Labour party. In particular, anti-Marketeters in the Conservative party challenged the Thatcher government's pro-European approach and argued that the Conservative government should find a new way to implement their economic policies (Forster, 2002). This argument had already been made clear during the 1975 referendum campaign: the Conservative party's support for a 'yes' vote was criticised and there were even attempts to collaborate with the left wing of the Labour party. Then in the 1979 election campaign, they opposed the Conservative party's manifesto pledging Britain's membership of the Exchange Rate mechanism (ERM), which in their view threatened Britain's national sovereignty on monetary policy (King, 1977). Furthermore, they pressured the Thatcher government to pay attention to the economic costs of EC membership, which was highlighted by an increase in food prices and of the unemployment rate, and a negative impact on Britain's financial imbalance (Forster, 2002). Whilst, in the Labour party, the new leader Michael Foot⁴³ continued to lead the party's anti-European stance which was based on the Alternative Economic Strategy (AES)⁴⁵. The party continually argued for the withdrawal of Britain's membership. To the anti-Marketeters in the Conservative party and the Labour party, Britain's financial problem was an ideal

⁴⁵The Alternative Economic Strategy presented that Britain's membership would prevent the party's policies on import controls and public ownership. See Forster (2002).

opportunity for both opponents to criticise the Thatcher government's pro-European approach. In order to avoid the criticism, the Thatcher government paid attention to solving its financial imbalance (Forster, 2002: 72).

Secondly, the failure of the Conservative government's economic policies made the financial problem even more salient. When the Thatcher government started its mandate in 1979, the British economy was hit by the world recession which had been sparked off in 1979 by the oil crisis. The new government immediately introduced a number of deflationary measures: the reduction of personal income tax, an increase in VAT from 8 per cent to 15 per cent, and an increase of interest rates from 12 per cent to 17 per cent, in order to smoothly manage monetary flow in the domestic market. However, the new government's deflationary policies ran into the world recession and the high value of the pound, producing adverse effects which brought about a serious depression of British economic activities; in particular increased bankruptcies of companies and a high rate of unemployment (George, 1998). The depression of British economic activity saw low government popularity in the opinion polls. The Thatcher government faced serious problems in implementing its policy of reducing public expenditures, which aimed to reduce the intervention of the government in accord with market liberalism in its economic programmes. The government decided to gradually reduce public expenditure and simultaneously started to reduce its expenditure in every possible area. This domestic political situation forced the Thatcher government to concentrate on its contribution to the EC budget (Heffernan, 2000: 29; George, 1998: 145).

When the government examined the issue of the British contribution to the Community's budget, the Chancellor of the Exchequer, Geoffrey Howe was 'shocked' by the size of Britain's contribution, which was far greater than he had expected (George, 1998: 137). Margaret Thatcher argued that, while the British public shared the financial burden in the form of reduction of public spending, the size of the British financial contribution to the Community expenditure programmes was an unacceptable waste of British taxpayers' money. The UK would concentrate on solving the problem through the settlement of the rebate system and an increase in the size of the UK's rebate (Thatcher, 1993: 79, 81).

The Thatcher government, thus, put the problem of the British financial contribution at the top of its European agenda and engaged in negotiation for the next five years (Thatcher, 1993: 79, 81; Lindner, 2006: 120).

Table 3.5 UK contribution to and receipts from the EC budget, 1981-84

	Million ECUs				£ million			
	1981	1982	1983	1984	1981	1982	1983	1984
Harmonized VAT Bases								
EEC	1,152,602	1,291,259	1,372,710	N/A				
UK	194,180	298,386	292,560	N/A				
Community VAT Rate (%)	.8667	.9248	.9980	N/A				
GROSS CONTRIBUTION								
Agricultural and sugar levies	395.5	548.3	394.9	491.6	218.2	307.3	231.7	284.2
Customs duties	1,550.9	1,784.5	1,832.5	1,920.0	860.5	1,001.0	1,075.1	1,109.8
VAT	1,930.8	2,782.7	2,844.6	2,918.5	1,095.2	1,554.4	1,668.9	1,687.0
TOTAL	3,877.2	5,115.5	5,072.0	5,330.1	2,173.9	2,862.7	2,975.7	3,081.0
RECEIPTS								
Own resources refund	190.2	236.3	221.2	241.0	113.5	133.7	129.5	139.3
EMS interest rate subsidies compensation	39.3	48.2	36.6	-	21.2	32.5	21.5	-
UK refunds	1,248.4	1,819.2	1,399.6	991.0	693.0	1,019.4	807.2	572.8
Other receipts	1,716.9	1,913.4	2,270.7	2,855.0	948.8	1,071.9	1,332.2	1,650.3
TOTAL RECEIPTS	3,194.8	4,017.1	3,928.1	4,087.0	1,776.5	2,257.5	2,290.4	2,362.4
NET CONTRIBUTION	-682.4	-1,098.4	-1,143.9	-1,243.1	-397.4	-605.2	-685.3	-718.6

<Source: House of Common 'Seventh Report from the Treasury and Civil Service Committee, Session 1983-84' (9 July 1984) (London: HMSO)>

6.2. The 'May Mandate'

At her first summit in Strasbourg in June 1979, Mrs Thatcher brought Britain's financial problem to the negotiating table. Following a brief discussion, an agreement was achieved to further discuss it at the European Council in Dublin in November 1979, on the basis of a report that the European Commission would prepare by September 1979 which would be first scrutinised by the Finance Ministers of the EC member states (George, 1998; Lindner, 2006). The Commission proposed to revise the 1975 rebate mechanism in order to increase the British cash rebate to the level of £ 350 million and to increase the share of EC expenditure to Britain by means of regional aid (Vandan Abeele, 1982).⁴⁶ The

⁴⁶ Regional aid proposed to reduce regional disparities between the member states in the European Community and was established by the Treaty of Rome in March 1957. In the two Paris summits of 1972 and 1974, the member states agreed to establish the European Regional Development Fund (ERDF). In 1975-1978, the EC member states set out national quotas for the

Thatcher government welcomed this general approach, but was not satisfied with the size of the cash rebate. In fact, they demanded a cash rebate of £ 1 billion and that a permanent solution to Britain's budgetary problem be found. These requests met with strong opposition from France, whose President, Valéry Giscard d'Estaing, argued that the UK's rebate should not exceed £ 350 million (Jenkin, 1980: 497). Mrs Thatcher's response was clear: 'We want our money back' (Thatcher, 1993: 79). The other heads of state and government regarded Mrs Thatcher's statement as a direct attack upon the own-resource system. The conflict between the UK and the other member states resulted in deadlock. At the Luxembourg European Council in April 1980, the European Commission proposed various formulas for calculating Britain's rebate, but none of them could satisfy Britain's demand for £ 1 billion. The negotiations at the Luxembourg European Council, inevitably, failed again (Lindner, 2006; George, 1998).

Although it was proving to be difficult to achieve agreement between the EC member states, the Thatcher government got a chance to overcome the deadlock at the Agricultural Council in May 1980. At the meeting, national Foreign Ministers and Ministers of Agriculture discussed the Commission's proposal for the prices of agricultural products for 1980-1981. In the proposal, the prices were lower than what some member states demanded,⁴⁷ which in fact asked for Britain's support to set prices⁴⁸ at a higher level than what the European Commission had proposed (Butler, 1986). The Thatcher government initially opposed the increase of agricultural prices: firstly, the Thatcher government's ideology of market liberalisation opposed agricultural protectionism, which meant that the EC would intervene in agricultural prices to protect farmers' incomes; secondly, the increase in prices would probably lead to an increase of Britain's

allocation of the ERDF. The Commission's proposal in 1979 indicated the increase of British national quotas in the allocation of the ERDF. See Allen (2005) and Conzelmann (2006).

⁴⁷ France, West Germany, Ireland, Italy, and the Netherlands were beneficiaries from the CAP and supported high prices for agricultural products in 1980. See Fouilleux (2007).

⁴⁸ In the decision-making over agricultural prices in 1980, EC member states could use Qualified Majority Voting in order to decide the price if member states satisfied the price recommendations of the Commission. However, member states desired higher prices than the Commission's proposal. The decision over prices required a unanimous decision. See Lindner (2006).

financial contributions to the EC budget (Butler, 1986).

The Thatcher government held that its consent on the increase of agricultural prices and the other member states consent on the increase of the UK's rebate were connected. This was meant to coerce Britain's partners at the negotiation table to make concessions for the increase of the UK's rebate (Lindner, 2006: 121). When faced with these threats from Britain, the other member states were divided. In particular, France was concerned about strong domestic pressure from the national farmers' union, which demanded a significant increase in agricultural products' prices in order to relieve farmers' struggling with the high rate of inflation (Jenkins, 1980). The Thatcher government insisted that Britain would not agree a decision on the CAP until the UK's financial problem was solved by a concession from its negotiating partners. Eventually, the EC member states reached agreement on a formula for the reduction of the UK's contribution in 1980 and 1981 on 30 May 1980, also known as the 'May Mandate'. Although the size of the rebate was less than the £ 1 billion which had been the initial demand from the Thatcher government, the UK obtained about £ 0.6 billion and £ 0.7 billion in 1980 and 1981 respectively under *ad hoc* shadow spending programmes. The EC member states, however, did not come to an agreement on a permanent solution to Britain's financial problem (Jenkins, 1980; Lindner, 2006).

6.3. An attempt to reach settlement of the UK's rebate mechanism

In June 1981 the European Commission presented a report on how to revitalise the Community, suggesting the development of new policies: economic, monetary, energy, industrial, research, regional, and social policies. It suggested the establishment of a new corrective financial mechanism to solve the UK's financial problem. In a more detailed plan presented to the Council in October 1981, the European Commission proposed a limit on CAP spending (by reducing subsidising agricultural prices for 1982-1983), and a corrective financial mechanism for solving the UK's problem. The proposal sparked off; once again, a disagreement between the UK and the other member states (Vanden Abeele, 1982).

At a meeting of the Foreign Ministers in January 1982, France and Italy strongly opposed the changes to the CAP, whereas the other member states agreed

with the Commission's view. In particular, the UK saw the reform of the CAP as a possible solution to reduce the UK's imbalance between contributions and receipts, but also argued that for the overall development of the EC it was essential to reduce CAP spending (Taylor, 1983). Regarding the settlement of the rebate mechanism for solving the UK's financial problem, a number of the member states, most notably France, continued to argue that the UK itself bore responsibility for its financial problem (Vanden Abeele, 1982). The overall position of the EC member states (except the UK, of course) was that the Commission's proposal for the new direction of EC spending policies would significantly benefit the UK rather than all member states, and for this reason they were unwilling to accept the Commission's proposal. The Thatcher government, thus, tried to make a linkage between the settlement of the rebate mechanism and the reform of the CAP to achieve reduction of the agricultural price subsidy in 1982-1983 in order to overcome the other member states' resistance to the Commission's proposal, as the Conservative government had done in the 1980 negotiation (Neville-Rolfe, 1984; Lindner, 2006).

This time the EC member states did not accept Britain's linkage. Actually, they expected that the UK's would ask their support to impose a trade ban against Argentina, with whom they had started a war over the Falkland Islands.⁴⁹ They had planned to use Britain's demand to exchange for Britain's agreement on agriculture prices for 1982-1983 (George, 1998; Taylor, 1983). However, unexpectedly Britain did not ask for the EC's help. In May 1982, the UK agricultural minister continued to block agreement on agriculture prices in order to draw a concession from other member states on the settlement of the rebate mechanism. On 18 May 1982, in the Council of Agricultural Ministers, the Belgian presidency, instead of keeping to the tradition of consensual decision-making, called for a majority vote on the decision of the price levels in order to

⁴⁹ On 2 April 1982, Argentina invaded the Falkland Islands, which are located approximately 250 miles from the coast of Argentina, and represented a small remnant of the British Empire. In order to divert public attention from the deteriorating domestic economic and political situation and shift it to foreign affairs the UK decided to send an expeditionary force to the area in order to retake the island. The Argentine military forces finally surrendered on 14 June 1982. See George (1998) and Taylor (1983).

overcome Britain's block (Lindner, 2006).

The British government argued that the presidency decision to call a majority vote disregarded the principle of the 'Luxembourg compromise'.⁵⁰ Only two member states, Denmark and Greece (which meanwhile had become member of the EC), sided with the Thatcher government and argued that member states should be able to use the Luxembourg compromise to preserve their national interests. However, the other member states agreed with the Belgian presidency's decision, and voted against the UK. In particular, France insisted that the Luxembourg compromise was meant to protect member states when their vital national interests were threatened, but since Britain's vital interests were not involved in the setting of agricultural prices, there was no reason to apply the Luxembourg compromise (Lindner, 2006).

The attempt made by the Thatcher government to link the settlement of the rebate system for solving Britain's financial problem and Britain's agreement on the increase of agricultural price subsidies in 1982-1983 had been successful in 1980 but this time failed. This was because the Thatcher government had underestimated the other member states' position, and in this case they wanted to avoid an increase of their financial burden (Butler, 1986; Taylor, 1983). A week later, at a meeting of Foreign Ministers, the member states agreed to give the UK £ 500 million for 1982, but that amount was still lower than the £ 1 billion the UK had hoped for (Lindner, 2006). Thatcher seemed inclined to reject the compromise, but the Foreign Secretary, Peter Carrington urged her to accept it. The Labour party publicly blamed the government for its inability to find a solution, and even urged it to act tougher in the EC (Gowland *et al.*, 2010).

6.4. A successful negotiation on the settlement of the UK's rebate mechanism

In June 1983, the Thatcher government had another chance to take the settlement

⁵⁰ In 1966, under the Luxembourg Council presidency, the founder six member states agreed the Luxembourg compromise. The Luxembourg compromise mandated that, under QMV decision-making, if any member states argued that a decision would threaten their 'vital national interests', the Council would postpone a decision. The EC member states would not be able to take a decision unless the member states reached a unanimous agreement. See Peterson and Bomberg (1999).

of the UK's rebate mechanism to the EC negotiation table. At the European Council in Stuttgart on 19 June 1983, heads of government and state discussed the new direction of the European Community in response to the return to the Cold War in international affairs set in motion by the Reagan Administration.⁵¹ This raised concerns among the member states about the EC's foreign and defence policies and the EC's relations with the Soviet block, particularly the EC's export in high-technology goods and the dependence on Russian gas by several EC countries (George, 1998).⁵² At the Stuttgart European Council, the heads of government and state planned to 're-launch' the Community and to tackle the problems that had prevented further European integration. The heads of government and state planned to engage in 'major negotiations' over the following six-month period to deal with all those issues, and committed their ministers to present the outcomes of the negotiations to the European Council in Athens in December 1983 (COM, 1984: 7-8; George, 1998; Lindner, 2006).

The EC's budgetary reform was certainly one of the most important issues in these negotiations. This was because, by 1983, the member states recognised that the Community budget was almost exhausted by the CAP and that there was a need to increase the EC's budget to ensure adequate funding for other policy areas and prepare for Spain and Portugal's accession in 1986. To increase the budget, the Community needed to reform the own resources system, particularly raising the ceiling percentage rate of VAT, and for this the agreement of all member states was required. At the Stuttgart summit, the Thatcher government had argued that the UK was not prepared to accept any change of the own revenues system unless member states agreed the settlement of the rebate system (Howe, 1994). Under the Germany presidency, member states decided to include the financial reforms with other important issues in a major negotiation round. The financial reform

⁵¹ The Reagan Administration in the United States which took office in January 1981 triggered a competition with the Soviet Union over a massive increase in armaments. The competition cooled down relations with the Soviet Union and signalled a return to the rhetoric of the Cold War.

⁵² In response to the change in international circumstances, the member states adopted a 'Solemn Declaration' which proposed political and economic unification of Europe in order to speak with a single voice on economic matters in international affairs (Bache and George, 2006).

consisted of the settlement of the rebate system, preparations for the enlargement in 1986, and a reform of the CAP. Due to Britain's threats, a solution of the British budgetary problem was central to the reform of EC finances (George, 1998; Lindner, 2006).

The EC Finance ministers were not able to achieve a compromise on the reform of the EC budget; hence, the issue was handed over to the European Council in Athens in December 1983. In that context, Thatcher spelt out the British position:

When we in the United Kingdom look at the problem, we ask ourselves what would be a fair net contribution for a country in the position of the UK, still below average in relative prosperity now and only just above it in a community of twelve. I have the impression that many of your governments are briefing you to look at it in terms of what it will allegedly cost you to reduce the burden on us; that is to say, in seven cases, how much your net benefits will fall. Since we are trying to devise a fair system for the longer term, we have to look at the likely outcome for all member states, ensuring that the least prosperous receive appropriate benefits and that those who will bear the burden of net contributions do so in relation to their ability to pay ... I made it clear at Stuttgart that I could only concede an increase in the Community's own resources if arrangements were agreed for a fair sharing of the budgetary burden and for effective control of agricultural and other expenditure. (Wall, 2008: 29).

Unsurprisingly, no agreement was achieved at the Athens European Council. President Mitterrand opposed the reform of the CAP in order to secure subsidies for his nation's farmers, who played an important role in French politics. He also rejected an agreement of the UK's rebate settlement because any reduction of the British contribution would mean an increase in the other member states' contributions. Mitterrand, thus, suggested an ad hoc payment rather than making a permanent agreement, but this proposal was not accepted by the UK. The heads of government and state decided to postpone the negotiation to the Brussels European Council on 19-20 March 1984. This decision was meant to put pressure on the French government to make concessions when France held the presidency of the Council of Ministers in the first half of 1984 (Ardy, 1988; George, 1998).

The French presidency valued its reputation as a leader in Europe, and announced that it would endeavour to reach an agreement on financial reform. At the March 1984 European Council, the member states agreed the reform of the CAP through the reduction of milk production and subsidies on exports of agricultural products (George, 1998).⁵³ Furthermore, the member states reached an agreement on the increase of VAT which would rise from a ceiling of 1.4 per cent in 1984 to 1.6 per cent in 1986 (COM 1985: 12). Due to the link between the settlement of the rebate system and the reform of the EC budget, although member states agreed the reduction of the CAP and the increase of VAT, these agreements were not valid until settlement had been reached (George 1998: 154).

Regarding settlement of the rebate system, there was a dispute between the UK and the other member states on how to calculate the British contribution to the budget. The Thatcher government argued that it should be calculated considering all its payments to the EC budget under the own resources system: VAT, tariffs, and agricultural levies. This was confronted with opposition from the other member states, which argued that tariffs and agricultural levies were not part of national contributions and asked that only VAT payment be used to calculate the size of the UK's rebate (George, 1998). In order to solve the conflict, the French presidency devised a formula which would calculate the rebate as a difference between the UK's VAT contribution and receipts. According to these calculations, in 1984, the UK's rebate would be approximately £ 600 million (Ardy, 1988). Chancellor Kohl of West Germany proposed to amend the presidency proposal and suggested a flat-rate of £600 million in each of the following three years: 1984, 1985, and 1986. The West German proposal was rejected by the Thatcher government and agreement was blocked again (Denton, 1982).

Three months later, at the Fontainebleau European Council on 25-26 June 1984, the Thatcher government agreed on a calculation which would only consider the UK's VAT contribution in order to secure the other member states'

⁵³ The Irish government opposed curbing Irish dairy products which accounted for 9 per cent of its GNP. The Irish government threatened to veto the proposal, and obtained an exemption on reducing milk production.

concession on an automatic and permanent formula for the rebate system. Thus, it agreed the UK's rebate mechanism which amounted to about £ 600 million for 1984 and then, from 1985, 66 per cent of the difference between its VAT contribution and receipts from the budget (Denton, 1984; George, 1998; Laffan, 1997; Lindner, 2006).

7. Conclusion

The UK's traditional conception of its special relationship with the US and the Commonwealth countries affected the British government's progress regarding European integration in the 1950s. The special relationship led the UK to think about its leadership in the world rather than European integration. In the 1960s when the British government realized its economic interests in the EC as well as the weakening of its special relationship, they attempted to apply for membership but were stymied by de Gaulle's veto. At The Hague summit, the six founder member states agreed on the own resources system, which required a high British contribution under the own resources system as a cost of membership. The negotiations of the British membership in 1970-1971 could be defined as partially successful. Despite not being able to solve its imbalance regarding the EC budget, Britain had become a member of the EC after failing on her previous two attempts. On the British contribution side, Britain paid too much for its contribution, whilst it had few benefits from Community expenditure. The British imbalance in the outcome of the negotiations in 1970-1971 brought about a political conflict in budgetary decision-making in the European Community.

This chapter has analysed the attempt that the various UK governments have made between 1974 and 1984 to address the problem caused by its high contribution to the EC budget. The Labour governments headed by Wilson and Callaghan and the Conservative government headed by Thatcher used different approaches in line with their party stance on European integration and more generally on economic and social policies, but they all shared the view that the UK had been significantly penalized by the accession agreement and that a way to correct this situation needed to be found. This question generated a number of

political conflicts between the UK and the other member states, which resisted any cut in the size of the UK's financial contribution in order to prevent an increase in their contribution. To secure its preferences, the UK governments used several tactics in the negotiations, linking various issues and the same time threatening to veto any progress in European integration and even to withdraw from the EC. This strategy worked and led the other member states first to accept the introduction of a 'corrective mechanism' at the Dublin summit in 1975, and then to the introduction of the UK's rebate system at the Fontainebleau European Council in June 1984.

Chapter 4

Defending the rebate: the UK's successful resistance in the 1980s and 1990s

1. Introduction

This chapter explores the British rebate negotiations specifically across the 1980s and 1990s during which time Britain succeeded in retaining its rebate. During this period, there were three financial negotiations: in 1988, for the financial perspective for 1988-1993; in 1992 for the financial perspective for 1993-1999, and in 1999 negotiation for the financial perspective for 2000-2006. In 1988, the institutions of the EC established an Interinstitutional Agreement (IIA) which proposed a multi-annual budget plan. The IIA affected the shaping of the Commission's financial proposal style which started to be characterised by a political linkage between European integration projects and the multi-annual budget plan in order to financially support projects.

This chapter analyses each of these three negotiation rounds, with the view to discuss how the UK managed to defend its rebate. For each negotiation, there are three sub-sections, with an analysis of the Commission's proposal, the domestic debate in the UK about the proposal, and the British behaviour at the EU negotiating table. In the Commission's financial proposal for 1988-1993, named the Delors I package, the Commission, under Delors' presidency, proposed a political linkage between 'deepening' (the Single European Market and the Single European Act) and 'widening' (the enlargement of Mediterranean countries), and

the financial proposal. The Delors II package proposed a political linkage between the EMU in the Treaty on European Union (TEU) and the financial proposal for 1993-1999. The Agenda 2000 package consisted of two projects: preparing the enlargement of the Central and Eastern European Countries, and the financial perspective for 2000-2006. In the political package, net contributors not only focused on minimising their contribution but also concentrated on achieving the financial agreement for the implement of the integration projects while net beneficiaries converged on maximising their financial benefits in the negotiation table. The negotiation styles pressured Britain to accept the reduction of its rebate.

2. The financial perspective negotiations for 1988-1993

This section explores the UK's negotiation on the 1988-1993 financial perspective against two types of threats. First, the initial proposal of the European Commission, linking the Single European Market (SEM) and the Single European Act (SEA), and the financial perspectives, threatened the UK's budget rebate. Second, in the negotiations member states pressured each other in order to secure their desired financial benefits. In spite of these difficult circumstances, the UK managed to retain its rebate.

2.1. Analysis of the Commission's proposal

The accession of three Mediterranean countries (Greece in 1981, and Portugal and Spain in 1986), which brought about wide economic disparities within the EC, risked jeopardising the achievement of the SEM. To reduce these economic disparities, not only was an economic and social policy introduced in the SEA, but the European Commission proposed the Delors I financial package on 18 February 1987. The Delors I package was the first multi-annual financial proposal in the EC.

2.1.1. Deepening of the Community: the SEM and the SEA

In the early 1980s, the European Community experienced an economic crisis because of the second oil crisis in 1979, and large trade deficits which derived

from the poor competitiveness of European firms in the international market in comparison with their trade partners in the US and Japan (Pelkmans and Winters, 1988). While economic difficulties were being experienced in several countries, particularly the UK, Belgium, Denmark, and the Netherlands, political parties which advocated the idea of the neo-liberal economy came to power and proposed devising a collective response at EC level to the economic crisis.⁵⁴ The other governments also started to seek a European solution to the economic recession. Member states' economic ideas converged to revitalise the single market programme (Young, 2005).

The project of revitalising the single market inherited ideas found in the Rome Treaties of 1957, which stood on the basis of the Spaak Report.⁵⁵ Article 2 of the Treaty in the EEC stipulated establishing a common market (single market) which consisted of four elements: removing national tariffs, creating a 'custom union', completing free movement, and adopting single legislation at the European level (Young, 2005). Removing national tariffs between member states aimed to establish a free trade area in the Community. The creation of a customs union proposed the erection of a Common External Tariff (CET) on member states' trade with non-EC countries in order to prevent member states from gaining a competitive advantage and distorting fair competitiveness in the internal market. Free movement was intended to promote the 'four freedoms': goods, labour, services, and capital. The aim behind the creation of single legislation was to regulate internal trade liberalisation through the harmonisation of national laws (Young, 2005; Egan, 2007).

Lack of progress in the creation of a single market in the 1970s and 1980s was hindered by the member states, which in order to secure their domestic interests frequently protected the *status quo*. The solution, therefore, seemed that

⁵⁴ Neo-liberal economic ideas advocate a liberalisation of the market from state intervention to bring about economic growth. Such ideas support removing national regulations or rules, and the privatisation of state-owned industries in economic policies (Young, 2005).

⁵⁵ The Belgian foreign minister Paul-Henri Spaak presented a blueprint for the SEM which consisted of three main elements: the elimination of national protective barriers in order to establish normal standards of competition in Western Europe; the elimination of state intervention and the curtailing of monopolistic conditions; and the harmonization of legislation at the European level (Egan, 2007).

of accelerating the pace of harmonisation (Dashwood, 1977; Armstrong and Bulmer, 1998; Egan, 2007). The European Commission proposed a new approach, advancing the idea of ‘standards harmonisation’ as an essential requirement for completing the common market (Peterson and Bomberg, 1999). By early 1985, the President of the Commission, Jacques Delors and Internal Market Commissioner Lord Cockfield, presented a White paper entitled *Completing the Internal Market* which proposed a number of legislative measures to be adopted by December 1992 (COM, 1985).⁵⁶

At the Milan European Council in June 1985, member states agreed the ‘1992 programme’ which proposed completion of the SEM by 1992 and 282 legislative measures on harmonisation (Egan, 2007; Young, 2005). Furthermore, member states recognised that the ‘1992 programme’ would have little chance to be implemented unless there was a significant reform of the decision-making procedures that addressed the issue of unanimity (Nugent, 2006: 80). At the Intergovernmental Conference (IGC)⁵⁷ convened in Luxembourg in December 1985, member states adopted the Dooge report⁵⁸ and agreed on the Single European Act (SEA), with the view ensure completion of the SEM by 1992 (Nugent, 2010).

The SEA not only strengthened the institutional system, but also introduced new policies, particularly ‘economic and social cohesion’.⁵⁹ Member

⁵⁶ Initially, Internal Market Commissioner Lord Cockfield proposed 300 measures on harmonisation in the White paper, but then member states reduced the number of measures to 282 at the Milan European Council. See Egan (2007).

⁵⁷ An Intergovernmental Conference (IGC), composed of representatives of the member states, the Commission, and the European Parliament, is convened to revise and amend the treaties in the European Community. The key actors are representative of the member states, and an agreement for treaty changes requires a unanimous decision.

⁵⁸ At Fontainebleau in June 1984, member states agreed an establishment of an *ad hoc* committee, under a Commissioner James Dooge, which conducted institutional reform, particularly expanding Qualified Majority Voting in the Council of Ministers and increasing the power of the European Parliament in EC decision-making (McNamara, 2005; Young, 2005).

⁵⁹ The SEA provided the following institutional reforms: the extension of QMV on internal market decisions; a ‘cooperation procedure’; a new ‘assent procedure’; enhancing the role of the Court of Justice. In particular, the SEA enhanced the decision-making capacity of the Council of Ministers through altering the decision-making rule from unanimity to QMV in order to prevent member states’ veto power from effectively achieving single legislation, and the power of the

states expected that the completion of the SEM would create new competitive threats to peripheral economic regions and member states in the internal market. For this, they enacted article 130s which emphasised economic and social cohesion.⁶⁰ The reduction of economic disparities would not only strengthen economic and social cohesion within the Community but would also promote economic convergence. In the completion of the SEM, if the Community concentrated on the reduction of economic disparities, poorer member states would more rapidly develop their economies and contribute towards the strengthening and expansion of the SEM (Armstrong and Bulmer, 1998).

2.1.2. Widening of the Community: The enlargement of Mediterranean countries

The enlargement involving first Greece (1981) and then Portugal and Spain (1986) overrode economic considerations. Greece applied for membership in 1961, but due to the underdeveloped nature of its economy, a transitional period was necessary before accession. But following a military coup (April 1967), the Community suspended its decision on the Greek membership. Once democracy was established (June 1974), the new Greek government re-applied for membership in November 1974, arguing that being part of the EC would help consolidation of democratic practises. While the Commission argued that Greece was not economically prepared and proposed an unlimited pre-accession period until Greece undertook economic reforms, member states rejected the Commission's proposal. In July 1976, negotiations restarted and in 1981 Greece became the 10th member state of the EC (Nugent, 2006; Barnes and Barnes, 2007).

European Parliament by introducing the 'cooperation procedure' and the 'assent procedure' in the legislative decision-making procedure. The SEA introduced a number of new policy areas: environment, research and technological development, 'economic and social cohesion', and European Political Cooperation (EPC) (Armstrong and Bulmer, 1998).

⁶⁰ Allen (2005:214) defines 'cohesion' as the removal of various disparities within the Community. Initially, the major focus in the idea of cohesion was the reduction of economic and social disparities between member states. After the Constitutional Treaty in October 2004, 'cohesion' refers to the reduction of economic and social disparities, and solidarity amongst member states.

Spain and Portugal made a first attempt for membership in 1962, but this was blocked due to these member states' authoritarian dictatorships until the mid-1970s and their underdeveloped economies. After overthrowing their dictatorships, Portugal and Spain applied for full membership of the EC in March 1977 and July 1977 respectively. Although the two Mediterranean countries' economies were not high enough to enter the EC, the Community agreed both countries' membership. The two countries became members of the EC in 1986 (Nugent, 2006; Barnes and Barnes, 2007).

Clearly, on the Mediterranean enlargement political considerations prevailed, as Greece, Portugal, and Spain entered the EC despite their underdeveloped economic condition (see Table 4.1). The enlargement brought about wide economic disparities between member states which not only became the cause of the Community's focus on reducing economic disparities within the Community and introducing 'economic and social cohesion' but also increased other member states' financial burden which derived from the new member countries' demands on the EC's redistributive policies and obtaining financial benefits (Bache and George, 2006: 543).

Table 4.1 Impact of the enlargement, 1973-1986

Enlargement	New members	Additional population (%)	Added GDP (%)	GDP per capita of new members (% of existing)
1973	Denmark, Ireland, UK	33.4	31.9	95.5
1981	Greece	3.7	1.8	48.4
1986	Portugal, Spain	17.8	11.0	n.a.

<Source: Barnes and Barnes (2007)>

2.1.3. Establishment of the financial perspective

In the mid-1980s the European Community went through a serious budgetary crisis, mainly for three reasons. First of all, even though the Community had diversified and increased its expenditure on more policy areas, expenditures on

the CAP was still very high, accounting for over 70 per cent of total EC budgetary expenditures. Secondly, budgetary resources (i.e. common customs tariff duties, agricultural levies, and a limited percentage of VAT) were not enough to fulfil the Community's financial obligations. Thirdly, following the decision on the British rebate at the 1984 Fontainebleau European Council, member states agreed to increase the percentage of VAT from 1 per cent ceiling to a 1.4 per cent ceiling. This decision, which came into effect from 1986, was too little and too late to stave off exhausting the Community budget in 1987 (Nugent, 2006).

The European Commission, under the Delors leadership, focused on seeking a solution, paying particular attention to how to fund the 'economic and social dimension' of the SEA. For this, it proposed an interinstitutional framework '*Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure*', which consisted of the financial perspective and an Interinstitutional Agreement (IIA). The financial perspective proposed a multi-annual budget plan for 5-7 years, which imposed the balance between revenue and expenditure in order to avoid the EC budget falling short, and a financial plan, which pre-allocated the budget into different headings of EC expenditure policies in order to constrain CAP expenditure (Lindner, 2006; Laffan, 1997).

The IIA was intended to solve the persistent struggle between the 'twin arms' of the budgetary authority, the Council and the Parliament, in order to prevent a delay in the annual budgetary decision. The EC had experienced delays in agreeing the annual budget in 1980 and 1985 when the European Parliament blocked annual financial agreements to strengthen its power in budgetary decision-making.⁶¹ The IIA, therefore, represented strengthening the role of the European Parliament in non-compulsory expenditure in the Community budget. The Council conceded the increase of the EP's power to avoid any tension which

⁶¹ The European Parliament blocked actions on annual budgetary decision-making in 1980 and 1985 with the view to increasing its role in budgetary decision-making. In 1980, after its first direct election in 1979, the EP exercised its power of rejection in decision-making, which was granted by the 1975 Budget Treaty, as a test of its role against the Council's. In 1985, the EP inserted several amendments on the compulsory items, in particular agricultural expenditure, which ignored the Treaty. The Council removed the amendments, but the EP reinstated the amendments and declared the budget passed. The Council took the EP to the European Court of Justice (Lindner, 2006).

could have blocked an agreement of the Delors I package on time as the EP did (Laffan, 1997; Laffan and Lindner, 2005; Bache and George, 2006).

2.1.4. The Commission's financial proposal

In its proposal for the 1988-1992 financial perspective (see Table 4.2), the European Commission packaged together the reform of the UK's rebate, the increase of regional aid, the reform of the own resources system, and the reform of the CAP. With regard to 'economic and social cohesion' and the enlargement of the Mediterranean countries, the Commission proposed an increase of regional aid from 16 per cent of the Community budget to about 25 per cent. To support this increase, the Commission decided to combine two methods: diverting the EC budget away from existing beneficiaries and increasing the size of the budget (COM, 1987a; COM, 1987b; Financial Times, 5 February 1987; Laffan and Shakleton, 2000; Bache and George, 2006).

On the one hand, the Commission, which believed that the UK's rebate was one reason behind the deficit of the Community budget in 1987, proposed to cut it down by about 50 per cent (Boyle, 2006: 147; Ross, 1995: 260). It also proposed reducing CAP expenditure from 75 per cent to 50 per cent of the Community budget (Financial Times, 5 February 1987; Boyle, 2006), arguing that a reform of the CAP would not only rescue the EC budget, but also help reduce the UK's rebate by eliminating one of the sources of disequilibria in the EC (COM, 1987a: 34). On the other hand, the Commission proposed the reform of the own resources system by creating an additional resource of the GDP which took into account member states' capacity to make payment into the budget. The Commission proposed the 1.4 per cent of the GDP and the reduction of the VAT rate from 1.4 to 1.25 per cent (COM, 1987a: 24; Financial Times, 5 February 1987).

Table 4.2 Financial perspective 1988-1992 (in EUR million-1988 prices)

	1988	1989	1990	1991	1992
Appropriations for commitment:	27500	27700	28400	29000	29600
1. EAGG GUARANTEE SECTION					
2. STRUCTURAL FUNDS	7790	9200	10600	12100	13450
3. POLICIES WITH MULTIANNUAL ALLOCATIONS	1210	1650	1900	2150	2400

4. OTHER POLICIES	2103	2385	2500	2700	2800
of which: non-compulsory expenditure	1646	1801	1860	1910	1970
5. REPAYMENTS AND ADMINISTRATION	5700	4650	4500	4000	3550
of which stock disposal	1240	1400	1400	1400	1400
6. MONETARY RESERVE	1000	1000	1000	1000	1000
TOTAL of appropriations for commitments	45303	46885	48900	50950	52800
TOTAL of appropriations for payments	43779	45300	46900	48600	50100
Appropriations for payments as % GNP	1.12	1.14	1.15	1.16	1.17
Margin	0.03	0.03	0.03	0.03	0.03
Own-resources ceiling(% of GNP)	1.15	1.17	1.18	1.19	1.20

<Source: Commission 'Report from the Commission to the Council and Parliament: on the financing of the Community budget' COM(87) 101 final>

2.2. The UK's attitudes to the Delors I package

On the Delors I package, the UK had mixed reactions. It broadly supported the SEM, manifested some concerns on the SEA, and opposed the increase of regional aid. Its main priority, however, remained that of maintaining its rebate.

2.2.1. European projects: the SEM and the SEA

When the Conservative party took power in 1979, the UK was facing major economic problems.⁶² Going against the Labour government's economic policies (1974-79) which had been based on Keynesianism and which stressed the role of government and public sector in economic policies (Evans, 1997), the Thatcher government took a new approach to deal with Britain's economic problems. The new approach combined neo-liberalism, by stressing the central role of the market in economic policy, and neo-conservatism, by emphasising the concept of national sovereignty. In economics, the new approach proposed privatisation, low levels of taxation, and the reduction of the trade unions' power in order to restructure the British economy and improve the UK's economic performance (Gamble, 1993; Norton, 1990; Geddes, 2004; Heffernan, 2000; Baker, Gamble, and Seawright,

⁶² During the Labour governments under Wilson and Callaghan, Britain's economic growth was slower than that of other EC member states. The UK's annual rate of GDP was 2.79 per cent while the average of EC member states was 4.63 per cent. Furthermore, Britain applied to the IMF for a loan in December 1976. See Evans (1997) and Harmon (1997).

2002; Evans, 1997; Sowemimo, 1996).

In 1980, Michael Foot challenged Mr James Callaghan's leadership of the Labour party and became the leader.⁶³ The Foot leadership brought about the left wing's dominance on European issues in the Labour party. The left wing, under Foot's leadership, adopted the Alternative Economic Strategy (AES) in order to shape the Labour party's European policies. The AES emphasised the role of the UK government in domestic economic policies, notably controlling imports, public ownership and the government's planning which opposed the Conservative government's market-based approach to economic policies. The Labour party criticised the Conservative government's economic ideas for creation of a single market as part of European integration, and argued that the single market formed part of capitalist objectives which would restrict the government's capacity to plan and to manage its own economy. The Labour party argued for withdrawal of the UK's membership as it obstructed the Labour party's economic policy objectives (Seyd, 1987; Forster, 2002).

During the 1983 general election campaign, the Conservative party's manifesto clearly stressed that their free market approach would reduce government intervention in order to boost competition in the domestic market. Their manifesto plan was accused by the Labour party of ignoring the public standard of living, but a sound victory in the June 1983 election confirmed that people liked this free market approach by Thatcher (Evans, 1997; George, 1998).⁶⁴

In its second term, the Thatcher government not only accelerated its domestic economic policies, particularly privatisation, openness, and deregulation, but also attempted a transposition of its free-market approach into the EC with the view to solving the large trade deficits with the US and Japan and addressing the

⁶³ In the election of the Labour party leadership, three candidates – Michael Foot, Peter Shore, and John Silkin – challenged Callaghan's approach to the EC and totally opposed the UK's membership. Denis Healey took a less sceptical approach compared to the other three candidates. See Forster (2002).

⁶⁴ On 9 June 1983, the Conservative party won 397 seats in the Parliament while Labour obtained 209 seats. The Conservative party had won 68 seats more than at the 1979 general election (George, 1998).

economic recession in Europe (George, 1998). The government proposed a revitalisation of the single market project and submitted a document to the Fontainebleau European Council in 1984. The document pointed to the economic problems of the EC: the growing technological gap with the US and Japan and a high level of unemployment across the EC (Sowemimo, 1996; Geddes, 2004). It did not, at least according to other member states, adequately address the issue of institutional reforms, which were central to the implementation of the SEM project. In response to this criticism, the Thatcher government re-emphasised the importance of national veto power for protecting member states' interests. The heads of state and government, nevertheless, agreed to set up the Dooge Committee to investigate the question of institutional reforms and required the Committee to submit its report to the European Council in March 1985 (George, 1998).

The outcome was inconclusive because the committee was divided between two groups: a majority group which demanded major institutional reforms and a minority group which opposed any significant institutional reform. This debate continued between member states. On the one hand, a large group of member states argued that major institutional reforms were a necessary condition for accelerating the procedure of decision-making. They proposed dismantling national veto power in decision-making, except for special policy areas which involved sensitive national interests. They also supported the majority's opinion in the Committee on the increase of the European Parliament's decision-making powers. On the other hand, a smaller group of countries (UK, Denmark, Greece and Ireland) argued that member states' veto was essential to protect national interests and reacted in a hostile way to the increase of the Parliament's power in decision-making, which would imply an erosion of national sovereignty. In the debate, the Thatcher government recognised that the direction of the European integration was moving away from what Thatcherism had intended (Sowemimo, 1996; George, 1998), and this was displayed during an interview with the *Sunday Express* (cited in Wall, 2008: 46):

They all talk about political union and people like me say “well now, what do you mean by political union?” That’s as far as we get. I believe in a Europe of separate countries, each with their distinctive character and identity, cooperating together in a common market. We haven’t yet got a common market ... and we’re a very long way from it. I do not believe in what I would call a united states of Europe [the very objective Chancellor Kohl had called for publicly earlier in the year]. I do not believe in a federal Europe and I think to compare it to the United States is absolutely ridiculous. They talk about things like a two-speed Europe and people like me say: all right; if you mean a two speed Europe, let me tell you what I mean: those who pay more are in the top group and those who pay less are not. It is absolutely ridiculous to expect a change in the treaty ... You might get one or two amendments for which there is a need. Just to sit down to create a new treaty is ridiculous.

The UK used an informal meeting of Foreign Ministers at Stresa in Italy on 8-9 June 1985 to persuade member states to agree to the British position, but its efforts were unsuccessful (Geddes, 2004; George, 1998). At the Milan European Council on 28-29 June 1985, it successively wrested an agreement from the other member states for the completion of the SEM by 1992, but could not prevent further European integration towards institutional reforms (George, 1998).

In domestic politics, the SEA resulted in a faction between Thatcherites and pro-Marketeers in the Conservative party, and a political conflict with the Labour party. First of all, in the faction in the Conservative party, Thatcher and her followers argued that the SEA indicated removing Britain’s influence in the decision-making on the SEM measure through the extension of majority voting system, and the increase of the EP’s involvement on EU decision-making. The removal would bring about the danger of losing Britain’s sovereignty in preserving its national interests in the SEM. Thus, they were unwilling to go beyond economic integration. In contrast to Thatcherites’ opposition, pro-Marketeers argued that for achieving the Thatcher government’s economic goal of the SEM, the SEA would be a prerequisite condition in completing the free market and boosting trade liberalisation (Forster, 2002: 71).

Secondly, in the Labour party, after defeat of the 1983 general election, Foot and the left wing’s dominance were challenged by Neil Kinnock and his followers who were members of the ‘soft left’ in political spectrum, and who

demanded the re-shape of its European approach. This was because the challengers saw that the defeat resulted from the party leader group's misunderstanding on public opinion. Finally, Kinnock⁶⁵ replaced Foot and the left wing's power and took a starting position to dilute the party's anti-European image. Despite this, on the SEA, the party threatened the Thatcher government's decision-making considering losing national parliamentary power (Jefferys, 1993; Daniels, 1998; Geddes, 2003).

At the IGC in Luxembourg in December 1985, Thatcher and her followers continued its hostility to institutional reforms and argued that agreement of the SEA would significantly challenge the ability of nation-states in decision-making, particularly parliamentary sovereignty (Baker, Gamble and Seawright, 2002; Geddes, 2004).⁶⁶ However, pro-marketeters such as the Foreign Secretary Sir Geoffrey Howe and Mrs Thatcher's personal adviser on EC affairs, David Williamson, persuaded Mrs Thatcher to make the concession of agreeing to the SEA in order to bring about the other member states' co-operation in completing the SEM by 1992. Finally, in December 1985, the Thatcher government reluctantly agreed the SEA which stipulated the extension of QMV in the area of internal market policies, but specifically excluded QMV in the areas of 'taxation, free movement of persons, health controls, and employees' rights'. Although the outcome of the faction between Thatcherites and pro-Marketeters in the Conservative party, and the Labour party's opposition in shaping Britain's approach on the SEA was the Britain's acceptance, the SEA became a turning point of diluting the Thatcher government's pro-European approach and of

⁶⁵ After the failure of the 1983 general election, Foot's leadership and the left wing's dominance in the Labour party were challenged by Neil Kinnock and followers who were the 'soft left' in political spectrum on European integration. In the leadership election in 1983, Kinnock became the leader of the Labour party. The Labour party's anti-European approach was diluted. See Jefferys (1993) and Daniels (1998).

⁶⁶ The Thatcher government, which had a Eurosceptical 'zero-sum' understanding of sovereignty, was concerned that the SEA would undermine British national sovereignty. By contrast, pro-European stance's 'non-zero-sum' concept held that strengthening the EEC's institutions would be the best way to solve political difficulties in decision-making among the member states in order to consolidate the advantages of European integration for its citizens. See Geddes (2004).

growing Thatcherites' hostility on European integration (Forster, 2002; George, 1998).

2.2.2. The financial perspective

With regard to the Delors I financial proposal, the UK's main priority was to retain its rebate. The Thatcher government argued that the UK had struggled with its financial burden since its entry in 1973 and that this problem was only mitigated by the agreement at Fontainebleau. Thus, it could not even think of the reduction of its rebate in just 3 years from the agreement in 1984, because it would simply encounter the same financial problem again (Boyle, 2006; Financial Times, 5 and 19 February 1987; Agence Europe, 25 February 1987; Laffan and Shackleton, 2000). Furthermore, in an interview in *The Times*, Thatcher explicitly argued that although the Conservative party supported the SEM project and understood British economic interest groups' wholehearted support to the SEM and the SEA, and the enlargement of Mediterranean countries for the benefit of their own interests; its view on the EC had slightly changed because of the SEA which not only introduced the reform of the institution but also damaged the direction of single market from her neo-liberal idea thanks to the introduction of 'economic and social cohesion' in the SEA. She said that the Conservative party suspected the direction of the EC and whether it would secure Britain's national interests. Regarding the financial perspective which was a package between the SEM, the SEA and the financial plan, she pointed out that the increase of regional aid resulted in the introduction of 'economic and social cohesion' in the SEA, and the size of regional aid caused the size of the budget to increase which pressured Britain into reducing its rebate; and said that, due to the introduction of the SEA, Britain was less interested in a corrupt single market. Thus its position on the integration was not enough to reduce its rebate to pay for the increase of the regional aid (The Times, 11 May 1987).

These views on the rebate shaped the UK's positions on other issues. The Thatcher government was against the Commission's proposal for the reform of the own resources system to add 1.4 per cent of GDP into Community revenue, because this reform would be over the financial agreement of the Fontainebleau

European Council and would put the UK's abatement at risk (Young, 2000). Furthermore, the UK opposed any increase-related elements of the EC budget, particularly the increase of regional aid, even though the UK agreed the enlargement of the Mediterranean countries because it was seen as another possibility to question the UK's rebate (Financial Times, 11 May 1987; Agence Europe, 25 February 1987; Thatcher, 1993: 729). The only item in the Commission's package which the British government supported, unsurprisingly, was the reform of the CAP (Boyle, 2006).

2.3. The UK and the negotiation on the Delors I package

In the financial negotiations for the Delors I package, heads of government or state agreed to delay the European Council after Britain's general election which was scheduled for 11 June 1987 (Financial Times, 29 June 1987). Shortly after the election, the financial negotiations were initiated at the Brussels European Council on 29-30 June 1987. The Delors I package was discussed at the three European Councils – two regular meetings in June 1987 in Brussels and in December 1987 in Copenhagen, and a special summit in February 1988 in Brussels. The UK struggled to retain its rebate because it was structurally intertwined with the issues of increasing regional aid and reforming the CAP. In doing this, it was involved in two negotiations: between net contributors and beneficiaries on the size of the Community budget, and amongst net contributors on sharing the financial burden.

2.3.1. Net contributors versus net beneficiaries

Regarding the Delors I package, the European Commission proposed the reform of the own resources system for the increase of the Community budget in order to prevent a budget crisis caused by the increase in regional aid (COM, 1987a: 24; Bache and George, 2006). The member states were divided into two groups: net contributors, or those who would increase net contribution, and net beneficiaries, or those who would increase financial receipts (Laffan and Lindner, 2005). The European Commission designated four member states – Greece, Italy, Portugal, and Spain – which were the most suitable member states on the basis of five

objectives⁶⁷ of regional aid and would become net beneficiaries, and proposed that regional aid would concentrate spending on the four member states in order to reinforce the effect of the small amount of regional aid in the Community's expenditure (Allen, 2000).

After the British general election on 11 June 1987, the European Council in Brussels on 29-30 June undertook the first negotiation for the financial perspective for 1988-1993. At the summit, member states could not have an in-depth discussion of the financial perspective because of a conflict between net contributors and beneficiaries on the formation of a package with regard to the Commission's proposal (Financial Times, 29 June 1987 and 2 August 1987). Net contributors wanted to break the package. They wanted to pay attention to securing issues related to their own interests rather than on taking on a complicated package deal. However, net beneficiaries pressured the Presidency of the Council Wilfried Martens, the Belgian Prime Minister, to maintain this form of the package in order to pressure net contributors to concede the increase in regional aid. Net beneficiaries threatened that if net contributors secured their preferences in the package, they would need to agree the increase of regional aid in order to keep the net beneficiaries on side (Financial Times, 30 June 1987). All net contributors agreed the package, except the UK, which was displeased since the package contained the reform of the UK's rebate. The European Council ended in failure and the financial negotiation was held over to the next European Council in Copenhagen on 4-5 December 1987 (Financial Times, 30 June 1987; George, 1998).

Before this, there was a meeting of the Council of Ministers on 24 November 1987 with the aim of achieving a compromise. In the meeting, there was a division between the UK and other contributors on the increase of regional

⁶⁷ The European Commission proposed five objectives which would become a criterion for choosing beneficiary regions and member states. Objective 1 would propose structural funds going to regions and member states which had less than 75 per cent of the EEC's GDP average. Objective 2 would focus on regions and member states which had high levels of unemployment over the EEC average. Objective 3 would propose regions and member states which were struggling to combat long-term unemployment. Objective 5 was subdivided between 5a, which would focus on agricultural and forestry assistance, and 5b, which would concentrate on the development of rural areas (Allen, 2005).

aid. British Foreign Secretary Sir Geoffrey Howe argued that net beneficiaries should not expect any concession from the UK on its rebate, because the UK's relative prosperity had not changed since the Fontainebleau summit. Furthermore, Britain remained the second-largest contributor to the EC budget even though it had its rebate. Thus, he said that Britain could not agree the increase of regional aid which pressured Britain to reduce its rebate (Agence Europe, 25 November 1987; Financial Times, 27 November 1987). The other net contributors, particularly Jean-Bernard Raimond, Minister of Foreign Affairs in France, said that they were ready to agree the increase of regional aid, however, he suggested that the amount of regional aid should be reduced in order to easily hammer out concessions from net contributors; and Ireland should be one of the four net beneficiaries instead of Italy (Agence Europe, 25 November 1987). In response, Attilio Ruffini, Italy's Minister of Foreign Affairs, issued the threat that if France questioned the Commission's proposal on regional aid, Italy would question agricultural expenditure. The debate on the increase of regional aid could not reach a satisfactory conclusion and was handed over to the European Council (Agence Europe, 25 and 27 November 1987; Financial Times, 27 November 1987).

At the Copenhagen European Council on 4-5 December 1987, member states discussed a Presidency compromise presented on 30 November which proposed retaining the UK's rebate, stabilising the CAP, and increasing GDP contribution to 1.6 per cent from 1.4 per cent with regard to the Commission's proposal. The percentages of regional aid and of VAT were not changed from the Commission's initial proposal (Agence Europe, 1 December 1987). Net contributors maintained that the compromise was an unrealistic proposal and argued for a reduction of regional aid in order to prevent the budgetary crisis. In particular, Thatcher strongly argued that the UK could not accept a boost of regional aid which would increase the size of the EC budget and threaten the UK's rebate (Financial Times, 4 December 1987). The net beneficiaries rejected these arguments and argued that the introduction of the 'economic and social cohesion' policy was meant to strengthen and expand the SEM, which net contributors had agreed in Luxembourg in December 1985. They threatened not to cooperate with

completing the '1992 programme' if net contributors did not change their position on the increase of regional aid (Agence Europe, 5 December 1987; Financial Times, 15 December 1987). The threat was highly effective in changing the net contributors' position: the latter agreed the increase in regional aid as a side-payment. In particular, the UK was far more strongly focussed on completing the '1992 programme' rather than preventing the increase of regional aid. The change of the UK's and other net contributors' position brought about a complex negotiation on sharing of the financial burden due to the increase in regional aid and the size of the EC's budget. This meant that the European Council ended in failure to achieving a financial agreement once again. The member states convened a special summit on 11-13 February 1988 (Agence Europe, 5 and 28 December 1987; Financial Times, 7 December 1987).

2.3.2. The negotiation between net contributors on sharing the financial burden

Negotiation between net contributors on sharing the financial burden resulted in the increase of both regional aid and the EC budget. The negotiation effectively began when net contributors accepted the increase of regional aid at the Copenhagen European Council in December 1987. Although in the Brussels European Council in June and the Council meeting in November net contributors mainly paid attention to negotiations with net beneficiaries on the increase of regional aid, there was also a brief discussion on the reduction of the UK's rebate and the reform of the CAP (Financial Times, 29 June and 2 August 1987; Agence Europe, 25 November 1987).

In the meeting of the Council of Ministers in November, the UK pointed out three reasons for its support of reform of the CAP. Firstly, high expenditures for agricultural subsidies in the Community (see Table 4.3) were a serious contributory factor in Britain's financial problems, and therefore the reform of the CAP would contribute to lightening the UK's financial imbalance (Agence Europe, 25 November 1987; Financial Times, 27 November 1987). Secondly, the CAP was based on interventionist ideas which went against liberalisation of the internal market and strengthening competition of the EC in trade with its US partners

(Heffernan, 2000; Norton, 1990; Agence Europe, 25 November 1987; Rieger, 2005).⁶⁸ Thirdly, a reduction of agricultural subsidies, estimated at about 60 per cent of the EC's budget, would mean more focus on high-technology areas, which could reduce the gap between the EC, the US and Japan (Agence Europe, 25 November 1987; George, 1998).

Table 4.3 EC Expenditure, 1987-1992, in % and at 1987 prices

	1987	1988	1989	1990	1991	1992
EAGGF Guarantee	60.1	58.8	57.1	55.6	53.7	51.5
Other intervention policies	22.9	24.3	29.7	32.7	36.0	38.9
Refunds and administration	17.0	16.9	13.2	11.7	10.3	9.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

<Source: Commission 'Report from the Commission to the Council and Parliament: on the financing of the Community budget' COM (87) 101 final>

This proposal to reform the CAP was confronted with opposition from Germany and France. Oskar Fischer, Minister of Foreign Affairs in Germany, stated that Germany did not want to cut agricultural spending, in order to maintain Franco-German cooperation (Laffan, 1997; Linder, 2006).⁶⁹ Raimond approached the reform of the CAP politically. Due to the Presidential election on 24 April 1988 in France, President Mitterrand could not overlook French farmers' support and argued that the CAP was a non-negotiable issue (Cole, 1994). The other member states in the net contributor group were not significantly involved in the debate on the reduction of the UK's abatement and the reform of the CAP (Financial Time,

⁶⁸ Since the 1950s, the US has used the General Agreement on Tariffs and Trade (GATT) to force the European Community to open its agricultural market. If the Community wanted to actively trade with the US, it would need to liberalise the agricultural market. See Rieger (2005).

⁶⁹ In the negotiation of the common market in the Rome Treaty, there was a political deal between Germany and France on the free trade of agricultural products and industrial goods. France sought Germany's agreement on free trade in agricultural products as a counterbalance of the French agreement on free trade in industrial goods. From that time onward, they maintained a common interest in agricultural policy in the EC. See Rieger (2005) and Laffan (1997).

27 November 1987).

After the net contributors agreed the increase of regional aid at the European Council in December 1987, during the negotiations regarding the sharing of the financial burden, the UK, Germany and France took on an aggressive negotiation style in order to secure financial benefits. The UK argued that the increase of the EC's budget should be met out of agricultural subsidies instead of being met by reducing its rebate in the package (Financial Times, 3 December 1987). France and Germany argued that the reduction of the UK's rebate was acceptable to cover the increase of the Community budget in order to secure agricultural subsidies. The debate resulted in the failure of the European Council and led to a special summit in Brussels on 11-13 February 1988 being hurriedly convened (Financial Times, 13 February 1988; Cole, 1994).

At the special summit under the German Presidency, France and Germany did not have an appropriate card to force Britain's concession in the negotiation. They could not use the '1992 programme' to threaten the UK as the net beneficiaries did in December 1987 because the '1992 programme' was also their preference as well as Britain's (Peterson and Bomberg, 1999; Young, 2005). They could not use the SEA as a bargaining chip, because Britain was not interested in the SEA (George, 1998). In contrast, although Britain demanded the financial agreement for completing the SEM by 1992 be achieved, it did not think about compromise. Thatcher knew that her negotiation partners could not threaten her by blocking the SEM, and she was no longer interested in further European integration towards the SEA. Thus, she paid more attention to retaining the UK's rebate rather than to increasing the UK's contribution for the SEA, and thus unilaterally argued for the reform of the CAP and retaining the UK's rebate (Boyle, 2006). Helmut Kohl, Chancellor of Germany, sought to end the difficult negotiation under the Germany Presidency, attempting to preserve a leadership role in the EC (Seldon and Collings, 2000). Mitterrand was struggling for time, considering there was to be a Presidential election in April 1988. He needed to achieve agreement in order to secure agricultural funds from European expenditure to support French farm subsidies. He decided to make a concession to the UK in order to avoid farmers' anger in the election. Thanks to the French and

German concessions, a financial agreement was achieved at the Brussels European Council in February 1988 (Seldon and Gollings, 2000; Boyle, 2006; Thatcher, 1993).

2.4. Outcome

The Delors I package, agreed in February 1988, contained the reform of the CAP at the Commission's proposal level, which provided some degree of financial burden upon France. Furthermore, agricultural subsidies were constrained by 'tighter and binding budgetary discipline' which provided a guideline⁷⁰ for severely restricting agricultural expenditure. Germany's contribution to the EC's budget increased based on its GDP. Regional aid was increased from 16 per cent to 25 per cent of the EC's budget, and the UK's rebate was retained. Member states agreed the introduction of the new budgetary resource pegged against GDP, which was agreed at 1.15 per cent in 1988 and gradually increased to 1.20 per cent by 1992. The rate of VAT resources became 1.25 per cent (Laffan, 1997; Laffan and Lindner, 2005).

3. The financial perspective negotiations for 1993-1999

The financial perspective for 1993-1999 presented a new threat to UK's rebate. In line with what had happened with the Delors I package, the European Commission made a political linkage between the Delors II financial package and the Treaty on European Union (TEU). Moreover, the UK held the Presidency of the Council at a crucial time, but managed to achieve a compromise to solve conflicts between member states and retain its rebate.

3.1. Analysis of the Commission's proposal

With regard to successively increasing the EC's budget in the Delors II financial package, the Commission adopted a similar style to the Delors I financial

⁷⁰ In the financial agreement, the guideline stipulated the CAP expenditure could not be over 74 per cent of the growth of the EC's GNP. See Laffan and Lindner (2005).

proposal: a political linkage was made between the European integration project and a financial proposal package. In February 1992, the European Commission proposed the financial perspective for 1993-1999 with political linkage made between the Treaty on European Union and the Delors II financial package (COM, 1992a: 14).

Table 4.4 Financial perspective 1992-1999 (in EUR million -1992 prices)

	1993	1994	1995	1996	1997	1998	1999
Appropriations for commitments:	35230	35095	35722	36364	37023	37697	38389
1. COMMON AGRICULTURAL POLICY							
2. STRUCTURAL FUNDS	21277	21885	23480	24990	26526	28240	30000
3. INTERNAL POLICIES	3940	4084	4323	4520	4710	4910	5100
4. EXTERNAL ACTION	3950	4000	4280	4560	4830	5180	5600
5 ADMINISTRATIVE EXPENDITURE	3280	3380	3580	3690	3800	3850	3900
6. RESERVES	1500	1500	1100	1100	1100	1100	1100
TOTAL of appropriations for commitments	69177	669944	72485	75224	77989	80977	84089
TOTAL of appropriations for payments	65908	67036	69150	71290	74491	77249	80114
Appropriations for payment as % GNP	1.20	1.19	1.20	1.21	1.23	1.25	1.26
Margin	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Own-resources ceiling (% of GNP)	1.20	1.20	1.21	1.22	1.24	1.26	1.27

<Source: Commission 'From the Single Act to Maastricht and beyond: The means to match our ambitions'
COM (92) 2000>

3.1.1. The European integration project: the TEU

It could be argued that the establishment of the TEU resulted from spillover effects⁷¹ of the '1992 programme' and the SEA. Spillover effects began with the revival of the single currency project.⁷² The European Community saw that a

⁷¹ For neo-functionalists, spillover means that integration in one sector would lead to further integration in other sectors. See Tranholm-Mikkelsen (1991).

⁷² At the Hague summit, the Werner plan produced the 'snake in the tunnel' which fixed the exchange-rate in the 'Deutsch mark zone', consisting of Germany, Belgium, Denmark, Luxembourg, and the Netherlands, and was scheduled to begin in 1973. A new exchange-rate regime, named the European Monetary System (EMS) began in March 1979, with Germany, the

single currency would be a necessary economic condition to eliminate the cost of currency conversion in trade between member states in the SEM, and would be the last part of the puzzle in completing the SEM (Phinnemore, 2007).

At the Hanover European Council in June 1988, member states agreed to set up a committee under Delors' Presidency in order to develop a plan for Economic and Monetary Union (EMU). The ensuing 'Delors Report', presented to the Madrid European Council in June 1989, proposed a three-stage process for the EMU: a period of convergence in policy, the creation of the European Central Bank (ECB), and adoption of the single currency by 1999 (McNamara, 2005). At the Madrid European Council, member states undertook majority voting – eleven member states agreed to convene an IGC in 1991 while only the UK voted against – to decide convening an IGC in 1991 which would prepare proposals to change treaties in preparation for a monetary union (Bache and George, 2006).

At the IGC in Luxembourg on 28-29 June 1991, the member states not only concentrated on achieving an agreement for EMU but also considered further European integration on social policy, institutional reform, border controls, and foreign and security policy which was affected by the spillover effect and a dramatic change in European affairs: the collapse of the communist block in Central and Eastern Europe, weakening of the power of the Soviet Union, and the unification of Germany in October 1990 (Geddes, 2004). First of all, the member states concerned themselves with the establishment of a 'social charter' in order to regulate a standard 'social dimension' at the European level. The issue was to prevent 'social dumping'⁷³ and to enhance stabilisation of member states' competition in the free market (Falkner, 2007). Secondly, the member states institutional reform to address the 'democratic deficit' in Community decision-making, though the SEA had enhanced the European Parliament's powers. Thirdly, the successful agreements of the SEM and SEA were attractive to the members of

Benelux countries, Denmark, France, Ireland, and Italy. The agreement of the '1992 programme' was a significant driver towards EMU. See Dyson and Featherstone (1999) and McNamara (2005).

⁷³ 'Social dumping' refers to member states' social policy which restrains social provision in order to gain advantage in producing low price products in the SEM (Falkner, 2007: 272).

the EFTA⁷⁴ as well as countries in the Central and Eastern Europe. Member states discussed the Community's state of preparation to deal with possible problems from potential enlargements. In particular, they were concerned with improving border control mechanisms at the EC level in order to deal with the movement of people⁷⁵ and cross-border crime. Finally, the member states considered developing European Political Cooperation (EPC) towards a Common Foreign and Security Policy (CFSP), in the light of the end of the Cold War and a weakening Soviet Union. Furthermore, the unification of Germany brought about concern in other member states about a possible resurgence of German nationalism. The CFSP was to tie up Germany with the Community to hold Germany in check (Bache and George, 2006).

At the Luxembourg summit, there were conflicts between member states on a number of issues, which disrupted agreement on advancing European integration.⁷⁶ At the subsequent Maastricht summit in December of that year in order to try and achieve agreement, member states agreed to establish the Treaty on European Union (TEU), which was signed the TEU in February 1992 and entered into force in November 1993 (Stefanou, 2007).

The TEU produced a new organisation of the European Union which consisted of three pillars: the European Communities (EC), a Common Foreign and Security Policy (CFSP), and Justice and Home Affairs (JHA). Under the Treaty, the EEC changed its name to the European Community (EC) and became

⁷⁴ In the early 1990s, the EFTA countries were Austria, Denmark, Finland, Iceland, Liechtenstein, Norway, Sweden, and Switzerland.

⁷⁵ The agreement of the SEM forced dismantling of national border controls for the 'four freedoms': goods, labour, services and capital. With regard to the potential enlargements, the European Community wanted to deal with 'cross-border crime, drug trafficking, international terrorism, and the movement of people. In particular, member states considered controlling mass migration from Central and Eastern Europe to Western Europe to be an issue of border control (Uçarer, 2005).

⁷⁶ Belgium, Italy, Luxembourg, and the Netherlands were held a positive position on EMU and the issues involved in further integration. Greece, Ireland, Portugal, Spain, and Denmark were willing to support these issues. In particular, the least prosperous member states in the group concentrated on strengthening economic and social cohesion. France supported EMU, but disagreed on strengthening the EC's institutions. Germany supported the development of the CFSP but was cautious on EMU. The UK adopted a minimalist position on the issues. See Nugent (2006).

the first pillar of the EU. The TEU contained the reform of institutions: enhancing the European Parliament's power in the legislative decision-making process, extending the term of office of Commissioners from 4 to 5 years, and established a Committee of the Regions and Local Authorities (CoR) and an Ombudsman for dealing with civil complaints about maladministration in the Community institutions' activities (Bache and George, 2006: 171, 237, 243-244; Dehousse and Magnette, 2006: 24; Nugent, 2006: 88; Wallace, 2005: 67).⁷⁷

In the first pillar of the EC, the Treaty also introduced a new policy of EMU and strengthened the EC's policy competences. The Treaty agreed the introduction of EMU which proposed a fixed exchange rate through the introduction of a single currency, and the establishment of a European Central Bank (ECB). EMU was scheduled to follow a timetable in order for a single currency to be adopted by 1 January 1999 (McNamara, 2005). The EC enhanced existing competences: social policy, the environment, and economic and social cohesion (Phinnemore, 2007). In particular, the TEU stipulated a 'social charter' for regulating 'social provision' in the EU (Falkner, 2007).

As for pillar two, the objectives of the CFSP were 'to safeguard the common values, fundamental interests and independence of the Union' (Nugent, 2006: 90; Bache and George, 2006: 170). For pillar three, the establishment of JHA was to provide legal powers of control to the Union in order to solve matters of common interest: asylum policy, immigration policy, and police-judicial cooperation (Uçarer, 2007).⁷⁸

⁷⁷ The TEU introduced two important principles. The principle of subsidiarity was to reduce over-centralisation of power in member states. In so far as member states could not sufficiently achieve agreements, the Community would take action. The principle of Union citizenship proposed that citizens in the EU would be given the rights to live and work in the territory of member states and vote in the European Parliament and local elections (Phinnemore, 2007).

⁷⁸ The TEU identified and detailed nine areas of 'common interest': asylum policy in order to regulate governing area in member states; immigration policy; combating drug addiction and trafficking, and international fraud; judicial cooperation in civil and criminal matters; customs cooperation; police cooperation to combat terrorism and international organised crime. See Uçarer (2007).

3.1.2. The Commission's financial proposal for 1993-1999

At the Hanover European Council in June 1988, member states reached agreement on establishing an *ad hoc* committee, under the Delors chairmanship, for developing a plan for EMU. The 'Delors Report' was discussed by member states in two European Councils: in Madrid in 1989 and in Luxembourg in June 1991. Finally, at the Maastricht European Council in December 1991, member states agreed the introduction of EMU in TEU. In the Treaty, EMU was to follow a three-stage process: setting up of convergence criteria, establishment of the European Central Bank, and adoption of a single currency. The Treaty stipulated five convergence criteria which were an essential economic condition upon those member states which wanted to join EMU. Applicants were not only required to have a low inflation rate which was an average of the three best-performing member states but were also called upon to have a low interest rate which was an average of the top three countries. Applicants were also required to have an annual budget deficit of less than 3 per cent of their GDP, and their total government debt was to be no more than 60 per cent of their GDP. Finally, it was required that their national currency's exchange rate be stable in exchange markets (McNamara, 2005; Dyson, 2008; Jones, 2006).

The TEU not only retained the economic and social cohesion objective but also created a new Cohesion Fund in order to help member states' economies to meet the economic convergence criteria of EMU. The Cohesion Fund concentrated on four member states – Greece, Spain, Portugal, and Ireland – which had per capita GNP less than 90 per cent of the Community average. The Cohesion Fund proved to be the determining factor in the increase of the Commission's proposal for 1993-1999 (Allen, 2005).

In February 1992, the Commission proposed the Delors II financial perspective for 1993-1999 which packaged together the increase of regional aid, the reform of the UK's rebate, and the CAP (COM, 1992a; Laffan, 1997; Barbour, 1996). For the increase of the EU budget, the Commission adopted the style of the Delors I package, and, thus, proposed an increased ceiling of national GDP from 1.2 per cent to 1.37 per cent, the reduction of agricultural subsidies from about 60 per cent to 45 per cent of the EU's expenditure, and sharply cutting the UK's

abatement by about 50 per cent (Ross, 1995; Laffan and Shackleton, 2000).

3.2. The UK's attitude towards the Delors II package

The UK not only opposed (most of the provisions included in) the TEU but was also against the financial perspective for 1993-1999. For the Conservative government, the TEU threatened British national sovereignty, which was one of the main features of Thatcherism. When John Major replaced Mrs Thatcher as Prime Minister, the Conservative government approach did not change. The Major government opposed the EMU and the Social Charter in the TEU, as well as their implications in the 1993-1999 financial perspective. Thus, there was no incentive for the UK to reduce its rebate, even though the Commission's proposal strongly pressured Britain to make a concession.

3.2.1. European project: the TEU

The victory of the Conservative party in the June 1987 general election was not expected to change the Thatcher government's pragmatic approach to European integration.⁷⁹ This meant supporting the '1992 programme' in order to secure Britain's economic benefits from the liberalisation of the internal market in the EC, even though the direction of European integration diverged from the Thatcher governments' idea about the internal market. However, a turning point to the UK's approach to European integration was the Hanover European Council in June 1988 and the Delors' speech in the European Parliament in July of that year (Forster, 1999).

At the Hanover European Council, member states excluding Britain engaged in an in-depth discussion of the EMU and supported the establishment of

⁷⁹ From the mid-1980s, the stabilisation of the oil price not only reduced the UK's revenues from North Sea oil exports but also depreciated the value of sterling. The depreciation of sterling resulted in boosting Britain's export growth which in turn contributed to reducing the rate of unemployment, increasing wages, and bringing the rate of inflation down. This economic growth brought about the Conservative government's victory in the 1987 general election. The Conservatives won 376 seats while the Labour party and the other parties won 229 and 22 seats respectively (George, 1998).

a European Central Bank which would control the single currency (Dyson and Featherstone, 1993). The Thatcher government was more concerned about losing British national sovereignty on controlling monetary policy rather than its domestic economic interest groups' support on the EMU and, thus, opposed movement towards EMU. This opposition found no counterpart in other member states and the UK was isolated from them. The agreement of the Hanover European Council on setting up the *ad hoc* committee for EMU without Britain's consent caused Britain to reconsider its approach on the European integration (Forster, 1999).

Similarly, Delors' speech in the European Parliament in July 1988 stimulated a change of British attitude because the speech attacked Thatcherism. He particularly emphasised a new social dimension and proposed to create European guidelines on the area. He considered three principles in the guidelines: securing the existing levels of member states' social policies, improving health and safety standards, and guaranteeing workers' rights (George, 1998). The speech infuriated the Thatcher government (Forster, 2002). At the College of Europe in Bruges in September 1988, Thatcher condemned Delors' speech and argued that, for her and the Conservative party, social policy could be considered a socialist attack on Thatcherism and neo-liberalism, which were respectively sources of the Conservative government's economic policies and the EC's free-market policy (Forster, 2002: 64; Geddes, 2006: 129-130):

My first guiding principle is this: willing and active co-operation between independent sovereign states is the best way to build a successful European Community. To try to suppress nationhood and concentrate power at the centre of a European conglomerate would be highly damaging and would jeopardise the objectives we seek to achieve. Europe will be stronger precisely because it has France as France, Spain as Spain, Britain as Britain each with its own customs, traditions and identity. It would be folly to try to fit them into some sort of identikit European personality (Financial Times, 20 September 1988).

At the end of her speech, Thatcher proclaimed that the UK would take anti-European attitudes on the European integration. Thatcher's Bruges speech not

only explicitly proclaimed the change of the Thatcher government's attitudes but also brought about a division of the Conservative government into two groups, pro-Europeanists and 'the Bruges friends',⁸⁰ which had frequent conflicts over shaping the Thatcher government's EC policies (George, 1998; Forster, 1999; Baker *et al.*, 2002).

In May 1989, the Commission launched the first draft of the 'social charter' on workers' rights.⁸¹ The Pro-Europeanist group did not push its argument on the issue. On the contrary, the 'Bruges friends' – particularly the Secretary of State for Industry, Lord Young and the Employment Secretary, Norman Fowler – argued that the Commission's proposals threatened the Conservative government's social policies which concentrated on the reduction of trade union power in order to boost privatisation for the revitalisation of the UK's economy, and employment policies which proposed flexibility over working time and limitation of part-time workers (Sowemimo, 1996). They argued that an agreement of the 'social charter' would restore the influence of trade unions. Eventually, the Thatcher government opposed the Commission's proposal on the social charter (George, 1998; Forster, 1999).

Meanwhile, after the disastrous 1987 general election, the Labour party, under the Kinnock leadership, substantially changed its approach from anti-to pro-European attitude in the late 1980. In particular, in 1988, the Labour party adopted the 'Policy Review', which not only focused on the idea of a 'social-Europe': welfare and social protection in the post-SEA project (the social chapter in the TEU), which was in line with the party's socialism; but also underlined Britain's

⁸⁰ Pro-Europeanists, particularly the Foreign Secretary Sir Geoffrey Howe, the Chancellor of the Exchequer Nigel Lawson, MP Michael Heseltine, the Home Secretary Douglas Hurd, and the Commissioner Lord Cockfield, opposed the change of Thatcher's approach to an anti-European stance, and pressured the government to accept EMU and the social charter in order to continue good relations with the EC and secure economic benefits from the internal market. The 'Bruges friends', mainly the Secretary of State for Industry Lord Young, the Employment Secretary Norman Fowler, and Mrs Thatcher's personal adviser Sir Alan Walters, supported Mrs Thatcher's approach which aimed to preserve British national sovereignty. See George (1998) and Garry (1995).

⁸¹ The social policy question was initiated by France, and faced with the growing enthusiasm of other member states, excluded Britain. See Forster (1999).

economic co-operation with the European partners with a view to reviving the British economic performance and to enhancing economic competitiveness in global market, and left Keynesian spending programme for the purpose of modernising the party's economic policies. The review's idea on European integration became a primary source in shaping the party's pro-European approach which supported the EMU and the social chapter (Gamble and Kelly, 2000; Geddes, 2004; Heath *et al.*, 2001). In addition, Thatcher's Bruges speech in 1988 affected the Labour party's approach. Given the adversarial nature of the UK's domestic politics, the Thatcher government's anti-European stance on the 'social dimension' and on the EMU provided an opportunity to the Labour party to criticise the Thatcher government's European policies, and to take a pro-European approach. The Labour party also proposed an alliance with the pro-EC Liberal party in order to effectively deal with the Conservative government in Parliament (Gowland *et al.*, 2010; Geddes, 2004).

Before the Madrid meeting of the European Council in June 1989, when the proposals of the Delors Committee were discussed, there was a new clash between the two groups within the Conservative party. Both Chancellor Nigel Lawson and Foreign Secretary Sir Geoffrey Howe in the pro-Europeanist group supported Britain's full membership of EMU, and threatened to resign if the Thatcher government did not agree to the UK's full membership of the EMU project. Sir Alan Walters, who was Mrs Thatcher's personal adviser on economics and a member of the 'Bruges friends' (Wallace, 1997; Garry, 1995; George, 1998; Garry, 1995), pointed out that the Delors Committee's report proposed a key role for the German Bundesbank in controlling the Exchange Rate Mechanism (ERM) and the creation of a European Central Bank (ECB) for managing a single currency. For this, he opposed full membership in that the EMU project would infringe upon British national sovereignty on currency control, which was seen as a necessity in fighting against inflation as the top priority in the Conservative government's economic policies (Baker *et al.*, 2002; Sowemimo, 1996; George, 1998). Nevertheless the government faced with the threat of Chancellor Nigel Lawson and Foreign Secretary Sir Geoffrey Howe's resignations and the Conservative party's election defeat in the election of the

European Parliament on 15 June 1989, Thatcher did not change her hostility on the EMU and finally declined Britain's EMU membership (George, 1998).⁸²

Due to the Thatcher government's continued anti-European approach, Lawson and Howe resigned from the cabinet in October 1989 and November 1990 respectively. These resignations boosted the pro-Europeanists' challenge to Mrs Thatcher's leadership in the Conservative party. Michael Heseltine (pro-Europeanist) called on Mrs Thatcher to account for the Conservative party's defeat in the European Parliament election. In subsequent ballot for the Conservative party leadership, Mr John Major was elected to succeed Mrs Thatcher as new Prime Minister (George, 1998; Gamble, 1993).⁸³

Major, who had been the Chancellor of the Exchequer in the Thatcher government after the resignation of Lawson in October 1989, was a member of the pro-Europeanist group in the Conservative party. His new government changed the tone on the EC, agreeing a part of the social charter on health and safety at work and supporting early entry for the UK to the EMU. In the House of Commons in November 1991, this new approach was attacked by backbench

⁸² In the campaign for the European Parliament election in June 1989, the Conservative government continued to take an anti-European stance, while the Labour party changed its position from anti- to pro-European. In particular, the UK's opposition on the social charter caused the trade unions to support the Labour party. The Labour party won 45 seats while the Conservative government won 32 seats. See George (1998), and Forster (1999).

⁸³ The statute of the Conservative party leadership stipulates that the leader must be elected by party members. A candidate must obtain more than 50 per cent of the votes. In the first ballot on 20 November 1990, Mrs Thatcher won 204 votes to her challenger Michael Heseltine's 152 votes, but she needed 4 more votes to win outright. This was because there were 15 per cent of abstentions which included spoilt ballots. A second ballot was required. However, Mrs Thatcher's cabinet members advised her to resign. Due to Mrs Thatcher's resignation from the Premiership and the leadership of the Conservative party after the first ballot, the Conservative party organised the second ballot for electing the leader of the Conservative party, who would become the Prime Minister, on 27 November 1990. In the second round of voting, there were three candidates: John Major, Michael Heseltine, and Douglas Hurd. Major obtained 185 votes while Heseltine and Hurd secured 131 and 56 votes respectively. Although Major won this election, his majority was less than 50 per cent of total votes. The party planned to have a third round on 29 November 1990. Due to the withdrawals of Heseltine and Hurd from the contest, Major became the leader of the Conservative party, and then Prime Minister, without the third round. See George (1998), Gamble (1993) and House of Common 'Leadership Election: Conservative Party <http://www.parliament.uk/documents/commons/lib/research/briefings/snpc-01366.pdf>.

Thatcherite MPs as well as the Labour party. In particular, the Thatcherite MPs demanded a referendum on monetary union before the UK agreed to participate. The Major government was faced with the intra-party faction, and uncertainty regarding the Labour party's support on the government's pro-European approach in Britain's adversarial political system. There was demands from British economic interest groups regarding Britain's membership of the EMU and Major was concerned about these divisions and thus decided on an 'opt-out' clause on the EMU and the social charter in order to gain the support of Thatcherite MPs for British membership of the TEU at the Maastricht summit in December 1991 (George, 1998; Forster, 2002). This view was eventually clearly spelt out in the Conservative party manifesto for the 1992 general elections:

I believe that Britain's destiny does lie in the European Community. But it must be a Community that remains true to the ideals of its founders: open and free. That is why we have been in the forefront of the campaign to complete the Single Market programme which will benefit all European citizens by liberalising their economies, and why we have persistently, and successfully, argued for reform of the CAP ... But Britain refused to accept the damaging Social Chapter proposed by other Europeans and it was excluded from the Maastricht treaty...(1992 Conservative Party General Election Manifesto 'The Best Future for Britain' www.conservativemanifesto.com/1992/1992-conservative-manifesto.shtml).

In the general election on 9 April 1992, the Labour party criticised the Major government's decision on opting-out from the social charter in the TEU. Although the Labour party won 271 seats⁸⁴ which was an increase of 42 seats from the 1987 general election, the party lost the election again. Electoral defeat caused Kinnock to step down as leader of the Labour party (Heath *et al.*, 2001). On 18 July 1992, Mr John Smith succeeded Kinnock and became the leader. However, 2 years later, the death of Smith caused a leadership election. Mr Tony Blair became leader of the Labour party on 12 May 1994. Although Kinnock had left the leadership of the Labour party, his approach towards the European Community was inherited by Blair (George, 1998).

⁸⁴ The Conservative party won 336 seats which represented a reduction of 40 seats from the 1987 general election (George, 1998).

3.2.2. The financial perspectives

The discussion on the financial perspectives for 1993-1999 was scheduled for the Edinburgh European Council on 11-12 December 1992. For the negotiation, the Major government focused on two points: achieving a financial agreement during its Presidency and retaining its budget rebate (Laffan and Shackleton, 2000). First of all, the Major government wanted its pro-European approach to be recognized by other member states, which still considered the UK to be an 'awkward partner'. Thus, achieving an agreement under the British Presidency was important to the Major government in order to gain credibility with other member states (Ludlow, 1993; George, 1998). Secondly, retaining the UK's rebate was an important issue to the Major government to reduce opposition from Thatcherite MPs and the Labour party in the Parliamentary ratification of the TEU (Laffan and Shackleton, 2000).⁸⁵ In fact, in the general election on 13 February 1992, the Major government had lost its ability to override Thatcherite MPs and the Labour party's opposition in seeking parliamentary approval of the British membership of the TEU (George, 1998).⁸⁶

As we saw earlier, one of the main reasons for increasing the EU's budget was the creation of the Cohesion Fund. Regarding the Commission's linkage between the TEU and the Delors II financial package, none of the issues were enough to cause Britain to reduce its rebate (Financial Times, 9 November 1992). An interviewee said that although Major took a pro-European approach which aimed to achieve the financial agreement during the term of the UK presidency, he was more concerned about retaining the rebate in order to prevent a faction in the Conservative party. He significantly concentrated on domestic politics rather than the European integration thanks to losing its majority in the general election and his decision of an 'opt-out' clause on the EMU. Thus, at that time, he did not have any ambitious European integration project which was pressurising him to

⁸⁵ The UK planned to take forward ratification by parliamentary approval in 1992, but the ratification was postponed until July 1993 (Nugent, 2006).

⁸⁶ Although in the 1992 general election, the Major government won 21 seats more than other political parties, the result was a narrow majority in Parliament compared to the 88 seats of the Thatcher government. The narrow majority caused the increase of Thatcherite MPs' power in the House of Commons (George, 1998).

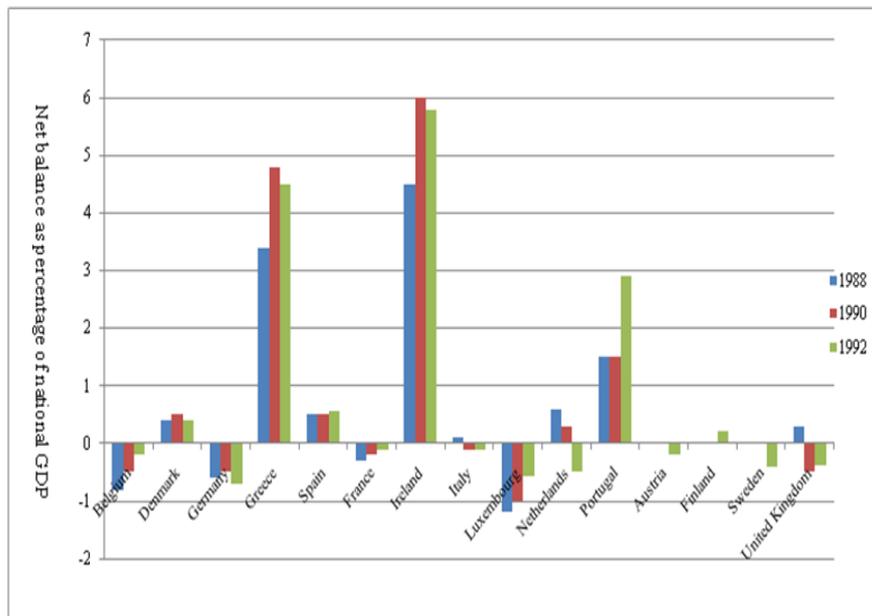
compromise on the rebate. In the negotiation, his priority was the retaining rebate rather than the role of the UK's presidency.

The Major government opposed the increase of the EU's budget and regional aid, which threatened to affect the retention of the UK's rebate, and supported the reform of agricultural subsidies (George, 1998: 251). The British position on the increase of the EU's budget was supported by net contributors, but brought about a conflict with net beneficiaries, particularly 'cohesion countries'. With regard to financial burden-sharing between net contributors, the British position was in conflict with other net contributors on the reduction of the UK's rebate and the reform of the CAP in the package (Laffan and Shackleton, 2000: 223; Lindner, 2006: 136).

3.3. Britain's financial negotiation on the Delors II package

Similar to the events of the Delors I package, the Delors II financial package saw two types of clashes: net contributors vs. net beneficiaries on the increase of the EU's budget and regional aid, and between net contributors on sharing financial burdens (see Figure 5.3). The net beneficiaries strongly demanded an increase in the EU's budget and regional aid while the net contributors deepened their complaints about the increase of their contribution. The UK Presidency of the Council took the negotiation of the Delors II package at the Edinburgh European Council in December 1992. The Major government wanted to achieve this financial agreement during its Presidency, even though it continued to demand retaining its rebate.

Figure 4.1 Net-contributions and net-benefits of member states (1988-1992)



<Source: Commission 'From the Single Act to Maastricht and beyond: The means to match our ambitions' COM (92)2000>

3.3.1. Net contributors versus net beneficiaries

The UK Presidency of the Council scheduled four Council meetings in order to prepare the UK Presidency compromise and the Edinburgh European Council on 11-12 December 1992: a General Affairs Council on 9 November; the Council of Economic and Finance Ministers (ECOFIN) on 23 November; a 'jumbo' meeting of Foreign Ministers and Finance Ministers on 27 November; and a General Affairs Council on 7 December (Laffan and Shackleton, 2000).

In the General Affairs Council meeting on 9 November, Germany politicised its financial problem. Its Minister for Foreign Affairs, Klaus Kinkel, stated that, before the unification, West Germany was one of the rich member states which had the second highest per capita income in the EC, but unification had dragged its prosperity down to sixth place. Yet, Germany continued to account for the highest contribution to the budget. Kinkel thus required reducing the size of its

contribution and the EU's budget (Laffan, 1997). Net contributors, particularly the British Foreign Secretary, Douglas Hurd, supported Kinkel's argument on the reduction of the size of the EU's budget. In response, the Spanish Minister of Foreign Affairs, Mr Javier Solana, argued that the cohesion countries supported the Commission's proposal and opposed any reduction of regional aid (Financial Times, 10 November 1992).

In the ECOFIN meeting on 23 November, the UK Presidency noted the wide gap between net contributors and net beneficiaries in relation to the sizes of the EU's budget and regional aid (Financial Times, 25 November 1992). In the 'jumbo' meeting on 27 November, the UK released a Presidency compromise on the financial perspective for 1993-1999. In that, it pointed out that although net contributors had agreed to the net beneficiaries' demand for an increase of revenue to a ceiling of 1.2 per cent of national GDP in the negotiation of the Delors I package in December 1987, substantial expenditure was 1.15 per cent of GDP at the end of the financial package period of 1992 (Laffan and Shackleton, 2000). In the Presidency compromise, the UK Presidency proposed freezing revenue from GDP at a 1.2 per cent ceiling during the financial period for 1993-1999, against the Commission's proposal of 1.37 per cent. This compromise would provide a sufficient budget for the creation of Cohesion Funds (Financial Times, 29 November 1992).

In response to the UK Presidency compromise, the Spanish Minister of Foreign Affairs, Mr Solana, who led the cohesion countries in the negotiation, argued that the size of the EU's budget would not be enough for the cohesion countries to meet economic convergence criteria, and demanded a new Presidency compromise to increase the size of the EU's budget and arrange redistribution of the EU's budget (Financial Times, 29 November 1992). Furthermore, Delors openly argued the Commission's plan for the development of the EU had been passed over by the UK Presidency, whose proposed compromise did not mediate between net contributors and net beneficiaries, but just reflected the complaints of the net contributors. Thus, in a letter which was sent to the member governments Delors stated that the compromise was an unacceptable proposal (Financial Times, 4 December 1992; Laffan and Shackleton, 2000). By contrast, net contributors

welcomed the compromise. Germany in particular strongly supported the compromise (Financial Times, 29 November 1992).

At the General Affairs Council on 7 December, the UK Presidency unsuccessfully tried to persuade member states to agree to the compromise. The conflict was passed forward to the negotiation between Heads of State in Edinburgh on 11-12 December 1992 (Financial Times, 8 and 9 December 1992). At the Edinburgh European Council, the Spanish Prime Minister, Felipe Gonzales, on behalf of the cohesion countries, stated that the Cohesion Fund constituted an essential redistribution policy to help cohesion countries meet the convergence criteria. He threatened a veto by cohesion countries of any financial agreement, saying they would not do their best in the national ratification of the TEU unless net contributors agreed to the increase of the EU's budget (Financial Times, 14 December 1992). The threat had more effect upon France and Germany than the UK. Chancellor Kohl and President Mitterrand were concerned that member states' failure in national ratification of the TEU would obstruct progress in the EU, as had been the case with the Danish referendum.⁸⁷ They agreed to endorse the increase of the budget and proposed increasing the revenue of the GDP ceiling to 1.27 per cent, which went beyond the UK Presidency compromise. This concession brought about the financial agreement on the size of the EU's budget (Financial Times, 14 and 19 December 1992).

3.3.2. The negotiation between net contributors on sharing the financial burden

At the meeting of the General Affairs Council on 9 November 1992, the UK Presidency and other net contributors not only concentrated on reducing the size of the EU's budget but also discussed the UK's rebate. Germany and other net contributors questioned the justification for continuing the UK's financial privilege. Although they examined all possible ways to reduce their net contribution, they concentrated primarily on reducing the size of the budget rather than on a reduction of the UK's rebate (Lindner, 2006). The UK Presidency

⁸⁷ In June 1992, the outcome of the Danish referendum was that 50.7 per cent of citizens opposed the TEU, while 49.3 per cent supported it (Bache and George, 2006).

argued that there were two reasons to retain its rebate. First of all, it was very difficult to reduce its rebate given the British domestic political situation. The rebate had to be retained if the UK wanted to succeed in national ratification of the TEU. Secondly, the UK was not part of the EMU and therefore should not pay for the Cohesion Fund. Thus, Mr Hurd argued that the UK would not let other net contributors take their rebate to the negotiation table (Financial Times, 10 November 1993).

Before the Edinburgh European Council in December, the net contributors continued to pay attention to reducing the size of the EU's budget. The UK Presidency also used the Presidency compromise to avert net contributors' eyes from the size of the budget. In the 'jumbo' meeting on 27 November, the UK Presidency proposed reducing the revenue of GDP to 1.2 per cent from 1.37 per cent in the Commission's original proposal (Financial Times, 29 November 1992). However, the compromise did not refer to such issues as the UK's rebate and CAP expenditure in order to avoid breaking up the united position of the net contributors on the size of the budget and the complex negotiation structure in the package for achieving financial agreement at the European Council. The UK Presidency also thought that the rebate and agricultural subsidies would not need to be reduced if the EU's budget was frozen at 1.2 per cent of GDP (Lindner, 2006).

At the Edinburgh European Council in December, a deal was made between Chancellor Kohl and President Mitterrand, who agreed the increase in the EU's budget in order to avoid the cohesion countries' threat. This deal brought about a chance for the UK to retain its rebate and achieve an agreement. As a result of the agreement between Germany and France, the UK's contribution would increase by about 0.07 per cent of GDP, if accepted by the UK. In order to engineer the UK's agreement, the two member states conceded keeping the UK's rebate in the financial period for 1993-1999. Major, finally, decided to end the negotiation, and the other member states agreed the conclusion to the UK Presidency (Laffan and Shackleton, 2000).

3.4. Outcome

The UK Presidency scheduled four Council meetings before the Edinburgh European Council in December in order to prepare the Presidency compromise and the European Council. The first two Council meetings on 9 and 23 November were to examine the possibility of reducing the size of the EU's budget. The UK Presidency proposed its compromise in the 'jumbo' meeting, and negotiated the financial perspective in the meeting of the General Affairs Council and the Edinburgh European Council (Laffan and Shackleton, 2000). However, the UK Presidency's schedule was not effective in achieving the outcome at the European Council. This was because the Major government did not want to reduce its rebate. The deal between Chancellor Kohl and President Mitterrand for a side-payment in order to avoid the cohesion countries' threat had the effect of achieving the financial agreement and retaining the UK's rebate (Financial Times, 16 December 1992; Laffan and Shackleton, 2000). The agreement saw that the UK's rebate would be retained until the end of the financial perspective period. The CAP expenditure was maintained, based on the 1988 system. Regional aid increased 41 per cent from the UK Presidency compromise. The revenue ceiling on GDP was maintained at 1.2 per cent in 1993 and gradually increased to 1.27 per cent by 1999. The existing 1.25 per cent VAT level was maintained until 1995 and progressively reduced to 1 per cent between 1995-1999 (Laffan and Shackleton, 2000; Laffan and Lindner, 2005).

4. The financial perspective negotiations for 2000-2006

In the second half of the 1990s, enlargement of the Central and East European Countries (ECEs) became a central issue for European integration. The EU took steps to prepare the enlargement with particular regard to the potential member states' deficient democratic processes and poorer economic conditions. Subsequent to the successful handling of the Delors I and II packages, the Commission proposed the Agenda 2000 package to prepare for the enlargement. This section examines the UK's financial negotiations for Agenda 2000, when despite strong pressure to reduce it; it succeeded in retaining its rebate.

The negotiations were carried out by the New Labour government, which in the May 1997 general election had beaten the Conservative government (Heffernan 2000: 65). New Labour dropped the party's traditional anti-European approach for a new working relationship with the EU (Riddell 2005: 363), which still aimed to protect Britain's interests. Blair argued the UK needed a 'constructive engagement' with France and Germany in order to play a central role in the EU instead of standing on the sidelines (Gowland *et al.*, 2010: 143-144).⁸⁸

4.1. Analysis of the Commission's proposal

The European Commission made a political linkage between preparing the enlargement involving Central and Eastern European countries and the financial perspective for 2000-2006. This was because the enlargement would not only increase the number of member states, but would also have an economic impact on the EU due to the applicants' poor economic condition. The Commission, however, proposed to freeze the ceiling percentage of the EU's revenue from national GDP, because of national budgetary difficulties in most member states. Freezing EU revenue increased the pressure to reduce the UK's rebate and reform the CAP.

4.1.1. Preparing the enlargement of CEECs and the Amsterdam Treaty

After the agreement of the TEU, the enlargement of the EU was an important issue for European integration. At the Lisbon summit on 26-27 June 1992, the member states agreed the enlargement of three EFTA countries: Austria, Finland and Sweden.⁸⁹ The three countries became members of the EU on 1 January 1995. While the enlargement of European Free Trade Association (EFTA) countries was

⁸⁸ The Labour party won 418 seats while the Conservative party won 165 seats.

⁸⁹ In the late 1980s, Austria, Finland, Norway, Sweden, and Switzerland as member states of the EFTA decided to apply for membership of the EC in order to share the investment boom related to the successful agreement of the 1992 programme. Switzerland took a referendum for membership in December 1992 and the Swiss people did not approve its membership. The Norwegians also rejected Norway's membership again in a referendum in November 1994 (Bache and George, 2006; Nugent, 2010).

in progress, the CEECs attempted to gain membership of the European Community. This attempt was influenced by political, security and economic motivations (Mayes, 2007). Politically, the collapse of the communist block brought about the CEECs' desire to be fully integrated in Europe and become members of the EC's liberal democratic system (Sedelmeier, 2000). From a security point of view, the CEECs believed that EC membership would reduce their security protection level and that it would provide a chance to join the North Atlantic Treaty Organisation (NATO). Economically, the CEECs expected that EC membership would be a good opportunity to liberalise and re-generate their economies, and achieve higher economic growth (Sedelmeier, 2005).

Table 4.5 Impact of enlargement (EFTA countries 1995)

Enlargement	New members	Additional population (%)	Added GDP (%)	GDP per capita of new members (% of existing)
1995	Austria, Finland, Sweden	6.3	6.5	103.6

<Source: Barnes and Barnes (2007) 'Enlargement'>

The CEECs' membership was proposed by the European Commission at the Strasbourg European Council in December 1989, as a way to end the division of Europe. The Commission stated that the EC (member states) had the responsibility to assist people and states in Europe which were demanding liberty and democracy. Although enlargement did not find immediate support across all EC member states, the EC still agreed on devising 'an appropriate form of association' with the CEECs. At the Dublin European Council in April 1990, it

agreed the creation of 'European Agreements' (EAs)⁹⁰ to provide guidelines for the EC's approach to CEECs. EAs firstly applied to Hungary, Poland, and Czechoslovakia, which were the leading reformers in the CEECs. These countries, however, maintained that the EU's economic support was below their expectation, and ceased their attempts towards membership of the EEC (Sedelmeier, 2005; Preston, 1997).

At the Copenhagen European Council in June 1993, the Commission raised the issue of the CEECs' membership again. The member states not only adopted the Copenhagen declaration,⁹¹ which endorsed the CEECs' membership but also demanded the devising of a strategy, based on the '*acquis communautaire*, for preparing the CEECs' accession (Sedelmeier, 2005). The preparation of a pre-accession strategy became one of the issues in the review of the TEU. At the Corfu European Council in June 1994, member states agreed to establish a 'Reflection Group' in order to examine and elaborate ideas on pre-accession strategy and the unfavourable public opinion of the Treaty's review (Nugent, 2006).⁹² In May 1995, the Reflection Group presented a White Paper which proposed three main areas: 'enabling the EU to work better and prepare for the enlargement, making Europe more relevant to its citizens, and giving the EU greater capacity for external action' (Preston, 1997). At the Madrid European Council in December 1995, member states discussed the White Paper and scheduled the Intergovernmental Conference (IGC) for July 1996 (Sedelmeier, 2005).

At the IGC in 1996, the UK blocked the negotiations in order to remove a

⁹⁰ At the Dublin European Council in April 1990, member states agreed to the creation of EAs, which meant that CEECs had to accept opening their domestic markets for industrial products, and a common foreign policy, if they wanted economic cooperation with the EC and to obtain EC technical and financial assistance (Sedelmeier, 2005).

⁹¹ The Copenhagen declaration not only contained an endorsement of CEECs' membership but also established 'the Copenhagen criteria'. These criteria stipulated that a candidate country in the CEECs had to have an established liberal democracy and a market-based economic system. It was also essential to the candidate to adopt the *acquis communautaire* (Nugent, 2004a and 2004b).

⁹² The Reflection Group was composed of a representative at the Ministerial level from each member states, two representatives from the European Parliament, and one representative from the European Commission (Nugent, 2006).

ban on exports of British ‘mad cow’ beef to Europe. The member states awaited the British general election on 1 May 1997, in the hope that the Conservative government would lose to the Labour party, which under Tony Blair’s leadership had taken a pro-European approach. The IGC laid plans for the European Council in Amsterdam on 16-17 June 1997 in order to review the TEU (Bache and George, 2006: 185). At the Amsterdam European Council, member states agreed the Treaty of Amsterdam, which consisted of six sections: Section I: freedom, security and justice; Section II: the Union and its citizens; Section III: an effective and coherent external policy; Section IV: the Union’s institutions; Section V: closer cooperation-‘flexibility’; and Section VI: simplification and consolidation of the Treaties (Nugent, 2006: 96-102; Laursen, 2002: 12-14).

The pre-accession strategy for the enlargement of CEECs involved Section IV and V in the Treaty of Amsterdam. The EU focused on an extension of Qualified Majority Voting (QMV), the functioning of the European Commission, and further strengthening the role of the European Parliament. Firstly, the extension of QMV was opposed by German Chancellor Kohl, who had at first supported it, particularly in the areas of industrial policy, social policy, and the free movement of labour. Section IV extended QMV in the areas of employment guidelines, social exclusion, equal opportunities for men and women, research in the EC pillar, and the CFSP policies. Secondly, the number of Commissioners would be retained: one representative from each member state unless more than six countries joined the EU. The size of the EP would be increased to about 700 seats. Thirdly, the role of the EP in EU decision-making was strengthened through the extension of the assent and co-decision procedure areas. Moreover, it would approve the European Council’s nominee for Commission president (Phinnemore, 2007; Shackleton, 2006; Falkner and Nentwich, 2000; Sedelmeier 2005).

Section V legally accepted ‘flexibility’ which reflected a discussion between member states. At the IGC, the member states assumed that the increase number of member states would bring about difficulties to achieve agreements for the direction of European integration. With regard to domestic interests all member states would not be in favour to agree European integration issues. Member states discussed ‘flexible integration’ which proposed allowing partial membership

(Stubb, 2000: 154). When the major member states were confronted with a minority of the less integrationist member states' dissatisfaction on certain issues, the Council of Ministers would take on such issues and achieve agreement by QMV. If any member state insisted its vital national interests on certain issues were threatened, the member state would not be allowed to participate in integration, instead of blocking the agreement (Sedelmeier, 2005; Stubb, 2000).

4.1.2. The Commission's financial proposal for 2000-2006

In July 1997, the Commission under President Jacques Santer⁹³ launched its financial proposal, named *Agenda 2000: For a Stronger and Wide Union*, which proposed a broad outline of the financial perspective for 2000-2006 and reforms of the EU's policies, notably the reduction of the rebate and the CAP, and the reform of regional aid with regard to the pre-accession strategy for the enlargement of CEECs (COM, 1998: 29). Agenda 2000 was based on a financial section of the Reflection Group's White Paper from May 1995 and proposed the creation of 'pre-accession aid' which consisted of the Instrument for Structural Policies for Pre-Accession Aid and the Special Accession Programme for Agricultural and Rural Development, in order to financially assist CEECs' preparation for membership (Allen, 2005; Sedelmeier, 2005). On 18 March 1998, the Commission proposed a detailed financial proposal which was submitted at the Cardiff European Council on 15-16 June 1998. At the European Council, member states fixed a deadline for financial negotiations for Agenda 2000 of March 1999, before the European parliamentary election in June (Laffan and Shackleton, 2000).

The Commission's financial perspective for 2000-2006 reflected Germany's financial problems and other member states' domestic political difficulties. First of all, Germany was afraid its contribution to the EU's budget would be high because it had struggled to overcome its national payment for the cost of its unification. Secondly, other member states had difficulties with their national budgets in spending on economic growth in order to meet the EMU convergence

⁹³ In 1995, Jacques Santer, the Prime Minister of Luxembourg, was chosen to become the president of the Commission after Delors left Brussels (Peterson, 2006).

criteria (Lindner, 2006: 140). For all member states, in short, it was difficult to increase their contributions in view of the enlargement of CEECs, because they were struggling with their existing financial burden. The Commission, thus, proposed freezing the ceiling of GDP at 1.27 per cent (COM, 1998: 30). With regard to freezing the EU's revenue from GDP, the Commission proposed a financial package: freezing regional aid, reforming the CAP, and reducing the UK's rebate (Lindner, 2006).

As we see from Table 4.6, the European Commission proposed allocating €75 billion, about 0.46 per cent of the EU's GNP, for regional aid, which was broken down into €30 billion for existing regional aid and €45 billion for pre-accession aid (Allen, 2005). It proposed the reform of the CAP, which would restrain CAP expenditure based on the 1992 MacSharry reforms⁹⁴ in order to change the EU's budgetary flow towards rural development and environmental protection (Fouilleux, 2007; Laffan and Shackleton, 2000). Finally, it proposed the reduction of the UK's rebate in order to reduce net contributor countries' financial burden (Lindner, 2006).

Table 4.6 Financial perspective 2000-2006 (in EUR million-1999 prices)

	2000	2001	2002	2003	2004	2005	2006
Appropriations for commitments	40920	42800	43900	43770	42760	41930	41660
1. AGRICULTURE FUNDS							
2. STRUCTURAL OPERATIONS	32045	31455	30865	30285	29595	29595	29170
3. INTERNAL POLICIES	5930	6040	6150	6260	6370	6480	6600
4. EXTERNAL ACTION	4550	4560	4570	4580	4590	4600	4610
5. ADMINISTRATION EXPENDITURE	4560	4600	4700	4800	4900	5000	5100
6. RESERVES	900	900	650	400	400	400	400
7. PRE-ACCESSION AID	312	312	312	312	312	312	312
TOTAL appropriations for commitments	92025	93475	93955	93215	91735	91125	90660
TOTAL appropriations for payments	89600	91110	94220	94880	91910	90160	89620
Available for accession			4140	6710	8890	11440	14220

⁹⁴ Agricultural subsidies initially guaranteed food prices on over-production and import competition. However, the Commissioner for Agriculture, Ray MacSharry introduced the 'MacSharry reform' in May 1992 which proposed the reduction of CAP subsidies, particularly reducing product support to farmers, in order to sink the prices of agricultural products in the Community to the levels of world prices (Rieger, 2005).

Appropriations for payments as % of GNP	1.13	1.12	1.18	1.19	1.15	1.13	1.13
Margin	0.14	0.15	0.09	0.08	0.12	0.14	0.14
Own-resources ceiling (% of GNP)	1.27	1.27	1.27	1.27	1.27	1.27	1.27

<Source: Commission 'Agenda 2000: Financing the European Union' COM (1998) 560>

4.2. The UK's attitude towards Agenda 2000

In 1997, the Labour party's pro-European approach, under the Blair leadership, won the general election. The new Labour government emphasised economic efficiency and social justice as the underpinning its domestic and European policies (Geddes, 2004; Ludlaw, 1988; Bache and Jordan, 2006). In domestic policies, the Blair government announced that it would concentrate on enhancing the role of the government with the aim of securing social welfare systems and public services. In European policies, it would base its approach on three elements: state intervention, social protection, and economic liberalism (Clift, 1988: 59-61). Its pro-European approach had been spelt out in a famous speech in Manchester on 21 April 1997 (cited in Wall, 2008: 162).

:

There are three choices open to Britain. The first is leaving; the second is in but impotent; and the third is remaining in but leading... Of course we must stand up firmly for Britain's interests. And, as I have always made clear, we must be prepared to stand alone in support of those interests if necessary. But it is misguided to make perpetual isolation the aim of our policy ... I want Britain to be one of the leading countries in Europe ... This is a good moment for Britain to make a fresh start in Europe.

The New Labour government immediately embarked on two negotiations at the IGC for reviewing the TEU with regard to the enlargement of CEECs in June 1997, and the negotiations of Agenda 2000, containing pre-accession aid, from June 1998 to March 1999. At the Amsterdam IGC, the government's pro-European approach positively dealt with European integration issues which tied up Britain's interests, particularly the social chapter. Without any fear of a loss of national sovereignty, the new government agreed the reform of institutions which paid attention to the increased 'pooling' of national sovereignties through

extensions in Qualified Majority Voting (QMV) and increased powers for the EP in the EU, new rules on transparency and new human rights and anti-discrimination provisions which were issues to prepare conditions for the enlargement of CEECs (Fella, 2006: 621, 624; Baker, 2005: 23). On the government's agreements, the Conservative party, under Hague's leadership⁹⁵ criticised the government's pro-European approach. However, due to the absolute majority of the Labour party, it was not very difficult to continue its position on the EU (Baker *et al.*, 2002: 404; Smith, 2005: 708; Redgrave, 2008: 424). In addition, the UK supported the enlargement and agreed to the Amsterdam treaty for preparing the enlargement, but did not accept the reduction of its rebate in the Agenda 2000 package.

4.2.1. The enlargement of CEECs

At the IGC in Amsterdam on June 16-17, 1997, the Blair government worked to remove the stigma of 'awkwardness' which had characterised the Conservative government's attitude on the EC. On the enlargement of CEECs, some member states⁹⁶ were not so enthusiastic, but the UK supported the enlargement. The New Labour government's approach to the enlargement was influenced by the 'third way': Britain saw that the enlargement would bring about a much bigger internal market in the EU which would provide economic advantages⁹⁷ to the UK via trading in the internal market (Baldwin *et al.*, 1997).

⁹⁵ In the 1997 leadership election in the Conservative party, William Hague won the election. The new leader changed the Major government's pro-European approach and threw out members of the European wing from the leader group in the party. The party's attitude on the EU returned to Thatcherite's anti-European approach. See Baker *et al.*, (2002).

⁹⁶ France was concerned about diminution of French influence in the direction of the EU. The enlargement would not only bring about an increased number of member states but would also risk generating institutional paralysis. The new member states would have veto powers which would obstruct the instinctual French preference for deeper integration. Greece, Ireland, Italy and Spain were also concerned about possible reduction of their voting power and of their financial benefits from EU subsidies. See Gowland *et al.* (2010).

⁹⁷ In 1985, Germany accounted for 42 per cent of the total EU' exports to the CEECs while the UK only accounted for 5 per cent. Thus, the UK saw that the enlargement would cause an increase in the percentage of British exports to the CEECs (Baldwin *et al.*, 1997).

The New Labour government's attitude on the enlargement of CEECs affected Britain's negotiations at the IGC in Amsterdam in June 1997. At the IGC, the Blair government was willing to agree both Section IV (the Union's institutions) and Section V (closer cooperation - 'flexibility') which had relevance to the enlargement. In Section IV, Britain agreed to the institutional reforms: some extension of QMV (on the areas of anti-fraud measures, regional aid and environmental policy), the increase of the EP's power in decision-making, and the increase in numbers at the EP. However, on the extension of QMV, Britain opposed giving up its veto on the areas of taxation, defence and security, immigration and treaty changes. Furthermore, in Section V, Britain was willing to agree 'flexibility' which would protect non-participants' interests in European integration (Best, 2002; Geddes, 2004; Gowland *et al.*, 2010).

4.2.2. The financial perspective

With regard to the Commission's financial package, the Blair government supported regional aid, freezing the EU's budget and the reform of the CAP, but opposed the reduction of the UK's rebate (Financial Times, 15 June 1998). Blair argued that the British rebate was not negotiable, for at least three reasons (Blair, 2010: 533). First of all, in term of economic growth, the UK ranked ninth within the 15 member states. The reduction of the UK's rebate would worsen this situation (Galloway, 1999). Secondly, the Blair government supported social protection, but social protection in the 'Third way' emphasised job *creation* rather than job *protection* (Gowland *et al.*, 2010: 146). Blair argued that agricultural subsidies only focused on safeguarding farmers' income even though it still represented about 48 per cent of EU expenditure. He, thus, supported the reform of the CAP in order to change the EU's budgetary flow towards job creation (Financial Times, 16 June 1998). Thirdly, the Labour party adopted a pro-European approach, vis-à-vis the previous Conservative governments, which had successfully retained the UK's rebate in the financial negotiations in 1988 and 1993 respectively. There was economic groups' support to the Blair government's pro-European approach on the enlargement. However, Blair hesitated to take a positive view on the rebate issues. This was because if the Blair government

agreed to the reduction of the UK's rebate, the public, the Conservative party, and the Labour party's left wing would criticise the government's pro-European attitude (Financial Times, 16 June 1998). These fears were confirmed by Blair (2010: 532-534) himself in his memoirs.

I had two problems over the rebate, both significant for how our relationship with Europe under my leadership could develop. The first was the near-hysterical-sorry, correct that-truly hysterical behaviour of the Eurosceptic media. Paper with a combined daily circulation of around eight million- a situation unique in Europe in terms of pervasion-were totally, wildly and irredeemably hostile to Europe, misrepresented what Europe was doing and generally regarded it as a zero-sum game: anything that pleased Brussels was bad for Britain ... Moreover, in the rest of the world a Britain semi-detached from Europe was regarded as odd, part of British eccentricity, something to be amused by, a 'goo old Brits' type of thing which I really detested.

In the light of all these reasons, Blair argued that even though the UK supported the enlargement of CEEC it would not accept the reduction of the UK's rebate – in fact, the reform of the CAP would be able to secure pre-accession aid (Financial Times, 16 June 1998).

Table 4.7 A historical perspective on agriculture in Europe

	Population active in agriculture (% total population)		Share of agriculture (% GDP)	
	1950	2000	1950	2000
Netherlands	17.7	3.4	12.9	2.2
Belgium	11.9	1.8	8.8	1.1
Luxembourg	24.7	2.3	9.5	0.6
France	30.9	3.4	15.0	2.2
Germany	23.0	2.5	12.3	0.9
Italy	44.4	5.3	29.5	2.4
Denmark	25.7	3.8	20.4	2.3
Ireland	40.2	10.2	31.3	2.5
UK	5.5	1.8	6.0	0.6

Portugal	53.1	14.3	26.8	2.4
Spain	51.5	7.3	35.0	3.6
Greece	48.9	13.4	33.5	6.7
Sweden	22.8	3.5	7.0	0.6
Finland	36.9	5.9	...	0.9
Austria	34.2	5.1	16.4	1.3

<Source: Rieger (2005) 'Agricultural Policy: Constrained Reforms'>

4.3. Britain's financial negotiation on Agenda 2000

Although in its proposal the Commission had considered net contributors' national budgetary difficulties and proposed freezing the EU's budget, Germany demanded the reduction of its financial burden. This significantly complicated the negotiations. Agenda 2000 entailed difficult negotiations between net contributors and net beneficiaries on the size of regional aid, and within the net contributors' group on sharing of the financial burden.

4.3.1. Net contributors versus net beneficiaries

Net contributors and net beneficiaries disagreed over reducing their financial burden and securing their financial benefits respectively. At the Cardiff European Council on 15-16 June 1998, under the UK Presidency, net beneficiaries drew a hard-and-fast line on the issue of freezing regional aid. The Spanish government, which had taken financial benefits from regional aid, argued that the creation of pre-accession aid was a primary element in threatening net beneficiaries' financial benefits and was unwilling to agree the flow of the financial benefits it received towards preparing for the enlargement of CEECs. Hence, Spain was prepared to resist all attempts which would threaten its beneficial position (Financial Times, 15 June 1998). The other Mediterranean member states, Greece and Portugal supported the Spanish argument, and demanded the increase of regional aid (Laffan and Shackleton, 2000). The Irish government also argued that it could not agree to Agenda 2000 because it was confronted with its own financial difficulties. Due to a steady economic growth since 1990, financial benefits from regional aid would be reduced. Furthermore, with regard to the Commission's CAP proposal, its benefits from agricultural subsidies would be reduced too (Laffan and

Shackleton, 2000).

While net beneficiaries opposed Agenda 2000, net contributors supported the Commission's proposal on freezing the EU's budget and regional aid. In particular, Chancellor Kohl was preoccupied with German national budgetary difficulties on paying the cost of German unification as well as the domestic political issue of a general election in September, and demanded the reduction of Germany's net contribution. Kohl also demanded the establishment of a 'correction mechanism' in order to reduce net contributors' financial burden⁹⁸. Blair and other the heads of other 'net contributor' governments saw that the demand restricted net beneficiaries' requirements on the size of regional aid, and thus, supported Germany (Financial Times, 15 and 17 June 1998). At the Cardiff European Council, member states ascertained that a wide gap between net contributors and net beneficiaries on Agenda 2000 was blocking a financial agreement and therefore decided to postpone the financial negotiation so that Chancellor Kohl could avoid domestic political difficulties⁹⁹ in the German general election and fixed a deadline for financial agreement of March 1999 (Financial Times, 17 June 1998).

At the Vienna European Council under the Austrian Presidency on 11-12 December 1998 member states started the financial negotiation, but could not bridge the wide gap which again was blocking agreement. Gerhard Schröder, Germany's new chancellor, pointed out the size of Germany's contribution to explain the appropriateness of reducing its contribution (Financial Times, 12

⁹⁸ Chancellor Kohl pointed to the Netherlands, Sweden and Austria as large net contributors to the EU's budget (Financial Times, 15 June 1998).

⁹⁹ The financial negotiation for Agenda 2000 would provide political difficulties for Chancellor Kohl in the German general election on 27 September 1998. Kohl's demands for the reduction of Germany's net contribution, and an agreement of the financial negotiation were difficult to meet. Thus, if Kohl agreed to increase the EU budget and Germany's contribution in order to achieve a financial agreement, he would not be able to avoid criticism from the other candidates over the increase of Germany's financial burden. If Kohl delayed the financial agreement in order to reduce Germany's financial burden, he would not be able to escape being criticised on the matter of his leadership in the EU (Financial Times, 17 June 1998).

December 1998).¹⁰⁰ With regard to the Commission's report *Budgetary imbalance for an individual member state* on 7 October 1998, Germany's payment to the EU's budget was Ecu 11.08 billion in 1997 while the Netherlands, which was the second-biggest net contributor and the wealthier member state based on GDP, was Ecu 2.32 billion; Britain's payment was Ecu 1.88 billion (Financial Times, 8 October and 10 December 1998). Due to Germany's economic difficulties, Schröder demanded freezing the EU's budget and regional aid in order to reduce its contribution. Blair hoped that Schröder's argument would effectively bring about a concession from net beneficiaries but actually brought about opposition from the net beneficiaries and blocked the negotiation (Financial Times, 12 December 1998). The Austrian Presidency handed over negotiations of Agenda 2000 to the German Presidency in the first half of 1999.

The German Presidency argued that it would concentrate on the reduction of Germany's contribution, a freeze of regional aid, the reform of the CAP, and the reduction of the UK's rebate in the financial negotiation for Agenda 2000 (Financial Times, 27 January 1999). During the meetings of Economic and Financial Ministers on 7 February 1999, and Foreign Ministers on 25 February 1999, the Presidency explored the possibility to reduce the wide gap between net contributors and net beneficiaries on the size of regional aid (Financial Times, 7 and 26 February 1999).

At the Berlin European Council on 24-25 March 1999, both net contributors and net beneficiaries made concessions to achieve the financial agreement. However, the concessions were caused by non-budgetary issues: the creation of a permanent committee for improving coordination of the Common Foreign and Security Policy (CFSP), and an institutional crisis¹⁰¹ (Lindner, 2006; Laffan and Shackleton, 2000; Financial Times, 24 March 1999). Both net contributors and net beneficiaries recognised the importance of the financial agreement in order to

¹⁰⁰ In the German federal election on 27 September 1998, Schröder led the Social Democratic Party (SPD) to victory, and became the Chancellor of Germany.

¹⁰¹ Article 214 of TEU stipulated that the European Parliament had a voting power to approve nomination of the President and the other members of the Commission. In January 1999, the EP held an approval vote and dismissed the Research Commissioner, Edith Cresson, which caused Commissioners' mass resignation in March 1999 (Peterson, 2006).

successfully encourage agreements to solve non-budgetary issues (Financial Times, 24 March 1999). The Presidency compromise proposed €13 billion of regional aid during the financial period for 2000-2006 which mediated between net beneficiaries' minimum acceptance level of €39 billion and net contributors' maximum acceptance level of €200 billion. Finally, both groups agreed the Presidency compromise (Allen, 2000).

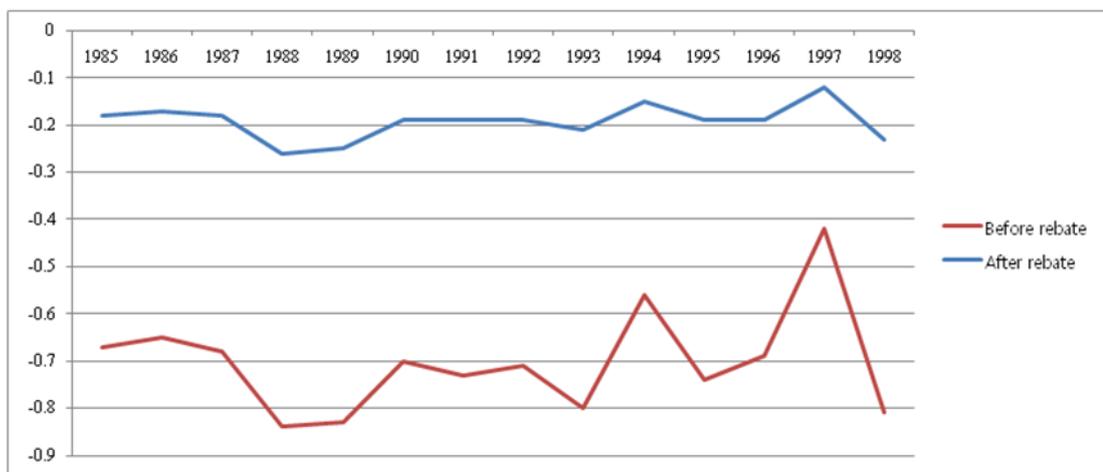
4.3.2. The negotiation between net contributors on sharing the financial burden

At the Cardiff European Council in June 1998, the UK's rebate was attacked by other net contributors. The UK Presidency pointed out Germany's demand on the size of its contribution which required not only the reduction of the UK's rebate but also the increase of other net contributor's contribution in order to reduce its contribution, and defined that the demand was a central issue in the negotiation between net contributors. The Presidency said that due to increased number of net contributors (the enlargement of EFTA countries in 1995) and freezing the size of the EU budget in the Agenda 2000, Germany's contribution would be reduced. Nevertheless Germany continuously demanded the reduction its contribution which pressured Britain and other net contributors. Blair argued that Britain was still struggling with the imbalance between its contributions and receipts (see Figure 5.4). Therefore, although the British Presidency took a pro-European approach, it was very difficult to accept Germany's demand on the reduction of the rebate (Financial Times, 15 June 1998).

In response, other net contributors argued that, in 1984, member states had agreed the rebate mechanism in order to reduce a British imbalance which resulted from over 70 per cent of the EC's budget spending going on agricultural subsidies. During the financial period for 1993-1999, farm spending was less than 50 per cent. The percentage of agricultural subsidies indicated a reduction of the British budgetary imbalance (Financial Times, 8 October 1998). Thus, the appropriateness of the British rebate was in question. Furthermore, the net contributors pointed out the percentage of the British contribution to the EU's

budget was too little compared to that of Germany, Greece, France, and Italy¹⁰², and thus, demanded sharing of the financial burden with regard to Germany's demand. Nevertheless, Blair was not convinced by these arguments and the negotiations on sharing financial burden were postponed to the Vienna European Council in December 1998 (Financial Times, 17 June 1998).

Figure 4.2 Budgetary balance of the United Kingdom



<Source: Commission 'Agenda 2000 Financing the European Union' COM (1998)560>

At the Vienna European Council, Schröder's argument for reduction of the German contribution not only suppressed net beneficiaries' demands for the increase of regional aid, but also required the reduction of the UK's rebate and the reform of the CAP (Financial Times, 12 December 1998). Schröder argued that the reduction of the British rebate was essential to prepare pre-accession aid for the enlargement involving CEECs (Financial Times, 12 December 1998). Blair made a political linkage between the reduction of the rebate and the reform of the

¹⁰² In 1997, Germany accounted for 26 per cent of the EU's total GNP, and contributed 28.2 per cent of the EU's budget. Greece was 1.5 per cent and 1.6 per cent respectively. France was 17.5 per cent and 17.5 per cent. Italy was 14.2 per cent and 11.5 per cent. However, the UK was 16.1 per cent and 11.9 per cent (Financial Times, 8 October 1998).

CAP. He insisted that the British rebate was fully justified because the CAP, which had caused the UK's imbalance, still accounted for the highest expenditure in the EU's budget. If net contributors wanted to reduce the UK's rebate, they should agree to a significant reform of the CAP in order to address the British imbalance (Financial Times, 17 December 1998). The French President Jacques Chirac argued that budgetary imbalance was not solely a British problem. Germany, the Netherlands, Sweden and Austria also had had budgetary imbalances and had paid their contribution without the rebate. Thus, he criticised Blair's political linkage and rejected an agreement on the reform of the CAP (Financial Times, 15 December 1998). Jean-Claude Juncker, the Luxembourg Prime Minister, criticised the debate on the reduction of the UK's rebate and the reform of the CAP and the concomitant deadlock of the negotiations (Financial Times, 12 December 1998).

At a meeting of Agricultural Ministers in Brussels on 9 March 1999, Jean Glavany, the Ministry of Agriculture and Fishing in France, agreed to the reform of the CAP in order to keep the strong alliance between France and Germany. The agreement placed considerable pressure on Britain to reduce the British rebate (Financial Times, March 9, 12, 1999; Lindner, 2006). At the Berlin European Council in March 1999, Chirac agreed to reduce agricultural subsidies from €51.6 billion in the Commission's initial proposal to €41.6 billion. Schröder argued that the reform of the CAP would reduce the UK's imbalance, and all member states, except Britain, welcomed the reform of the UK's rebate (Financial Times, 23 March 1999). Britain criticised the agreement over CAP reform as being not enough to reduce the British imbalance. With regard to the EU's market-based economic policies, the reform would significantly cut down the size of agricultural subsidies (Financial Times, 12 and 23 March 1999). Although Britain provided several reasons for retaining the rebate, the Blair government's fear of criticism over its European policies in the domestic political arena, compared with the previous Conservative governments' success, was a major factor (Blair, 2010: 535-536). Finally, given Schröder's ambition to be as much a leader of Europe as his predecessor, the Germany Presidency accepted retaining the UK rebate. Schröder thought that this consolidated reputation would help his party to win in

the election of the EP in June 1999 (Lindner, 2006).

4.4. Outcome

In the two European Councils in Cardiff and Vienna, Germany concentrated on the reduction of its contribution to the EU's budget, and thus, demanded agreement of the Agenda 2000 package: the reduction of the UK's rebate, the freeze of the EU's budget and regional aid, and the reform of the CAP. However, during the German Presidency, Schröder not only concentrated on the reduction of his nation's contribution but also the agreement of Agenda 2000 on time to maintain the continuity of German Chancellors as 'leaders of Europe'. Although the German Presidency succeeded in cutting down EU revenue from 1.27 per cent of GDP to 1.13 per cent, agricultural subsidies from €1.6 billion to €1.6 billion, and regional aid, including the pre-accession aid, from €32.5 billion to €29.1 billion, the Presidency failed in the matter of the reduction of the UK's rebate; This meant that Germany would remain the biggest net contributor. Britain retained the UK's rebate safely (Laffan and Shackleton, 2000; Lindner, 2006).

5. Conclusion

In the Delors I package, article 130s of the SEA (economic and social cohesion) was a key element in increasing the EC's budget and regional aid which placed pressure on Britain to reduce its rebate. On the European project of 'deepening', whilst the Thatcher government supported the single market programme which was in line with its market-based economic ideas, it had a sceptical attitude on the SEA because it was believed to undermine national sovereignty, which was one of the elements of Thatcherism. The Thatcher government's approach on the SEM meant that the UK agree the increase of regional aid and the size of the EC budget in the negotiations between net contributors and net beneficiaries at the Luxembourg European Council in December 1985. The British concession was a side-payment to the Mediterranean member states in order to boost the member states' co-operation for completing the single market by 1992. In the negotiation within net contributors on sharing financial burden, due to the sceptical approach

to the SEA, Britain was undaunted by other net contributors' threats. Other net contributors were willing to support the SEM. Thus, their threats were not strong enough to pressure Britain to reduce its rebate; the UK succeeded in retaining its rebate at the Brussels European Council in February 1988.

The Delors II package contained the key element of creating the Cohesion Fund which aimed to support poorer member states to meet economic convergence criteria in the EMU. The Cohesion Fund caused the EU's budget to increase, which called into question once again the British rebate. On the TEU, the Thatcher government took an anti-European approach in order to secure national sovereignty. In the financial negotiations, although the new Major government wanted to take a more pro-European approach, the Conservative government's anti-European approach was restrained by Thatcherites in the Conservative party. In the negotiation between net contributors and net beneficiaries on the size of the EC budget and regional aid, the UK did not feel heavy pressure to reduce its rebate. Although the Conservative government was able to retain the rebate and to oppose the increase of the EC budget, due to Major's wish to change the view of the UK of being an 'awkward partner', it agreed to the increase of the EC budget and regional aid in order to play the role of the Presidency successfully. In the negotiation with net contributors on sharing financial burden, the net contributors did not have any cards to use to pressure Britain to reduce its rebate. At the Edinburgh European Council in December 1992, the UK managed to retain its rebate.

Finally, the pre-accession aid for preparing the enlargement of CEECs was a key concern in the Agenda 2000 package. Taking into account the net contributors' financial burden, the European Commission proposed freezing the EU's budget and regional aid. However, Germany's demand for reduction of its contribution complicated the negotiations. The New Labour government not only had a pro-European approach but also supported the enlargement. In the negotiations between net contributors and net beneficiaries on the size of the EU's budget, and within net contributors on sharing financial burden, Germany's and net contributors' demands were further removed from the project. Although the New Labour government took a pro-European approach, Germany's demand was

unacceptable to Britain and thus, the Blair government opposed the reduction of its rebate at the Berlin European Council in March 1999.

Chapter 5

Sacrificing the rebate: the UK's concession in 2005

1. Introduction

On 10 February 2004, the European Commission published a proposal which packaged together the Lisbon strategy and the financial perspective for 2007-2013. Taking into account the enlargement of Central and Eastern European Countries in 2004 it proposed a reduction of the UK's rebate. The UK rebate became a controversial issue at the Brussels European Council in June 2005, under the Luxembourg presidency. On the one hand, several member states added to pressure on the UK, despite their being aware of the UK's imbalanced contributions, in order to avoid an increase of their own contribution. On the other hand, the UK struck a blow, but in line with its support of the Lisbon strategy and the enlargement, Tony Blair made a conditional offer, linking the UK's rebate and the reform of the CAP. For Britain, the CAP was not only a barrier to the modernisation of EU spending priorities, but also a primary cause of Britain's financial imbalance. This proposal was confronted with French and German opposition, which caused Britain to leave the negotiation table, and the eventual failure to achieve a compromise under Luxembourg's Presidency.

The financial negotiations were continued in the Brussels European Council, December 2005. The new UK Presidency organised several meetings, such as an informal European Council and other Council meetings, to persuade member

states on the importance of the modernisation of the EU. Member states continued to pressure the UK to take seriously the responsibilities of net contributors and of the Presidency of the Council, and change its position on the rebate in order to achieve the financial agreement. At the Brussels European Council in December, Britain unexpectedly accepted a reduction in the size of its rebate and successfully led member states towards achieving the financial agreement.

This chapter, thus, explores the negotiations for the 2007-2013 financial perspective, explaining the change of the UK's position on the rebate in December 2005. To do so, it consists of three main sections. The first section analyses the Commission's proposal in order to identify the main influences upon the Commission proposed reduction of the UK's rebate. In particular, it looks at the Lisbon strategy, the Eastern enlargement, and the proposal to cut the British rebate. The second section concentrates on the UK's approach to the Commission's proposal, again paying attention to the Lisbon strategy, the enlargement, and the proposal for a reduction of its rebate. The third section concentrates on the negotiations between member states, first under the Luxembourg Presidency and then under the UK presidency. The aim is to explain the difference in the British decisions between the two European Council meetings in June and December 2005.

2. The Commission's financial proposal for 2007-2013

Two elements affected the shaping of the Commission's financial proposal: the Lisbon strategy and the enlargement of Central and Eastern European Countries. The Lisbon strategy indicated the direction of the EU for further European integration with regard to the challenge of globalisation, and in the intention of the Commission the 2007-2013 financial perspective aimed to financially support it. The 2004 and 2007 enlargement rounds not only increased the number of member states from 15 to 27 but also resulted in the increase of the size of the EU budget for redistribution.

2.1. The Lisbon strategy

At the European Council in Lisbon on 23-24 March 2000, the member states discussed a modernisation of the EU which derived from Delors' White Paper in 1993. The White Paper not only emphasised strengthening the EU's economic growth, competitiveness, and jobs in order to prepare conditions within the EU for the global stage, but also required radical social and economic reforms. The Delors proposal had originally died out with Delors' resignation. However, when the EU was faced with the challenge of globalisation and demographic changes, the Delors' White Paper was revitalized (Jones, 2005).

Since the 1990s, two elements had boosted globalisation: the development of technology and the collapse of the Cold War. First of all, it could be said that globalisation was an outcome of the development of technology which had been able to encourage information sharing, and movement of goods across countries and continents, thereby facilitating communication. Secondly, after the end of the Cold War, neo-liberalism spread and led to the removal of trade barriers, which resulted in a dramatic growth in foreign trade and investment (Dion, 2005). Globalisation had brought about the boosting of 'competitiveness' in the world market (Howarth, 2007).

At the time, the EU was witnessing the economic success of the US under the Clinton administration. In response to financial advice from the Federal Reserve Bank, the Clinton administration changed its macroeconomic policies, notably cutting down interest rates. This policy brought about an increase in investment concentrated on technological innovation in the Information and Communication Technologies (ICT) industries. The investment not only stabilized US economic growth but also ended the run of the previous Republican administrations under Reagan and Bush senior fighting against stagnation, and the high fiscal deficits of 1985-1992 (Collignon, 2008). Furthermore, the investment raised productivity in the ICT industries which encroached on the global market. The US experienced an increase in GDP from 2.2 per cent in 1992 to 3 per cent in 2000 and a 4 per cent fall in the unemployment rate in 2000 (Collignon, 2008; Dierx and Ilzkovitz, 2006; Mundschenk *et al.*, 2006). This outstanding performance brought about a wide gap between the EU and the US. In particular,

the EU's per capita GDP was 30 per cent lower than that of the US while the EU's employment was about 87.4 per cent of the US. A reform to modernise the EU was seen as essential to catch up with the US's economic growth in the global market (Dierx and Ilzkovitz, 2006).

Furthermore, the European Commission expected that, from 2010 onwards, the EU would experience a demographic shock: declining birth rates and an increasing of life expectancies. Due to the retirement of the post-war baby-boom generation, the working population in Europe would decline about 18 per cent by 2050. The reduction of the working population would not only contribute problems for the EU economy in terms of low productivity but also would become a cause of difficulty in providing finance for welfare systems in Europe. This demographic change meant that an appropriate solution to the reduction of the EU's labour force and productivity, and the financial shortfall needed to be found (Dierx and Ilzkovitz, 2006; Dion, 2005).

With regard to the challenge of globalisation and the demographic changes, the EU held a series of European Councils. At this series of European Councils, member states did not agree to create any substantial policies for the reform of the EU. Thus, the outcomes of the European Council were called 'processes' (Collignon, 2008). At the first European Council in Luxembourg in December 1997, the member states launched the 'Luxembourg process' which focused on promotion of employment and a lifelong learning strategy.¹⁰³ Six months later, the member states held the Cardiff European Council in June 1998, and agreed the 'Cardiff process', which required a proposal from the Commission on a new policy of environmental protection.¹⁰⁴ Finally, at the Cologne European Council in June 1999, the 'Cologne process' outlined the reform of the EU (Wallace, 2004; McCann, 2010; Meyer *et al.*, 2007).

At the Lisbon European Council on 23-24 March 2000, the member states

¹⁰³ In the context of the 'Luxembourg process', the Commission analysed national employment action plans and proposed an annual employment report in order to provide guidelines. The report had suggested the reform of the labour market, notably towards lifelong learning strategy, in order to increase labour supply and participation (Nugent, 2010).

¹⁰⁴ The Cardiff European Council required the Commission to prepare a report regarding creating integrated environmental projections within EU policies (Nugent, 2010).

adopted the Lisbon strategy. The Lisbon strategy was a ten-year agenda for making the EU 'the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, with more and better jobs and greater social cohesion' by 2010. At the Gothenburg European Council in June 2001, the environmental dimension became an additional component in the strategy (McCann, 2010; Begg, 2008; Dion, 2005; Mundschenk *et al.*, 2006).

The Lisbon strategy consisted of 6 objectives: economic performance, employment, research, innovation and education, economic reform, social cohesion, and environment. On the objective of economic performance, member states agreed to increase the average economic growth rate by 3 per cent. On employment, the member states agreed increasing the overall employment rate to about 70 per cent and that for older workers about 50 per cent by 2010. For the objective of research, innovation and education, the member states agreed financial expenditure of about 3 per cent of the EU's GDP to support human capital, Research and Development (R&D), innovation, Information and Communication Technology (ICT) and education for the development of human resources and life-long learning by 2010. On economic reform, the member states agreed to complete the internal market for finance and services. For social cohesion, the strategy proposed combating poverty and securing pensions. Finally, the strategy proposed reducing greenhouse gas emissions by 2005 and reducing the use of electricity by 22 per cent by 2010 (Wallace, 2004; Dieckhoff and Gallie, 2007; Jones, 2005; Meister and Verspagen, 2006).

Within the objectives of the Lisbon strategy, the objective on research, innovation and education in particular was top of the agenda for the modernisation of the EU with regard to the challenges of globalisation and demographic change. The strategy emphasised that the objective would increase labour participation through the extension of older workers' retirement, and would strengthen the EU's competitiveness in the knowledge-based economy to catch up with the US's economic growth in the global market. Thus, the strategy proposed an increase in the EU's expenditure on education and training systems in order to improve the quantity and quality of human capital. Although human capital and R&D investment would bring about lower employment and economic growth during the

education and training period, the member states believed that the improvement of human capital would be a key element for increasing economic prosperity through higher labour skills and productivity in the global market (Dion, 2005; Jones, 2005; Meister and Verspagen, 2006).

The Lisbon strategy did not propose any uniformity and regulation of methods to achieve the objectives, but proposed a flexible ‘Open Method of Coordination’ (OMC). The OMC allowed the member states to take diverse approaches to the objectives in order to avoid member states’ reluctance to transfer competences to the EU on economic and social policy and areas about which the member states had political sensitivities, and to find the best practices (Schelkle, 2005; Dion, 2005). In the OMC, the Commission played a key role of ‘quantitative and qualitative indicators’. The member states submitted annual reports about the progress of their approaches to the Commission. The Commission adopted the best practices in order to recommend them to member states. The member states would take benchmarking from the best practices in order to effectively shape their approaches. The strategy was scheduled for mid-term review in March 2005 in order to check the member states’ progress (Nugent, 2010; Wallace, 2004).

The Brussels European Council in March 2004 established a special committee, under the leadership of the former Dutch Minister, Wim Kok, in order to investigate the progress of the Lisbon strategy for the mid-term review. The committee published a report: *Facing the Challenge: The Lisbon Strategy for Growth and Employment* in November 2004, and presented it to the Brussels European Council in March 2005 (Haar and Copeland, 2010). The Kok report not only indicated member states’ efforts had been inadequate in achieving the Lisbon strategy but also flagged necessary reform of the EU in order to deal properly with globalisation (Begg, 2008). The report said that globalisation had encouraged the leadership of the US through technological development, and had strengthened Asia countries’ competitiveness by ‘imitation productivities’ in the world market.¹⁰⁵ The exceptional performance of the US and Asian countries in the

¹⁰⁵ Since the 1990s, Asian countries had imitated the industrial model in order to develop and increase their productivities. Due to the cheap labour cost in Asian countries, Asian products

global market alarmed the EU sufficiently for it to rapidly adopt the Lisbon strategy and raise the level of high-tech productivities for strengthening the EU's competitiveness (Dieckhoff and Gallie, 2007; Haar and Copeland, 2010). In particular, the report emphasised the EU's knowledge-based productivities in order to defend against imitation of their products and to compete with the US's products, and suggested a creation of financial incentives through the EU's budgetary flow toward knowledge-based economic areas, in order to encourage member states to endeavour to achieve the Lisbon objectives (Meister and Verspagen, 2006; Dion, 2005).

The European Commission agreed with the Kok report's viewpoint and proposed an increase of the EU's budgetary spending on research and development in order to modernise EU industries and employment policies (Nugent, 2010: 341). At the Brussels European Council on 22-23 March 2005, the member states agreed to set up 'integrated guidelines' on economic and employment policies. These 'Integrated guidelines' proposed establishment of the European Technology Institute (ETI) which would not only focus on improving research and education programmes in order to develop EU policies of knowledge, innovation and human capital but also would concentrate on securing the EU's budgetary flow towards education and training (Jones, 2005; Dion, 2005; Haar and Copeland, 2010).

2.2. The enlargement of CEECs

During 1994-1996, ten Central and Eastern European Countries (CEECs) applied for membership of the EU.¹⁰⁶ The accession negotiations included two Mediterranean island states: Malta and Cyprus.¹⁰⁷ The EU divided the ten

had not only reduced the price of products but also encroached on the world market. See Dion (2005).

¹⁰⁶ In 1994, Hungary and Poland within the CEECs first decided to apply for the EU membership. Romania, Slovakia, Latvia, Estonia, Lithuania, and Bulgaria applied for membership in 1995. In 1996, the Czech Republic and Slovenia joined the applicant group (Barnes and Barnes, 2007).

¹⁰⁷ Although Cyprus and Malta applied for membership of the EU on 4 and 16 July 1990 respectively, Cyprus' EU membership was delayed by Turkey's opposition and Malta also had a

applicants plus Malta and Cyprus into two groups according to the Copenhagen criteria. The first group included the Czech Republic, Hungary, Poland, Estonia, and Slovenia, plus Cyprus which were close to meeting the Copenhagen criteria. Bulgaria, Latvia, Lithuania, Romania, and Slovakia plus Malta composed the second group, which needed more time to meet the criteria (Nugent, 2004b).

At the Luxembourg European Council in December 1997, the member states agreed that the EU would open the first accession negotiations with the first group in March 1998 (Sedelmeier, 2005). In the Commission's regular report in October 1999, the Commission suggested a start to accession negotiations with the second group (Barnes and Barnes, 2007: 423). At the Helsinki European Council in December 1999, the member states adopted the Commission's recommendation and decided to open the negotiations in February 2000. The member states also agreed to complete the enlargement before the European Parliament's election in June 2004 (Nugent, 2010).

In November 2000, the Commission proposed a flexible framework which provided flexible conditions with regard to the Copenhagen criteria to the applicants, and a 'roadmap' which would give priority of EU membership to the more prepared states within the applicants, in order to complete the negotiations by December 2002 (Nugent, 2010). There were two reasons for the Commission's proposal. First of all, the EU was considering its economic growth through the enlargement. The enlargement would bring about an increase in size of the EU's internal market due to increasing the EU's population by about 106 million people. Thus, removing trade barriers between the EU and CEECs would boost trade and would revitalise the EU's economic growth. The Commission focused on speeding up the completion of the enlargement in order to overcome the recession affecting the EU's economic growth (Nugent, 2004a: 5; Bache and George, 2006: 212). Secondly, the EU was wary of the President of the Russian Federation

domestic political debate on the EU which delayed its EU membership. In March 1998, the two Mediterranean island states joined the accession negotiations of the CEECs. See Pace (2006).

Vladimir Putin's aggressive nationalism¹⁰⁸ and its role in Central and Eastern Europe, which caused it to accelerate the accession negotiations with the applicants (Archer, 2004; Barnes and Barnes, 2007).

At the Nice European Council in December 2000, and the Gothenburg European Council in June 2001, the member states discussed and accepted the Commission's proposal. At the Copenhagen summit in December 2002, the member states achieved agreement of the enlargement and scheduled the signing of an agreement in April 2003. The agreement indicated that all applicants apart from Bulgaria and Romania would become member states of the EU in May 2004. The member states decided to delay Bulgaria and Romania's membership until the two applicants were ready to meet the Copenhagen criteria. At the Brussels European Council in December 2004, the member states agreed Bulgarian and Romanian membership – they would become EU members in January 2007 (Goetz, 2005; Nugent, 2004b).

Since the application of flexible conditions to the applicants to speed up the negotiations, the EU succeeded in making the enlargement despite the applicants' poor economic condition. The enlargement increased the size of both the population of the EU and territory by about 33 per cent, and the EU's GDP by only 5 per cent, while it brought about a fall of about 18 per cent in the EU's average per capita GDP (Allen, 2005; Nugent, 2004a; Barnes and Barnes, 2007). The applicants' economic condition was poorer than that of the EU's poorest member state, Greece. The poor economic condition of the new members demanded that the Commission propose generous redistributive policies in the financial proposal for 2007-2013 (Nugent, 2004a).

2.3. Analysis of the Commission's financial proposal

In December 2003, the heads of the net contributor states (Austria, France, Germany, the Netherlands, Sweden, and the UK) sent a joint letter to the President

¹⁰⁸ The nationalist Vladimir Putin became acting President in December 1999 and won the 2000 presidential election. Once President of the Russian Federation, Putin's nationalism focused on recovering the status of 'great power', which was one of the elements of Russian identity.

of the Commission, Romano Prodi,¹⁰⁹ proposing a ceiling of 1 per cent of the EU's GDP on revenue as a level for Agenda 2000 for the Commission's financial proposal for 2007-2013, with a view to reducing their financial contribution (Nugent, 2010). However, on 10 February 2004, the European Commission proposed 1.14 per cent on the EU's expenditure and 1.24 per cent on the EU's revenue in its financial proposal (COM, 2004a, 2004b). The increase resulted from the Commission's consideration of elements of the Lisbon strategy and the enlargement of Central and Eastern European Countries (Laffan and Lindner, 2010; Nugent, 2006).

Firstly, the European Commission took into account the Sapir report,¹¹⁰ which suggested a transformation of the EU's redistributive policies from supporting regional aid and farmers' income to paying attention to education, research and technology, aimed at strengthening the EU's competitive economy in the world (Laffan and Lindner, 2010: 220). The Commission not only introduced a new title of 'competitiveness for growth and employment' in the EU's expenditure policies but also allocated 8.3 per cent of the EU's budgetary spending to support achieving the Lisbon strategy by 2010 (Nugent, 2006: 436; COM, 2004a; Lorca, 2005).

Secondly, the Commission predicted that the enlargement would add 5 per cent to the EU's GDP and revenues but would expand the EU by 30 per cent in terms of population (Financial Times, 12 February 2004). The new member states' economic poverty demanded an increase in regional aid. The Commission proposed increase of regional aid from €275 billion in the 1999-2006 financial

¹⁰⁹ After the resignation of Jacques Santer as President of the Commission in 1999, Romano Prodi succeeded him as President and took was in the position during 1999-2004. Prodi prepared the Commission's financial proposal for 2007-2013. Josè Manuel Barroso succeeded the President in 2004 and took part in financial negotiation in 2005. See Appendix No. 2: The Presidents of the Commission.

¹¹⁰ Prodi mandated an independent economic expert's group, chaired by the Belgian economist, André Sapir, to present a report about the EU's redistributive policies for solving the EU's sluggish economic growth. In July 2003, the Sapir report criticised the EU's redistributive policies which had focused on agricultural subsidies and suggested refocusing EU spending policies towards research and technological development in the Lisbon strategy. See Laffan and Lindner (2010).

perspectives to €335 billion in the 2007-2013 financial perspectives (Allen, 2005: 222, 233).

On the EU's revenue side, for the increase of the EU's expenditure and budget, the Commission was not able to package it with the reform of the CAP for sharing CAP expenditure with the objectives of 'competitiveness for growth and employment' and regional aid because of the 2003 reform¹¹¹, which fixed agricultural subsidies at about 42.8 per cent of the EU's budget until 2013 (Nugent, 2010: 404, 2006: 466). In order to fulfil the increase of the EU's budget, the Commission proposed a 'generalized correction mechanism'¹¹² to re-adjust the UK's rebate system (Laffan and Lindner, 2010: 221). The Commission expected that thanks to the enlargement of CEECs, EU spending which had gone to poorer parts of Britain would go to new members. The consequence would be that, in the UK's rebate system, the UK would pay in less than any other rich member states: 0.25 per cent of the EU's budget compared with 0.56 per cent for the Netherlands, 0.54 per cent for Germany and 0.37 for France (The Economist, 10 July 2004). Therefore, with the new corrective mechanism, the European Commission proposed to replace Britain's special treatment with a general rebate for all countries with excessive net budget contributions, thus putting pressure on Britain to share the other net contributors' financial burden (Financial Times, 9 September 2004; COM, 2004b).

¹¹¹ In December 2001, at the World Trade Organisation (WTO) Doha Ministerial Meeting, the EU and other countries agreed to launch the Doha round. The Doha round focused on reducing domestic support programmes which had distorted trade. At the Brussels European Council in October 2002, the member states not only discussed the CAP expenditure but also concluded the reform of the CAP which would apply to the period of 2003-2013. The 2003 reform reduced agricultural subsidies through reducing costs for export subsidies from about 48 per cent of the EU's budget to 42.8 per cent. See Rieger (2005), Woolcock (2005), and Fouilleux (2007)..

¹¹² A 'generalised correction mechanism' focused on the budgetary burden, which would otherwise become excessive in relation to member states' relative prosperity. In the Commission's proposal, the new mechanism concentrated on the reduction of the UK's abatement (Laffan and Lindner, 2010).

Table 5.1 Financial Perspective 2007-2013 (in EUR million)

	2006	2007	2008	2009	2010	2011	2012	2013
Appropriations for commitments:	47582	59680	62800	65800	68240	70660	73715	76790
1. SUSTAINABLE DEVELOPMENT								
1a. Competitiveness For growth and employment	87910	12110	14390	16680	18970	21250	23540	25830
1b. Cohesion for Growth and employment	38791	47570	48410	49120	49270	49410	50175	50960
2. PRESERVATION AND MANAGEMENT OF NATIONAL RESOURCES	56015	57180	57900	58120	57980	57850	57825	57810
Of which: Agriculture-Market related expenditure and direct payments	43735	43500	43670	43350	43030	42710	42506	42290
3. CITIZENSHIP FREEDOM, SECURITY AND JUSTICE	1381	1630	2015	2330	2645	2970	3295	3620
4. THE EU AS A GLOBAL PARTNER	11232	11400	12180	12950	13720	14500	15115	15740
5. ADMINISTRATION	3436	3675	3815	3950	4090	4225	4365	4500
Compensations	1.041							
Total appropriations for commitments	120690	133600	13870 0	14310 0	14670 0	15020 0	15432 0	15850 0
Total appropriations for payments	114740	124600	13650 0	12770 0	12600 0	13240 0	13840 0	14310 0
Appropriations for payment as a % of GNI	1.09	1.15	1.23	1.12	1.08	1.11	1.14	1.15
Margin	0.15	0.09	0.01	0.12	0.16	0.13	0.10	0.09
Own-resources Ceiling (% of GNI)	1.24	1.24	1.24	1.24	1.24	1.24	1.24	1.24

<Source: Commission 'Communication from the Commission to the Council and the European Parliament: Financial Perspectives 2007-2013' COM (2004) 487 final>

3. The UK's attitude to the Commission's proposal

The Blair government played a leading role in the adoption of the Lisbon strategy – considered an optimal way to strengthen the EU's competitiveness in the global market – and supported the enlargement of Central and Eastern European Countries – with the aim of not only gaining some economic advantages but also strengthening the position of the EU in the global arena. It could not, however, accept the Commission's proposal to package the Lisbon strategy, the enlargement and the financial perspectives for 2007-2013, particularly the reduction of the UK's rebate. This section, thus, reviews the reaction of the Blair government, paying particularly attention to the domestic political difficulties it would have to face if it accepted the reduction of its budget rebate.

3.1. The Lisbon strategy

In the early 1980s, the Labour party adopted the Alternative Economic Strategy (AES), which emphasised the role of the British government in economic policy to protect national industries, to manage renationalisation, and to secure public services. For this the Labour party took an anti-European approach and even called for a British withdrawal from the EC,¹¹³ its concern being that the EC had put too much emphasis on the role of the market rather than the role of the state. However, after the failure of the 1987 general election, the Labour party gave up its argument on British membership and abandoned the AES (Daniels, 2003: 227).

In the early 1990s, the Labour party attempted to come to terms with globalisation and changed its economic policy with regard to the market and global economies. It understood that globalisation was an inevitable external economic constraint which required Britain to consider the increasing liberalisation of trade and market individualism, in order to rightly respond to the global activities of businesses (Wilkinson, 2000:137). The Labour party, thus, devised the concept of the 'Third Way' instead of continuing Labour's traditional social democracy¹¹⁴. But this divided the party into 'Old' and 'New' Labour (Finlayson, 1999: 272; Heffernan, 2000:xii; Watson and Hay, 2003: 296). After the 1997 general election, the New Labour government concretised its economic policy with regard to the 'Third Way', which meant adapting the market individualism of the neo-liberal approach in order to modernise the UK (Coates, 2000: 2). By doing so, it distanced itself from 'old' Labour's state-centred approach to regulating market forces and focused on designing market forces to be dynamic and to secure the public interest (Newman, 2001: 1; Coates, 2000: 6).

The Blair government not only concentrated on promoting dynamic and

¹¹³ In the 1983 and 1987 general elections, the Labour party's manifesto clearly pointed out its anti-European approach. The Labour party argued that its economic ideas on the role of the government in economy were incompatible with the EC (Daniels, 2003).

¹¹⁴ Since the 1990s, the Labour party has adopted the concept of the 'Third Way' which was a criterion of a division of the Labour party between 'Old' and 'New' Labours. 'Old' Labour was defined by its ideology of social democracy which not only emphasised the government's intervention in the market but also focused on the role of the government in controlling taxation and public expenditure for economic and welfare politics. 'New' Labour adopted the concept of the 'Third Way'. See Heffernan (2000), and Chadwick and Heffernan (2003a).

competitive business but also considered combining economic dynamism and social cohesion to design its domestic policies. It focused on the role of the government in supporting education and training systems for improving the quantity and quality of human capital (Coates, 2000: 11; Stedward, 2000: 171). It argued that Britain needed to invest in strengthening human capital in order for the British economy to survive in globalisation and international competition, and to enhance employability to reduce the rate of unemployment. Thus, the government repositioned the education and training system to become a primary component in economic policy in order to assist workers to effectively develop their skills and competencies (Tonge, 1999: 228). Ultimately high-skilled workers would become high-waged employees and would contribute to economic prosperity. The support for the education and training system was an appropriate policy to meet the government's social cohesion aim, which paid attention to increasing employability rather than increasing the UK's national budget expenditure on public services (Stedward, 2000: 171, 174).

Globalisation not only influenced a change in Labour's economic ideas but also affected the New Labour government's approach to European integration. In the 'Britain in Europe' campaign in October 1999, Blair pointed out the UK's economic connections with the European single market. He said that, in 1999, the single market provided 3.5 million British jobs due to over 50 per cent of British trade being with EU member states. In trade, the British companies daily sold about 320 million pounds value of their goods and services in the single market. Furthermore, the British membership attracted investment flows from non-EU companies which tended to choose Britain as a bridgehead for getting their products into Europe. Non-EU investment created 50, 000 British new jobs (Blair, 2003a: 237; Chadwick and Heffernan, 2003b: 223). Finally, not only did he emphasise the British membership of the EU but he also stressed a common destiny between the UK and the EU in terms of economic prosperity in the global market (Chadwick and Heffernan, 2003: 223).

The New Labour government not only focused on the modernisation of British economic policies but also addressed the development of the single market in the EU (Hughes and Smith, 2003: 233; Blair and Schröder, 2003: 115). It

argued that the EU urgently needed to reform its social regulation agenda of the 1980s in order to strengthen the competitiveness of European industry (Blair and Schröder, 2003: 115; Gifford, 2007: 472; Redgrave, 2008: 424). Moreover, considering that all member states were faced with the same challenges, it called for the EU to advance a collective response to effectively deal with the challenges of globalisation (Sherrington, 2006: 71; Gifford, 2007: 472; Chadwick and Heffernan, 2003b: 223; Blair, 2003b: 240). This new pro-European approach overcame the Labour party's traditional hostility to the EU and put the UK in a position to be able to guide the reform of the EU: to advocate working with globalisation rather than against it (Bulmer, 2008: 608; Daniels, 2003: 228; Hughes and Smith, 2003: 232).

In view of the Lisbon European Council in March 2000, the Commission proposed that the EU would focus on the development of a knowledge-based economy for strengthening innovation, competition, and employment (Bulmer, 2008: 608; Sherrington, 2006: 71). The New Labour government supported the Commission's proposal and tried to persuade other member states, arguing that the Commission's proposal would not only enhance the EU's economic competitiveness but would also help to tackle unemployment (Sherrington, 2006: 71; Gifford, 2007: 472; Hughes and Smith, 2003: 232). As for the other member states, the centre-right politicians, the Prime Minister of Spain, José Maria Aznar and his Italian counterpart Silvio Berlusconi supported the UK views (Smith, 2005: 710; Bulmer, 2008: 608). The French President Jacques Chirac was concerned that the new economic strategy would reduce France's financial benefits from the CAP. Furthermore, he argued that Britain's economic idea for the modernisation of the EU was based on an 'Anglo-Saxon' economic model,¹¹⁵ and, thus, the reform of the EU would undermine the EU's traditional social model (Hopkin and Wincott, 2006: 51, 61; Gowland *et al.*, 2010: 148).

Blair, in turn, argued that the New Labour government's Third Way

¹¹⁵ Chirac used the term 'Anglo-Saxon' regarding the economic model in order to criticise the New Labour government's economic idea of the 'Third Way' which guided the modernisation of the EU. He described the 'Anglo-Saxon' model as based on US-style economic policies which focused on achieving economic growth rather than social cohesion. See Hopkin and Wincott (2006).

combined an ‘Anglo’ dimension by focusing on economic competitiveness and a ‘Nordic’ component by emphasising social equity. The Third Way, therefore, could be described as an ‘Anglo-Social’ model rather than an ‘Anglo-Saxon’ economic approach (Hopkin and Wincott, 2006: 61). Furthermore, he argued that the Third Way was a ‘post-ideological’ concept, which was able to modernise the EU’s economy in response to globalisation and concentrated on the reform of the EU’s economic policy to provide people’s needs in the global era (Bulmer, 2008: 608; Hughes and Smith, 2003: 232; Redgrave, 2008: 424). Eventually, the member states adopted the Lisbon strategy and also agreed on the voluntary approach of the ‘Open Method of Coordination’ (OMC), welcomed by the UK as a soft way to promote the Lisbon strategy’s acceptability to member states, several of which did not support the UK’s economic ideas for the modernisation of the EU (Bulmer, 2008: 609; Smith, 2005: 710).

3.2. The enlargement of the CEECs

The EU faced a dilemma between ‘widening’ and ‘deepening’ in the enlargement of Central and Eastern European Countries (CEECs). Some member states (France, Ireland, Spain and Portugal) argued that deepening would threaten widening, while the UK was a member of the group which supported the enlargement (Nugent and Mather, 2006: 144).¹¹⁶ Britain’s requirements for recovering British world power, gaining economic benefits and strengthening the EU’s competitiveness affected the shaping of its position on the enlargement (Gowland *et al.*, 2010: 153; Bulmer, 2008: 602; Nugent and Mather, 2006: 144; Barnes and Barnes, 2007: 422). First of all, Britain’s support for the enlargement derived from the New Labour government’s goal to recover British leadership in the world. The New Labour government not only demanded maximisation of

¹¹⁶ France and less prosperous member states, notably Ireland, Spain and Portugal, were not willing to support the enlargement of the CEECs. They were concerned about a potential reduction of their financial benefits from the EU budget, to be used to support new member states. Thus, they argued that the enlargement should be postponed. Germany and the UK supported the Eastern enlargement. Germany considered its security and economic benefits from the enlargement. Britain’s position on the enlargement was reflected by its attempt to recover world power and modernise the EU (Nugent, 2004a).

British national power to influence matters abroad through the EU but also played a leading part in leading the EU to have a new political vision and role in international affairs (Stephens, 2003: 254; Hughes and Smith, 2003: 231). The British position considered the CEECs' security issues. During August and December 1991, the Soviet Union experienced the independence of member states in the former Soviet Republics which brought about the collapse of the Soviet Union. After the period, the Russian government was pressured by nationalists to recover its world power and to increase its involvement in Central and East Europe. In these circumstances, the CEECs were anxious about threats to their security from a recovery of Russian nationalism, which proclaimed an aggressive Russia's involvement in Europe. Thus, CEECs urgently pressed both the EU and the North Atlantic Treaty Organisation (NATO) to accept their membership in order to include them under the liberal democratic states' security umbrella (Nugent, 2004a: 4). In NATO, the US hesitated over the membership of the CEECs because the US did not want to upset its relations with Russia. In the EU, Britain pressured the EU to accept the membership of the CEECs in order for the EU to play a role in stabilising Central and Eastern Europe. For Britain, the enlargement was an opportunity to demonstrate its leadership in European affairs (Bache and George, 2006:551; Barnes and Barnes, 2007: 422).

Secondly, Britain not only considered its economic advantages from the enlargement of the CEECs in 2004, but was also interested in strengthening the EU's competitiveness through the enlargement (Gowland *et al.*, 2010: 153; Nugent and Mather, 2006: 144; Nugent, 2004a: 5). The accession of the 10 + 2 countries would increase the size of the single market in the EU and the EU's population by 106 million people (Nugent, 2004a: 5). The accession of the CEECs into the single market would not only abolish national governments' control on the movement of goods but would also remove trade barriers. Britain expected to gain economic prosperity from trade liberalisation in the new EU (Grabbe, 2004: 71). Furthermore, the CEECs' EU membership would be attractive to both EU and non-EU companies because of the availability of high-skilled labour with cheap labour cost. Increasing investment flows would develop the new member states' economies and would transfer their economic structure from manufacturing

industries to technological industries. Investment would also create jobs and would solve unemployment in the new member states (Baltas, 2004: 155). The economic development of the new members would boost the EU's economic dynamics, which would strengthen the EU's competitiveness in the global market. These economic developments would meet with the new Labour government's ambition to modernise the EU's economic policies in order to enhance the EU's competitiveness in the Lisbon strategy (Bulmer, 2008: 602).

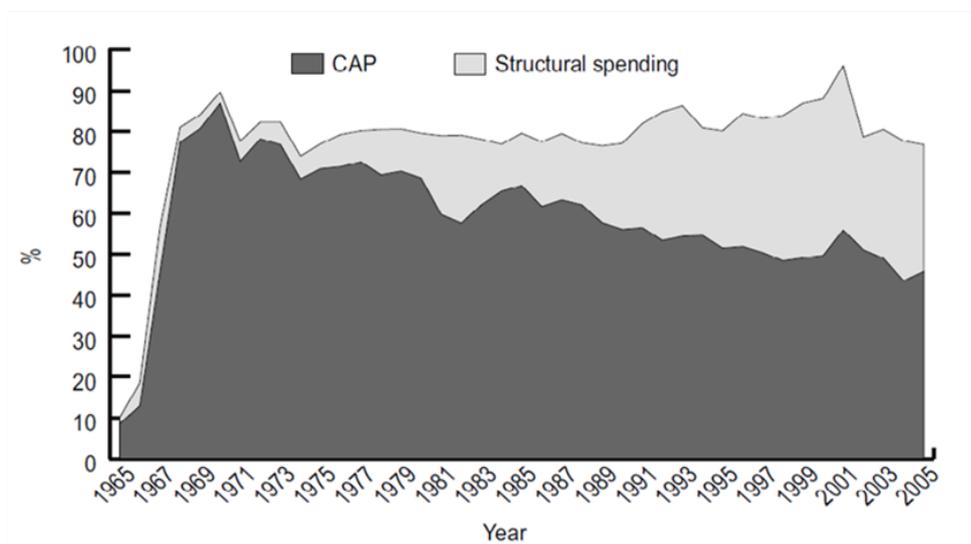
3.3. The financial perspective

In its proposal for the financial perspective for 2007-2013, the European Commission introduced a new title of 'competitiveness for growth and employment' in the EU's expenditure policies with regard to the Lisbon strategy and decided to take into account the potential impact of the enlargement of the CEECs. As a result, it proposed 1.24 per cent of GDP for the EU's revenue and the reduction of the UK's rebate (Nugent, 2010: 404). In response, the UK argued that the EU's expenditure in the financial period of Agenda 2000 (1999-2006) was only 0.98 per cent and, even taking into account the Lisbon strategy and the upcoming enlargement rounds, the increasing size of the EU's revenue was too high and would add to net contributors' financial burden. Consequently, it insisted on keeping the ceiling at 1 per cent of GDP (The Guardian, 10 February 2004).

Moreover, an interviewee said that he and his colleagues understood the domestic economic groups' demand to financially support the Lisbon strategy and the enlargement of CEECs. However, they recognised that the Commission's financial proposal was not a new version of 'Lisbon budget' plan for financially supporting the modernisation of the EU. Rather, the proposal continued in line with the 'Delors budget'. As a result of this, the government had to focus on retaining the rebate and Britain's financial imbalance as the previous governments did during the 'Delors budget' negotiations. The government argued that the CAP expenditure still remained a big size in the budget. Though the Commission could not include the reform of the CAP in the financial proposal due to reform in 2003, it still want the Commission to propose some changes to reflect the Lisbon strategy in its proposal (Nugent, 2010; The Guardian, 10 February 2004). In fact,

the Commission's proposal would bring about imbalance for the UK: compared with France, which has a similar size of population and economy, the UK would pay more for the EU budget but would receive fewer benefits from farm subsidies (See Figures 6.1 and 6.2)¹¹⁷ Thus, the UK had no desire to reduce its rebate and to accept the Commission's proposal (The Guardian, 15 July 2004; Financial Times, 8 July 2004).

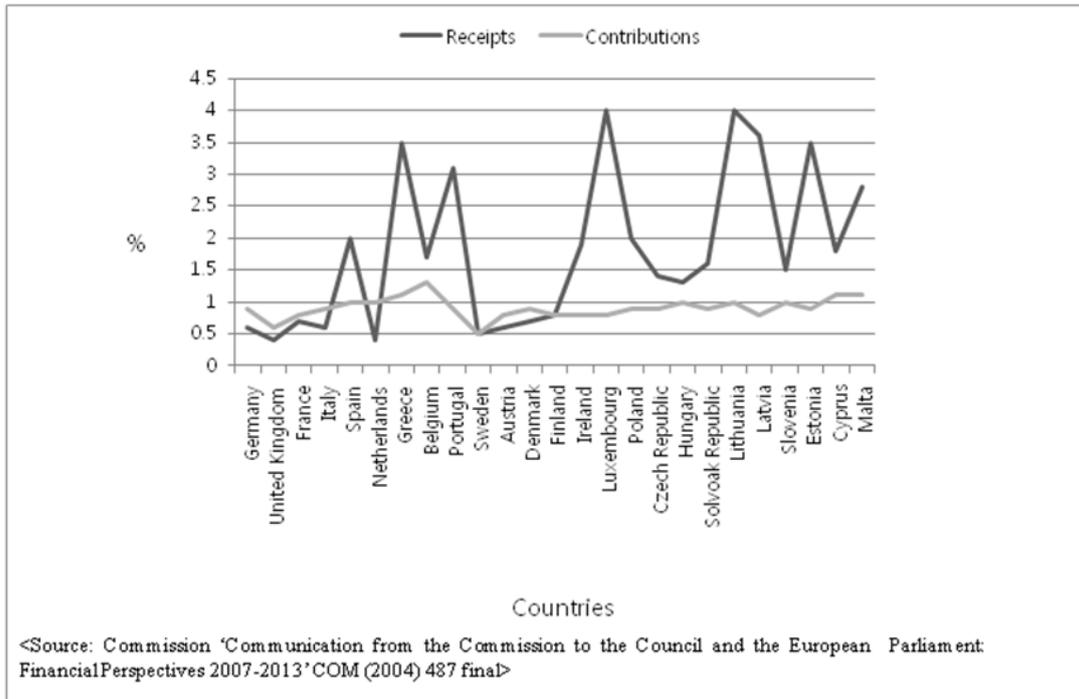
Figure 5.1 The distribution of EU budget expenditure in 1965-2005



<Source: European Commission 'the EU budget' <http://europa.eu.int/comm/budget>

¹¹⁷ With regard to the Commission's financial perspective for 2007-2013, without the UK's rebate, the British financial contribution would soar from 0.25 per cent to 0.65 per cent, i.e. 50 per cent more than France (The Economist 10 July 2004; Financial Times, 9 July 2004).

Figure 5.2 Member States' contributions to and receipts from the EU budget as a percentage of GDP in 2004



It should be also take into consideration that Blair's unpopularity with the British public increased the burden upon the New Labour government's approach on its rebate. The UK's involvement in the war in Iraq¹¹⁸ in 2003 resulted in a significant reduction of the Labour party's parliamentary majority of 65 and loss of public support (Bulmer, 2008: 603; 605; Smith, 2005: 714).¹¹⁹ Meanwhile, Britain's euroscepticism also increased and pressured the Blair government's pro-European approach. In 2004, a YouGove poll found that only 27 per cent of Britons believed that British membership of the EU was a 'good thing'. The

¹¹⁸ After the terrorist attack on the Twin Towers and the Pentagon on 11 September 2001, the Bush administration proclaimed 'The War on Terror'. The US made an association between the Iraqi regime and Al-Qaeda and took military action to topple the regime of Saddam Hussein in 2003. The Blair government took heed of the special relationship between the UK and the US and decided to participate in the US-led military action. See Gelpi *et al.*, (2005) and Bulmer (2008).

¹¹⁹ In the 1997 general election, the Labour party won a remarkable parliamentary majority of 418 and became the governing party. Although in the 2001 general election, the Labour party lost 3 seats, the party still had a parliamentary majority of 413. In the 2005 general election, Blair's unpopularity affected the result of the election which was significantly reduced to 355 seats. See Geddes (2004), Smith (2005).

percentage significantly decreased. 50 per cent of the electorate were against the Blair government's pro-European approach while 18 per cent said 'don't know' (Daily Telegraph, 30 April, 2004). The anti-Blair Daily Mail, argued that the figure showed that public attitudes on the EU changed from uninterest to hostility, and criticised Blair's pro-European approach (Daily Mail 21, April 2004). Furthermore, in the 2005 general election campaign, the leader of the Conservative party Michael Howard made his party's position clear which indicated the Conservative party's opposition to the Blair government's pro-European approach (Baker and Sherrington, 2005: 308). Furthermore, the government was under pressure from colleagues in the Labour party and the Chancellor of the Exchequer, Gordon Brown, who argued that the UK must retain the rebate to avoid any increase of the Labour government's unpopularity (Brown, 2005: 14). Mr Brown, who was the most influential actor to the government's EU policies due to his special relationship with Mr Blair (Bulmer and Burch, 2009: 138; Heffernan, 2004: 359),¹²⁰ thought that the unpopularity of the government would threaten his ambition to become Prime Minister after Mr Blair (Naughtie, 2002: 69-75; Smith, 2005: 706). Thus, he opposed any the reduction of the UK's rebate (Brown, 2005: 15).

In light of all these issues, Blair vowed to veto the existing proposal on the size of the EU's budget and the reduction of the UK's rebate on the UK rebate, which triggered several disputes between member states (Financial Times, 8 July 2004; Laffan and Lindner, 2005).

¹²⁰ After the Labour leader John Smith's death in 1994, Tony Blair and Gordon Brown formed the 'Granita Pact' (named after a restaurant in London where they met) for leading the Labour party in the 1997 general election. Brown agreed to concede the Leadership of the Labour party to Blair, who would lead the party in the 1997 general election. If the Labour party won the election, Blair would hold the position of Prime Minister. In return, Brown would be allowed to dominate powers over the UK's domestic policy while Blair would have a commitment to policies on social justice and employment. Furthermore, after Blair's premiership during an agreed period of time, Blair would hand over the position of the Prime Minister to Brown. See Naughtie (2002).

4. Britain's negotiation on the financial perspective for 2007-2013

In line with what had happened with the schedule of the financial negotiations in 1987, the financial negotiations for the financial perspective for 2007-2013 was delayed by heads of government or state from December 2004 to June 2005 due to Britain's General Election on 5 May 2005 (Financial Times, 21 June 2005). In 2005, there were two European Councils in Brussels, in June and December, which dealt directly with the negotiations of the financial perspective for 2007-2013. The UK's rebate was a controversial issue, which not only blocked a financial agreement in June but also brought about conflicts between the UK and other member states in December. The Blair government changed its position in the second half of 2005, whilst the UK held the Presidency of the Council and at the Brussels European Council on 15-16 December 2005 agreed to reduce its rebate. This change was affected by both the UK's presidency responsibilities and its ambition to lead the EU towards modernising EU policies in response to the challenge of globalisation.

4.1. The financial negotiation at the Brussels European Council in June 2005

The Brussels European Council in June 2005 initiated the financial negotiations for the financial perspective for 2007-2013. At the European Council, the Luxembourg Presidency proposed its compromise which focused on mediating conflicts between the Commission's proposal and member states' oppositions. However, the compromise did not satisfy member states' demands and was unable to overcome conflicts between member states. The European Council paved the way to clarify member states' positions on the financial perspective for 2007-2013.

4.1.1. The Luxembourg presidency compromise

Luxembourg held the Presidency of the Council in the first half of 2005. On the EU budgetary issue, Prime Minister Juncker recognised that the UK and other net contributors, i.e. Germany, France, the Netherlands, Sweden and Austria, as the six biggest net contributors, opposed the Commission's proposal, notably concerning the size of the EU's revenue. They demanded that the budget ceiling

be held below 1 per cent of the EU's GDP (Financial Times, 12 May 2005). The EU, meanwhile, had experienced the 'No' vote by the French on 30 May 2005, and by the Dutch on 2 June 2005, in referendums on the EU constitutional treaty, and, consequently urged net contributors towards compromise for the financial perspective for 2007-2013 as a step towards overcoming this political crisis in the future of Europe (Financial Times, 21 June 2005; Church and Phinnemore, 2007).

At the Brussels European Council on 16-17 June 2005, the Luxembourg Presidency proposed a compromise. This compromise occupied a middle point between the UK and the net contributors' oppositions and the Commission's proposal. In particular, it proposed freezing the UK rebate at the average for 1997-2003, i.e. €4.6 billion, in 2007, and then gradually reducing it from 2008 to 2013 (European Report, 11 June 2005; Times, 21 May 2005; Financial Times, 15 June 2005; Hearl, 2006: 54). Such reduction would allow the excessive Dutch, German and Swedish contributions to be reduced in turn (Hearl, 2006: 54). The Luxembourg Presidency also suggested a compromise of 1.06 per cent, € 870 billion of the EU's revenue above the largest contributor nation's demand of 1 per cent and significantly below the Commission's proposal of 1.24 per cent (Financial Times, 14 and 16 June 2005; European Report, 11 June 2005; Hearl, 2006: 54). This meant reducing all areas of budget expenditure: competitiveness by (39 per cent), cohesion policy (10 per cent), natural resources (5 per cent), citizenship, security and justice (20 per cent), global partnership (19 per cent), and administration (12 per cent) (European Report, 11 June 2005). Although the compromise was meant to reduce conflicts, it actually did the opposite, between old and new beneficiaries on sharing benefits, between net contributors and net beneficiaries on the size of the EU's revenue, and within net contributors on sharing of the financial burden (Laffan and Lindner, 2005: 205-206).

4.1.2. Old versus new beneficiaries on sharing financial benefits

The new member states in the CEECs could be characterised by the term 'new beneficiaries'. Because of their poorer economic condition, the Commission decided to increase the EU budget but also divided net beneficiaries into old and new beneficiaries, and challenged the old net beneficiaries' financial benefits from

the EU's expenditure through the sharing of budgets (Zeff, 2004: 171; Nugent, 2004a: 15). In particular, it proposed to allocate cohesion spending¹²¹ to these new beneficiaries in order to boost their economic growth to catch up with the overall levels of the EU. The old beneficiaries concentrated on preventing an abrupt ending of the EU's financial support to their poor regions as a result of transference of financial aid to the new beneficiaries. The new member states, being full member, were able to veto the financial agreement. Thus old beneficiaries' demands to reduce financial flow to the new member states were difficult to achieve (Lindner, 2006: 209).

At the Brussels European Council in June 2005, both old and new beneficiaries opposed the Luxembourg Presidency compromise (Financial Times, 17 June 2005). They argued that the compromise implied a reduction of regional aid which would not be able to cover net beneficiaries' demands for economic growth (Financial Times, 18 June 2005). Furthermore, both sets of beneficiaries were in favour of reducing the UK rebate because they believed that the reduction of the UK's rebate would reduce other net contributors' financial burden, which in turn could concede the increase of the EU's budget (Financial Times, 18 June 2005). Italy and Spain, as part of the beneficiaries in regional aid, persisted in demanding a reduction of the UK's abatement. Italy's Silvio Berlusconi complained that the Luxembourg Presidency compromise to reduce regional aid would mean a substantial fall in Italy's receipts from the EU. In his view, a radical revision of the UK rebate was one of Italy's priorities (European Report, 17 June 2005). Spanish Europe Minister Alberto Navarro and Foreign Minister Miguel Moratinos also said that Spain demanded a modification of the UK rebate (European Report, 18 June 2005).

¹²¹ Regional aid had another name: the Structural Funds, which consisted of the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Financial Instrument for Fisheries Guidance (FIFG) and the Cohesion Fund. The Structural Funds existed for the purpose of enhancing economic cohesion between member states. They were funnelled into three objectives, which had been reduced from since Agenda 2000. In particular, Objective 1 was designed to support the development of regions whose development was behind the overall EU average. Under the Commission's proposal for 2007-2013, 78 per cent of the structural funds would be allocated to objective 1. Regions in the new member states would be the main beneficiaries from Objective 1. See Allen (2005) and Zeff (2004).

4.1.3. Net contributors versus net beneficiaries

The UK and other net contributors not only opposed the Luxembourg presidency compromise but also refused net beneficiaries' demands to sustain the level of the Commission's proposal on the size of the EU's revenue, and instead proposed a revenue size of about less than 1 per cent of GDP (Financial Times, 18 June 2005).

In particular, after the failure¹²² to ratify the constitutional treaty on 1 June 2005, the Dutch Prime Minister Jan Peter Balkenende faced domestic political pressure on the issue of European integration. For this, he insisted that the Netherlands not only opposed the Presidency's suggestion on the size of the EU's budget but also called for a cut in €1.5 billion of the Dutch net contribution (European Report, 18 and 22 June 2005).

Table 5.2 Classification of net recipients and net contributors

Net recipients

€ million, total 1986-2003	Spain	Greece	Portugal	Ireland	Belgium	Denmark
Contribution	85,833	17,510	15,785	12,380	46,384	23,260
Receipts	161,812	76,397	49,413	44,554	56,308	25,559
Net payment	-75,976	-58,885	-33,631	-32,174	-9,926	-2,305

Net contributors

Finland	Austria	Luxembourg	Sweden	Italy	Netherlands	France	UK	Germany
10,252	17,817	2,678	20,243	155,131	72,282	208,568	146,216	307,225
9,800	12,454	11,045	10,787	135,313	45,597	180,332	91,621	145,757
450	5,364	8,997	9,458	19,817	26,682	28,241	54,593	161,469

<Source: Parliament 'Parliamentary answer 'How much do other countries pay in?' 25 February 2005>

Germany focused on reducing its contribution to the EU's budget, which

¹²² The Netherlands held a referendum on approval of the Constitutional Treaty on 1 June 2005. The Dutch's financial burden to the EU's budget was one of the reasons why 61.7 per cent of voters were against the Treaty on a 63 per cent turnout (Nugent, 2010).

would flow to the new member states. The Chancellor of Germany, Gerhard Schröder, was very eloquent: 'in the past, if there has been a problem, the Germans would just write a cheque to sort it out. The Germans aren't willing or able to do that any more' (Financial Times, 18 June 2005). The financial framework for 2007-2013 not only indicated a doubling of the German contribution but also foresaw a reduction in German benefits from regional aid, which would be quietly allocated to the poorer regions in the new member states from the former Soviet bloc. The German argument was in favour of reducing the EU budget to 1 per cent of GDP (Financial Times, 30 July 2004).

France initially supported the other net contributors' position which not only opposed the size of the EU's revenue in the Commission's proposal but was also against the Presidency compromise. In particular, at the beginning of the European Council, Chirac refused the compromise as it involved a cut of €8 billion from the CAP on natural resources to fund the farm sector in the acceding states (European Report, 18 June 2005). During the European Council, he argued that if the CAP spending was retained, France would be ready to accept the compromise on the issue of increasing the revenue to 1.06 per cent of GDP. Chirac considered increasing France's contribution in response to retaining the CAP expenditure, but then argued for the reduction of the UK's rebate. Other net contributors supported Schröder's argument on reducing the EU budget size because they were also interested in the reduction of their contribution. As a result, the UK's rebate became a central issue for the financial burden to be shared (European Report, 22 June 2005).

4.1.4. The negotiation between net contributors on sharing the financial burden

The UK was not ready to accept the Luxembourg Presidency compromise (Gowland *et al.*, 2010: 178). Firstly, it restated its initial objections that the change in the EU's budget was not enough to support the Lisbon strategy (Financial Times, 13 June 2005) and that the reduction of the CAP expenditure would not really allow to prioritise research, education, and innovation (Gowland *et al.*, 2010: 179). Secondly, the member states and the Commission's demand for the

reduction of the UK's rebate, and the net contributors' demand on the size of the EU's budget for reducing their contribution, implied that net contributors would shift the cost of the enlargement onto Britain. The Blair government argued that the UK did not want to become a sacrifice for the cost to be borne (Financial Times, 15 June 2005).

Table 5.3 Towards Lisbon-related goals (Euro)

Purpose of the money	Extra money
For the Social Agenda	100 million
For Competitiveness and Innovation	400 million
For trans-European networks	500 million
For Research and Development	300 million
For Lifelong Learning	800 million

<Source: Commission 'Financial Perspectives 2007-2013' COM (2004) 487 final>

Nevertheless, it proposed a political linkage between the reform of the CAP and the reduction of the UK's rebate: if the other member states were ready to accept the reform of the CAP, the UK would concede the reduction of its rebate (Financial Times, 13 and 15 June 2005). This approach was spelt out by Blair in a speech in the European Parliament on 23 June 2005, when he presented the lines of the UK Presidency:

People say: we need the budget to restore Europe's credibility. Of course we do. But it should be the right budget. It shouldn't be abstracted from the debate about Europe's crisis. It should be part of the answer to it. I want to say a word about last Friday's summit. There have been suggestions that I was not willing to compromise on the UK rebate; that I only raise CAP reform at the last minute; that I expected to renegotiate the CAP on Friday night. In fact I am the only British leader that has ever said I would put the rebate on the table. I never said we should end the CAP now or renegotiate it overnight. Such a position would be absurd. Any change must take account of the legitimate needs of farming communities and happen over time. I have said simply two things: that we cannot agree a new financial

perspective that does not at least set out a process that leads to a more rational budget; and that this must allow such a budget to shape the second half of that perspective up to 2013. Otherwise it will be 2014 before any fundamental change is agreed, let alone implemented. Again, in the meantime, of course Britain will pay its fair share of enlargement. I might point out that on any basis we would remain the second highest net contributor to the EU, having in this perspective paid billion more than similar sized countries.

Britain's political linkage was supported by the Netherlands, Denmark, and Sweden within the net contributors (European Report, 18 and 22 June 2005), but was opposed by France and Germany. In particular, the French President Jacques Chirac, fearing domestic unpopularity, insisted that Britain had to respect the 2003 agreement on CAP expenditure and that the reduction of CAP expenditures was not an option in the financial negotiation (The Guardian, 14 June 2005; European Report, 15 June 2005). For Schröder, the UK rebate issue was 'the central point', which generated too many conflicts within net contributors on sharing the financial burden. He pointed out that the UK had the sixth-highest per capita income among the member states but its contribution to the EU budget was far behind this, due to its rebate (Financial Times, 17 June 2005). He also made it clear that Germany would not reopen discussions on reform of the CAP, as demanded by the UK (Financial Times, 18 June 2005).

4.1.5. Outcome

The Brussels European Council meeting on 16-17 June 2005 on the future EU budget was unable to overcome the conflicts between member states. The British proposal was rejected by France, which was in favour of retaining the CAP expenditure and argued for the reduction or elimination of the UK's rebate – in order to shift the cost of the enlargement of the CEECs onto the UK, to reduce its net contribution, and to avoid any reduction of its benefits. France's opposition brought about Britain's departure from the negotiation table. The Netherlands, Denmark and Sweden could not accept the request for the increase of their contribution compared with their demand to contribute to the EU's budget. Italy also refused reducing its financial benefits in sharing regional aid with the new net

recipient group in the Luxembourg compromise. The financial negotiation for 2007-2013 therefore became the responsibility of the UK Presidency which started on 1 July 2005 (The Guardian, 18 June 2005; European Report, 22 June 2005).

4.2. Analysing the UK's presidency in the second half of 2005

During the UK Presidency in the second half of 2005, the British position on its rebate changed from 'conditional change' to 'reduction'. Holding the Presidency meant that the UK had the 'responsibility' to guide member states towards achieving the agreement: the UK had to reduce its rebate in order to strengthen the credibility of British leadership in driving the EU towards modernisation with regard to the Lisbon strategy. The Blair government considered the role of the Presidency and its own ambitions for modernisation, and after lengthy and difficult negotiations, decided on the reduction of its rebate at the Brussels European Council in December 2005.

4.2.1. The Presidency of the Council

When the UK commenced the six-month-rotating Presidency of the Council, expectations were low. In general, a successful Presidency would be ready to sacrifice its own interest to solve conflicts rather than being at the centre of conflicts in negotiations. Britain's position on its rebate would be a central part of the problem rather than the solution in the EU budgetary negotiations (Whitman and Thomas, 2007: 61-62).

My interviewees, on the contrary, explicitly stated that they felt a strong sense of responsibility towards the role of the Presidency and that shaped the UK's position on the rebate. In his speech to the European Parliament on 23 June 2005, Tony Blair explicitly indicated that the UK's Presidency would emphasise engaging the EU budget with the interests and enthusiasm of EU citizens rather than retaining the UK's rebate, and reaching financial agreement (Whitman, 2006; Henderson, 1998). In particular, referring to the CAP expenditure in the Commission's proposal for the financial perspectives for 2007-2013, he argued that nearly 45 per cent of the EU budget would go on supporting 5 per cent of the

population of farmers, and 20 per cent of CAP spending would go to France alone (European Report, 25 June 2005). This financial plan would never satisfy EU citizens' desires to tackle sluggish economic growth and the problem of 20 million unemployed and that the extant EU expenditure policies in the Commission's proposal would have delivered neither the economic prosperity nor the social justice that its citizens desired (Financial Times, 23 June 2005).¹²³ The UK Presidency argued that the CAP funds should flow instead towards the modernization of the EU, in particular the new member states, and go towards alleviating the impoverishment of farmers in underdeveloped areas, rather than to French farmers (Financial Times, 23 June 2005). My interviewees confirmed that the British presidency sought to find the best way to achieve a financial agreement to favour the new member states' financial need for regeneration of their economic structures in the globalisation era for the new member states. For this, he criticised the Luxembourg presidency compromise, which guided the EU in the wrong way, if the aim was to rebuild public support and trust (Financial Times, 13 and 15 June 2005).

4.2.2. Persuading member states

The British presidency not only sought to challenge the Luxembourg presidency compromise, but also speeded up the progress of the financial negotiations for achieving an agreement. For this, it scheduled the informal European Council on 28-29 October 2005 at Hampton Court Palace in England with the view to persuading member states before the Brussels European Council in December 2005 on the need to modernise EU expenditure policies to avoid being 'victims of globalisation' (European Report, 28 October 2005).

In that context, the UK insisted that EU policies would need to concentrate on strengthening economic competitiveness and reducing unemployment to overcome the challenges of globalisation (The Guardian, 27 October 2005). To achieve this objective, the presidency emphasised the reform of EU spending

¹²³ Blair's analysis was that the EU constitutional crisis resulted from EU citizens' dissatisfaction with sluggish economic growth and having 20 million unemployed (Financial Times, 13 June 2005).

priorities as essential to the future direction of Europe (European Report, 28 October 2005). In particular, the reform of the CAP would allow transferring the EU budget towards modernisation of EU economies, placing the emphasis on creating jobs and development of trade, education, innovation, and research (The Guardian, 27 October 2005).

France and Germany, once again, opposed the UK's arguments. Schröder explained that the EU was confronted with a choice between liberalisation and the retention of basic European values of socialism. The UK's vision for the EU's future direction, he argued, was 'social dumping', undermining the European social model by liberalisation (Financial Times, 28 October 2005). Chirac argued that the EU had to respect the CAP agreement which was modified in 2003¹²⁴ with a process to open up to the world by 2013, and thus said that the UK presidency's challenge on the reform of EU spending priorities before the end of the financial perspective period of 2013 would undermine the credibility of the EU. He explicitly insisted that France would protect its traditional CAP benefits at the December summit. The French argument for keeping its traditional CAP benefits was in direct conflict with the UK's desire to reform EU spending priorities. Chirac also used the informal summit to advise caution over Europe's Trade Commissioner Peter Mandelson's plan¹²⁵ which would agree the reform of the CAP in the WTO talks in Hong Kong in December 2005 (The Guardian, 24 and 28 October 2005; Financial Times, 28 October 2005; The Birmingham Post, 29 October 2005).

The new beneficiaries placed a harsh spotlight upon the responsibility of the

¹²⁴ In the 'Doha Development Round', it was agreed that all issues would be concluded in December 2005 in Hong Kong. The agricultural negotiations in the Doha Round mainly focused on the reduction of tariff and export subsidies which distorted trade in the CAP. In view of the WTO negotiations in 2005, in 2002 the European Commission proposed the reform of the CAP to introduce the Single Farm Payment (SFP) to reform the CAP direct payment. In 2003, the Agricultural Council agreed to shift 3 per cent of direct payment each year towards EU rural development measures from 2007-2013. See Fouilleux (2007) and Smith (2007).

¹²⁵ Europe's Trade Commissioner Peter Mandelson would offer farm concessions to cut over 60 per cent of EU's highest agriculture import tariffs in WTO negotiation in Hong Kong in December 2005. He decided his plan in the Geneva WTO negotiation on 8 July 2004. See The Birmingham Post (29 October 2005).

UK presidency to make a financial agreement work at the European Council in December. Hungary's Prime Minister Ferenc Gyurcsany, who chaired the Visegrad group,¹²⁶ argued that the new member states were angry with the UK presidency for delaying the financial negotiation until December 2005, and pressured the presidency to call in strong terms for the EU budget agreement to match their needs (The Guardian, 27 October 2005; European Report, 3 November 2005). Artis Pabriks, the Latvian foreign minister, and Danuta Hubner, Poland's European Commissioner, also argued that delaying the EU budget agreement to the next Austrian presidency in the first half of 2006 would cause them to be unable to implement key regeneration projects (The Guardian, 24 and 27 October 2005).

The UK presidency's plan to discuss the reform of EU spending priorities throughout the informal summit did not succeed. Blair understood that securing the EU budget was a priority issue for the future of the EU and it was also important for the new member states to be given a chance for their economies to regenerate. He vowed that he would do his 'level best' to ensure EU budget agreement in December 2005. The UK presidency organised two additional meetings, of the 25 Foreign Ministers on 7 November, and of EU ambassadors on 10 November. The aim was to reach a compromise after these two meetings (European Report, 3 November 2005).

The Foreign Ministers' meeting on 7 November

On 7 November, the 25 foreign ministers from the EU member states met in Brussels for their first formal discussions on the EU budget after the collapse of the EU budget negotiations in June (Financial Times, 7 November 2005). At the meeting, the UK Foreign Secretary, Jack Straw, and the European Affairs Minister, Douglas Alexander, argued for further change of the Luxembourg presidency compromise. Mr Straw said that the UK presidency would concentrate on restructuring and modernising the EU budget, to balance spending between traditional EU expenditure policies, particularly farm subsidies, and new areas such as innovation, education and research (The Independent, 8 November 2005).

¹²⁶ The Visegrad group is composed of the Czech Republic, Hungary, Poland and Slovakia.

Furthermore, he insisted that the UK was a low recipient from EU budget spending, especially CAP spending, despite the UK contributed more than France and Italy, even with the abatement: with the Luxembourg presidency compromise, the UK contribution would significantly increase, at the level of the EU's second largest net contributor (The Independent, 8 November 2005; The Guardian, 8 November 2005). Mr Straw, therefore, argued that the EU budget would need to adjust CAP spending, and this could only be the option for the UK to accept the reduction of its abatement in December 2005 (The Independent, 8 November 2005; The Guardian, 8 November 2005)

Philippe Douste-Blazy, the French Foreign Minister, tried to isolate the UK, arguing that its attempts to retain its budget rebate would cause delay in the EU budget agreement (The Independent, 8 November 2005; European Report, 9 November 2005). He also warned that at the European Council in December France would not accept any change of the Luxembourg presidency compromise, also because it had been agreed by 20 member states (The Independent, 8 November 2005).¹²⁷

Four of the net contributor states (the Netherlands, Sweden, Austria and Germany¹²⁸) accepted the UK's focus on the modernisation of the EU in response to the challenges of globalisation, but required the reduction of their contribution to the EU budget (European Report, 9 November 2005).¹²⁹ However, they joined in the French criticism of the UK rebate (Financial Times, 7 November 2005; The Guardian, 8 November 2005). The new beneficiaries also criticised the UK abatement discussion which was delaying the agreement, as the French argued, and sought concessions from the UK over the rebate (Financial Times, 7 November 2005; The Guardian, 8 November 2005). Furthermore, they stressed the need to achieve a financial agreement in December 2005 in order to obtain

¹²⁷ The UK, the Netherlands, Sweden, Austria, and Spain vetoed the Luxembourg presidency compromise in June 2005 (European Report, 9 November 2005).

¹²⁸ Angela Merkel, who was a new leader in a grand coalition of the Christian Democratic Union (CDU) and Social Democratic Party (SPD), restricted increasing the EU budget, See Heisenberg (2006).

¹²⁹ In particular, the Dutch Foreign Minister Bernard Bot said that The Netherlands welcomed the presidency's challenges as a step in the right direction, but required further changes and the reduction of their contribution by €1 billion (European Report, 9 November 2005).

their financial benefits¹³⁰.

Although the European Foreign Ministers reopened the financial discussion, the UK presidency's recognised there was deadlock (The Irish Times 8 November 2005). The UK presidency organised a new Foreign Ministers' meeting for November 21 and said that a detailed presidency compromise would be presented in early December (European Report, 9 November 2005).

The meeting of the EU member states' ambassadors on 10 November

At the meeting of EU member states' ambassadors on 10 November, a large number of delegations criticised the presidency paper for not concentrating on the issues essential to the financial negotiations in December 2005 and they saw it as indicative of reluctance to make an agreement on the EU budget negotiation. Responding to the criticisms, the UK ambassador Kim Darroch promised that he would discuss his understanding with London and organised a new meeting for 17 November, with the view to proposing the timing for review clause on EU spending priorities and revenue (European Report, 11 November 2005).

The meeting of EU member states' ambassadors on 17 November

At the meeting of EU member states' ambassadors on 17 November, the UK presidency did not present a detailed proposal of the UK presidency compromise for the EU budget negotiation in December 2005. It proposed a Globalisation Adjustment Fund (GAF), but it was opposed because there was not enough time to decide before the December European Council. Some countries in the net contributor group, moreover, were not willing to add extra money to the EU budget (European Report, 19 November 2005).

¹³⁰ At the Lisbon European Council, the member states not only agreed the Lisbon strategy but also agreed to provide the cohesion fund of about €9.7 billion to the new member states. The cohesion fund would be allocated in the financial perspective for 2007-2013. Delaying a financial agreement to the next year would mean that it would be difficult for the new member countries to receive the cohesion fund in 2006 to modernise their economic structure and growth (European Report, 11 and 29 June 2005).

The Foreign Ministers' meeting on 21 November

The Foreign Ministers' meeting on 21 November 2005 was the final meeting before the negotiation in December. Mr Straw was confronted with opposition from 20 member states which had agreed the Luxembourg presidency compromise in June 2005. The 20 member states pressured the UK presidency not to deviate too far from the Luxembourg presidency compromise, including the reduction of the UK rebate (European Report, 23 November 2005; European Report, 30 November 2005). In particular, Mr Douste-Blazy, the French Foreign Minister, argued that the UK must concede its rebate to pay its fair share of the financial burden with other net contributors, and to achieve financial agreement in line with its presidency responsibilities. France led other member states to pressure the UK to take responsibility as one of the rich countries in the EU to contribute towards the EU budget for the development of the EU, even though the UK still received few benefits from EU expenditure policies (European Report, 23 November 2005; The Irish Times, 22 November 2005).

Responding to the opposition, Mr Straw said that the UK presidency would do its best to reach an agreement in December 2005 and that a compromise would be presented on 5 December (European Report, 23 November 2005). It was his intention, he argued that the total EU budget would be reduced to 1.03 per cent of GDP, as compared to 1.06 per cent of EU GDP under the Luxembourg presidency compromise. Consequently, the presidency would propose the reduction of regional aid (European Report, 30 November 2005). The UK presidency organised a special meeting of the Foreign Ministers on 5 December 2005 to prepare for the European Council on 15-16 December (European Report, 23 November 2005).

4.2.3. The UK presidency compromise

At the special meeting of the Foreign Ministers on 5 December 2005, the UK presidency presented its compromise. It proposed the total ceiling to €847 billion at 1.03 per cent of GDP, which was reduced from €871 billion at 1.06 per cent of GDP under the Luxembourg compromise, and €1,025 billion at 1.24 per cent of GDP under the Commission proposal of 2004 (European Report, 5 and 7

December 2005). To reduce the EU budget, the compromise proposed that regional aid for the old and new net recipient groups would be cut by 10 per cent, about €14 billion compared to the Luxembourg compromise (European Report, 5 December 2005; Financial Times, 5, 6, 8, and 10 December 2005; House of Lords, 5 December 2005; Whitman and Thomas, 2007: 71; Whitman, 2006: 61). UK officials gave two reasons for this reduction in regional aid. First, the UK argued that the structural funds were not fully spent each year (European Report, 5 December 2005). Secondly, the UK pointed out that €150 billion of regional aid was twice the value of the Marshall Fund for the economic reconstruction of Western Europe after World War II.¹³¹ The UK presidency asserted that reduced regional aid would still be enough to help build net beneficiaries' economic growth (European Report, 3 and 7 December 2005).

The British Presidency took the difficult decision to propose a cut of the UK rebate by €8 billion over the seven-year budget period. The size of the reduction in the UK's rebate also took into account the exclusion of the new net recipient group's benefits under CAP spending (European Report, 7 December 2005).

On the basis of my interviews and an analysis of Blair's speech in the House of Commons on 19 December 2005, the change in Britain's position was affected by two main reasons. First of all, an interviewee claimed that it resulted from the Blair government's willingness to reach an agreement under the UK presidency, in order to strengthen the credibility of Britain's leadership towards the modernisation of the EU through the Lisbon strategy. Due to the net contributors' demand to reduce the UK's rebate and thus reduce their own contribution, if Britain had continued to argue for retaining its rebate, the financial agreement would not have been achieved at the Brussels European Council in December. Secondly, Blair said that the UK presidency had considered the UK's 'moral uprightness' as a rich member state in taking decisions on the rebate. If the UK received its rebate from the poor new member states through the UK rebate system, it would have invalidated the UK's role as net contributor (House of

¹³¹ After World War II, in 1948, the Secretary of State of the US, Mr Marshall, proposed about \$ 13 billion of aid to West European countries to rebuild their economies: See Geddes (2004).

Common, 19 December 2005):

We supports enlargement; yes, we supports enlargement.- [interruption.] We support the wealthy countries paying for the poorer countries. That is right too; isn't it? ... The one thing that is obvious is that the budget does indeed need fundamental change, but the whole point about getting this deal in December is that, without it, the new central and eastern European countries could not have planned ahead for the next budget period. That is why we had to have an immediate deal in December so that they could have the certainty of the money coming to them, and then, in the medium and longer term, the prospect of the mid-term review that would allow us fundamentally to change the structure of the budget.

Finally, an interviewee said that the Blair government's vision of modernising the EU matched with the new member states' demands to achieve the financial agreement in December for regeneration of their economic structures and growth. Britain was willing to support the new member states' economic regeneration through providing cohesion funds in 2006, and regional aid in the financial perspective for 2007-2013. The new beneficiaries would had economic difficulties in supporting modernising Eastern Europe, if the UK presidency had decided to delay the financial agreement to the next (Austrian) presidency in the first half of 2006 (The Guardian, 19 December 2005).

Due to reducing the size of the EU's revenue, the UK presidency proposed to cut € 7 billion from the rural development budget, € 2 billion from farm spending for Romania and Bulgaria, €0.7 billion from internal policies, and €1 billion from administrative costs (European Report, 7 December 2005). The UK presidency, furthermore, proposed a review of EU spending priorities as part of future reform of EU policies for modernisation in its compromise (European Report, 7 December 2005). In the review clause, the European Commission would examine all EU spending, particularly the CAP, in the mid-term of the financial perspective for 2007-2013, and would submit its report to the European Council. Heads of member states would, then, make a decision about the reform of EU spending priorities. The review would be held in 2008 (Financial Times, 5 December 2005).

At the Foreign Ministers meeting, ministers from new net recipient countries criticized the compromise on the reduction of their benefits from EU regional aid. In particular, Poland's Prime Minister Kazimierz Marcinkiewicz¹³² said that it was a 'bad budget' and a 'bad proposal', and required improvement before the European Council (European Report, 7 December 2005). In the net contributor group, France and Sweden were the most vocal. Sweden was not likely to benefit under the UK presidency's compromise, as it would reduce the Swedish net contribution by 0.01 per cent; hence, it was unhappy with this lack of improvement in the country's net contributor position. France, whose net contribution would increase by 0.01 per cent, criticized the reduction by just €8 billion of the UK rebate. The French Foreign Minister Philippe Douste-Blazy asserted that the limited reduction of the rebate was unacceptable in terms of solidarity and fairness, and called for a new compromise with a further reduction to €14 billion, instead of reducing regional aid. Furthermore, France would have domestic political difficulties if it accepted the review clause, particularly the CAP.¹³³ (European Report, 7 and 10 December 2005).

In the old net recipient group, due to receive a cut of €7 billion from the rural development budget, Portugal and Spain would lose 20 per cent and 33 per cent of their rural development allocations respectively, compared to the Luxembourg presidency proposal (European Report, 10 December 2005).

In the net contributor group, the Netherlands and Germany were positive about the UK presidency compromise, involving as it did a trimming of EU expenditure. Dutch Finance Minister Gerrit Zalm welcomed the cut of €700

¹³² Marcinkiewicz envisaged that cutting 10 per cent of regional aid would result in a 20 per cent reduction in structural funds for Poland. Due to some structural and cohesion funds being allocated to rural development funds, Poland was a prosperous country compared to other new member states, and, as a result, it would lose €530-560 million from regional aid. Marcinkiewicz demanded the increase of regional aid in order to ensure Poland's financial benefits (European Report, 10 December 2005).

¹³³ Chirac's EU policies were regarded with suspicion by the French public. As a result, the government not only lost the French regional election of 2003 and the European election of 2004 but also were defeated in the national referendum of the Constitutional Treaty in May 2005. Chirac was afraid of the French farming union's opposition to his EU policies. He opposed the review clause in the UK presidency compromise (Gowland *et al.*, 2010).

million in the Dutch contribution, as they had demanded a €1 billion saving in June. Germany also had a positive position on the reduction of the EU budget, which would now flow towards the new net recipient group instead of the East German regions. However, Germany was concerned that the UK proposal would not be accepted by the old and new net recipient groups, and by members of the net contributor group whose net contribution would not be reduced under the compromise (European Report, 7 December 2005).

In the UK presidency compromise, reducing the UK abatement by € 8 billion was not a large enough concession to obtain a deal for the financial negotiations in December 2005. Although the UK presidency took account of the net contributor group's desire for a reduction in the EU budget and their net contribution, and proposed a 'Mini-budget', the presidency compromise still failed to fulfil all member states' demands, particular those of the net beneficiaries (European Report, 7 December 2005). France and Sweden were especially adamant in demanding reductions in their net contributions. The old and new net recipient groups also argued for increases in the regional aid budget to build their economies (European Report, 7 December 2005).¹³⁴ To obtain a deal with these countries, the UK presidency needed to reduce its rebate by more than €8 billion over the financial period. Such a move seemed as if it might be the only solution that would allow an increase in EU expenditure simultaneous with a reduction in the net contributor group's contribution to the EU budget (European Report, 9 December 2005).

4.2.4. The Brussels European Council in December 2005

On the eve of the Brussels European Council on 15-16 December 2005, there were many criticisms of the UK presidency compromise. Of course, the two net recipient groups condemned the UK presidency compromise for reducing regional aid. The net contributors group found fault with the compromise. Both France and the European Commission's President, Mr Barroso, criticized the compromise. Mr

¹³⁴ European Commission President José Manuel Barroso defined the UK compromise 'unacceptable', and labelled the proposed UK budget one for a 'Mini-Europe'. He pressured the presidency to increase the size of the EU budget and reduce the size of the UK's rebate (European Report, 7 December 2005).

Barroso pressurised the UK presidency to propose a new presidency compromise with €55 billion of the total EU budget at 1.04 per cent of GDP, to offer a higher level of regional aid to the new net recipient group, and to permanently adjust the UK rebate mechanism (European Report, 14 December 2005). Chirac demanded that the UK rebate be cut by up to €14-15 billion to ensure the UK made a fair contribution and to increase both the EU's budget and regional aid. Chirac also argued that the UK must consider accepting the new collective system with permanent abolition of the UK rebate, in order to avoid the debate recurring in future negotiations. Spain and Germany also agreed with the French request for adoption of a new permanent UK rebate mechanism (European Report, 14 December 2005; European Report, 21 December 2005).

Taking into account all these criticisms, the UK presidency proposed a new compromise. The new compromise indicated an increase by €2 billion in the total EU budget to €49 billion from the 5 December proposal. The rate of the EU's revenue, however, was to remain around 1.03 per cent of GDP (European Report, 17 and 21 December 2005; Financial Times, 17 December 2005). The new compromise allocated an increase of around €1.175 billion to competitiveness spending on growth and employment, including structural and cohesion funds, and increased by €340 million the budget for rural development compared to the first presidency compromise of 5 December. The new compromise also allocated an additional €465 million to cut the Dutch and Swedish net contributions in order to induce them to accept the deal. Increasing regional aid meant that the compromise proposed a total of €260 billion for the new net recipient group. The UK conceded reducing the rate of the UK rebate to €10.5 billion as a maximum reduction that would constitute the UK's contribution to increasing the EU budget (European Report, 17 December 2005)

Despite these new adjustments, the UK was still faced with opposition from the new net recipients group, as well as from France, which insisted that the compromise was not enough for them to participate in the deal. The new net recipients group argued that only a reduction of the UK rebate by €4 billion, as the French had insisted upon all along, would be enough to generate additional funds that would satisfy their demands. Furthermore, the review of EU spending

priorities was conditioned by France's blocking tactics and pressure for a € 14 billion UK rebate reduction in the UK presidency compromise (European Report, 15 December 2005)

The UK presidency asked Germany to concede €100 million, which would have been allocated for German regional aid, to Poland. Germany accepted but demanded that the financial agreement be achieved in December (Nicoll and Delaney, 2007: 1). Mrs Merkel understood the British presidency's efforts to resolve the financial agreement and persuaded Chirac to make a concession on the issue of the review clause. France finally accepted a compromise with the review clause by 2008. Finally, the member states achieved the agreement of the financial negotiation for the financial perspective for 2007-2013 at the Brussels European Council in December 2005 (European Report, 23 December 2005; Financial Times, 17 December 2005; House of Common, 19 December 2005).

4.2.5. Outcome

The negotiation of the financial perspective for 2007-2013 achieved an agreement on 16 December 2005. The UK's offer to cut its rebate to €10.5 billion persuaded the net contributor and the net recipient groups to agree to €862.3 of the EU budget at 1.045 per cent of GDP. Due to the increase in the EU budget, regional aid was slightly increased to 0.37 per cent from 0.36 per cent in the second presidency compromise. Rural development funds were €9.25 billion compared to €6.34 billion (European Report, 21 December 2005; Financial Times, 17 December 2005; House of Commons, 19 December 2005; Whitman and Thomas, 2007: 71; Lorca, 2005: 6). All EU leaders were satisfied with the outcome (Begg and Heinemann, 2006; Lorca, 2005).

5. Conclusion

In February 2004, the Commission published its financial proposal for the financial perspective for 2007-2013, which was influenced by both the Lisbon strategy in 2000 and the enlargement of the CEECs in 2004. First of all, the Lisbon strategy not only proposed modernisation of EU policies in order to

strengthen the EU's competitiveness in the global market, but also paid attention to investing in education and training systems in order to improve the quality of human capital which would boost employment and economic growth. Secondly, the EU accelerated the enlargement of the CEECs with the view to increasing the size of the EU's internal market and protecting CEECs from aggressive Russian nationalism. With regard to the Commission's considerations of the Lisbon strategy and the enlargement, the Commission not only introduced the title of 'competitiveness for growth and employment' in the EU's expenditure policies but also proposed an increase of the EU budget in order to support the increase in regional aid. In order to secure the EU budget, the Commission proposed both the reduction of the UK's rebate and the increase of the EU's revenue.

The Blair government both supported and played a leading role in European integration projects in line with its notion of the 'Third Way' and its ambition to recover British global power. The government not only led the agreement of the Lisbon strategy in 2000 in order to effectively deal with the challenge of globalisation, but also guided member states to agree the enlargement. Although the Blair government supported these projects, it did not welcome the Commission's financial proposal. Britain not only pointed out that the CAP expenditure would allocate about 45 per cent of the EU's expenditure in the Commission proposal, but also identified CAP expenditure as a main barrier to the modernisation of the EU and argued that the Commission's proposal was not compatible with the Lisbon budget. Furthermore, the Blair government was also confronted with domestic political pressure which required the government to retain the UK's rebate in the financial negotiations. This motivated the Blair government to take an oppositional stance on the Commission's proposal, and the Luxembourg presidency compromise, which meant that at the Brussels European Council in June 2005 member states failed to achieve financial agreement.

In the second half of 2005, Britain assumed the presidency of the Council, and this heavily affected the negotiations. Although the UK presidency focused on a change of the Commission's proposal towards the 'Lisbon budget' through the informal European Council and Council meetings, it was faced with uncompromising positions by France over the reform of the CAP, and by the net

beneficiaries over the increase of the EU budget. Furthermore, the new member states pressured the presidency to achieve financial agreement at the Brussels European Council in December in order to secure cohesion funds. The British presidency understood that without the reduction of its rebate, it would have been very difficult to achieve an agreement. For this, the UK not only conceded introduction of the review clause in 2008 instead of the reform of the CAP, but also decided to sacrifice the UK's own interests and significantly cut its rebate. At the European Council in December 2005, thus, Blair was able to announce that the member states had found an agreement for the financial perspective for 2007-2013.

Chapter 6

Conclusion: budgetary politics and the UK's approach to European integration

1. Introduction

Since the UK joined the EC in 1973, the size of its contribution to the budget has been a very controversial issue. For more than 10 years, various British governments led by both Conservative and Labour leaders blocked the increase in price of agricultural products as a means of solving the UK's financial problem. Eventually, at the Fontainebleau European Council in June 1984, the Thatcher government successfully drew concessions from other member states with the establishment of the UK's rebate system. This agreement generated a number of clashes between the UK and other net contributors over sharing of the financial burden. In the 1980s and 1990s the Conservative governments firstly and the Labour government laterally managed to defend the rebate. Eventually, at the Brussels European Council in December 2005, the Blair government decided to substantially reduce its rebate.

The thesis briefly, in this chapter, looks at the results of four alternative issues: public opinion, intra-party politics, the pressure of national economic interest groups and the dynamics of EU negotiation, which were tested in the empirical chapters, in explaining the UK's behaviours in the rebate negotiations. First, public opinion did not play its role in shaping Britain's behaviours in its rebate negotiations. This was because the Heads of government or states managed

the schedule of the financial negotiations in order to avoid giving the UK government any room for manoeuvre in shaping Britain's actions from public pressure (the result of an election). Due to scheduling Britain's general election on 11 June 1987, and 5 May 2005, Heads of government or states agreed to delay the financial negotiation until after the general election, and initiated the negotiation on 29-30 June 1987, and on 16-17 June 2005 respectively. The delay gave a chance to the UK government to avoid public pressure in shaping its behaviours during its rebate negotiations. Furthermore, after his involvement in the war in Iraq, Blair was faced with significantly increasing unpopularity. His pro-European approach was also confronted with significant criticism from the Conservative party and the popular press, which pressured Blair to protect the UK rebate. Despite this, Blair decided to reduce the rebate at the Brussels European Council in December 2005.

Second, in Britain's intra-party politics, European integration project: the SEM/SEA and the EMU that linked with the Delors I and II package respectively, in the negotiations there was a clash between Thatcher, Major and other members of the Conservative party. These divisions however did not affect the Conservative governments' position and the UK was able to retain its rebate in both circumstances. Furthermore, during the 2005 financial negotiation, Brown had a personal ambition to become the Prime Minister, and his followers encouraged Brown to pressure Blair to take opposition on the rebate issue in order to prevent the increase of the Labour party's unpopularity. This division, however, did not prevent Blair from agreeing to reduce the size of the rebate in December 2005.

Third, the preferences of the various Conservative governments in the 1980s and early 1990s certainly reflected the positions of economic groups, but only because these coincided with the Conservative party's neo-liberal ideology. Nevertheless, the Thatcher and Major governments did not hesitate to block agreements when EU budget negotiations – even when these were packaged with important European projects: the SEM and the EMU – threatened the UK budget rebate. Under the Labour governments, domestic economic groups were eager to reap the benefits of the upcoming enlargement to CEECs in the Agenda 2000 negotiations. The first Blair government, however, resisted the pressure and

refused to accept any reduction of the UK rebate due to Germany's unacceptable demand. The Blair government's behaviour changed in the 2005 negotiation for the 2007-2013 financial perspectives. This was due to transforming the perception of the UK from an 'awkward partner' into a 'constructive partner' and becoming 'good' and 'effective' Presidency, the Blair government agreed the reduction of its rebate.

Fourth, in the financial package issues, the enlargement of the CEECs would bring about the UK's economic benefits, particularly new investment opportunities. The enlargement not only dealt with the Agenda 2000 negotiation but also was an issue in the 2005 financial negotiation for the financial perspective for 2007-2013. However, the Blair government took different behaviours in negotiation. If it assumed that the UK used the rebate as a side-payment to guide their partners towards the agreements for gaining its other economic advantages, this assumption would become wrapped in mystery to explain the changes of the Blair government's behaviours on the enlargement between the 1998-1999 and the 2005 negotiations.

Rather, by tracing the history of Britain's rebate negotiations, this thesis has, therefore, shown that domestic political parties' approaches to European integration have played a central role in shaping the UK's behaviour in the EU's financial negotiations. By doing so, it has challenged Liberal Intergovernmentalism, which emphasises the role of economic interests and downplays the role of political factors. Moreover, it has qualified the view that the UK is an 'awkward partner'. For this, rather than talking about national preferences, it would be better to talk of the preferences of the party in government, which since the early 1980s have adopted anti- and pro-European stances. Due to the fact that the Blair government adopted a more constructive approach together with the expected role of acting 'appropriately' whilst holding the rotating presidency explains why there was an unexpected decision to cut the rebate.

These findings on British politics' contribution are more generally re-discussed together with the politics of budget negotiation in the EU. The last section briefly sketches the prospects of rebate in the financial perspectives for

2014-2020. The expectation is that the (remaining portion of the) rebate would still be a contentious issue: most member states will demand a further reduction, but the existence of a coalition government comprising of a pro-integration party and an anti-integration party will complicate matters.

2. Summary of the main findings

This thesis has identified three main phases in the UK's negotiations for the EU budget: securing the rebate between the 1970s and 1984; defending the rebate, in the late 1980s and in the 1990s; and then sacrificing the rebate in 2005. In the first phase, the UK penalised by the late accession and membership deal, eventually found a remedy to the imbalance between contributions and receipts through the settlement of the rebate system. In the second phase, the common strategy by Conservative and Labour governments was that of retaining the rebate, which attracted criticism from a number of fronts. In the third phase, the UK made concessions to reduce the size of its rebate, with the view to modernising the EU's economy.

Similarly, since the UK joined the EU in 1973, there have been three distinct types of disputes between member states in EU budgetary politics. The first phase was characterized by an intense conflict between the UK and the other member states over Britain's financial problem, which ended with the 1984 deal. During the second phase there was an increased number of conflicts between member states over different issues: between net contributors and net beneficiaries on the size of the EU budget, and between the UK and other net contributors on sharing their financial burden. This involved the negotiations of the Delors I package between June 1987 and February 1988, the negotiations of the Delors II package in December 1992, and the negotiations of Agenda 2000 between June 1998 and March 1999. The third phase, which involved the negotiations between June and December 2005 for the financial perspective for 2007-2013, was characterised by the addition of new conflicts between old and new net beneficiaries on sharing the financial benefits to the existing conflicts.

2.1. British politics and European integration

In explaining Britain's behaviours in the rebate negotiations, the governing party's approach to European integration plays a prominent role. This also affects the way in which the government in power views its role of rotating presidency: if it takes a pro-European approach, it tends to act responsibly and a concession can be reached more readily. By contrast, if it takes an anti-European approach, it may use the privileged position to pursue its interest and retaining the rebate looks like the most plausible option. Yet, although Britain takes a pro-European approach and holds the presidency, Britain's concession to reduce the rebate depends on the presence of an ambitious and feasible European project.

This thesis has identified two approaches that have characterised the UK's behaviour over the EU's budgetary negotiations, one more anti-European taken by the Conservative party and one more pro-European taken by the Labour party. But this has not always been the position of these parties. For instance the Conservative government under Heath took a pro-European approach: in line with its neo-liberalism ideology in economic policies, it supported the idea of the common market and therefore sought to gain potential economic advantages by applying for EC membership. Because of this, it was prepared to accept the own resources system, which was going to cause a number of financial problems in the years to come.

The Thatcher government represents an interesting case. Initially, it had a pro-European approach on the common market, consistent with the Conservative party's neo-liberal ideology. It also tried to address the financial problem, with the view to overcoming the euroscepticism at the domestic level. But when in 1983 the European Community started undertaking negotiations for the reform of the budget in preparation for Spain and Portugal's accession in 1986 and considering that a large chunk of expenditures were still used for the CAP, the Thatcher government changed position. The dispute between the UK – which wanted to settle a rebate system – and France – which sought to preserve the CAP and resist the introduction of a rebate because that would increase its financial contribution – was tense. A solution was eventually found at Fontainebleau European Council in June 1984, where the French presidency made its concession in setting up the

rebate system, partially reforming CAP expenditures, and increasing VAT to consolidate its reputation as a leader of Europe.

The anti-European approach characterised the other Conservative governments in the 1980s and 1990s. In particular, in the 1987-88 and 1992 financial negotiations, the UK not only opposed the reduction of its rebate, but was not particularly interested in increasing the size of the budget for supporting European integration projects. In fact, the 'Delors I package' emphasised upon the completion of the SEM by 1992, and the SEA which not only focused on the reform of institutions, noticeably the extension of QMV and the increase of the EP's involvement in the decision-making, for the SEM measure but also presented 'economic and social cohesion' with the aim of reducing economic disparities between member states, which in turn would promote the development of all member states' economies. On the integration issues, there was a faction regarding the ideology of the Conservative party in shaping Britain's approach beyond economic integration. In the faction, Thatcher and anti-Marketeters' concern on losing the national sovereignty in the SEA went against pro-Europeanists who emphasised the reform of the institutions in completing the SEA by 1992. Thatcher was persuaded by pro-Europeanists in the government, and then reluctantly agreed the SEA. This meant that the government's hostility on the direction of the integration slightly increased and affected Britain's behaviour in the financial negotiation for the Delors I package. In the negotiations, the net beneficiaries threatened to withdraw their cooperation for the completion of the SEM unless the net contributors agreed to boost the budget. Eventually, the UK and the group of net contributors accepted the net beneficiaries' demands, but the increased size of the budget brought about a conflict on sharing financial burden. In the negotiation between Britain and other net contributors, the UK adopted an aggressive negotiation style: rather than cutting the rebate it argued that the reform of the CAP would have freed up an enormous amount of resources for other policy areas. It was possible to take this style of negotiation thanks to its position on the SEA. Facing a stumbling block, Germany made a concession in order to reaffirm its position as a leader of Europe.

Similarly, the Conservative Party's anti-European approach affected the

UK's behaviour in the negotiations for the financial perspective for 1993-1999. In 1992, the European Commission proposed the 'Delors II package', in which the EMU became a primary element behind the increase of the budget. The creation of the Cohesion Fund was meant to financially support Greece, Spain, Portugal, and Ireland, to meet the EMU's economic convergence criteria. In the initial discussion for the TEU, a faction between Thatcherites and pro-Europeanists in the Conservative party emerged again in shaping Britain's approach. Thatcherites took an 'anti-European' approach, particularly on the social charter and the EMU. Thatcherism on free-market policy and the importance of British national sovereignty affected the shaping of their 'anti-European' attitude. Its main concern was that the creation of EMU would involve a loss of national sovereignty on monetary policy, and that the social charter would be a socialist attack on the EC's free-market policy. The 'anti-European' attitude was challenged by the pro-Europeanists, especially when Major successfully replaced Mrs Thatcher as Prime Minister. Although the new pro-European government took charge of Britain's negotiations for the Delors II package, because of the pressure of Thatcherite MPs, it had a little room for manoeuvring. In the negotiations, the four cohesion countries' argument for increasing the size of the budget was accepted by the net contributors, particularly Germany and France which were the main actors in support of the EMU and the social chapter in the TEU. However, at the Edinburgh European Council in December 1992, Germany and France not only faced political difficulties for their support to the cohesion countries, but also recognized Britain's strong opposition to the reduction of the rebate which reflected Britain's position on the EMU and the social chapter in the TEU. Eventually their decision to become paymasters in the Delors II package was a decisive factor in achieving the financial agreement.

The pro-European approach of the Labour party shaped its behaviour in the negotiations for the 1999-2006 and 2007-2013 financial perspectives. In 1997, the European Commission proposed Agenda 2000 which packaged together the multi-annual budget plan for 2000-2006, and the preparations for the enlargement of Central and Eastern European Countries, particularly through the creation of 'pre-accession aid'. The New Labour government took a pro-European approach to

European integration and enlargement in line with the concept of the 'Third Way'. In fact, it expected that the enlargement would not only extend the internal market but would also bring about economic advantages to Britain via added commercial opportunities. Nevertheless it took its pro-European approach and presidency, at the Cardiff European Council in June 1998, it did not want to accept any reduction of the rebate, mainly for two reasons. First of all, Germany's demand to reduce its financial contribution was not of an acceptable size to the UK. In its proposal, the European Commission proposed freezing the size of the budget with regard to Germany's financial problem, which had arisen from the cost of unification in 1990, other member states' financial difficulties in preparing for EMU, and the enlargement of the EFTA countries in 1995 which not only increased the number of net contributors but also implied a reduction of the financial burden. The UK argued that Germany's demand on a reduction size of its contribution was too big to be accepted. Secondly, Britain's rebate was not a central factor in the budgetary negotiations. Germany's demand called for sacrifices by all member states in order to maximise the reduction in size of Germany's contribution. The reduction of the UK's rebate was not enough to satisfy Germany and all the other member states' demands. Britain, the other net contributors and the net beneficiaries could not accept Germany's demands. Consequently the negotiation was delayed to the Berlin European Council in March 1999, where the German presidency not only proposed the reduction of its demand in order to reduce other member states' financial burden, but also led other member states to agree on retaining the rebate, and eventually achieved the agreement on time.

Finally, in February 2004, the European Commission proposed the financial perspectives which packaged together the multi-annual budget plan for 2007-2013 and the Lisbon strategy, which sought to strengthen the EU's economic competitiveness through the development of human capital and reinvigorate the new member states' economies. In line with the Blair government's concept of the Third Way emphasising free market, the UK took a pro-European approach on both the Lisbon strategy, which would help meet the challenge of globalisation, and on the enlargement, which would bring about economic and political advantages to the UK in playing its leadership role in the EU and the world. At the

Brussels European Council in June 2005, the Blair government paid attention to modernising the EU's budget expenditure rather than to retaining the rebate. Although it was faced with a political faction with the Chancellor Brown over the rebate, it proposed a package involving the reduction of the rebate and the reform of the CAP. However, the proposal was rejected due to France's opposition over the reform of the CAP, which handed over the negotiations to the UK presidency. At the Brussels European Council in December 2005, the British presidency agreed on a reduction of the rebate without the reform of the CAP, as a result of the pressure made by the new member states about their economic regeneration and the fact that the Blair government appreciated the responsibility involved in holding the presidency.

The role of the presidency

The way the UK behaved when it held the rotating presidency during the financial negotiation round deserves some attention. The six-month-rotating presidency of the Council offers member states the opportunity to pursue their own interests – and in the case of the UK this would mean retaining the rebate – or to mediate between the parties with the view to pursuing the common good – and in the case of the UK this would mean sacrificing the rebate. The UK held the presidency in the 1992, 1998, and 2005 financial negotiations.

At the beginning of the 1990s, in the Conservative party, there was a division, particularly on the social charter and EMU, between Thatcherites who had a more euro-sceptical view and pro-Europeanists who took a pro-European attitude in shaping Britain's approach on the Delors II package. The division limited the behaviour of the Major government when it held the rotating presidency in the context of the 1992 financial negotiations. On the one hand, it actively sought to achieve a feasible compromise and remove Britain's image as an 'awkward partner'. On the other hand, retaining the rebate was a very sensitive issue, used by Thatcherite MPs in the Conservative party, and by the Labour party to weaken the credibility of the Major government. The presidency proposed a weak compromise, reducing revenue to a 1.2 per cent ceiling from the Commission's proposal of 1.37 per cent but also removing the rebate and the CAP

reform from the debate. Despite strong criticisms made by the net beneficiaries, the UK presidency did not change position. Eventually, the decision of Chancellor Kohl and President Mitterrand to pay for the increase of the budget to 1.27 per cent represented the only way out of the impasse.

In the negotiation for Agenda 2000, the UK held the presidency in the first half of 1998. Although the New Labour government had a pro-European approach, it also had to bear in mind the level of the UK's economic growth, the risks of criticism in domestic politics, and its overall approach to European integration in line with the 'Third Way'. First of all, economic growth had been slower in the UK than in other member states, and a reduction of the rebate would bring about Britain's financial problem again. Secondly, the New Labour government was concerned about criticism from the Labour party's left wing, the Conservative party, and the public over its pro-European approach if it accepted the reduction of the rebate. Finally, the 'Third Way' did not support the EU's expenditure policies which concentrated on agricultural subsidies instead of emphasising job creation. All these factors prevented the Labour government from being a 'responsible' presidency and achieving a compromise. It should be however added that Germany's demand for a substantial cut of the UK's rebate, the increase of other net contributor's budget contribution, and the reduction of net beneficiaries' financial benefits was deemed not acceptable not only by the UK but also by the majority of other member states. In fact, neither the net beneficiaries nor the other net contributors were ready to, respectively; accept a cut of their benefits and an increase of their contributions for reducing Germany's budget contribution. In the financial negotiation, in fact, Germany's demand was a central issue rather than the UK's rebate. This meant that although the Blair government held the presidency, it could not make the presidency concession because the rebate was not a controversial issue which could satisfy all member states in the negotiation.

Finally, during the negotiation of the financial perspective for 2007-2013, the UK held the presidency in the second half of 2005. In general, the Blair government had a pro-European approach on the Lisbon strategy and the enlargement of CEECs in 2004, whilst at the same time was not happy about the size of the CAP expenditure. Moreover, the Blair government faced a faction

between Blair and Brown over the rebate thanks to the Blair government's unpopularity due to its involvement in the war on Iraq in 2003. The faction brought about a political difficulty in deciding the reduction of the rebate. Nevertheless, the UK presidency tried its best to persuade member states to understand the case for modernising the EU in response to the challenge of globalisation. The new member states added significant pressure arguing they needed financial support for the regeneration of their economies. The New Labour government considered the responsibilities of the presidency in order to achieve the financial agreement before the end of its term. Furthermore, it considered the UK's 'moral uprightness' as one of the net contributors, arguing that it was not possible for poor member states to pay for the UK's rebate.

2.2. Budgetary politics

Budgetary politics can be defined as the process of achieving agreements on the size of the EU's budget, with member states seeking to contribute as little as possible to, and to extract as much as possible from the budget. The outcome of the negotiations clearly indicate the 'winners' and the 'losers' and figures often cause domestic political difficulties to heads of governments or states in that they draw the attention of domestic political parties, public and the media. However, following the 1988 budgetary reform, the concept of the 'winners' and the 'losers' partially changed in that the financial perspectives started to be seen against the broader evolution of the European Union. More generally, the financial perspectives require richer member states, generally net contributors, 'to act responsibly' and compensate for poorer member states, with the aim of advancing European integration and fostering higher economic growth in Europe. Poorer member states, by contrast, seek to lower the level of their contribution and at the same time demand increases in their benefits. All these tensions underpin each negotiation round (Lindner, 2007; Laffan and Lindner, 2010).

The increase of the budget generated several conflicts between net beneficiaries and net contributors on its size, and between the UK and other net contributors on sharing of the financial burden. The net beneficiaries sought to maximise their financial benefits from European integration projects: economic

and social cohesion in the SEA, the Cohesion Fund in the TEU, pre-accessional aid in the Amsterdam Treaty, and the increase in EU spending on education and training systems in the Lisbon strategy. The enlargement of CEECs in 2004 not only divided net beneficiaries into two groups, old and new, but also brought about a conflict between them on sharing financial benefits. The remainder of this section explores all these conflicts, identifying three different phases (Laffan and Shackleton, 2000; Lindner, 2006; Laffan and Lindner, 2010).

Phase 1: the UK vs. other EU member states

The own resource system in 1970 budget treaty disadvantaged the UK on both the revenue and expenditure sides. On the revenue side, considering its trade with the Commonwealth countries and the US, the UK was the second-largest contributor, but was one of the member states that received little benefits. In contrast, on the expenditure side, the predominance of the CAP provided little benefit to the UK in the EC's expenditure policies. The UK called for a reform of the CAP and for budgetary discipline, and the development of other EC spending policies to bring about a better balance of the UK's contributions and receipts. Margaret Thatcher continuously referred to the unacceptable size of the UK contribution to the budget. At the Fontainebleau European Council in 1984, the EC member states agreed the UK rebate system, which would refund two-thirds of the difference between British contributions and receipts.

Phase 2: net beneficiaries vs. net contributors and UK vs. other net contributors

The enlargement of Mediterranean countries brought about new dynamics. Net beneficiaries threatened blocking an agreement of the financial package: European integration project (the SEM and the SEA) and the multi-annual financial plan for 1988-1993 in order to pressure net contributors to agree on the increased size of the budget. The net contributors sought to reduce their contribution, but eventually had to agree to for the sake of completing the project. This, however, brought about a new conflict between the UK and other net contributors, which not only argued that the UK had to contribute to the budget in

a way commensurate to its economic capabilities, but also put pressure on the UK to reduce its rebate in order to share the financial burden with them. This conflict delayed the agreement of the Delors I package until Germany, which was holding the presidency, in a special summit made some extra concessions by increasing its contribution and persuaded net contributors to agree the financial negotiation. This concession not only reduced net contributors' contribution but also retained Britain's rebate.

Similarly, with the Delors II package, the increase of the budget caused by the creation of a new Cohesion Fund replicated the conflict between net beneficiaries and net contributors on the size of the budget and between net contributors and the UK on sharing of the financial burden. Interestingly, when the UK held the EU rotating presidency in second half of 1992, it opposed the increased size of the budget caused by the Cohesion Fund due to its unwillingness to share the costs of the EMU and actually proposed a significant reduction of the budget from the Commission's original proposal. The threat of the 'cohesion countries' led by Spain's Prime Minister Felipe Gonzales to veto any other agreement which did not include an increase of cohesion funds had an effect on some of the net contributors. Chancellor Kohl, in the light of the failure of the Danish referendum in June 1992 on the Maastricht Treaty and the political difficulties of some countries to agree on the EMU, urged the UK to take more responsibilities as president of the EU and agree on a reduction of its rebate. Facing a stumbling block, in order to recover public enthusiasm for European integration, Germany made some extra concessions and agreed on a higher spending plan in order to make an effective deal for building the EMU.

The budgetary politics of Agenda 2000 were similar to the negotiations of the Delors I and II packages. In March 1998, although the EU created 'pre-accession' aid, the European Commission proposed stabilizing the size of the EU budget at the level of the Delors II package. This was a response to the complaints about the financial burden made by some net contributors, particularly Germany and the Netherlands. In the negotiations, Germany demanded a reduction of its contribution by more than the level proposed by the European Commission. Germany's demand made the conflicts more difficult. The net beneficiaries argued

that they could not accept the European Commission's proposal and Germany's demands, because pre-accession aid would reduce their financial benefits. The net contributors – the accession of Austria, Finland and Sweden in 1995 had brought an increase in the number of net contributors – supported Germany's demand for the reduction of the EU budget but opposed the increase of their contribution. Although there were two European Councils, in Cardiff in June 1998 under the UK presidency and in Vienna in December 1998 under the Austrian presidency, Germany's demand blocked negotiations.

In the first half of 1999, Germany held the presidency and scheduled the Berlin European Council in March 1999. In that context, both net beneficiaries and net contributors conceded to change their initial position on the size of the budget in order to promote European integration: improving the Common Foreign and Security Policy and solving the institutional crisis which eventually led to the resignation of the Santer Commission. Finally, in the conflict between net beneficiaries and net contributors, the member states found a middle ground and agreed the size of the EU budget. In the conflict between the UK and other net contributors, Germany continued to demand the reduction of Britain's rebate in order for financial burden-sharing to take place, while Britain opposed it. Finally, the new German Chancellor, Gerhard Schröder, made the presidency's concession in order to make Germany's presidency successful.

Phase 3: net beneficiaries vs. net contributors, UK vs. other net contributors, old vs. new beneficiaries

In the financial negotiation for the financial perspective 2007-2013, the enlargement of CEECs in 2004 not only divided net beneficiaries into two groups (old and new recipients) but also brought about a new conflict between two groups on sharing the financial benefits from regional aid. Due to the increase in EU spending on education and training systems in the Lisbon strategy and the enlargement, the Commission proposed a significant increase of the EU's budget.

At the Brussels European Council in June 2005 under the Luxembourg presidency, both old and new net beneficiaries sought an increase of the EU's budget, and strongly pressured the net contributors to agree the increase of the EU

budget. This affected the conflict between the UK and other net contributors over sharing of the financial burden. Other net contributors pressured Britain to reduce its rebate, while Britain made a linkage between the reduction of its rebate and the reform of the CAP in order to transfer more resources for the implementation of the Lisbon strategy. Due to the French opposition to the reform of the CAP, the UK's proposal was rejected and the negotiation was postponed to the second half of 2005 under the UK's presidency. The Blair's pro-European approach held the presidency and re-considered shaping its behaviour over the rebate. Finally, at the Brussels European Council in December 2005, due to its responsibility of the presidency, the UK accepted a significant reduction of its rebate in order to achieve the agreement on time.

3. The future of the UK's rebate negotiation in 2013

In 2012, the EU will begin the negotiations for the 2014-2020 financial perspectives. How will the UK behave in respect of the rebate? Britain's behaviours will certainly be affected by political parties' approaches to European integration. As a result of the 2010 general election, the Conservative party successfully established a coalition government with the Liberal Democrats. This means that the Conservative party's neo-liberalism and anti-European approach could come into an ideological conflict with the Liberal Democratic party's pro-European approach. The Conservative party may oppose the increase in size of the EU's budget to financially support regional programmes and agricultural subsidies in order to reduce states' intervention in the market, while the Liberal Democrats will continue to support European integration. Furthermore, other member states may pressure Britain to reduce the rebate from the 2005 concession in order to increase Britain's contribution for financial burden sharing and to increase EU spending for overcoming economic depression in Europe. These positions may bring about conflicts between the UK and other member states. New research, thus, will be necessary.

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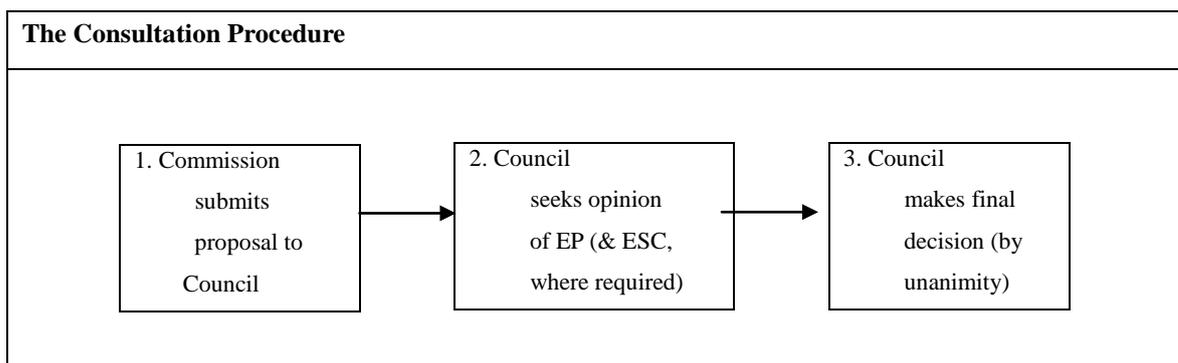
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- Daily Telegraph
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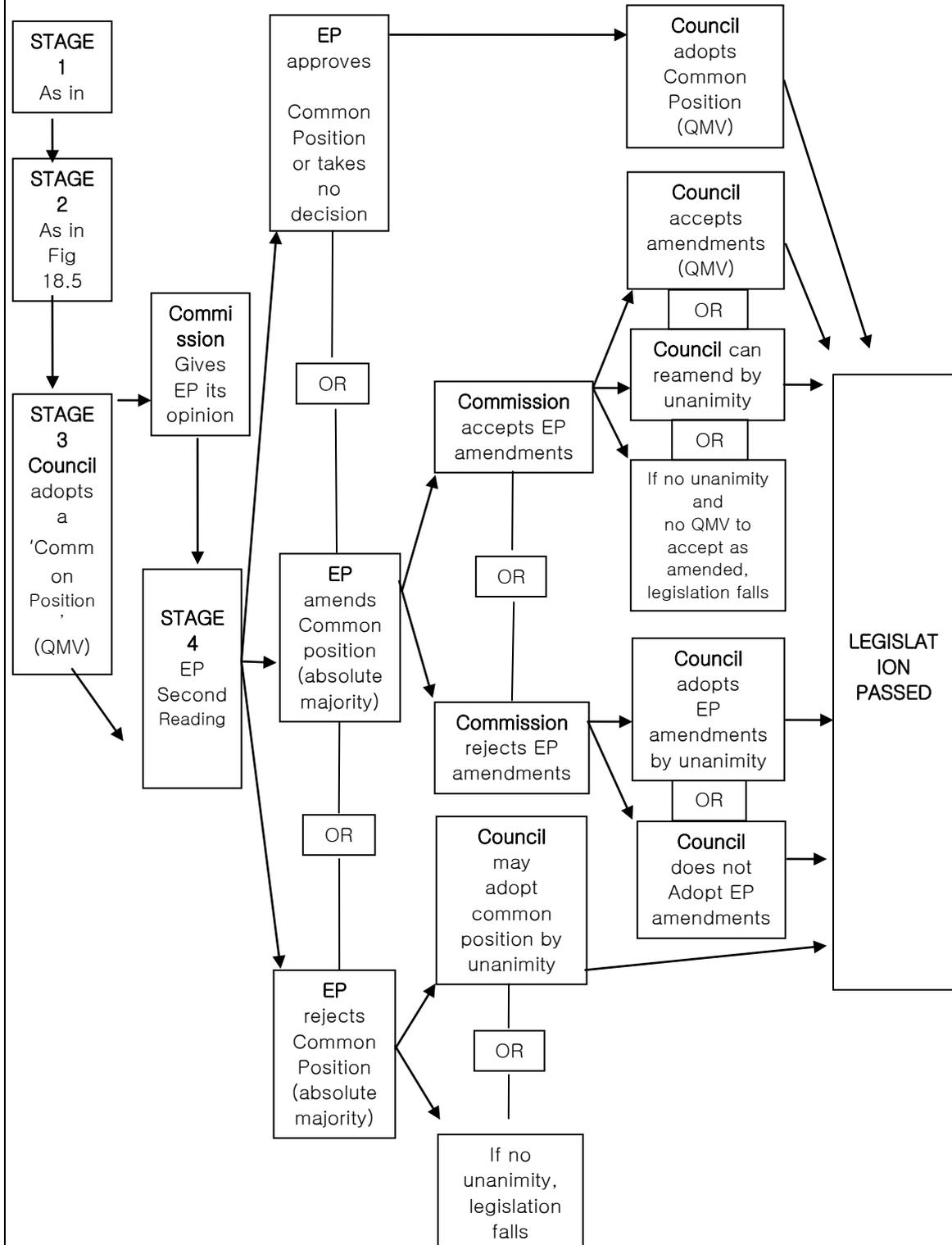
Appendix

Appendix No. 1: Legislative Procedures

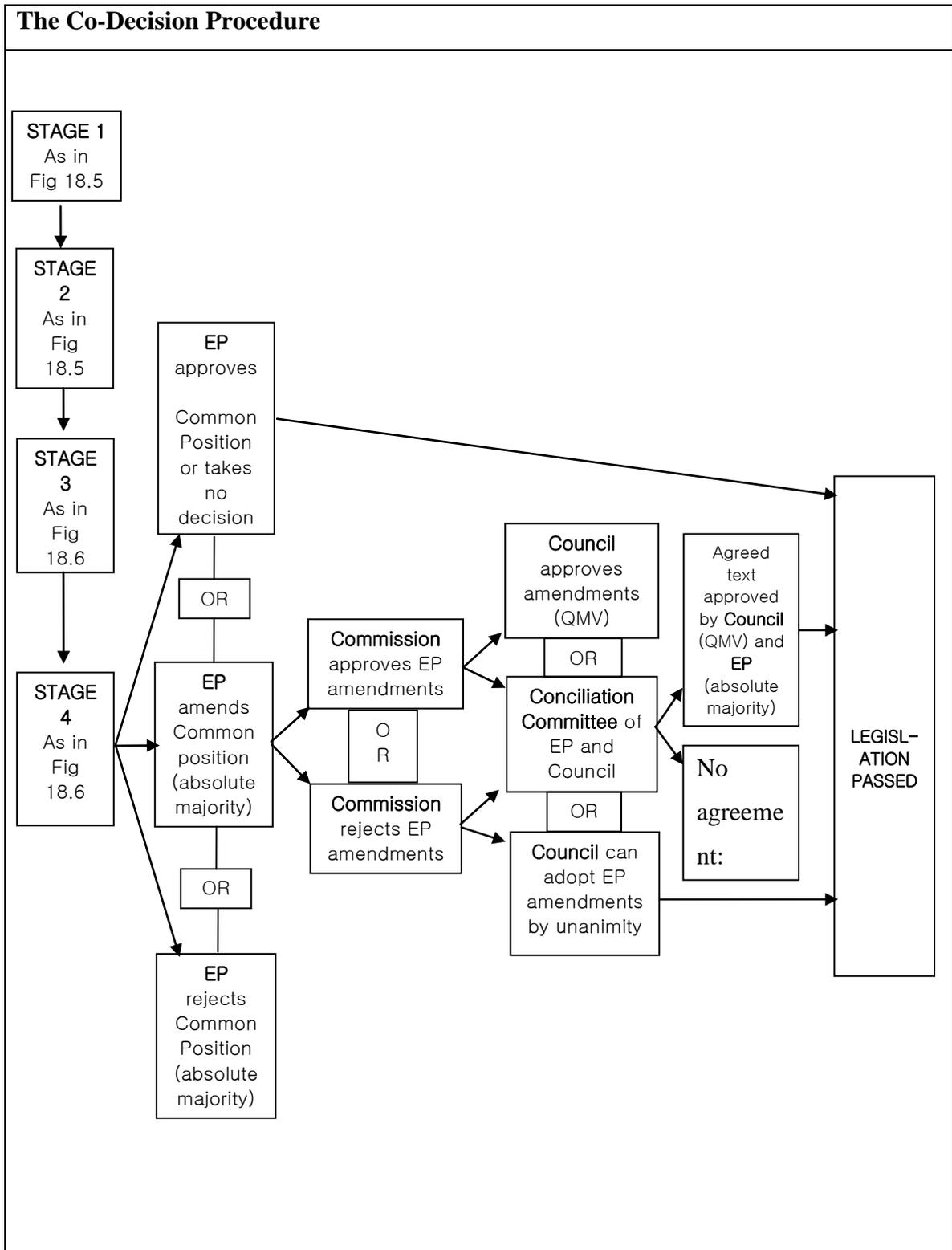


The procedure dealt with issues of agricultural policy issues, asylum, immigration, and visa.

Co-operation Procedure



The procedure was most legislation relating to the single market programme.



The procedure dealt with subjects of cultural policy, the multi-annual technological research, and development framework programmes.

Source: Bache and George 2006

Appendix No. 2: The Presidents of the Commission

The Presidents of the Commission	
Presidents (nationality*)	Period of tenure
Walter Hallstein (D)	1958-67
Jean Rey (B)	1967-70
Franco Maria Malfatti (I)	1970-72
Sicco Mansholt (N)	1972-73
François Xavier-Ortoli (F)	1973-77
Roy Jenkins (UK)	1977-81
Gaston Thorn (L)	1981-85
Jacques Delors (F)	1985-95
Jacques Santer (L)	1995-99
Romano Prodi (I)	1999-2004
José Manuel Barroso (P)	2004-present
<p>*Note that the Presidency has been held by a non-national of one of the original EEC-6 only twice.</p>	

Source: Peterson 2006

Appendix No. 3: The Constitutional Treaty

From Nice to a Constitutional Treaty			
2001	26	February	Treaty of Nice signed
	7	March	'Future of Europe' debate launched
	15	December	Laeken Declaration
2002	28	February	Inaugural plenary session of the European convention
	28	October	Praesidium unveils first 'skeleton' constitution
2003	26	May	Praesidium unveils revised text of Part I
	27	May	Praesidium unveils revised text of Part II-IV
	11-13	June	Convention debates and agrees by 'broad consensus' revised Parts I and II of the <i>Draft Treaty establishing a Constitution for Europe</i>
	20	June	Part I and II of the <i>Draft Treaty</i> presented to the Thessaloniki European Council
	9-10	July	Convention debates and agrees by 'broad consensus' revised Parts III and IV of the <i>Draft Treaty establishing a Constitution for Europe</i>
	18	July	Complete <i>Draft Treaty establishing a Constitution for Europe</i> presented to the President of the European Council
	29	September	IGC opens
	12-13	December	European Council fails to reach agreement on a <i>Treaty establishing a Constitution for Europe</i> and IGC negotiations are effectively Suspended
2004	24	March	European Council decides to resume IGC negotiations
	17	May	IGC negotiations resume
	18	June	European Council agrees a <i>Treaty establishing a Constitution for Europe</i>
	29	October	<i>Treaty establishing a Constitution for Europe</i> signed
2005	29	May	French electorate reject the Constitutional Treaty in a referendum
	1	June	Dutch electorate reject the Constitutional Treaty in a referendum
	16-17	June	European Council announces a 'pause' in ratification
	11	November	New German government announces it wishes to revive ratification in 2007
2007	1	November	Scheduled date for the entry into force of the Constitutional Treaty

Source: Nugent 2010

Structure of the Constitutional Treaty

The Treaty was divided into four parts, each of equal rank.

Part I was devoted to the principles, objectives and institutional provisions governing the new European Union and was divided into nine Titles: the definition and objectives of the Union; fundamental rights and citizenship of the Union; Union competencies; the Union's institutions; the exercise of Union competence; the democratic life of the Union; the Union's finances; the Union and its neighbours; and Union membership.

Part II comprised the European Charter of Fundamental Rights. It contained seven Titles, preceded by a Preamble: dignity; freedoms; equality; solidarity; citizens' rights; justice; general provisions.

Part III comprised the provisions governing the policies and functioning of the Union. The internal and external policies of the Union were laid down, including provisions on the internal market, economic and monetary union, the area of freedom, security and justice, the common foreign and security policy (CFSP), and the functioning of the institutions. It contained seven Titles: provisions of general application; non-discrimination and citizenship; internal policies and action; association of the overseas countries and territories; the Union's external action; the functioning of the Union; and common provisions.

Part IV grouped together the general and final provisions of the Constitution, including entry into force, the procedure for revising the Constitution and the repeal of earlier Treaties.

A certain number of protocols were annexed to the Treaty establishing the Constitution, in particular the: Protocol on the role of national parliaments in the European Union; Protocol on the application of the principles of subsidiarity and proportionality; Protocol on the Euro Group; Protocol amending the Euratom Treaty; Protocol on the transitional provisions relating to the institutions and bodies of the Union.

Source: http://www.europa.eu.int/scadplus/constitution/introduction_en.htm

Composition of the Constitutional Convention

In addition to its Chairman (Valéry Giscard d'Estaing) and two Vice-Chairmen (Giuliano Amato and Jean-Luc Dehaene), the Convention was composed of:

- Fifteen representatives of the Heads of State or Government of the Member States (one from one Member State);
- Thirteen representatives of the Heads of State or Government of the candidate States (one per candidate State);
- Thirty representatives of the national parliaments of the Member States (two from each Member State);
- Twenty-six representatives of the national parliaments of the candidate States (two from each candidate State);
- Sixteen members of the European Parliament;
- Two representatives of the European Commission.

There were alternates for each full member.

Observers were invited to attend from the Economic and Social Committee (three representatives), the Committee of the Regions (six representatives), the social partners (three representatives), and the European Ombudsman.

The Laeken Declaration provided for the candidate States to take a full part in the proceedings without, however, being able to prevent any consensus emerging among the Member States.

Source: <http://european-convention.eu.int/organisation.asp?lang=EN>