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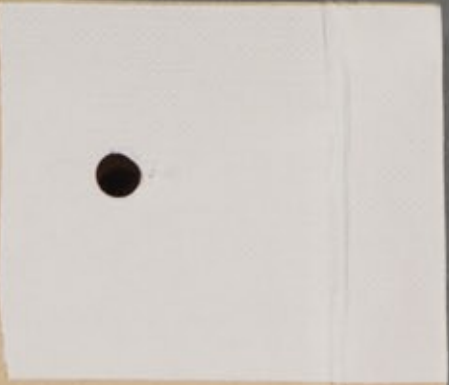
EUROPEAN POLICY

(future policy towards EEC,
including budget)

(Part 2)

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PREM 19/54



Future policy towards the EEC
The Community Budget

Part 2

EUROPEAN POLICY

PART 1 : MAY 1979

PART 2 : JULY 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
16.7.79		25.10.79					
19.7.79		-Part 2 ends-					
27.7.79							
31.7.79							
30.8.79							
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8.10.79							
17.10.79							
18.10.79							
24.10.79							

PREM 19/54



PART 2 ends:-

Cab Office to MAFF 25.10.79

PART 3 begins:-

Note for the Record 25.10.79

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
OD(E)(79) 24	16/07/79
CC(79) 10 th Conclusions, Minute 3 (Extract)	19/07/79
OD(E)(79) 7 th Meeting, Minute 2	19/07/79
CC(79) 14 th Conclusions, Minute 3 (Extract)	30/08/79
OD(79) 24	10/09/79
OD(79) 6 th Meeting, Minutes	12/09/79
CC(79) 15 th Conclusions, Minute 2	13/09/79
OD(E)(79) 32	25/09/79
OD(79) 25	27/09/79
CC(79) 16 th Conclusions, Item 2 (Extract)	04/10/79
OD(79) 9 th Meeting, Minutes	08/10/79
OD(79) 33	17/10/79
CC(79) 17 th Conclusions, Min 3 (Extract)	18/10/79
OD(79) 35	18/10/79
OD(79) 36	19/10/79
OD(79) 11 th Meeting, Minute 2	24/10/79
Limited Circulation Annex, OD(79)11 th Meeting, Min3	24/10/79

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES

Signed Wayland

Date 21 November 2009

PREM Records Team



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CABINET OFFICE
70 WHITEHALL
LONDON SW1A 2AS

25 October 1979

01- 233 8339

P.0128

G R Waters Esq
Ministry of Agriculture, Fisheries
and Food.

Enrop
Pst
M. Whitmore *KMH* *26c*
to pg. *AMS*

Dear Sir,

You told me that your Minister was concerned that the Cabinet minutes of 18 October had not included the point he had made about the effect of the ceiling on VAT contributions to the EEC Budget and thus the possibility that the Chief Secretary's paper C(79) 42 might be making over-provision for our EEC contributions. You asked on his behalf that an amendment should be made to the record to reflect the point.

Having taken advice, and consulted our notebooks, I am writing to say that we could not advise the Prime Minister to accept such an amendment. We do not of course dispute that Mr Walker made the point but it did not arise out of a specific issue then before Cabinet - the Prime Minister had ruled that discussion on agricultural spending would be deferred until 1 November as would consideration of the public expenditure package as a whole. Given that the Chief Secretary had also, while disputing the point, agreed to look at it after the meeting (and he has of course subsequently entered into correspondence with your Minister about it), it seemed to us that the appropriate course would be to pick up any resulting discussion and conclusions in the record of the 1 November Cabinet.

I am copying this letter for information to Tim Lankester, No 10.

Yours sincerely
P Le Cheminant

P Le CHEMINANT

25 OCT 1979

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Ref. A0495

PRIME MINISTER

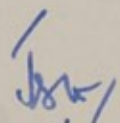
Community Affairs

You might wish to tell the Cabinet that you saw Mr. Roy Jenkins on 22nd October and left him in no doubt of our determination to reach a satisfactory solution to our Budget problem at the Dublin European Council, but, as you told the House on Tuesday, staying just within the limits of the law in pressing to get our way. (The decisions taken by OD today on our negotiating tactics in relation to the Budget would not be appropriate for Cabinet discussion.)

2. You might also wish to confirm to Cabinet that OD on 24th October reached agreement on the line the United Kingdom should take in the 29th October Fish Council. Provided the industry would go along with this course, the Fisheries Ministers would seek progress at next week's Council on a Community conservation regime, leaving quotas and access to be settled later.

3. The Foreign and Commonwealth Secretary might be invited to report on the exchanges which took place last weekend at the informal Foreign Ministers' meeting at Ashford Castle in Ireland, on his talks with the Italian Foreign Minister in London on 22nd October (Signor Malfatti also saw the Chancellor of the Exchequer), and on the outcome of the 23rd October Development Council (which took no decisions of major importance but made useful progress on aid for non-associates).

4. OD(E) will be considering on the afternoon of 25th October the line to take at the 30th October Agriculture Council on sheepmeat. But meanwhile the Minister of Agriculture might be invited to inform the Cabinet of the message he has been warned to expect - presumably on this subject - from the French Government.


(John Hunt)

24th October, 1979

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24 JUL 1979



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Ref. A0484

PRIME MINISTER

Community Budget

(OD(79) 33, 35 and 36)

The last discussion approved a line to be taken with the Commission on possible mechanisms which would produce "broad balance" between our contributions and receipts. This has been followed up. Mr. Roy Jenkins told you that the Commission would probably propose several possible solutions including our own. My minute A0463 of 19th October set out the likely sequence of events from now until the Dublin meeting. The main purpose of this OD discussion is to review the means at our disposal to put pressure on our partners short of the threat of withdrawal from the Community. There has already been a good deal of Press speculation as to what the Government should or might do if you do not get your way in Dublin: and, while too many overt threats at this stage may not be helpful particularly before your meeting with Schmidt, I do not think that this speculation has done any harm. But there is a difference between speculation and leaks, and you will want to stress to your colleagues that this is, for the moment, highly confidential contingency planning.

2. The Committee deliberately did not consider fall-back positions last time. The Chancellor says if we are offered reduction by a half of our net contribution for a limited period we should not accept. The Foreign and Commonwealth Secretary does not express an opinion but recommends that you should discuss what might be an acceptable outcome with those most directly concerned. You may want to pick up this suggestion at the beginning of the meeting and say that you propose to have such a discussion early in November i. e. after the Schmidt-visit and before you see Giscard. The Group might consist of yourself, the Chancellor, the Foreign and Commonwealth Secretary, the Lord President, the Lord Privy Seal, Sir Robert Armstrong, Sir Kenneth Couzens, Sir Michael Palliser and Mr. Franklin.

3. You may then want to take the three papers in the following order:-

- (a) OD(79) 36: this is a carry-over from the last discussion about what should happen if the United Kingdom became an above-average GDP country.
- (b) The Chancellor's paper OD(79) 35 on the possibilities of withholding our contribution.
- (c) The Foreign and Commonwealth Secretary's paper OD(79) 33 on other possible instruments of pressure.

(a) The robustness of the GDP criterion (OD(79) 36)

4. At their last meeting (OD(79) 9th Meeting) the Committee were concerned lest we should cease to get any benefit for any reason our GDP per head rose above the Community average. The Chancellor of the Exchequer has circulated a detailed note by officials. His conclusion now is that the possibility of this happening over the next five years is too small to justify expending much negotiating capital and that we should therefore go for:

- (i) Raising the present 85 per cent trigger in the Financial Mechanism to 100 per cent of the Community average.
- (ii) Retention of the three-year averaging provision.
- (iii) A review clause.
- (iv) An automatic three-year phasing-out arrangement should we nevertheless go above 100 per cent.

5. You will not want to repeat the discussion of last time and should be able to establish fairly quickly whether everyone is now content that we should negotiate along the lines suggested by the Chancellor. If so, you will be able to conclude that the Committee endorses the line in OD(79) 36.

(b) EEC budget: contingency planning (OD(79) 35)

6. The Chancellor of the Exchequer has consulted the Attorney General about the scope for withholding our contribution and to what extent this would put us on the wrong side of the law. He argues that until after the Dublin European Council we should keep all options open; and that meanwhile further work should be commissioned on the implications of stopping the United Kingdom cheque.

7. The Attorney General's provisional advice is set out in Annex A to the Chancellor's paper and summarised in paragraph 6 of the main paper. He considers that -

- (i) It will be impossible for us to argue successfully before the Court that we are entitled to withhold our contributions (paragraph 14 of Annex A).
- (ii) If the Commission took us to the European Court, under Article 169, the Court could make almost immediately an Order for interim measures which might allow the Commission to withhold payments due to us or require us to make the payments we were seeking to withhold (paragraph 22 of Annex A).
- (iii) The possibility of a successful action being brought in the United Kingdom courts as a result of the withholding of our contribution is not negligible; and that it would be unacceptable for the Government to contemplate refusing to implement a judgment given by a United Kingdom court (paragraph 21 of Annex A).
- (iv) We would stand a better chance of success in any proceedings before the European Court if we took the initiative by seeking under Article 175 to enforce a duty on the Community to modify the budgetary provisions in our favour to bring them into line with the basic objectives of the Treaty. Whether such an action would be successful is in the Attorney's view doubtful (paragraph 11 of Annex A). The Treasury has since provided (Annex B) a note on the arguments we could deploy.

HANDLING

8. The Chancellor of the Exchequer might be invited to introduce his memorandum, and the Attorney General to give his views. There are really two distinct issues:-

- (i) Should we be willing to contemplate withholding all or part of our contribution and face the seemingly inevitable legal consequences? The Chancellor does not want to rule out anything at this stage, but the Attorney General, the Foreign and Commonwealth Secretary and the Lord President of the Council will doubtless argue against this course.

- (ii) The merits of ourselves appealing to the European Court through the Article 175 procedure whilst presumably continuing to pay. How does the Attorney General rate our chances having seen Annex B? Unless they are reasonably good, we may find that we end up in a worse position than by continuing to negotiate. If the Court were to decide against us we could no longer maintain that withholding was lawful. The Foreign and Commonwealth Secretary will have views on the political impact of such a course and the dangers in other contexts e.g. fish of our seeking to establish through the Court that the Council has a duty to act.

CONCLUSIONS

9. Depending on the discussion you may be able to conclude that:-
Unilaterally withholding our contribution presents very great difficulties but a final decision should be reserved until after the November European Council. In the meantime, the Chancellor of the Exchequer might continue to explore with the Attorney General the possibility of mounting a case under Article 175, with a view to putting a further paper to the Committee before Dublin.

(c) Community budget: possible instruments of pressure (OD(79) 33)

10. The note by FCO officials attached to the Foreign and Commonwealth Secretary's memorandum discusses a range of legal means of pressure. It rules out the empty chair as ineffective; points out that our blocking power is more dependable if exercised in conjunction with one other large member state; asserts that there would be risks to our interests if we were seen to abandon our positive commitment to the Community, or if our pressures rebounded on us through our bilateral relations with third countries; but shows that on certain conditions we could block or delay the 1980 and 1981 budgets and the 1981 CAP price fixing, as well as numerous other measures of greater or lesser importance to individual member states. It concludes that we need to avoid making it politically impossible for other Governments to get their own public opinion to accept concessions to us on the budget; and that, with our longer-term Community interests in mind, we should therefore do enough to signal our absolute determination, while holding out the alternative of full co-operation.

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11. The Foreign and Commonwealth Secretary's covering memorandum endorses these conclusions and recommends a series of tactical moves in line with them:-

- (i) We should make no threats up to the end of the first day in Dublin. But if by then an acceptable outcome is not in sight we should demand that the European Council reconvene within a month and that meanwhile the Finance/Foreign Affairs Councils concentrate all their efforts on finding a solution i. e. no other business is concluded.
- (ii) If sufficient progress is not made during that period or if no second European Council is agreed, we should let it be known early in December that we were considering either selective or general obstruction. This threat should be kept open until the early stages of the resumed European Council.
- (iii) If we still did not get our way at the December meeting of the European Council, we should carry out our threat flexibly in a way that would maximise the uncertainty in the minds of our partners whilst minimising the risks to our own interests. We should throughout stress our desire to return to full co-operation as soon as our budget problem is solved.

HANDLING

12. You may wish to invite the Foreign and Commonwealth Secretary to introduce his memorandum. Thereafter the discussion might be addressed to the following questions:-

- (i) If an acceptable deal does not emerge in Dublin, the Community will inevitably be in crisis. Is the idea of reconvening the European Council before Christmas the best way to escalate the pressure particularly on the French? Should we concert with the Italians?
- (ii) How will the threat of obstruction affect our friends (if any) and will it convince the others of the need to give way?
- (iii) If we have to carry out our threat, should we be selective as the Foreign and Commonwealth Secretary suggests or would it be better just to block all Community measures which would increase our net contribution? The

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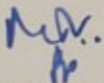
latter would be directed to the problem, still encompass most major Community activities including the 1980 and 1981 budgets and the CAP price fixing, and be more compatible with the Government's commitment to the Community.

13. The Lord President, the Lord Privy Seal and Sir Donald Maitland may all have advice to offer on the best tactics.

14. Apart from threats, there is also the question of inducements. We have rejected any notion of linkages but it may be helpful to our budget problem if the atmosphere can be lightened by parallel progress on other items at or before the European Council. The discussion earlier on the agenda of OD(79) 34 will have shown whether there are prospects for progress on fish. You have separately decided that we should make no move on EMS for the time being. OD(E) discussed energy on 18th October and agreed that, if you so wished and thought it helpful you could, without risk to our own oil supplies, let it be known in Dublin that the Government would be ready to take a less restrictive view than its predecessors of the scope for long-term oil supply contracts. The French are likely to be in considerable difficulty and need our help on sheepmeat. Outside the Treaty there may be helpful things which can be said to Schmidt and Giscard about detente and defence matters; these are being looked at in the briefing for those meetings. You may want to ask for suggestions from the Foreign and Commonwealth Secretary and the Lord President; but within the Treaties we do not appear to have any cards of magnitude except the promise of co-operation if this is settled and the certain prospect of continued obstruction if it is not.

CONCLUSIONS

15. Subject to the discussion you may be able to conclude that the Committee accepts the recommendations in paragraph 2 of OD(79) 33, and agrees that any available inducements should be deployed as necessary in the Anglo-German and Anglo-French bilaterals or the European Council itself. The actual implementation of any campaign of obstruction should be the subject of a separate decision by the Committee in the light of the results of the November European Council.


JOHN HUNT

23rd October, 1979

Original on
France, Sept 79.
Whitmore's mtg with Wahl.



10 DOWNING STREET

From the Secretary for Appointments

22 October 1979

Dear Mark,

I have already passed on to John Hunt and Michael Franklin the main points which arose when I saw Jacques Wahl in Paris last Thursday, and the purpose of this letter is simply to record them more formally.

Rather to my surprise Wahl did not take a particularly tough line on the Community Budget. He said that the French acknowledged that we had a problem, but it was worse than it need be for two reasons. First, Britain had not integrated her agricultural trade into the EEC as much as she might have done and she was still importing too much from third countries. If we imported more from the Community, this would reduce our levies and thus our total budgetary contribution. If we were to take action on these lines, it would go down particularly well with his Government. Second, the level of investment in the UK economy should be raised. This would reduce consumption and this would in turn reduce our VAT contribution. We should bear in mind that if some budgetary relief was to be found for the United Kingdom, it was likely to be primarily at the expense of Germany, and for that reason he would expect the Germans to welcome any move on our part to reduce our gross contribution. If we were prepared to offer commitments on both his points at the Dublin meeting of the Council, he thought that the chances of finding a satisfactory solution would be improved.

In reply to his first point I said that Britain had already changed her patterns of trading farther and faster in the period since our accession than any other member of the Community had done in comparable circumstances. We had in any case a particular problem with New Zealand (which Wahl readily acknowledged). As regards his second point, nobody wished to see the level of investment in the UK raised more than the present Government. It was a fundamental part of their economic policies that more resources should be switched to that part of the economy which was wealth creating. The Cabinet had been meeting that very morning to take difficult and controversial

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decisions to bring public expenditure under control and thus to reduce the demands which the public sector was making on the economy. But even if we were to accept that there was substance in his points, neither of them offered the prospect of an early reduction in our contribution. The British Government was determined to find a solution which would give us a broad balance between our gross contribution and our receipts in 1980. In that year our net contribution was going to be £1,000m and, particularly at a time when a number of public expenditure programmes were being reduced, it was politically impossible for the British Government to see a net outflow of this size continuing. The British Government saw the problem as one of equity. They could not accept that Britain should be in the uniquely unfavourable position within the Community of being both a net contributor to the Budget and of having a below average gnp per capita. For these reasons, the British Government was looking for a solution at the Dublin Council: the longer the problem was left the worse it would become. Wahl and I left the matter there.

We also touched on fish, but he did not seem to be taking the "guerre des langoustines" very seriously.

When we turned to nuclear matters, Wahl was at pains to say that if the Prime Minister wanted to discuss such subjects with President Giscard during his visit next month, it was up to us to raise them. The French had had enough of getting nowhere on this with the Labour Government. He added that the French Government were determined to press ahead with their SSBN programme. As regards TNF, they were considering, as alternatives, what he called a French SS20 and a French Cruise Missile: they had studies on both possibilities in hand. They were also studying a "reinforced radiation weapon" which he said was like the ERW but was not quite the same. He did not elaborate on the differences.

I also raised Rhodesia with him and emphasised that we should need the help of the French Government and of our other allies when we reached the point of seeking international support for our proposals. I mentioned to him that Robin Renwick was visiting both the Elysee and the Quai the following day to brief French officials on the present position.

I am sending a copy of this letter to George Walden (FCO).

Yours etc,

Martin Vile

Martin Vile, Esq.

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Top Copy :
European Policy, May 79
Call on Pm by Mr Roy Jenkins

Extract of meeting record between the Prime Minister and the
President of the European Commission, Mr Roy Jenkins, at
10 Downing Street at 1130 on Monday 22 October

Community Budget

The Prime Minister said that Britain was seeking an equitable solution to the problem of the Community Budget. She was assuming that Britain's partners would accept the justice of the claim. The obligation flowing from the 1970 language that she had quoted in the Luxembourg speech was clear. There was no question at this stage of our threatening anything: the expectation was that our partners would meet their obligations. HMG intended to conduct the negotiation according to the Queensberry Rules. However, if others

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declined to abide by the rules, Britain would not either.

Mr. Jenkins said that he was glad to hear that the Prime Minister intended to remain within the rules. It was important not to talk about withholding Britain's contribution. Both the present British Government and the previous one had always succeeded in avoiding doing anything illegal. The French had been extremely provocative in their reaction to the European Court's judgement on sheep meat. He and Mr. Gundelach had been taking a very tough line with them. Britain should not follow the French example if we did not achieve a satisfactory result in Dublin. There was a whole range of retaliatory measures open to us which did not involve illegality.

Turning to the handling of the Dublin meeting, Mr. Jenkins said that he knew the Prime Minister needed to achieve a substantial result there. He supported her in this objective. But in his view it would be wrong to stake everything on the Dublin meeting. There would of course have to be a crisis there: the occasional crisis did the Community no harm. But it was important that the Prime Minister should not become a prisoner of her public position. If the Government were to achieve a reasonable result in Dublin it would be a remarkable success considering how short the Government's period in office would by then have been. The Prime Minister should avoid a situation where such a success might either be unacceptable to her or be presented by others as a failure. The Prime Minister said she was not prepared to be fobbed off with a compromise solution. If the Community were not prepared to endorse and pay for an equitable solution to the Budget problem, she would have to reconsider some of her attitudes to the Community. The House of Commons was about to reassemble and she expected to be under constant attack on the Budget question thereafter. It would be no good for the Community to offer her, say, five or six hundred million pounds as a full solution.

Mr. Jenkins said he took the point. But the other members of the Community were unlikely to regard it as right to put any country in a position where its net contribution was in balance regardless of the policies it pursued. This would mean that the country in

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question was not concerned by the way the Community's policies developed and would lead to an attitude of indifference about the consequences of membership. If, for instance, Britain were put in that position it would remove any pressure on her to reform the CAP. The Prime Minister said there was no danger of this in her case. Even if Britain's contribution was in balance, she would not be prepared to see the total size of the Budget grow. She would not wish to see the amount of British money passing through the Community's hands increased. Nor would her interest in securing reform of the CAP diminish. The CAP had been catastrophic for Britain. Indeed there were few Community policies which had been advantageous for this country. Community policy on fish, on industrial matters, on energy and on trade (eg the Multi-Fibre Agreement) had all been unhelpful. The Community had failed to react with sufficient speed or vigour to the fact that US subsidies on oil were giving them an edge in all areas where oil, whether as a source of energy or as a base for synthetics, was a factor in price.

Mr. Jenkins took note of the last point and undertook to ensure that Vicomte Davignon followed it up soon. On the general point, he said that membership of the Nine gave Britain a stronger negotiating position than she would enjoy in isolation. He cited the Multi-lateral Trade Negotiations as a specific example. He added that Britain's position in 1976 would probably have been much more serious had she not been a member of the Community. (The Prime Minister agreed.) Even where agriculture was concerned, Britain had not done as badly as might at first appear. It was not inconceivable that a national policy based on deficiency payments might have cost more than the present contribution to the Budget. The Prime Minister disagreed with the last point. She said that the combination of high intervention prices and co-responsibility levies was absurd. Its only effect was to keep the Brussels bureaucracy in business.

Mr. Jenkins asked how the Prime Minister intended to play the energy card at Dublin. He was not asking that Britain should in any way surrender control of North Sea oil but merely that the matter should be handled less casually. He was aware that 50% of

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/ Britain's oil

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Britain's oil exports already went to Europe. This could be turned to advantage. Britain should operate like a garage dealing with local customers. One did not offer preferential prices: one offered preferential treatment. Herr Schmidt was particularly interested in security of supply. The Prime Minister said that HMG did not have sufficient control of the activities of the oil companies. Mr. Jenkins was in fact suggesting that all long-term contracts being negotiated through BNOG should be submitted to her. However the matter could be looked into further.

The Prime Minister said that at some stage she might have to remind the other members of Britain's contribution to the defence of Europe. Mr. Jenkins said that this was a card that had to be played with considerable caution. He had been involved in an earlier occasion (in 1968) when Mr. Wilson had tried this tactic with the Germans and it had backfired very badly. A move towards membership of the EMS exchange rate mechanism might be a more useful card. Was there any chance of HMG making such a move? The Prime Minister said that it was still too early. She wanted to see the results of a further relaxation of exchange controls. She recognised the political advantages but was not prepared at present to take the risk with the money supply that full membership would involve. Mr. Jenkins pointed out the risks of leaving membership too late. The fundamental problem with Britain's membership of the Community as a whole had been that we had joined too late and at the wrong time. There were great disadvantages in joining an organisation whose rules had been formulated in one's absence. Moreover, in remaining outside the exchange rate mechanism Britain was denying herself the interest rate subsidy. This would be worth some 200 mua and would be well worth having in its own right. The Prime Minister did not regard a figure of 200 muaas of any great significance.

Turning to the personalities involved, Mr. Jenkins said it was essential for the Prime Minister to retain Chancellor Schmidt's support. Without Herr Schmidt, the UK would be completely isolated and finding itself in a position where a rupture with the Community was a real possibility. It would be important to bring home to Herr Schmidt the need to push President Giscard into being reasonable:

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given the importance he attached to the Franco/German relationship this would not be easy. With Herr Schmidt's support, it should be possible to secure the backing of the Italian, Dutch, Belgian and Luxembourg Governments. The Danes and the Irish would be difficult. But with the backing of a reasonable cross-section of the Community the isolation of President Giscard ought to be attainable. It might well be a useful tactic for the Prime Minister to speak very toughly indeed to President Giscard in a plenary meeting of the European Council. The more allies Britain had the less likely a real split in the Community would be.

Reverting to the general question, the Prime Minister repeated that she was seeking an equitable adjustment. This meant something very close to a broad balance: £600 million would not be enough. She was not saying that she would not contribute to the Budget but she was not prepared to contribute on the present scale. If Britain's GNP were to rise then she would be prepared to see Britain's contribution rise. She was of course continuing to look at the courses of action open to her in the event that the outcome at Dublin was unsatisfactory. She was considering everything that she could do within the law: she was prepared to go within a hair's-breadth of what the law would permit.

Mr. Jenkins said that he recognised the need for a solution on a large scale. The Commission would produce a paper. It would not propose a single solution but would set out a number of approaches including one which would give Britain everything she asked and another which would produce two-thirds of her requirement. (The Prime Minister interjected that two-thirds would not be enough.) He did not think it would be possible to produce a complete solution that would operate within a few months. Moreover, there were conflicting claims on the Budget. Mr. Franklin pointed out that the members of the Community had all accepted the existence of a problem: having done so it was difficult to see why they were unwilling to accept the scale of the problem. Mr. Jenkins said that it was important to look at the problem through the eyes of other members. They were conscious that Britain, as a result of her energy resources, was moving into an ever stronger bargaining position and found it difficult to accept her claims to be poverty-stricken.

Mr. Jenkins added that a solution which tackled the receipts as well as the contribution side of the problem might run into difficulties if the 1% VAT ceiling were rigidly observed. The Prime Minister said that she intended to see the ceiling was observed. Mr. Jenkins said that it was inevitable that the 1% VAT ceiling should be breached at some stage. The Prime Minister said that she was determined to use the 1% ceiling to force a reform of the CAP. Mr. Franklin pointed out that HMG did not wish to spend their way out of the Budget problem. We wanted a cash payment within the current Budget.

Commissioner Gundelach

Mr. Jenkins said that Mr. Gundelach had incurred criticism in Denmark as a result of not pressing for interim measures on pout fishing. He had taken a very courageous stand on this issue. He was an influence for good within the Commission. It was not clear that he had spoken as had been reported on the question of the European Court's impending judgement on the UK's fish conservation measures.

Telematique

Mr. Jenkins said he attached great importance to the formulation of a Community approach to the development of micro-electronics technology. The EEC represented 30% of the market at present. There should be a common purchasing policy. The Prime Minister took note.

BBC External Services

Mr. Jenkins expressed concern about reports that the BBC French language services were likely to be curtailed. He was not worried about broadcasts to France as such but he thought the consequences of a reduction in services to Francophone Africa would be serious. In the absence of the BBC, the listeners in that region would have no programmes other than French national programmes to which to listen.

The meeting ended at 1320.

23 October 1979



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BRITISH EMBASSY,
 PARIS

cc Mr Whitmore
 Sir J Hunt
 (initials)

23/10

22 October 1979

M J E Fretwell Esq CMG
 Foreign and Commonwealth Office
 London S W 1

PA.
 JAL
 24X.

Dear John,

I had lunch today with Jacques Wahl, the Secretary-General of the Elysée and we naturally discussed inter alia the handling of the British budget problem at the European Council and at the meeting between President Giscard and Mrs Thatcher on 19/20 November. Wahl made various observations which may be of interest to you.

2. He said that it would be very difficult for any French leader to accept the doctrine that Britain was a poor country. It was quite true that Britain's economic performance had been unsatisfactory in recent years but the present government was trying to correct that and in this had the full sympathy of the French Government. But for all Frenchmen a decisive feature of the scene was Britain's possession of North Sea oil. France considered itself to be at the beginning of a very difficult economic period. The absence of indigenous sources of energy in France was bound to put France at a very serious economic disadvantage over the next few years. If France had anything like the British resources in North Sea oil, she would be able to face the future with equanimity. Frenchmen were convinced that the possession of North Sea oil should enable Britain to face the future with relative equanimity.

3. The fundamental problem was who was to pay more if Britain paid less. It was obvious that the member country which would have to pay most would be the Federal Republic of Germany. France would have no difficulty in agreeing to any arrangement which caused Germany to pay a good deal more. But France herself could not contemplate carrying a large share of the burden.

4. Wahl then went on to talk in a way which seemed to imply that he thought Britain might expect a solution awarding her 1000 MUA. I took him up on this and said that we were talking about £ Sterling 1,000 million. He insisted that he had been thinking that the UK might be satisfied with 1000 MUA. I said that it seemed to me that arguments which were already being put forward by the Commission and various partners seemed to imply a readiness to go as far as £ Sterling 400m. But this was less than half of the sum for which Britain was looking. I noted that Wahl did not demur at the suggestion that £ Sterling 400m might already be there to be picked up. He did not even say that it was totally unrealistic to think of doubling that sum.



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5. He then asked me if I thought the British Government would be able to accept a formula to the effect that because it would take time for British commerce to be re-adjusted in the direction of the Community and because it would take time for Britain's economy to be satisfactorily relaunched, Community partners were prepared to extend help to the UK in certain forms. He said that a formula of this sort would make it altogether easier for people like Monsieur Barre to reconcile themselves to the idea of giving some help to Britain. He did not mention President Giscard in this connection but I assume that this was because he preferred to have a stalking horse.

6. He went on to say that this question of redirection of British commerce was an important one for France. France would certainly welcome a greater orientation of British commerce towards the Community. I drew his attention to the fact that re-orientation was already taking place but could not proceed quickly, and in any case it was not one of the Community's aims to cut off the trade of individual members with the outside world. He accepted this but said that the re-orientation of trade was nevertheless important from the French point of view and more particularly in the field of agricultural products. There should be no problem between France and the UK over the agricultural surpluses. France did not want or need them. The problem of surpluses lay between the UK and the Federal Republic. What France wanted was the unified market for agricultural products which enabled her to sell her products freely throughout the Community. She would hope for example that in due course Britain would buy more French wheat and more French milk products. It was the assurance that Britain would eventually buy more from Community partners that France was looking for.

*I am
convinced
more
than in
the
past.*

7. You can probably imagine that we had a fairly vigorous discussion about these things. I stuck firmly to the line that Britain was looking for a solution to the budget problem which would bring a broad balance as regards contributions and that the figure which the Prime Minister had been repeating publicly was £ Sterling 1,000m. I denied that Britain had dragged its feet in re-orientating its commerce towards the Community or that it would make any significant difference to the Community to try to cut off the relatively small flow of imports from, for example, New Zealand. I do not think there is any need to record my comments at any length as I was drawing on the familiar briefing material and the important aspect of the conversation was what Wahl had to say.

8. I am not sure what significance to give to Wahl's comments. They certainly seem to imply that the French are casting about vigorously for ways in which they might reconcile some adjustment in Britain's favour with advantage to France. Wahl was obviously aware that the formula he tried out on me was not one on which

/I could

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I could give any answer, but he seemed to be indicating that it was a formula to which the French Government and President Giscard may revert before the end of November.

9. We had a brief discussion about fisheries but he was evidently not fully briefed about my recent conversation with Monsieur Le Theule. I brought him up to date on that. He showed no desire to argue on fisheries questions. On sheepmeat the only argument he seemed interested in using was the New Zealand one, and he did not demur when I said that it was for the French Government to find national means of helping its own farmers and it was no use trying to make a whipping boy of the New Zealanders.

I enclose three extra copies in case you want to copy this letter to anyone in London and I am sending a copy to Michael Franklin in the Cabinet Office. I am writing separately to Julian Bullard about some more general matters which we discussed which nevertheless have a bearing on the Summit meetings.

Yours ever,

Reginald Hibbert

copy to: Sir Donald Maitland GCMG OBE
BRUSSELS

Sir Oliver Wright, KCMG DSC
BONN

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24 OCT 1979



Ref: A0463

SECRET

PRIME MINISTER

Run-Up to the European Council

You are seeing Mr. Roy Jenkins on Monday, 22nd October. In addition to the other briefing being provided I think you may find it helpful to have this note on the key stages in the run-up to the November European Council. It will also be relevant to the OD discussion on 24th October when the various negotiating cards are to be considered. The sequence will be as follows.

1. The Commission Paper

The Commission expect to finalise this by the end of October. All the signs are that it will set out a range of options and include corrective mechanisms which would be acceptable to us as well as other less satisfactory possibilities. But the Commission may well not come down in favour of a particular solution; we would not want them to unless it is one we could accept in which case this would of course be very helpful. You will want to probe Mr. Jenkins on this.

2. November Finance and Foreign Affairs Councils

The Commission's report is likely to be discussed by both the Finance Council on 19th November and the Foreign Affairs Council probably on 20th November. If, as we hope, the Commission's paper is reasonably helpful to our case it is bound to be exposed to attack at these meetings by the financial experts and others in the member States who are likely to see their own interests suffering if we get what we want. We should therefore see these as damage-limitation operations. since a decision of the magnitude we are seeking can only be taken at Head of Government level. We cannot however evade the process of discussion in the Finance and Foreign Affairs Councils without incurring the risk of postponement at Dublin on the ground that the issue had not been sufficiently prepared for Heads of Government. The other member States will be staking out positions: and we must stick firmly to our stated requirements. We must however ensure that the

SECRET

question is put to the European Council in as clear and helpful a form as possible. We shall therefore need to get an instruction to COREPER to prepare a suitable paper for Heads of Government which simply sets out the issues which they will be called upon to decide. If, contrary to our present expectations, the Commission's report does not even include options which would produce the result we want, we shall of course be ready to table proposals of our own.

3. Bilaterals

Although we may not see much real movement before Dublin, the various bilateral contacts at top Ministerial level will be important in getting over the Government's determination to see this basic inequity put right. Schmidt recognises that something has to be done although he naturally wants to limit the financial burden on Germany. He will probably go along with whatever consensus emerges: but he will not fight our battles for us and he will not be ready to have a major disagreement with Giscard. It will however be essential to press him as far as possible during the Bonn bilateral on 31st October.

The Anglo-French Summit on 19th-20th November will have a special significance, not only because Giscard is likely to be the main person who has to be won over but because it comes closest in time to the Dublin meeting. Although French officials are taking a very tough line indeed Giscard has not shown his hand and it will be a matter of nice judgment nearer the time whether it will be right to give him any hint of what we would regard as "acceptable". There is little if anything in the Community field which we can, or would want to, offer him to secure his co-operation but there are possibilities of constructive discussion in other fields of interest to him (e.g. East/West and nuclear) which might improve the atmosphere. I will send you a separate note about the nuclear aspect.

You will not be seeing Mr. Lynch again before Dublin but we ought to arrange some direct political contact if only about the handling of the meeting (see below).

M. Wahl, of President Giscard's Office, told me yesterday that we should not assume that the report will contain options. He says that there is a good deal of disagreement within the Commission, caused in part by what some regard as Mr Jenkins' unnecessarily pro-British approach.

Do you wish to pursue this idea? If you do, we will get further advice.

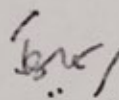
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4. The European Council

While we shall have taken every opportunity to get the political message across at the highest level in advance of Dublin, it seems inevitable that the real negotiation on figures will take place there. It will therefore be essential to ensure that the first day at Dublin is devoted to this topic so that the usual overnight meeting of officials can be given clear instructions.

It also follows that we need to keep our demand for "broad balance" formally on the table up to the opening of the Dublin meeting. Before then, however, Ministers will need to have considered what might be an acceptable outcome. In his paper (OD(79) 33) the Foreign and Commonwealth Secretary recommends that this should be done in a small informal group of Ministers without any written record: this meeting should probably take place after the Schmidt visit and before Giscard.

Ministers will be considering papers on ways in which we can exert pressure within the Community to secure our budget objectives. It seems unlikely that there is scope for any direct trade-off ("We will do this if you will do that"): in any case we should not have to make concessions to correct a demonstrable unfairness. On the other hand our stance on other current issues will have an influence on the attitude of other member States towards our requirements. We shall have to monitor this carefully.


(John Hunt)

19th October 1979

COMMUNITY BUDGET

~~Euro Pol.~~

What the Italians Want

Ruggiero has given me an account of what the Italians will be asking for at the European Council. Final details are still under study but Italian Ministers have approved the broad outline. The Italians propose to discuss their ideas further with the French and the Germans before circulating a paper towards the end of the month. They have already had a first round with the Germans (see below).

Their proposals will fall into two parts, the first dealing with the balance of the Community Budget as a whole and the second with the balance within the CAP.

Community Budget

They want the European Council to lay down guide lines for shifting the balance away from the CAP and towards regional, social, energy and industrial policies. They would like it laid down that the percentage of the Budget spent on the CAP shall decline by 1982, to, say, 55 per cent (though they recognise that this figure is over ambitious) and that the percentage spent on the other four policies should increase to, say, 25 per cent. They do not want themselves to specify the percentages but are trying to get the Commission to do so.

They would be ready to accept that this shift in the balance should be achieved without exceeding the 1 per cent VAT ceiling and understand that we will support the Germans and the French on this point. But their position will be that the shift should be achieved any way, if necessary going beyond the 1 per cent.

/They have

They have explained these ideas to the Germans and have had a favourable reaction from the Chancellor's Office, the ^{FINANCE} ~~DEFENCE~~ Ministry and Lamsdorff.

The CAP

(6) HC) Italian ideas are less worked out. They want a general commitment (not spelt out in percentages) that the balance of CAP expenditure will be shifted away from the wasteful surpluses of Northern products and towards their own agriculture. They have four ideas (the first three of which are not new):

- (b) (a) More aid to the better marketing of their Mediterranean production inside the Community.
- (c) (b) More help to improve the structure of their Southern agriculture.
- (c) (c) As assurance that when trade concessions are made on Mediterranean products they will not have to bear the full economic brunt and will therefore be compensated financially.
- (a) (d) Help to improve their own production, e.g. of beef, in order to reduce imports.

They recognise that it will be very difficult to get anything very specific spelt out under this heading at Dublin. The Germans were pretty negative. They attach great importance to our support, arguing that their Community Budget aims are equally in our interests as well as theirs and that the amount of money which they will hope to get on their CAP aims is very small in relation to what we hope to get from the correcting mechanism. In their view it would be a fair exchange for us to support them in return for their support of us.

/Suggested Line to Take

Suggested Line to Take

Community Budget

1. We will look at the Italian ideas sympathetically. We certainly share the Italian aim of reducing expenditure on the CAP in relation to what is spent on other policies.
2. We shall however want to ensure that the 1 per cent ceiling is not reached.
3. Other members of the Community may say that the Italian proposal is sufficient to take care of that part of the British problem which arises because of inadequate receipts from the Budget. We could not accept this. The correcting mechanism must deal with our inadequate receipts as well as our excessive gross contribution.
4. Subject to that we see some attraction in the European Council laying down guide lines for reducing the share of the Budget spent on the CAP.

The CAP

1. We could not of course contemplate adding to Community expenditure unless we have a satisfactory Budget solution.
2. Nor could we contemplate any action which would result in making the same mistakes for Mediterranean products as have been made for Northern products. But we are sure the Italians do not want to create surpluses themselves.
3. We will have to **consider** the Italian proposals carefully when they are fully worked out and will do so in a sympathetic spirit.

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Seen by PM
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copy in Ewald. CAP.

PRIME MINISTER

Community Affairs

You might wish to inform the Cabinet of the main outcome of your talks in Rome on 4th-5th October with the Italian Prime Minister.

Signor Cossiga showed himself to be sympathetic to our budgetary objectives but anxious also to ensure that the Dublin European Council did not send Italy away empty-handed. He wants a commitment that more of the Community Budget should be spent on the regional and social funds and support for Mediterranean agricultural producers, and less on price guarantees under the CAP. On Theatre Nuclear Force modernisation he was reasonably encouraging, though he was worried about the timing of NATO decisions.

2. The Chancellor of the Exchequer might be invited to report on the second and final round of discussions at the 15th October Finance Council of the Commission's Reference Paper on the Budget problem. The Germans and others stressed the need to build on the existing Financial Mechanism; the French were predictably negative. The Commission agreed to produce their proposals for a solution in good time before the 19th November Finance Council. You will be talking to Mr. Roy Jenkins on Monday; and OD will be discussing the budget question again on 24th October.

3. The Minister of Agriculture will wish to report on the sheepmeat discussions at the 15th-16th October Agriculture Council, at which he secured the backing of all seven other member states and the Commission for pressing France to comply with the European Court ruling condemning her import restrictions on British lamb and mutton. Agriculture Ministers are to hold a special meeting in the margins of the 29th-30th October Fish Council to take forward the long standing discussions on a possible sheepmeat regime. OD(E) will consider later on 18th October what tactical use can be made of the sheepmeat lever in the Budget context; and Mr. Walker plans to clear his detailed line for the special sheepmeat meeting in OD(E) next week.

J.H.
John Hunt

17th October 1979

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MR. ALEXANDER

for. Rmt (2)
Prime Minister
ant *Rmt*

Community Budget: VAT Own Resources

During recent discussions on the Community Budget, the Prime Minister has asked for more information about "Own Resources" and especially the VAT element and the extent to which we might be suffering a disadvantage as compared with other member states. I attach a note which the Treasury has prepared for the Chancellor of the Exchequer, but this is very technical and I do not think the Prime Minister need be troubled with it. The salient points are as follows.

2. As the Prime Minister knows, part of the Community Budget which cannot be financed from the proceeds of Customs duties and agricultural levies is financed by VAT. The concept of VAT as an additional source of Community revenue was originally embodied in the Own Resources Decision of 21st April 1970. It allows the Community to raise revenue by imposing a Community rate of VAT, not exceeding 1 per cent, on all transactions falling within a harmonised base.

3. When the Budget is established each year, the Commission has to say how much VAT will be required. Our estimate for 1980 is that approximately 0.76 per cent will be required. For all practical purposes, the Community rate of VAT once established then forms part of the VAT levied nationally. The rate of VAT actually charged in each member state - including zero rating - is irrelevant. To ensure that there is a uniform basis of assessment, the Council adopted the Sixth Directive of 17th May 1977 provided that the following should be subject to VAT:-

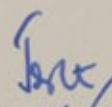
- (i) The supply of goods or services within the territory of the country by a taxable person acting as such.
- (ii) The importation of goods.

The Directive then goes on to define in detail the scope and coverage of the tax.

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4. Once the system is fully operational all member states will be taxing the same goods and services, so that the value of each country's harmonised base will reflect the overall level of consumption of those goods and services. In 1979 three member states are still paying contributions based on GNP because they have not yet introduced the VAT arrangements. In 1980 two of these at least are expected to switch to VAT contributions. The possible exception is Germany which has problems with Parliamentary ratification. During this transitional period, member states who are not applying the Sixth Directive have to make additions to or subtractions from their national base so as to bring its value into line with that of the harmonised base. These adjustments have to be agreed with the Commission. There is thus, in theory, no discrimination between one member state and another. Their VAT contributions will reflect GNP shares except to the extent (as in the United Kingdom's case) that their propensity to consume differs from the average for the Community as a whole.

5. In practice, however, the amount of VAT actually collected will depend upon the rate of evasion in the different member states. The VAT accounts and related systems in each member state are subject to audit by the Commission and the Community's Court of Auditors is now taking a lively interest in this subject. However, the first annual VAT Own Resources Accounts (for 1979) will not be produced until the middle of next year, so it is too early to reach any firm judgment as to the adequacy of other member states' system of control and account, or on the Commission's ability to audit them. Under-payments from private sector evasion would not necessarily come to light under this procedure. Since this involves a much greater loss of domestic than EEC revenue, there is no incentive for member states' Treasuries to connive at the shortfall; quite the contrary. Nevertheless, as the Treasury note brings out, this is likely to be a problem in Italy and one to which the Community will need to give attention.


John Hunt

C O N F I D E N T I A L

OWN RESOURCES

1. Payments by Member States to the Commission.

Each month the Treasury (or other appointed body) of each Member State must make available to the Commission the amount recorded in the own resources account it is required to maintain. In the UK own resources collected by Customs & Excise (98-99% of the total) and the Intervention Board for Agricultural Produce are, together with any other "national" duties and taxes they collect, paid into the Consolidated Fund; and payments of own resources to the Commission are made by transfers from the Consolidated Fund to the Commission's account with the Paymaster General. I think that broadly similar procedures are followed in other Member States but that in some there is a greater degree of separation of own resources and national revenue, both by the Treasury and the taxation departments.

2. The Own Resources account.

The monthly own resources account must include all amounts of own resources (mainly customs duties and agricultural levies) established in the previous month but one. (In principle an amount payable is established as soon as it is duly determined even if it is collected later, e.g. under deferment arrangements, or not collected at all.) But special arrangements apply to own resources derived from VAT (and financial contributions based on GNP): the monthly own resources account must include one-twelfth of the forecast amount payable for the year in question by the Member State (as entered in the Community Budget) and these "interim payments" are adjusted in the following year when the Member States produce their annual VAT own resources accounts.

3. Difference in procedures etc. in Member States.

There are marked differences between the various Member States as regards, for example, the organisation of the various departments and agencies responsible for assessing, collecting and accounting for the different types of own resources and the accounting and control procedures of such departments and agencies. In general, however, I do not think that such organisational and procedural differences have much bearing on the question whether Member States pay to the Commission the correct amounts of own resources: as one would expect, what really matters is how efficiently the various departments carry out their work. For example, the accounting procedures used by the French Customs department are very different from those used by HM Customs and Excise, but I think they are "different" rather than "better" or "worse".

4. Accuracy of the own resources accounts.

The accuracy of a Member State's own resources account, and therefore the amount it pays over to the Commission, can be affected by accidental or deliberate errors and omissions by three groups of

/people

people or organisations: taxpayers (e.g. importers, exporters, VAT taxable persons, sugar producers); the departments or agencies responsible for collecting own resources (e.g. customs, agricultural agencies, VAT departments); and the treasury or central organisation responsible for producing the main own resources account on the basis of information supplied by the taxation departments. In practice I have seen no evidence to suggest that treasury or taxation departments deliberately exclude establishments of own resources from the accounts: the worst that can be said is that Member States (including the UK) sometimes give themselves the benefit of the doubt, with varying degrees of "openness", e.g. where it is not certain whether particular types of receipts constitute own resources or national revenues, or as regards the correct treatment of amounts of own resources remitted or written-off as irrecoverable. In general amounts involved in such cases are very small in relation to the total amounts of own resources and these "grey areas" are being steadily clarified. In practice the main "leakage" of own resources will arise if the control, enforcement and auditing procedures of the taxation departments are inadequate to combat errors or evasion by taxpayers which result in under-establishment or no establishment at all, or if their accounting procedures do not ensure that all establishments of own resources are accurately recorded, distinguished from national receipts of revenue, and reported to the treasury.

5. Control of own resources by the Commission.

The primary responsibility for ensuring that own resources are correctly established, entered in the accounts and made available to the Commission rests with the Member State: but the Commission are entitled to require a Member State to carry out any additional inspection measures it may ask for in a reasoned request and the Member State must associate the Commission at its request with the national inspection measures and generally facilitate the Commission's audit work.

In practice officials from the Commission pay several visits (each lasting about a week) each year to each Member State covering in turn the various taxation departments and working with the audit bodies of those departments. In the course of these visits they compare the department's accounts with the figures in the own resources account maintained by the Treasury and carry out sample checks designed to test the adequacy and accuracy of the control and accounting systems and compliance with the relevant EEC regulations. A report of the Commission's findings on each visit is sent to the Member State concerned for comments, and the reports and comments are subsequently considered by the Advisory Committee on Own Resources (which includes representatives from all Member States) and copied to the European Court of Auditors.

Member States have usually shown themselves ready to correct any inaccuracies or infringements found in the course of such visits and to take appropriate action if such errors demonstrate weaknesses in control procedures or accounting arrangements. More difficult problems arising from such visits may be referred to other

C O N F I D E N T I A L

- 3 -

departments or committees of the Commission for technical advice, etc.

Taken as a whole the reports of Commission visits have not produced any evidence of very serious inadequacies in other Member States' systems of control or accounting or of deliberate attempts to underpay own resources to the Community. From these reports (and other information) I would certainly not seek to claim that the UK systems are, overall, better than those of our major partners France and Germany or indeed than those of most other Member States, though I have some reservations about one or two. It must, however, be recognised that the Commission auditors are faced with a very difficult task and it would be unwise to assume they have succeeded in uncovering all that may be wrong. My impression is, however, that the quality of the Commission audits is steadily improving and there are signs that the European Court of Auditors is also finding its feet and will in future play a useful and effective role in the field of own resources.

Various attempts are being made (e.g. a proposed Council Regulation on Irregularities) to strengthen the Commission's ability to control own resources. The inclusion of provisions affecting domestic VAT in that Regulation and other similar provisions give some problems to the UK and some other Member States, but the VAT element in own resources will be of considerable and increasing significance and it is in the UK's general interest that the Commission has power to satisfy itself that all Member States have effective control procedures.

6. VAT Own Resources.

Control by the Commission of VAT own resources will involve audit visits to Member States similar to those mentioned above, but the first annual VAT own resources accounts (for 1979) will not be produced until the middle of next year. Although a good deal of preliminary work is being done in the Advisory Committee on Own Resources (VAT), it is too early to reach any firm judgment as to the adequacy of other Member States systems of control and accounting or on the Commission's ability to audit them. In theory Member States have a greater incentive to ensure that VAT is properly controlled and collected since they retain most of the revenue, whereas customs duties and agricultural levies are paid over in full to the Commission (apart from 10% for the cost of collection); but the own resources base will be affected to the Community's detriment if any Member State works on the principle that it is more cost-effective to produce a required revenue yield by concentrating on collecting, say, 80% of the potential revenue from a high rate of VAT than by seeking to collect 100% of the revenue from a lower rate. (The VAT base on which the own resources payment is calculated is not affected by the rate of taxation applied by the Member State.)

/So

C O N F I D E N T I A L

- 4 -

So far the main point of concern is the Italian VAT system. In 1977 and 1978 the Italian forecasts of their VAT base, produced for the purposes of the Community Budget, were very much lower than anyone expected particularly when compared with their GNP figures. The first possible explanation that this was due to forecasting errors has apparently been ruled out following detailed bilateral discussions between the Commission and Italy and it now seems to be generally accepted, even by the Italians, that these figures reflect a massive level of VAT evasion in Italy. If this is so, and action is not taken, Italy will pay a much smaller share of VAT own resources than is due from them (and it is no real consolation to the other Member States that the Italians are at the same time losing considerable amounts of national revenue). The Commission are well aware of this problem, and are regularly reminded of it by various Member States at meetings of the Own Resources Advisory Committee, and it has also been brought to the attention of the European Court of Auditors. The Commission, spurred on by other Member States and by the Court, will of course be expected to take action in the course of control visits, particularly when the 1979 VAT accounts are received. But since, if the other Member States' suspicions are well-founded, what is needed is a very substantial improvement in the Italian control of VAT evasion, which could hardly be achieved in the short-term, the Commission are going to be faced with a very difficult problem and I do not think they - or indeed anyone else - knows (as yet) how to solve it.

T. Hallinan.

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FOLLOWING FROM UKREP BRUSSELS

FINANCE COUNCIL: 15 OCTOBER

CONVERGENCE: MIPT

FOLLOWING IS THE TEXT OF THE CHANCELLOR'S FIRST INTERVENTION.

1. THE CHANCELLOR EXPRESSED SYMPATHY WITH ITALIAN CASE. AS THEY

fn. *Wants - b/x*

1. THE CHANCELLOR EXPRESSED SYMPATHY WITH ITALIAN CASE. AS THEY RIGHTLY SAID, THE BUDGET SHOULD BE BETTER BALANCED; THE SHARE OF COMMUNITY EXPENDITURE DEVOTED TO CAP SHOULD BE REDUCED; FLOW OF RESOURCE TRANSFERS IN THE COMMUNITY SHOULD BE IMPROVED TO PROMOTE CONVERGENCE AND REDUCE THE NON-BUDGETARY RESOURCE COSTS WHICH ARE IMPEDING CONVERGENCE. BUT WE HAD OUR ADDITIONAL AND IMMEDIATE BUDGETARY PROBLEM. NOTHING IN THE SUPPLEMENTARY MATERIAL TABLED BY THE COMMISSION IN ANY WAY DETRACTED FROM THAT, OR DIMINISHED ITS SERIOUSNESS.

2. THE CHANCELLOR THANKED COMMISSION FOR SPEED AND EFFICIENCY IN PRODUCING SUPPLEMENTARY PAPER. IT WAS IMPORTANT THAT COMMISSION SHOULD NOW PROCEED AS EXPEDITIOUSLY AS POSSIBLE TO IDENTIFY AND ASSESS THESE POSSIBILITIES FOR REMEDIES AND TO PUT FORWARD ITS PROPOSALS ON POSSIBLE SOLUTIONS. THESE SHOULD BE AVAILABLE TO MEMBER STATES BY THE END OF OCTOBER OR A DAY OR TWO AFTER, OTHERWISE THE COMMUNITY WOULD NOT BE ABLE TO ADHERE TO THE TIMETABLE LAID DOWN AT THE JUNE EUROPEAN COUNCIL. THE CHANCELLOR SAID THAT THE SUPPLEMENTARY MATERIAL INCLUDES TEXT OF HIS STATEMENT AT LAST FINANCE COUNCIL ON 17 SEPTEMBER. HE DID NOT WISH TO REPEAT IT.

3. BUT HE WAS CONCERNED BY INDICATIONS THAT HAD REACHED HIM THAT THERE WAS STILL ROOM FOR SOME MISUNDERSTANDINGS. WE MUST BE SURE THIS WAS NOT SO BEFORE WE MOVED INTO THE FINAL PRE-DUBLIN STAGE.

4. THE FIRST POSSIBLE MISUNDERSTANDING WAS THAT WE WERE CONCERNED ONLY WITH THE CONTRIBUTIONS SIDE OF THE BUDGET, AND THAT THE SOLUTION COULD BE CONFINED TO THAT ASPECT. THAT WOULD NOT BE ENOUGH. THE SOLUTION MUST DEAL WITH THE LOW LEVEL OF UK RECEIPTS AS WELL AS WITH OUR EXCESSIVE GROSS CONTRIBUTION SO AS TO ACHIEVE A BROAD BALANCE. SO AN AMENDMENT OR AMENDMENTS OF EXISTING FINANCIAL MECHANISM MIGHT HELP, BUT IT WOULD NOT BE ENOUGH.

5. A SECOND POSSIBLE MISCONCEPTION WAS THAT A SOLUTION MIGHT BE FOUND THROUGH MAJOR EXPANSION OF COMMUNITY STRUCTURAL FUNDS. FOR THE UK THIS DID NOT PROVIDE THE ANSWER. THE COUNCIL SHOULD LOOK AT THE TABLES IN PAGES 10 AND 11 OF SECTION A OF THE COMMISSION'S SUPPLEMENTARY PAPER. THEY SHOWED THAT EVEN IF THE REGIONAL FUND WERE MORE THAN DOUBLED FROM ITS PRESENT SIZE, THE NET GAIN TO THE UK WOULD BE NO MORE THAN 95 MEUA. TO YIELD A GAIN EVEN OF 475 MEUA TO THE UK, THE FUND WOULD HAVE TO BE INCREASED BY 5,000 MEUA. THIS WOULD BE INSUFFICIENT. EVEN THEN THE BENEFIT WOULD TAKE THREE TO FIVE YEARS TO COME THROUGH.

TO FIVE YEARS TO COME THROUGH.

6. THIRD, THE SOLUTION MUST LAST AS LONG AS THE PROBLEM. FOR EXAMPLE, THERE HAD BEEN SUGGESTIONS THAT THE PRESENT TRANSITIONAL ARRANGEMENTS MIGHT BE EXTENDED FOR A LIMITED PERIOD, OR THAT ANY SOLUTION SHOULD BE APPLIED ONLY OVER A FIXED PERIOD OF A YEAR OR SO. NEITHER WOULD MEET THE CASE. DEVICES OF THIS KIND WOULD MERELY PROVIDE A marginally more gradual approach to the intolerable. THEY WOULD ENSURE THE RE-EMERGENCE OF THE PROBLEM IN EVEN MORE ACUTE FORM WITHIN A YEAR OR SO LATER. THEY WOULD BE NO SOLUTIONS.

7. THIS DID NOT MEAN THAT THE SOLUTION MUST LAST FOREVER. FEW THINGS DID. ON THE EXPENDITURE SIDE ALL RECOGNISED THAT, IN TIME, SOME CHANGE IN THE STRUCTURE OF THE BUDGET IS DESIRABLE IN ITSELF AND WOULD BE NECESSARY TO REDUCE THE PREDOMINANCE OF THE CAP. ON THE REVENUE SIDE, FURTHER RE-ORIENTATION OF THE UK'S TRADE PATTERN TOWARDS THE COMMUNITY SHOULD LEAD TO A REDUCTION IN THE UK'S GROSS CONTRIBUTION. BUT, AS OUR EXPERIENCE MADE CLEAR, THESE DEVELOPMENTS WERE LONG-TERM AND UNPREDICTABLE. THE CHANCELLOR RECALLED ACCESSION NEGOTIATIONS OF 1976. THE COMMISSION HAD THEN ENVISAGED A SITUATION IN WHICH THE CAP COULD BY 1986 REPRESENT ONLY 4% PERCENT OF BUDGET EXPERIENCE SHOWED WE SIMPLY COULD NOT BANK ON SUCH FORECASTS AGAIN. WE WOULD LOOK FOR FAVOURABLE DEVELOPMENTS, BUT MEANWHILE THE COMMUNITY SHOULD PROVIDE FOR AN IMMEDIATE SOLUTION WHICH WOULD LAST WHILST THESE LONG-TERM TRENDS WERE COMING INTO EFFECT, AND UNTIL SUCH TIME AS THEY COULD BE CLEARLY SEEN TO HAVE REMOVED THE PROBLEM. NOBODY HOPED MORE THAN UK THAT NEED FOR SOLUTION WOULD GO AWAY.

8. THERE HAD BEEN SUGGESTIONS THAT THE ANSWER COULD BE FOUND THROUGH REDUCING CAP EXPENDITURE. THIS WAS CLEARLY DESIRABLE. WE BELIEVE EXPENDITURE COULD BE REDUCED WITHOUT ATTACKING BASIC PRINCIPLES OF THE POLICY. BUT WE HAD TO BE REALISTIC. GIVEN RISING FARM PRODUCTIVITY, IN THE SHORT TERM, A MAJOR EFFORT WOULD BE NEEDED TO KEEP FEOPA AT PRESENT LEVEL, LET ALONE REDUCE IT. IT WAS DESIRABLE IN ITSELF BUT NOT THE ANSWER TO OUR PROBLEM, WHICH WAS IMMEDIATE.

9. THE CHANCELLOR ASKED THE COUNCIL TO CONSIDER WHY WE WERE PRESSING FOR A SOLUTION WITH IMMEDIATE EFFECT. WAS OUR PROBLEM REALLY SO BIG AND SO URGENT? IT WAS COMMON GROUND, FROM THE COMMISSION'S PAPER, THAT IN 1986 OUR NET CONTRIBUTION WOULD BE OVER POUNDS STERLING ONE BILLION - 4% PERCENT ABOVE THE ONLY OTHER MAJOR NET CONTRIBUTOR, GERMANY. CALCULATIONS FURTHER AHEAD, OF COURSE, INVOLVE ALL SORTS OF ASSUMPTIONS ABOUT CHANGES IN TRADE PATTERNS.

NET CONTRIBUTOR, GERMANY. CALCULATIONS FURTHER AHEAD, OF COURSE, INVOLVE ALL SORTS OF ASSUMPTIONS ABOUT CHANGES IN TRADE PATTERNS, ABOUT EXCHANGE RATES, ABOUT DEVELOPMENT OF THE CAP, ABOUT RESOURCE TRANSFERS, ABOUT RELATIVE CHANGES IN GNP, AND ABOUT ENLARGEMENT OF THE COMMUNITY. BUT UNLESS SOME QUICK-ACTING CORRECTIVE MECHANISM COULD BE FOUND, WE WERE CERTAIN THAT, ON ANY COMBINATION OF ASSUMPTIONS THAT WE HAD YET BEEN ABLE TO MAKE, THE UK'S NET CONTRIBUTION SEEMED DESTINED TO RISE EVEN MORE STEEPLY OVER THE NEXT FEW YEARS. ON ONE CALCULATION, BASED ON QUITE REASONABLE ASSUMPTIONS, OUR NET CONTRIBUTION COULD EASILY BE POUNDS STERLING ONE AND A HALF BILLIONS BY 1983, AT PRESENT PRICES. THE IMMEDIATE PROBLEM WAS BAD ENOUGH. THE PROSPECT OF SUCH A SITUATION IN FUTURE WAS LUDICROUS AND INTOLERABLE.

10. HE WAS BOUND TO REGARD SUCH A TREND AS SERIOUS AND REQUIRING IMMEDIATE ACTION. HE HOPED OUR CONCERN WAS NOW ABSOLUTELY CLEAR. HE WAS NOT CALLING INTO QUESTION COMMUNITY POLICIES AS THEY HAVE EVOLVED OVER THE PAST TWO DECADES. CHANGES WERE NEEDED, MAYBE (EG IN CAP COSTS). BUT THAT WAS A SEPARATE QUESTION. NEITHER WAS HE CALLING INTO QUESTION FUNDAMENTAL COMMUNITY CONCEPTS - OWN RESOURCES, ESSENTIAL PRINCIPLES OF THE CAP, THE COMMON COMMERCIAL POLICY. WE WERE CONCERNED SOLELY AND SUBSTANTIALLY WITH THE PERVERSE AND INTOLERABLE CONSEQUENCES OF THE PRESENT BUDGETARY POSITION. AS PANDOLFI HAD SAID, WE HAD A SYSTEM WHICH OUGHT TO PROMOTE CONVERGENCE, BUT WHICH NEVERTHELESS WAS CLEARLY PACING THE GREATEST BURDEN ON THE SLOWEST GROWING MEMBERS OF THE COMMUNITY. FOR THE SAKE OF THE COMMUNITY, THIS REQUIRED CORRECTION, URGENTLY, BY A MECHANISM WHICH EFFECTIVELY, AND FOR AS LONG AS THE PROBLEM PERSISTED DEALT WITH THE INEQUITY WHICH THE COMMISSION'S PAPER SO CLEARLY DEMONSTRATED.

11. IT MIGHT BE SUGGESTED THAT THE UK WAS MAKING UNREASONABLE DEMANDS ON THE COMMUNITY. THAT WAS NOT SO. THE UK HAD BEEN ASSURED IN ACCESSION NEGOTIATIONS THAT BALANCE OF COMMUNITY BUDGET WOULD CHANGE AND THAT BUDGETARY PROBLEMS OF THE SORT WE NOW FACED WOULD THEREFORE NOT ARISE. COMMUNITY ALSO DECLARED, IN PAPER ON FINANCIAL ARRANGEMENTS IN AN ENLARGED COMMUNITY, THAT "SHOULD UNACCEPTABLE SITUATIONS ARISE . . . THE VERY SURVIVAL OF THE COMMUNITY WOULD DEMAND THAT THE INSTITUTIONS FIND EQUITABLE SOLUTIONS".

12. THE TRANSITIONAL ARRANGEMENTS NEGOTIATED FOR UK ENTRY ARE NOW OVER. BUT THE PROMISED IMPROVED BALANCE HAD NOT BEEN ACHIEVED. THE "UNACCEPTABLE SITUATION" ENVISAGED AT THE TIME OF ENTRY HAD ARISEN. AND, UNFORTUNATELY, THE FINANCIAL MECHANISM NEGOTIATED

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ARISEN. AND, UNFORTUNATELY, THE FINANCIAL MECHANISM NEGOTIATED
IN 1974/5 HAD PROVED TO BE INADEQUATE TO DEAL WITH THIS SITUATION.
IT WAS "AN EQUITABLE SOLUTION" TO A MAJOR COMMUNITY PROBLEM THAT
THE UK NOW SOUGHT. COLLEAGUES SHOULD BE UNDER NO ILLUSION AS TO
THE SCALE AND THE URGENCY OF THE SOLUTION SOUGHT.

FCO ADVANCE TO:

FCO - PS/SOFS, PS/LPS, PS/PUS, PS/MR HURD, BUTLERN FRETWELL
SPRECKLEY, HAZLE

CAB - ELLIOT, FRANKLIN, WALSH, PS/LORD PRESIDENT

NO 10. - ALEXANDER

TSY - PS/CHANCELLOR, COUZENS, JORDAN-MOSS, MRS HEDLEY-MILLER
MIDDLETON, ASHFORD, THOMSON, BAKER

B/ENGLAND - GPS, MCMAHON, BALFOUR, BULL.

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FM BONN 111805Z OCTOBER 79

TO IMMEDIATE FCO

TELEGRAM NO 582 OF 11 OCTOBER

INFO IMMEDIATE ROME AND UKREP BRUSSELS

INFO PRIORITY DUBLIN AND PARIS

INFO SAVING OTHER EEC POSTS

Prime Minister

MT

ITALIAN PRIME MINISTER'S VISIT TO BONN: COMMUNITY ISSUES

1. AT THE CONCLUSION OF HIS TALKS WITH CHANCELLOR SCHMIDT ON 9 OCTOBER, SIGNOR COSSIGA TOLD THE PRESS THAT HE LEFT BONN WITH RENEWED CONFIDENCE IN COOPERATION BETWEEN THE FRG AND ITALY. FOR HIS PART, SCHMIDT SAID THAT HE HAD QUOTE PROFITED AND LEARNT UNQUOTE FROM THE BILATERAL COOPERATION WITH ITALY. THE TWO SIDES ANNOUNCED THEIR DECISION THAT AT FUTURE MEETINGS THEY WOULD EACH BE SUPPORTED BY MEMBERS OF THEIR CABINETS: AND THAT SUCH CONSULTATIONS SHOULD TAKE PLACE TWICE A YEAR. SCHMIDT WOULD VISIT ROME DURING THE FIRST HALF OF 1980.
2. GERMAN OFFICIALS SAY THAT THE TALKS WENT EXTREMELY WELL. SCHMIDT AND COSSIGA HELD DISCUSSIONS WITHOUT INTERRUPTION FROM 10.30 AM TILL 2 PM, CONTINUING OVER LUNCH. IT IS CLEAR THAT COSSIGA REINFORCED THE EXCELLENT IMPRESSION ALREADY MADE BY PERTINI. ON COMMUNITY QUESTIONS, THE TALKS WERE SUPPLEMENTED BY DISCUSSIONS BETWEEN RUGGIERO AND LAUTENSCHLAGER.
3. THE ITALIANS SAID THAT THEIR APPROACH TO CONVERGENCE WAS A COMMUNAUTAIRE ONE. THEY SOUGHT OBJECTIVE RECOGNITION OF THEIR OBJECTIVE PROBLEM. THEY WANTED A SWITCH FROM FEOGA EXPENDITURE TO EXPENDITURE ON QUOTE STRUCTURE UNQUOTE IN ALL ITS FORMS IE EXISTING COMMUNITY POLICIES AND NEW POLICIES, E.G. ENERGY AND RESEARCH. THEY SAW THIS APPROACH AS THE ONLY WAY OF MAINTAINING THE 1 PER CENT VAT CEILING, ON WHICH THEY WERE PREPARED TO SUPPORT THE FRG PROVIDED THE COMMUNITY ACTED ON THEIR REQUEST. THEY WERE LOOKING FOR QUOTE FIGURES AND DATES UNQUOTE AT THE DUBLIN EUROPEAN COUNCIL. THE ITALIANS ARGUED THAT THEY WERE IMPORTING RELATIVELY MORE FOOD FROM THEIR COMMUNITY PARTNERS, THAN OTHERS. THIS SHOULD BE COMPENSATED BY COMMUNITY SUPPORT FOR THE PRODUCTION IN ITALY OF CONTINENTAL FOOD PRODUCTS (SIC). THE ITALIANS SAID THAT THE COMMUNITY ARRANGEMENTS WITH THIRD COUNTRIES HAD INVARIABLY

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ACTED TO ITALY'S DETRIMENT. ITALY COULD NOT SUPPORT ANY MORE CONCESSIONS IN THIS AREA UNLESS HER DEMANDS ON STRUCTURAL SUPPORT WERE MET.

4. ON THE COMMUNITY BUDGETARY QUESTION THE ITALIANS SAID THAT THEY RECOGNISED THAT A PROBLEM EXISTED FOR BRITAIN. BUT, RECALLING THE INTERNAL PROBLEMS CREATED BY ANDREOTTI'S DECISION TO JOIN THE EMS EXCHANGE RATE MECHANISM, THEY EMPHASISED THAT THE DOMESTIC DIFFICULTIES WOULD BE CONSIDERABLE IF THE DUBLIN COUNCIL DECIDED TO HELP ONLY THE UK.

5. ACCOUNTS BY GERMAN OFFICIALS OF THE FRG RESPONSE TALLY BROADLY WITH ROME TELS NOS. 449 AND 451. THE FEDERAL CHANCELLOR'S OFFICE HAVE TOLD US THAT SCHMIDT ATTACHES IMPORTANCE TO COSSIGA'S SUPPORT OVER THE 1 PER CENT VAT CEILING. AFTER THE MEETING HE TOLD THE PRESS THAT QUOTE WE ARE BOTH GOING TO THE EUROPEAN COUNCIL IN DUBLIN, WITH A PREPAREDNESS IN PRINCIPLE TO COMPROMISE... WE ARE BOTH READY TO WORK FOR REASONABLE, INTEGRATION-TARGETTED SHIFTS ON THE EXPENSES SIDE OF THE BUDGET, AND TO ENSURE THAT A GREATER PART OF EEC EXPENSES ARE IN FACT RELATED TO IMPROVING ECONOMIC STRUCTURES UNQUOTE. HE ADDED THAT BOTH HE AND COSSIGA WANTED TO MAINTAIN THE 1 PER CENT VAT CEILING. COSSIGA TOLD THE PRESS THAT THERE WAS BROAD COINCIDENCE OF VIEWS ON COMMUNITY QUESTIONS AND THAT HE HAD BEEN HAPPY AT THE ATTENTION WITH WHICH SCHMIDT HAD LISTENED TO WHAT HE HAD TO SAY.

6. IN SPEAKING TO US THE CHANCELLOR'S OFFICE (VON DER GABLENTZ) CAREFULLY AVOIDED SAYING THAT THE ITALIAN REQUIREMENT WOULD MAKE IT MORE DIFFICULT TO FIND A SOLUTION AT DUBLIN TO THE BRITISH PROBLEM. SCHMIDT FORESAW THE POSSIBILITY THAT THE DUBLIN EUROPEAN COUNCIL MIGHT LAY DOWN GUIDELINES FOR A GRADUAL SHIFT OF EMPHASIS IN THE CAP FROM SUPPORT TO RESTRUCTURING. HIS VIEWS ON THE CAP WERE WELL KNOWN AND EVEN THE FRENCH MIGHT BE PREPARED TO CONTEMPLATE A SHIFT IN EMPHASIS AFTER 1981. BUT PROGRESS WOULD NOT BE QUICK. AND ITALY'S REQUIREMENTS WERE STILL VAGUE. THE OLD PROBLEM REMAINED: IT WAS HARD TO CONTEMPLATE INCREASED STRUCTURAL SUPPORT FOR THE ITALIANS UNLESS THEY CAME UP WITH PROPERLY CONSIDERED SCHEMES.

7. VON DER GABLENTZ TOLD US THAT SCHMIDT WAS DETERMINED THAT THERE SHOULD BE SOME RELIEF FOR THE UK AT DUBLIN. THERE WAS CERTAINLY A PROBLEM: BROADLY THE GERMANS ACCEPTED THE COMMISSION FIGURES. SCHMIDT WOULD, WITH RELUCTANCE, TRY TO MEDIATE AT DUBLIN IF FORCED TO DO SO. IT WAS HIS OBJECT TO ENABLE THE COMMUNITY TO GO FORWARD, AGAINST THE BACKGROUND OF UNCERTAINTIES BOTH IN EASTERN EUROPE AND

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THE UNITED STATES. THIS WAS A VESTED INTEREST FOR THE FRG. SHE WAS PREPARED TO FIND HERSELF THE LARGEST NET CONTRIBUTOR ACCORDINGLY. BUT THE FRG ALSO HAD OTHER PARTNERS. THE PRINCIPLE OF OWN RESOURCES MUST BE MAINTAINED. THE CHANCELLOR WOULD BE MORE RECEPTIVE TO ARGUMENTS BASED ON THE EFFECTIVE FUNCTIONING OF THE COMMUNITY AND ECONOMIC REASON THAN TO A HASSLE OVER DETAILED POINTS OF NATIONAL ADVANTAGE: SOME REGARD MUST BE PAID TO THE UK'S ULTIMATE ECONOMIC WEIGHT: AND THE UK SHOULD CONTINUE TO MAKE CLEAR ITS STRONG OVERALL COMMITMENT TO THE COMMUNITY. VON DER GABLENTZ ADDED THAT PROVIDED THE UK PLAYED ITS HAND IN THESE TERMS SCHMIDT WAS NOT HIMSELF THINKING IN TERMS OF LINKAGE TO OTHER COMMUNITY SUBJECTS, BUT IT DEPENDED VERY MUCH ON OUR OWN APPROACH IN DUBLIN. AS REGARDS THE EMS VON DER GABLENTZ REITERATED THE POLITICAL MESSAGE IN MY TELNO 566.

3. NOTWITHSTANDING THIS, LAUTENSCHLAGER AND OTHER OFFICIALS HAVE BEEN TAKING THE LINE THAT THE ITALIAN STANCE HAS ADDED A NEW COMPLICATING FACTOR IN THE BUDGETARY DISCUSSION, IN THAT THE ITALIANS HAVE MADE IT QUITE CLEAR THAT THEY WOULD NOT REPEAT NOT ACCEPT A BUDGETARY SOLUTION SATISFACTORY TO THE UK UNLESS SOMETHING WAS ALSO DONE FOR ITALY. THIS, OFFICIALS ADD, COULD BE VERY EXPENSIVE.

FCO PLEASE PASS TO SAVING ADDRESSEES.

WRIGHT

(REPEATED AS REQUESTED)

FCO WHITEHALL DIST:

WED



Foreign and Commonwealth Office
London SW1A 2AH

Telephone 01- 233 6105 *WJG/10*

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Mr. C. ... We want to have the paper - but not the Treasury memo
12/10

UNCLASSIFIED

R W James Esq
British Embassy
DUBLIN

Your reference

Our reference

Date 8 October 1979 *12/10*

Dear James

COMMISSION REFERENCE PAPER ON BUDGETARY QUESTIONS

- / 1. I am enclosing a copy of the Reference Paper as requested. In spite of the Commission classification, it may be treated as unclassified now.
- / 2. I am also enclosing a copy of a short note on the paper by the Treasury and of the Explanatory Memorandum prepared for Parliamentary purposes.

Yours ever
J M Macgregor

J M Macgregor
European Integration
Department (Internal)

cc: (second two enclosures only)

Chanceries:

- Paris
- Bonn
- Brussels
- The Hague
- Luxembourg
- Copenhagen
- Rome

THE COMMISSION REFERENCE PAPER ON BUDGETARY QUESTIONS: A SUMMARY

The Remit

1. At Strasbourg in June the European Council invited the Commission to produce a reference paper describing the financial consequences of applying the budgetary system in each member state, especially in 1979 and 1980. The paper was to take account of

- The economic, financial and social effects of each member state's participation in the Community
- The Community nature of own resources
- For 1980, the agricultural prices fixed for the 1979-80 marketing year

and to examine the conditions under which the corrective mechanism decided on in 1975 (the "Financial Mechanism") could play its part in 1980, and the extent to which it fulfilled the objectives assigned to it. The Commission's response to this remit is in four parts--introduction, analysis of expenditure and receipts, the Financial Mechanism, economic, financial and social aspects.

INTRODUCTION

2. A number of general considerations are held to apply to any attempt to attribute the costs and benefits of Community membership to individual member states. Some benefits are not strictly quantifiable, notably the access to a larger market which membership gives to all member states alike. Community policies are interdependent; one could not have a customs union without a Common Agricultural Policy. The true economic costs and benefits of Community policies do not always coincide with their budgetary effects; for example a quantity of agricultural produce exported with subsidy from member state A increases A's budgetary receipts but it also helps to sustain

the price level for that produce in all member states. Finally the development of Community policies would be greatly hampered if every member state expected "juste retour" - getting out of the Budget exactly what it put in.

ANALYSIS OF EXPENDITURE AND RECEIPTS

3. The key figures are in the attached table. Some of the Commission's comments are recorded here.

4. On the expenditure side, the Commission note that market support under the CAP will take some 70% of the Community's Budget in both 1979 and 1980. The incidence of this expenditure between the four largest member states is forecast as; Germany 25%, France 20%, Italy 16-17%, UK 8%. The UK's low share reflects her relatively low agricultural production and her status as a big importer of food. The Commission attribute UK and Italian import MCAs as a benefit to the UK and Italy (ie they support version (a) in the table) but they note that so long as the UK MCA remains low (currently 3.4%) this attribution is of little practical significance. Outside the CAP, the Commission note that expenditure on the structural funds (chiefly the Regional and Social Funds) is growing and that Italy (33%) and the UK (21%) receive high shares from these funds - but the funds as a whole still comprise only 12% of the Community Budget.

5. On the revenue side, the Commission point out that only in 1980 will each member state pay its full share of Own Resources without modification. It is therefore the 1980 figure rather than that for any earlier year which should be taken as a guide for the future. Whereas for some member states the amount of customs duties and levies contributed to the Community may not reflect the true incidence because of entrepot trade, the UK's contributions under these heads are a fairly accurate measure. The share of customs revenue contributed by the UK (forecast at 26.7% in 1980) is high compared with our 16% share of Community GNP, in part because of the relatively high proportion of ^{our} imports which come from third countries. But the proportion of UK imports coming from the Community is growing and hence our contribution to customs revenue should decrease. Our share of VAT revenue (forecast at 17.36% in

1980) is also higher than our share of Community GNP. The paper comments that member states with a low investment rate and/or a balance of payments deficit will tend to have a larger VAT tax base (because VAT is a tax on consumption and is levied on imports but not on exports).

6. In commenting on the balance between expenditure and receipts the paper notes that Italy, in contrast to the position in 1978, is forecast to be a major net beneficiary from the Budget in 1980. The UK's forecast deficit for 1980 is attributable roughly half to financing the budget in excess of her GNP share and half to below average receipts. The forecast deficit of 1552 in EUA for the UK in 1980 allows for a refund of 68m EUA under the Financial Mechanism in respect of 1979; but it now seems unlikely that this refund will be payable (see next paragraph).

THE FINANCIAL MECHANISM

7. The paper lists the criteria which have to be satisfied if a refund of excessive gross contributions is to be paid to a member state under the Financial Mechanism agreed in Dublin in 1975. It notes that no such refund has yet been paid. A refund for the UK of 68m EUA in respect of 1979, payable in 1980, was included in the forecasts made earlier this year; but very recent revision of the UK balance of payments statistics indicates that we have not met the requirement of a cumulative balance of payments deficit over the three preceding years (1976, 1977 and 1978). If we are in balance of payments deficit over 1977, 1978 and 1979, the paper forecasts that the Mechanism in its present form might yield us a refund of about 300m EUA gross or 250m EUA net (after deduction of our contribution to our own refund).

8. In discussion of the effectiveness of the Financial Mechanism, it is argued that one of its key elements is that it should give only a partial correction of excessive contributions. A further appreciation of sterling would reduce the refunds payable because it would raise our share of Community GNP (measured at market exchange rates) relative to that of other member states and the refund is payable only on the difference between a member state's

share in financing the Budget and its GNP share. It is noted that the balance of payments constraint and the limit on the total refunds payable in any one year to 3% of the Community budget were introduced at a late stage in negotiations on the Mechanism, and that they may severely restrict its effect. If refunds were made in full rather than in part and the balance of payments constraint and the 3% ceiling did not apply, Britain could get a refund of 630 in EUA gross (520m EUA net) from the Mechanism in respect of 1980.

ECONOMIC, FINANCIAL AND SOCIAL ASPECTS

9. The Common Market has contributed over the years to the general improvement in living standards in the original Six. The period since the accession of three new members in 1973 has been brief and troubled by economic crisis² originating outside the Community. But the three new members have benefitted too.

10. Regional imbalances persist within the Community and the impact of Community policies has not always been helpful in this respect. Community regional policy is being progressively developed and the Regional and Social Funds are growing but the Community's resources for bring about structural improvements in agriculture are still too limited; nevertheless the poorest parts in the south of Italy and France and in the west of Ireland benefit increasingly from such resources as are available. If the cost of disposal of food surpluses could be cut, the share of CAP expenditure in the Community's Budget would fall and the distribution of the Budget between member states would change.

11. The effect of the Community Budget is considerable in certain sectors but it should not be over-stated; it represents only 0.8% of total Community GNP.

Cabinet Office

10 September 1979

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TABLE: COMMUNITY BUDGET 1979 AND 1980
ESTIMATED CONTRIBUTIONS AND RECEIPTS BY MEMBER STATES

	Belgium	Denmark	Germany	France	Ireland	Italy	Luxembourg	Netherlands	UK
1979									
Gross Contribution	871	327	3,992	2,607	98	1,579	18	1,251	2,291
Receipts (a)	1,209	551	2,837	2,285	463	2,333	269	1,323	1,764
Receipts (b)	1,239	782	2,974	2,517	676	2,060	269	1,480	1,037
Net Contribution (-) or Receipt (+) (a)	+ 338	+ 224	-1,155	- 322	+ 365	+ 754	+ 251	+ 72	- 527
Net Contribution (-) or Receipt (+) (b)	+ 368	+ 455	-1,018	- 90	+ 578	+ 481	+ 251	+ 229	-1,254
1980									
Gross Contribution	922	368	4,578	3,037	137	1,750	20	1,270	3,113
Receipts (a)	1,460	651	3,471	2,917	573	2,621	312	1,629	1,561
Receipts (b)	1,472	738	3,530	3,018	650	2,484	312	1,692	1,299
Net Contribution (-) or Receipt (+) (a)	+ 538	+ 283	-1,107	- 120	+ 436	+ 871	+ 292	+ 359	-1,552
Net Contribution (-) or Receipt (+) (b)	+ 550	+ 370	-1,048	- 19	+ 513	+ 734	+ 292	+ 422	-1,614

*the explanation is in the notes: but the size of the...
was in practice over...
EUROPEAN UNITS OF ACCOUNT (EUA) - 1979*

NOTES

- (a) If UK and Italian import Monetary Compensatory Amounts (MCAs) are attributed as a benefit to the UK and Italy.
- (b) If UK and Italian import MCAs are attributed as a benefit to the exporter.

EXPLANATORY MEMORANDUM ON EUROPEAN COMMUNITY DOCUMENT

COMMISSION COMMUNICATION TO THE COUNCIL ON THE CONVERGENCE OF THE ECONOMIC PERFORMANCE OF THE MEMBER STATES OF THE COMMUNITY ("REFERENCE PAPER ON BUDGETARY QUESTIONS").

Submitted by H.M. Treasury

October 1979

SUBJECT MATTER

This document, which the Commission submitted in the first instance to the September 1979 Finance Council, discharges a remit given to it by the European Council at its meeting on 21-22 June. The Council asked the Commission "to submit a reference paper describing the financial consequences of applying the budgetary system on the situation in each Member State, especially in 1979 and 1980", and "to examine the conditions under which the corrective mechanism decided on in 1975 can play a part in 1980 and the extent to which it fulfils the objectives assigned to it".

The document falls into four main sections:-

- i. The introduction consists of a number of general observations about the difficulties which attend any attempt to assess accurately the economic effects of Community policies.
- ii. The second, and largest, section contains an analysis of expenditure and receipts in the Community Budget, the results of which are summarised in the table appended to this Memorandum. This demonstrates very clearly that by 1980 the UK will be far and away the largest net contributor to the Community Budget. If the Monetary Compensatory Amounts paid on UK agricultural imports are treated as benefits to the exporter (approach (b) in the table), as the Government believes right, then the UK net contribution will by then be almost twice that

of Germany. As the concluding passage of this section shows, the UK will be alone amongst the three Member States with a GDP per head below the Community average (Italy, the UK and Ireland) in being a substantial net contributor to the Budget in 1979 and 1980.

- iii. The third part of the page describes the Financial Mechanism, explains why it has so far failed to operate and identifies the two limitations incorporated in it which make it unlikely that it will ever have much effect. It concludes that the Mechanism's application has so far been too limited to judge its scope and effectiveness.

- iv. The fourth section briefly considers the wider economic financial and social effects of Community membership. It avers that the Community has been largely responsible for the economic advance recently experienced by the countries of Europe. It acknowledges, however, that Community policies have not always benefitted the structurally weaker parts of the Community and argues that Community policies should be adapted to give more help to these areas. Finally, it points out that despite the limited scale of Community expenditure when seen against total Community output, it can have a significant impact in certain countries and in certain sectors.

II MINISTERIAL RESPONSIBILITY

The Treasury has the primary interest in the overall economic effect of Community policies, but the implications of a paper with as wide a scope as this are naturally of concern to other departments also.

III IMPACT ON UK LAW

None.

IV POLICY IMPLICATIONS

The Communication does not contain a draft Decision and has no direct implications for UK economic and financial policy. It is,

never, relevant to the Government's continuing efforts to secure a reduction in the UK's net contribution to the Community Budget and thereby to relieve the burden that this at present imposes on public expenditure and the balance of payments.

V TIMETABLE

This Communication was discussed by the Finance Council on 17 September and Finance Ministers will consider it further on 15 October. It will be submitted to the European Council for its meeting on 29-30 November, along with the Commission's proposals for a solution to the problems that it reveals.

TABLE : COMMUNITY BUDGET 1979 AND 1980
 ESTIMATED CONTRIBUTIONS AND RECEIPTS BY MEMBER STATES

EUROPEAN UNITS OF
 ACCOUNT (EUA) - MILLIONS

	Belgium	Denmark	Germany	France	Ireland	Italy	Luxembourg	Other-lands	UK
1979									
Gross Contribution	871	327	3,992	2,607	98	1,579	18	1,251	2,291
Receipts (a)	1,209	551	2,837	2,285	463	2,333	269	1,323	1,764
Receipts (b)	1,239	732	2,974	2,517	676	2,060	269	1,480	1,037
Net Contribution (-) or Receipt (+) (a)	+338	+224	-1,155	-322	+365	+754	+251	+ 72	- 527
Net Contribution (-) or Receipt (+) (b)	+368	+455	-1,018	- 90	+578	+481	+251	+229	-1,254
1980									
Gross Contribution	922	368	4,578	3,037	137	1,750	20	1,270	3,113
Receipts (a)	1,460	651	3,471	2,917	573	2,621	312	1,629	1,561
Receipts (b)	1,472	738	3,530	3,018	650	2,484	312	1,692	1,299
Net Contribution (-) or Receipt (+) (a)	+538	+283	-1,107	-120	+436	+871	+292	+359	-1,552
Net Contribution (-) or Receipt (+) (b)	+550	+370	-1,048	- 19	+513	+734	+292	+422	-1,814

NOTE: (a) If UK and Italian import Monetary Compensatory Amounts (MCAs) are attributed as a benefit to the UK and Italy.

(b) If UK and Italian import MCAs are attributed as a benefit to the exporter.

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Evro PD.

RECORD OF A DISCUSSION IN PLENARY SESSION BETWEEN THE PRIME MINISTER
AND SIGNOR COSSIGA, THE PRESIDENT OF THE ITALIAN COUNCIL OF MINISTERS,
AT THE PALAZZO CHIGI AT 1120 ON FRIDAY 5 OCTOBER 1979

Present

Copied:
Evro PD: EMS.
: CAP.

Prime Minister	Signor Cossiga <i>Defence</i> : TNF.
Foreign and Commonwealth Secretary	Signor Malfatti Minister of Foreign Affairs
HE Sir Ronald Arculus	Signor Pandolfi Minister of the Treasury
Mr. J.L. Bullard	Ambassador Malfatti Secretary-General, Ministry of Foreign Affairs
Mr. M. Butler	Ambassador Ducci Italian Ambassador in London
Mr. M. Franklin	Minister Ruggiero Head of Private Office, Minister of Foreign Affairs
Mr. C.A. Whitmore	Minister Alessi Assistant Under Secretary supervising EEC matters
Mr. H. James	Counsellor Squillante Signor Cossiga's Private Office
Mr. J. Adams	Minister Berlinguer Diplomatic Adviser
Mr. M.O'D.B. Alexander	Signor Zanda Press Attache
Mr. G.G.H. Walden	Signor Santini Economic Adviser

Bilateral Talks

Having outlined the agenda and referred to his tête-à-tête with the Prime Minister the previous evening, Signor Cossiga said that he hoped it would be possible to institutionalise talks between the Italian and British Governments at Head of Government level. The Italian Government already had talks on a regular basis with other members of the Community. It would be appropriate for the talks to take place twice a year. The Prime Minister said that bilateral talks were often more productive than summit meetings. She agreed that the bilateral talks at Head of Government level should be institutionalised on the basis proposed by Signor Cossiga.

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/(The Prime Minister

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(The Prime Minister said initially that the talks should be held on an annual basis. But in the subsequent discussion she agreed that the talks should be held bi-annually.) She looked forward to seeing Signor Cossiga in London next year.

EEC

Signor Cossiga said that while there might be some differences in the short-term objectives of the two Governments, their long term interests in the EEC were identical. It should be possible to develop a line of common action. The basis of this would be that the Community could not count on a full contribution from Italy and the United Kingdom if they were not getting satisfaction from the partnership. The Prime Minister said that she was absolutely committed to making Europe function as effectively as possible. However, the grievances of individual members would have to be resolved if it were to work as well as it could.

The Community Budget

Signor Malfatti said that the Italian Government were very critical of the reference document produced by the Commission in response to the directive from the European Council at Strasbourg. The document failed to stress the deterioration in the balance of trade between Italy and the rest of the Community. As compared with 1978, the balance of trade had moved against Italy to the tune of 1,000 MUA. The erosion of the external tariff was also causing major difficulties for the Italian Government. It had a particularly damaging impact on the poorer section of the population. As regards the figures on the budget, the Italian Government did not accept the Commission's forecast. They expected that their net balance would be no more than 150-200 MUA, i.e. much less than the Commission had anticipated.

In explanation of this point, Signor Ruggiero said that the Commission had shown the MCAs as benefitting Italy. The Italians did not accept this. Moreover, the Commission's calculation was based on a payments forecast that was quite unrealistic. In addition, the Commission had failed to produce solutions to the problems created for Italy by the inadequacies of the present

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regional policy; by the CAP; and by the erosion of the external tariff against the import of Mediterranean produce from non-members of the Community. Signor Malfatti said that the Italian Government would await the production of a further document by the Commission before they would be prepared to refine their demands any further. They were looking for a general shift in the balance of CAP expenditure. They wanted action on a number of headings:

- (a) the operation of the guarantee section of the FEOGA fund should be changed so that the impact on the Italian balance of payments of the import of agricultural products, e.g. beef, from other members of the Community, was reduced;
- (b) the present discrimination against Mediterranean products within the CAP removed;
- (c) the present wasteful surpluses in the CAP, particularly dairy products, reduced, perhaps through the use of co-responsibility levies;
- (d) aid given to improve the marketing of Mediterranean products within the Community; and
- (e) an assurance that if trade concessions had to be made to non-Community producers of Mediterranean products, the European producers, notably Italy, should be compensated.

More generally, Signor Malfatti said that they wanted to see the relationship within FEOGA between the guidance and guarantee sections changed; and to see the relationship between the CAP and other elements in the budget changed. At present 72% of the budget was taken up by the guarantee fund; 12% by structural, regional and social policies; and only 2% by energy, industry and transport. The Italians would like agreement to be reached in Dublin on a three-year programme by the end of which, e.g., 25% of the budget would be being spent on structural policies. There should be specific structural mechanisms to meet the particular situations of member countries.

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/The Prime Minister

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The Prime Minister said that as she understood it there were three principal Italian complaints. These were that:

- (a) too much of the total Community budget was spent on agriculture as opposed to regional, structural and other policies. The British Government agreed on this but considered that the total size of the budget should not go over the 1% VAT ceiling. Any changes in budgetary allocations would have to take place beneath that ceiling;
- (b) within the CAP, the balance of expenditure should be changed. Less should be spent on surpluses and more on dealing with other agricultural problems; and
- (c) Italy was having to bear too much of the cost of concessions made in the negotiation of trade agreements from which the EEC as a whole was the beneficiary.

Signor Cossiga said that the Prime Minister's summary was accurate. The Prime Minister repeated that the British Government had much sympathy with the Italian Government's complaints. They agreed that less should be spent on surpluses and more on aid to the regions. They accepted that this meant the re-structuring of the CAP. But it was essential that these changes should take place within the 1% VAT ceiling. They would like to see a start made with the reform of the CAP but considered that this would take time to bring to fruition. Signor Malfatti said that while the Italian Government wanted a re-allocation of expenditure, they were less concerned about the total size of the budget. The Prime Minister said that if Governments showed flexibility on the ceiling, the CAP would never be re-structured. The ceiling gave those who favoured reform a lever which had to be used.

Signor Pandolfi said that the broad objective of the Italian and British Governments seemed to him to be similar. Basically both Governments were asking that the requirements of convergence should be given a higher priority in EEC policies. However, in the short term there was a possible conflict in the positions of the Italian and British Governments. The British Government

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had a specific short-term problem, viz that their contributions and receipts were grossly out of balance. The Italian Government understood the necessity for the British Government to secure change in this situation. The Italian Governemnt were less concerned about the budget. Even if the Commission figures were wrong, the Italian position had improved substantially. Their concerns were more general, viz the disproportion between the CAP and the rest of the budget and the imbalance between the guidance and guarantee sections of FEOGA. Given this difference of interest, the Italian and British Governments needed to work out guidelines for common action in ECOFIN and elsewhere. The Italian Government were ready to support the UK but in doing so they would rely on the UK to support them.

Signor Pandolfi said that he had talked to the Germans in Belgrade about these problems. He sensed a disposition on the part of the Germans to be helpful on both the British and Italian requests. But there would be limits on German helpfulness. They were not prepared to go through the 1% VAT ceiling. Signor Pandolfi said that he personally agreed that in present circumstances that ceiling should be maintained. There was in any case a 13% margin in hand. (Signor Pandolfi noted the potential complications of enlargement in this context.) The Germans, secondly, would not be prepared to accept either the British or the Italian position in full. They would propose gradual implementation of any solution in either area.

The Prime Minister said that the British Government were suffering from the operation of the budget in two ways. Britain was contributing more than their GNP share and receiving less. The third poorest member of the Community was the largest contributor. The Prime Minister said that much as she would like to play Lady Bountiful to the Community she could not afford it at a time when the British Government was having to cut back its expenditure on health, education, local government and numerous other areas of great electoral sensitivity. The present situation was grossly unjust. Failing a move on the budget, there would be a serious and hostile reaction in the United Kingdom. The British Government were not asking that

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they should be net beneficiaries from the budget. They did not want money from their partners. They sought instead a broad and reasonable balance. The Community should not underestimate the determination of the British Government.

As regards the longer term, the Prime Minister said that it was of course ridiculous to create and support agricultural surpluses. The CAP would have to be changed. The Italian Government would encounter no difficulties with HMG in its efforts to secure such a change. But perhaps some of the other members would see more difficulties. Perhaps it would suffice for the European Council to declare its intention to seek reform in the CAP. Signor Cossiga questioned the use of the word "intention". The Italian Government would need a commitment, not a statement of intention. The Prime Minister said that the problems identified by the Italian Government were even more complicated than that faced by the British Government. Perhaps the Dublin Council should aim to define the Italian difficulties more clearly; to declare its intention to deal with them; and to commission papers for the following Council. The British Government would support such a programme very strongly. It seemed doubtful whether the Italian Government could get all they were seeking at the Dublin meeting. Signor Pandolfi said that the Prime Minister's remarks suggested there was some difference of position between the two governments. The Foreign and Commonwealth Secretary said that the British Government sympathised with and would support the general approach put forward by the Italians. They had no wish to ignore the difficulties faced by the Italian Government. However, we needed more details of what the Italians had in mind. It might be that the difficulties of securing movement would not be as great as appeared. The Prime Minister agreed with the Foreign and Commonwealth Secretary's remarks and asked whether the Italians had worked out their ideas in detail and whether a paper could be made available so that it could be discussed in further bilaterals at official level and with other Governments.

Signor Pandolfi said that the Italian Government would be putting specific proposals to the Commission in the following week.

/The proposal

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The proposal would seek action under three headings:

- (a) that a decision should be taken to reduce gradually but in a definite period (3-5 years) on a year-by-year basis the percentage of the total expenditure of the budget devoted to the CAP. The reduction might be of the order of one or two percentage points per year;
- (b) that the same process should take place within FEOGA, re-directing expenditure from the guarantee to the guidance fund; and
- (c) that action be taken to diminish the cost to Italy of the import of agricultural products from other members of the Community and to encourage the increased production of some agricultural products, particularly meat, in Italy.

The Prime Minister asked whether Italy would be seeking fixed percentages and timescales in Dublin. Signor Pandolfi said that if precise decisions were not taken in Dublin there would be further delay. It was essential that the Italian and British Governments should not be divided. Both the Prime Minister and the Foreign and Commonwealth Secretary said that it would be easier to get a decision in principle than a decision with figures. Signor Pandolfi said that figures were essential, although he was not dogmatic about what those figures should be. The Prime Minister said that it was essential to have the details of the Italian proposals as soon as possible. The British Government would look at them carefully and sympathetically with the intention of being constructive. The interests of the two Governments were the same. British representatives in forthcoming bilaterals would say that they were studying the Italian proposals sympathetically. The Prime Minister hoped that Italian representatives would say the same about their approach to the British problem.

Signor Cossiga said that Italy's experience had been that the decisions at Strasbourg had not been translated into a paper satisfactory to his Government. The Italians did not want to find themselves after Dublin in the same position as they were now after Strasbourg. It was essential that the problem should

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be quantified. General political indications would not suffice. Signor Pandolfi said that Monsieur Ortoli would be in Rome the following week and would be given precise details of the Italian proposal. (Officials in subsequent discussions cast some doubt on whether the Italians would in fact hand a paper to the Commissioner.) It was agreed that the discussion would be continued at the forthcoming meeting between Signor Malfatti and the Foreign and Commonwealth Secretary and that in the interim talks at official level would continue.

/European Monetary System

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FM BONN 051540Z OCTOBER 79

TO IMMEDIATE FCO

TELEGRAM NO 552 OF 5 OCTOBER

INFO IMMEDIATE PARIS AND WASHINGTON

INFO ROUTINE MOSCOW, UKDEL NATO, UKREP BRUSSELS, OTHER EEC POSTS
AND OTHER NATO POSTS.

Prime Minister

per Axel

MY TELNO 555: FRANCO/GERMAN SUMMIT

1. SUBSEQUENT CONTACTS WITH GERMAN OFFICIALS HAVE CONFIRMED THE ASSESSMENT IN MY T.U.R. THE CHANCELLOR'S OFFICE HAVE TOLD US THAT THE ATMOSPHERE OF THE TALKS WAS EXCELLENT AND THAT THE VISIT WAS A GREAT SUCCESS. MUCH OF THE EXTENSIVE PRIVATE TALK BETWEEN THE FEDERAL CHANCELLOR AND PRESIDENT GISCARD WAS ON EAST/WEST RELATIONS, SECURITY AND RELATIONS WITH THE UNITED STATES. HENCE THE EMPHASIS GIVEN TO SALT II AND DETENTE IN THE JOINT PRESS CONFERENCE. THE FRENCH EDC PROPOSAL WAS DISCUSSED BETWEEN GENSCHER AND FRANCOIS-PONCET IN SOME DEPTH. ALTHOUGH THIS DISCUSSION LEFT A NUMBER OF POINTS OF DETAIL STILL UNCLEAR, THE GERMANS GAVE THE PROPOSAL THEIR BLESSING. ALTHOUGH THEY REGARD THE SECOND STAGE (REDUCTIONS) AS UNREALISTIC, THEY WELCOME THE FIRST STAGE AS PROVIDING A DEFENSIBLE WESTERN POSITION ON CBMS, AND ONE WHICH HAS THE GREAT ADVANTAGE FROM THE GERMAN POINT OF VIEW OF WIDENING THE AREA OF APPLICATION BEYOND THE MBFR REDUCTIONS AREA AND THUS TAKING THE FOCUS OFF GERMANY.

COMMUNITY BUDGET

2. THE TWO SIDES AGREED THAT THE BUDGETARY BURDEN ON BRITAIN SHOULD BE EASED. THEY SET OUT PARAMETERS FOR DEALING WITH THE QUESTION. FIRST THE PRINCIPLE OF OWN RESOURCES SHOULD BE MAINTAINED (THE AUSWAERTIGES AMT ASSUME THIS MEANS THAT THE CONCEPT OF PROGRESSIVITY SHOULD BE REJECTED). SECONDLY THE 1% VAT CEILING SHOULD BE MAINTAINED. THIRDLY THE SOLUTION SHOULD BE QUOTE TEMPORARY UNQUOTE. THE QUESTION REMAINED OPEN WHAT TEMPORARY MEANT. BOTH SIDES AGREED THAT THE REMEDY SHOULD HAVE COME TO AN END BEFORE THE COMMUNITY CONSIDERED SERIOUS PROPOSALS TO INCREASE OWN RESOURCES. BUT THE FRENCH WENT FURTHER THAN THIS AND WERE CLEARLY THINKING FIRMLY IN TERMS OF A FINITE TIME LIMIT. AT ONE POINT IN THE DISCUSSION THEY INDICATED A PERIOD OF ONE YEAR.

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3. BOTH SIDES CAME DOWN AGAINST A NET SOLUTION, THE FRENCH VERY STRONGLY SO. IT APPEARS THAT FIGURES WERE NOT DISCUSSED, BUT CLEARLY NEITHER SIDE IS THINKING OF ANYTHING LIKE OUR QUOTE BROAD BALANCE UNQUOTE. THE FRG STATED THEIR PREFERENCE FOR A DEVELOPMENT OF THE DUBLIN MECHANISM. THE FRENCH AGREED THAT THIS WAS ONE POSSIBILITY, BUT ANOTHER WOULD BE TO EXAMINE AN EXTENSION OF THE ARTICLE 131 ARRANGEMENT.

4. IT WAS CLEAR TO THE GERMANS THAT WHILE THE FRENCH WANTED THE BUDGETARY PROBLEM DEALT WITH THEY WERE GENERALLY MUCH MORE RESERVED THAN THE FRG: AND WERE VERY MUCH CLEARER IN THEIR DESCRIPTION OF PRINCIPLES WHICH MUST NOT BE BREACHED (THAT THE CAP SHOULD NOT BE PUT IN QUESTION: THAT THE BUDGET WAS NOT A MECHANISM FOR REDISTRIBUTION: AND THAT ITS OBJECT WAS TO FINANCE EXISTING COMMUNITY POLICIES) THAN ON THE POSITIVE SIDE. THE GERMANS CONCLUDED FROM THE DISCUSSION THAT THE GAP BETWEEN BRITAIN AND FRANCE WAS LARGE AND WOULD BE DIFFICULT TO BRIDGE AT DUBLIN. OFFICIALS IN THE CHANCELLOR'S OFFICE CONSIDER THAT IT WILL BE NECESSARY TO PRESS THE COMMISSION TO SPEED UP THEIR PROPOSALS AND TO HAVE AN ADDITIONAL MEETING OF FINANCE MINISTERS BEFORE DUBLIN (BUT THEY DID NOT SAY THAT THE FRG WOULD TAKE THE LEAD IN PRESSING FOR THIS). AFTER THE MEETING GERMAN OFFICIALS WERE TAKING THE LINE THAT ALTHOUGH SPECIFIC LINKAGES WERE NOT DISCUSSED, BOTH ENERGY AND FISHERIES WILL STILL BE IMPORTANT FACTORS IN THE OVERALL ATMOSPHERIC PACKAGE FOR DUBLIN.

CAP

5. SCHMIDT TRIED TO PERSUADE GISCARD THAT ACTION HAD TO BE TAKEN. AT THE PRESS CONFERENCE HE WAS ABLE TO ANNOUNCE THAT THE TWO HEADS OF GOVERNMENT HAD AGREED THAT IT WAS NECESSARY QUOTE TO DISCOURAGE AGRICULTURAL SURPLUSES UNQUOTE. (OFFICIALS ARE NOT HOWEVER DISPOSED TO SUGGEST THAT THIS MOVE REPRESENTS SIGNIFICANT PROGRESS). SCHMIDT SUGGESTED AT THE PLENARY SESSION THAT FINANCE MINISTERS SHOULD BE MORE INVOLVED IN THE WHOLE QUESTION OF AGRICULTURAL PRICES: BUT HE DID NOT PRESS THE POINT, NOR DID THE FRENCH TAKE IT UP.

ENLARGEMENT

6. THE FRG ARGUED THAT THE SPANISH ACCESSION NEGOTIATIONS SHOULD BE ALLOWED TO MOVE FORWARD WITH DUE SPEED. THE FRENCH POINTED OUT THAT THERE WERE SERIOUS PROBLEMS OF FRENCH DOMESTIC POLICY INVOLVED. THE GERMANS REPLIED RESOLUTELY THAT SPAIN HAD DOMESTIC POLITICAL PROBLEMS TOO.

1980 BUDGET

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7. BOTH SCHMIDT AND GISCARD WERE AGREED THAT THE MESSAGE TO THE EUROPEAN PARLIAMENT WAS THAT THE COMMUNITY'S RESOURCES WERE LIMITED AND THAT THE PARLIAMENT SHOULD BE CAREFUL. THEY AGREED THAT THE COMMUNITY SHOULD INSIST THAT THE ALLOWED MARGIN FOR INCREASING THE DRAFT BUDGET PROVISION FOR NON-OBLIGATORY EXPENDITURE MUST BE RESPECTED AND THAT IF IT WAS NOT, THE NEW PROCEDURE FOR REDUCING INCREASES PROPOSED BY THE PARLIAMENT SHOULD BE FOLLOWED.

EURATOM CHAPTER VI

8. THE TWO FOREIGN MINISTERS EXPRESSED GENERAL SATISFACTION WITH DEVELOPMENTS TO DATE. THEY AGREED THAT THE MINISTERS AND NATIONAL EXPERTS WOULD HAVE TO WORK ON THE BASIS OF THE FOLLOWING PRINCIPLES (A) FREE MOVEMENT OF SUPPLIES (B) NON DISCRIMINATION AND (C) COMMON ACTION VIS-A-VIS NON MEMBER STATES. ANY PROPOSALS TO ADAPT THE TREATY WOULD NEED TO TAKE INTO ACCOUNT ECONOMIC AND INDUSTRIAL FACTORS.

INDUSTRIAL POLICY

9. THE FRG ARGUED AGAINST THE FRENCH WISH TO PROLONG THE CRISIS MEASURES FOR STEEL. THE FRG THOUGHT IT IMPORTANT TO AVOID GIVING THE INDUSTRY THE IMPRESSION THAT THEY WOULD BE PROTECTED INDEFINITELY ON TEXTILES THE FRENCH ARGUED THAT TEXTILE IMPORTS HAD TO BE ACCOMPANIED BY PROOF OF ORIGIN CERTIFICATES, THIS WOULD BE ADMINISTRATIVELY COMPLICATED FOR THE FRG, WHO SAW IT AS A FRENCH ATTEMPT TO INCREASE PROTECTIONISM IN THIS FIELD.

NUCLEAR

10. THERE WAS AN EXCHANGE OF VIEWS (BUT NO MORE) ON NUCLEAR ENERGY AND ON NEW ENERGY SOURCES, BOTH SIDES AGREED THAT NUCLEAR ENERGY COULD NOT BE DISPENSED WITH.

NORTH-SOUTH

11. SEE BONN TEL 560.

BILATERAL

12. THE MAIN RESULT WAS THE CONCLUSION OF AN AGREEMENT TO DEVELOP TWO TV SATELLITES, ONE IN EACH COUNTRY, WHICH WOULD BE LAUNCHED (PROBABLY NOT BEFORE 1983) INTO GEO-STATIONARY ORBIT BY THE ROCKET-LAUNCHER ARIANE. NEGOTIATIONS HAVE TAKEN PLACE OVER MANY MONTHS. FURTHER DISCUSSIONS WOULD TAKE PLACE BILATERALLY ON THE TERMS OF THE INDUSTRIAL COOPERATION, AND MULTI-LATERALLY AT THE NEXT SESSION OF ESA.

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13. IN EDUCATION, THE TWO SIDES AGREED THAT THE BILATERAL COMMITTEE OF EXPERTS ON EDUCATION WOULD EXAMINE WAYS OF BOOSTING THE STUDY OF FRENCH IN GERMANY AND VICE VERSA; THAT TEACHER EXCHANGES SHOULD BE INCREASED; AND PROCEDURES FOR MUTUAL RECOGNITION OF QUALIFICATIONS ACCELERATED.

14. THE ONLY SOUR NOTE WE HAVE DETECTED THROUGHOUT THE SUMMIT WAS A MINOR ONE CONCERNING GISCARD'S APPEARANCE ON TELEVISION. THE FRENCH WERE RATHER TAKEN ABACK BY THE HOSTILITY OF QUESTIONING, ESPECIALLY ON THE FRENCH ROLE IN AFRICA, WHERE FRANCE WAS DESCRIBED AS THE CUBA OF THE WEST AND IT WAS SUGGESTED THAT THE SEARCH FOR RAW MATERIALS WAS BEHIND HER ACTIVITY. FOR THEIR PART THE GERMANS WERE RUFFLED BY GISCARD'S CORRECT BUT COOL RESPONSE TO A QUESTION ON REUNIFICATION, FROM WHICH HIS LACK OF ENTHUSIASM WAS PAINFULLY EVIDENT.

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PRIME MINISTER

United Kingdom Community Budget Contribution:
Corrective Mechanisms
(OD(79) 25)

PURPOSE OF THIS DISCUSSION

You agreed earlier that Sir Donald Maitland might draw on the conclusions in paragraphs 22 and 23 of this Note by Officials in talking to the Commission, on a personal basis and without committing Ministers, in advance of the Commission's formal meeting on 5th October to discuss the Budget issue. Ministers now need to decide whether they endorse these conclusions so that we can continue to lobby accordingly with the Commission and with other member states. A further meeting of OD after the Party Conference (on 24th October) will take two papers on (i) the leverage we can exercise and (ii) the action we can take if we don't get our way.

BACKGROUND

2. As agreed at OD(79) 6th Meeting, the Chancellor of the Exchequer made our requirements clear at the 18th September Finance Council (text of his statement attached):

A corrective mechanism dealing with both our excess contributions and inadequate receipts in order to achieve broad balance.

Action as from 1980.

The corrective to last as long as the problem lasts.

Not to invoke major increases in the Budget.

The same OD meeting charged officials to report urgently on the merits and de-merits of the different mechanisms and how they would work in practice. OD(79) 25 was prepared by officials of the Treasury and the FCO under Cabinet Office chairmanship. It shows that, in theory, we could achieve broad balance through any of the four options which the Chancellor identified in an earlier paper. (paragraph 7). But in terms of negotiability, the most promising approach looks like being one of the so-called hybrid solutions - making the Financial Mechanism work and adding on to it a mechanism to compensate us

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for our low receipts. The Foreign and Commonwealth Secretary will probably favour this approach. It has the great merit within the Community of building on something which exists and in domestic political terms of being a significant improvement of something negotiated by the previous Government. The Chancellor of the Exchequer, however, may prefer to go for a straight ceiling on our net contribution, fearing that if we follow the approach of the Financial Mechanism we may end up with only a partial solution. Both solutions will involve getting the Community to accept a correction on account of our low receipts, which will certainly be the hardest nut to crack. The Commission will be tempted to offer us a mechanism to bring our contribution into line with our GNP share plus a promise that we can expect to improve our receipts position gradually as the share of the budget swallowed up by the CAP is reduced. To guard against this we have to insist that any mechanism must deal with both the causes of our imbalance. This is stressed in paragraph 22 of the paper.

HANDLING

3. The Chancellor of the Exchequer should be asked first to comment on the general approach in OD(79) 25, followed by the Foreign and Commonwealth Secretary. The discussion thereafter might focus on:-

- (i) qualifying criteria (paragraphs 5 and 6)
- (ii) acceptable mechanisms (paragraphs 7 - 18)
- (iii) the method of payment and financing (paragraphs 19-21)

Qualifying Criteria

4. On (i) the paper suggests that countries which are both below average GNP and net contributors should benefit and that phasing-out arrangements (paragraph 6) should be sufficient to meet the (unlikely) contingency that our GNP could rise above the Community average. The Chancellor of the Exchequer admits that this is unlikely to happen but wants a guarantee that, if it did, the United Kingdom would still get, indefinitely, an abatement of its net contribution. The Foreign and Commonwealth Secretary will probably say that this is non-negotiable and the chances of it happening so remote as not to justify expenditure of negotiating capital.

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Acceptable Mechanisms

5. On (ii), is there any advantage in fixing on one method now? We should certainly remain free to suggest our own remedy if the Commission's proposals are unsatisfactory. But is it agreed that we should steer the Commission towards a revised Financial Mechanism subject to conditions recommended in paragraph 22? Or is it better to start with something even more radical like an overriding no net contribution rule expecting to be driven off it.

Financing

6. On (iii) the advice of officials is that we should not open up the question of how our rebate is financed until we have got further in negotiating the size of the rebate we are going to get. In the meantime we should have discussions with the Commission at expert level. You will want to call for a further paper on this. The Chancellor, understandably concerned to get immediate relief, may suggest that we ask for monthly repayments so as to get the best possible cash flow. This is obviously desirable but is it essential? The system under the Financial Mechanism gives us 75 per cent of what is estimated to be due after the end of the Community calendar year but before the end of our financial year. Thus even for the 1980 Budget, we should get largely repaid before the end of the 1980-81 financial year. Thereafter, getting repaid in arrears becomes less serious.

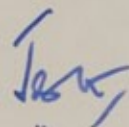
CONCLUSIONS

7. You may wish to sum up that:-

- (i) Subject to points made in discussion the approach described in paragraphs 22-23 of OD(79) 25 is agreed for use in future contacts with the Commission (including your talk with Mr. Jenkins on 22nd October) and in subsequent bilateral discussions with member states.
- (ii) The Chancellor should bring a further paper to the Committee, with recommendations, once the Commission's proposals are known.

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- (iii) Officials should produce further advice on the financing of any refund mechanism after discussion with Commission experts.
- (iv) The Committee to meet on 24th October to consider the weapons we can use in order to get our way.



(John Hunt)

5th October 1979

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- (ii) This is a... (ii)
- (iii) This is a... (iii)

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(John Doe)

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BRIEF RECORD OF MAIN POINTS DISCUSSED AT THE TETE-A-TETE BETWEEN THE PRIME MINISTER AND SIGNOR COSSIGA AT 1900 ON 4 OCTOBER AT THE PALAZZO CHIGI.

Signor Cossiga said he was most grateful for this opportunity of a meeting with the Prime Minister, the first he had had with the Head of a foreign government. He spoke of the traditional friendly relations between Britain and Italy and of his own personal interest in British constitutional history.

Signor Cossiga said he would shortly meet Chancellor Schmidt and the Dutch Prime Minister, Mr van Agt, and then President Giscard in preparation for the Dublin Summit and to discuss TNF.

Italy had been shocked by the death of Lord Mountbatten. Both countries had a common obligation to fight terrorism. He was grateful for British collaboration in this field.

Signor Cossiga hoped that Anglo-Italian meetings could now be placed on an institutional basis. There were meetings between himself, the German and French leaders twice a year, and he hoped the same pattern could be established between Britain and Italy.

The Prime Minister thought that we should examine this idea. Such meetings should not be too long. Her present visit to Rome was the right length, ie inside 24 hours. We too had regular meetings with the Germans and French, and the more preparation that took place before European Council Meetings the better. Italy had a very important defence burden. Italy would also be the host at the forthcoming Economic Summit in Venice.

Signor Cossiga congratulated the Prime Minister on the British initiative on Rhodesia. In this problem, as in the very delicate question of South African relations with the rest of the world, Britain had a key role.

/The Prime Minister

The Prime Minister referred to the constitutional proposals which the parties at the Conference had until Monday to examine. It was vital to maintain momentum in these negotiations.

The Prime Minister went on to express sympathy for the recent earthquake disaster in central Italy. She also thanked Signor Cossiga for his efforts to resolve the Schild case, which could not be in more expert hands. Anything Italy and Britain could do together to combat terrorism had her whole-hearted support. This was a field in which she would also agree to extra expenditure.

Signor Cossiga said that as a Sardinian he felt particular concern for the Schild case. He handed the Prime Minister a document which he had prepared on this matter. He also referred to collaboration which had taken place with the British Metropolitan Police and M15 and M16. In this connection the Italian Government would do both what was possible and "what was impossible". They would arrange matters so that the Schild family could take any necessary initiative.

The Prime Minister then referred to the two most important problems relating to her visit, namely Community questions and Theatre Nuclear Forces. On the Community, there was no question of the British Government being anti-European, but there was this particular injustice concerning the Budget which had to be resolved soon. No doubt Italians had felt similarly about their problems relating to the CAP.

Signor Cossiga said that on the Community Italy was not in an easy situation. He was not an economic expert and was in the hands of his Economic Ministers. But before dealing with the Community he wished the Prime Minister to know what he was trying to achieve with respect to the Italian economy. [There then followed a lengthy explanation by Signor Cossiga of his economic strategy on lines which the Embassy has already reported.] In the course of this discussion and in reply to the Prime Minister's questions, Signor Cossiga said that as a former Minister for the Civil Service he personally enjoyed good relations with the trade unions and hoped that they would in the end do no more than make noises.

/Signor Cossiga

Signor Cossiga said that Italy's experience in the EMS had been relatively painless so far, and had in effect helped the Italian Government in their attempts to convince Italian political forces of the need to struggle against inflation. He perfectly understood that the fact that Britain was not a member of EMS was not in conflict with her membership of the Community as a whole.

Signor Cossiga then explained his Government's position on the Budget/convergence. Italy was in complete agreement with the rest of the Community on this subject. Anglo-Italian collaboration had resulted in the agreement achieved at the European Council at Strasbourg. But he had told President Jenkins that the Commission reference paper was not in complete accordance with the directives of the Strasbourg European Council. The problem was not exclusively one of the Budget, but was also one of the poorer regions which were to be found in Britain, Italy and Ireland. In addition to the resolution of the budgetary problem there had to be parallel measures, and the Commission had to reflect this in the reference document as a basis for the forthcoming Dublin Summit. He hoped that the Prime Minister would understand the Italian position and referred to the fact that his Government had been created in exceptionally difficult circumstances.

The Prime Minister hoped that a resolution of the budgetary problem would not have to wait. Britain was the third poorest country in the Community and the biggest single net contributor. This was a unique situation, with the exception of the Italian net budgetary deficit in 1978. The problem created sharp political resentment in Britain since it was neither reasonable nor just. Britain did not ask for benefit from the Community but should not be asked to pay heavily to it, particularly at a time when the British Government had had to introduce significant measures of economy. There was an immediate need for a solution and unless this could be obtained at Dublin the attitude of the British public could be very resentful. The Prime Minister added that she was very anxious to be constructive and quite accepted that those like Britain which were among the poorer countries [ie Italy and Ireland] should not be asked to pay more for a solution to the budgetary problem.

/Signor Cossiga

Signor Cossiga said that although the short-term objectives of the two countries might be different their objectives were surely the same. Britain faced in the short-term an imbalance in the budget while Italy suffered a hidden transfer of resources through the trade effects of the CAP. The Prime Minister made it clear that Britain also suffered from the requirement to buy dear Community products.

Signor Cossiga said that Britain and Italy should agree that the budget should be formed in order to increase expenditure on structural and regional support. He then spoke of the political price which Italy had to pay for concessions to Mediterranean countries. (NB: although in reply to Mrs Thatcher's question, he said that he was referring to the enlargement question, it seems likely that this was a reference to the Italian wish to be compensated for tariff concessions to third country Mediterranean suppliers, eg Cyprus).

He repeated that Italy and Britain should have the same objective viz to restructure the Budget so that there was more expenditure on regional and social funds; on structure; and on new research, energy and industrial policies, etc.

Signor Cossiga said that the Italians had a draft proposal for an addition to the Commission reference paper and he thought that Minister Malfatti would discuss this with Lord Carrington this evening.

The Prime Minister said that these were matters that had to be discussed at the Plenary meeting. The net payment of £1,000 m. a year to the Community Budget caused considerable political resentment in Britain and the matter had to be resolved in Dublin. Otherwise there could be no advance in Community policies. She did not wish to cause trouble in the Community or to dominate the Community with this issue. But it had to be got out of the way. This was a matter of equity. Once justice had been established we could make a more creative contribution to many questions for example to the reform of the CAP. The Agriculture Ministers only made little
/adjustments

adjustments to the CAP and never got to grips with the basic problem. Signor Cossiga agreed and said that although his Agriculture Minister was a personal friend he was one of his most difficult colleagues!

The conversation then turned to TNF. Signor Cossiga said that he was glad that SALT II had been successful and hoped the US Congress would ratify it soon. The Madrid Conference in 1980 was very important and there should be close co-operation between the European partners to prepare for this. In an international situation the only serious basis for detente was the re-establishment of a balance of forces between East and West. In a situation where the Soviet Union had conventional and strategic superiority, the TNF problem was vital. Italy was determined to take a positive decision. He had been shocked to read of the cynical way in which Gromyko had spoken to Minister Malfatti recently about the Soviet missiles (SS20) and Backfire bomber as if they were children's toys. These weapons were a threat to the whole of Europe as well as North Africa.

Signor Cossiga repeated that Italy would take a positive decision on TNF in the forthcoming alliance meetings. But it was highly desirable to have the approval of all the countries of the Alliance. Denmark and Norway though not nuclear countries should give their approval while all the existing nuclear countries should accept the modernisation of nuclear weapons. In this context his forthcoming meeting with the Dutch Prime Minister, Mr van Agt, was important. He intended to exert maximum pressure on him and the Dutch Foreign Minister, who would also be present. He was also trying to help Chancellor Schmidt by persuading German Christian Democrat contacts, eg Dr Eckt, Herr Strauss and Kohl, that they should not make party difficulties for the German Government. Signor Cossiga hoped that the British Government would also bring pressure on the Dutch. He, Cossiga, had an internal problem with the Italian Socialists and Chancellor Schmidt and the Dutch Government could, by a positive decision, also help him. This morning, 4 October, he had a special meeting in preparation for Mrs Thatcher's visit with his Foreign, Defence, and Interior Ministers as well as co-opted Ministers from
/the

the Liberal and Social Democrat Parties in the Coalition. They completely agreed with his positive decision on TNF. When the time came to make an announcement this would be by a routine statement by the Defence Minister. Cossiga would not make a lot of speeches.

Nevertheless, he regretted that there would at present be a gap between the decision of the Nuclear Planning Group and the subsequent decisions in the Defence Planning Committee and the NATO Council. In that period the Soviet Union could bring damaging pressure to bear on Italy as well as on Germany and Holland. He, Cossiga, would not change his position but hoped something could be done to associate the countries of the Alliance which were not members of the Nuclear Planning Group with the latter's positive decision so that a definitive decision could be taken at the NPG. Finally, he intended to consult (he later said "inform") the PCI and try to make them accept that this was an opportunity of proving that they were independent of the Soviet Union.

The Prime Minister thanked Signor Cossiga for his resolute attitude.

As the Prime Minister was leaving Signor Cossiga made the expected request for British support for the candidature for Zichichi for the direction of CERN. He would also be approaching the Germans since there was a rival German candidate. He handed a document on this to the Prime Minister.

The Prime Minister said that she believed there was a study group which was producing a report and that we would be examining this.



CABINET OFFICE

With the compliments of
Sir John Hunt GCB
Secretary of the Cabinet

C.A. Whitmore, Esq.

70 Whitehall, London SW1A 2AS
Telephone: 01-223 8319



SECRET



CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir John Hunt GCB

4th October, 1979

Ref. A0365

EEC Budget: Contingency Planning

At OD(79) 6th Meeting on 12th September there was general agreement that the Prime Minister would need to know in good time before her bilateral with Chancellor Schmidt on 31st October what cards we would have to play if we did not get satisfaction over our contribution to the EEC Budget.

2. Two papers were envisaged:-

- (i) a paper by the Foreign and Commonwealth Secretary on the various means by which we could if necessary put pressure on the Commission or on other member States to meet our Budgetary requirements;
- (ii) a paper by the Chancellor of the Exchequer on whether we could in the last resort withhold our contribution to the Community's Budget.

3. It was originally envisaged that paper (i) would be taken at OD on 8th October when the Committee will be considering the paper on the Corrective Mechanisms: and that paper (ii), on which you were awaiting the advice of the Law Officers, would have to be taken a little later and possibly in a smaller group because of its sensitivity.

4. During the course of the briefing meeting yesterday for her visit to Rome the Prime Minister, unprompted, asked about these papers and why they were not ready. I said that we had never envisaged putting them to her before Rome but that they were well on track and that she would have ample time to reflect on them before she sees Chancellor Schmidt. Since yesterday however I have made further enquiries and am slightly disturbed by what I have heard. In the first place the FCO paper will not now be ready for OD on 8th October: this is a pity but in many ways the FCO paper is more closely related to yours on "withholding" than to the paper on financial mechanism, and there could be advantage in taking both the "cards to play" papers at the same meeting. I understand however that the Treasury have not yet received advice from the Law Officers on the "withholding" point and that your people cannot say when your own paper will be ready.

/5. .

Sir Douglas Wass, KCB

SECRET

5. I am therefore writing this letter to tell you and Michael Palliser that we have a slot in the Prime Minister's diary on Wednesday, 24th October to take both papers: that she will certainly not want to consider them any later than this: and that she will want ample time to study them in advance. They ought therefore to be circulated on Friday, 19th October at the latest and preferably earlier. Unless I hear to the contrary I shall assume that you will both be able to manage this.

6. I am sending a copy of this letter to Michael Palliser: and also to Bill Beckett and Clive Whitmore.

JOHN HUNT

Euro PS
Budget Pt 2

Meeting extract PM/Chancellor at 9.00am 4.10.79

- ii. The Prime Minister said that she intended to say in her Luxembourg speech that the UK would not contribute more than one per cent of its VAT receipts to the Community Budget without significant reforms. The Chancellor did not dissent from this approach.

Subject file - Euro PS - Consultations
with IMF

CONFIDENTIAL

GPS 670

CONFIDENTIAL

FM BONN 031700Z OCTOBER 79

TO IMMEDIATE FCO

TELEGRAM NO 555 OF 3 OCTOBER

INFO IMMEDIATE PARIS AND WASHINGTON

INFO ROUTINE MOSCOW, UKDEL NATO, UKREP BRUSSELS, OTHER EEC POSTS
AND OTHER NATO POSTS.

FRANCO/GERMAN SUMMIT

1. PRESIDENT GISCARD VISITED BONN ON 1 AND 2 OCTOBER FOR THE 34TH ROUND OF THE REGULAR 6-MONTHLY FRANCO/GERMAN CONSULTATIONS BETWEEN HEADS OF GOVERNMENT UNDER THE 1963 FRANCO/GERMAN TREATY. THE RANGE AND DEPTH OF THE DISCUSSIONS WERE UNDERLINED ONCE AGAIN BY THE PANOPLY OF MINISTERS WHICH GISCARD BROUGHT WITH HIM. HE WAS ACCOMPANIED NOT ONLY BY HIS PRIME MINISTER (BARRE) AND FOREIGN MINISTER (FRANCOIS-PONCET) BUT ALSO BY THE MINISTERS FOR ECONOMY (MONORY), INDUSTRY (GIRAUD), LABOUR (BOULIN), EDUCATION (BEULLAC) AND WOMEN'S QUESTIONS (MADAME PELLETIER), AS WELL AS BY THE DEPUTY GOVERNOR OF THE BANQUE DE FRANCE.

2. THE OCCASION PROVIDED YET ANOTHER OPPORTUNITY, WHICH WAS AMPLY TAKEN BY BOTH SIDES, TO DEMONSTRATE THE IMPORTANCE THEY ATTACH TO THE FRANCO/GERMAN RELATIONSHIP. THE GERMANS MADE EVEN GREATER EFFORTS THAN USUAL TO FLATTER THE FRENCH. PRESIDENT CARSTENS AS WELL AS CHANCELLOR SCHMIDT ATTENDED GISCARD'S RETURN DINNER AND GISCARD TOOK THIS OCCASION TO ACCEPT CARSTENS' INVITATION TO MAKE A STATE VISIT TO THE FEDERAL REPUBLIC NEXT YEAR. AS GISCARD PUT IT AT THE DINNER QUOTE FRANCE AND GERMANY ARE TODAY LIKE LIMBS OF ONE AND THE SAME BODY UNQUOTE. AFTER THE TALKS GISCARD WENT ON TELEVISION TO ANSWER QUESTIONS FROM A GERMAN AUDIENCE.

3. AT THE PRESS CONFERENCE AT THE END OF THE VISIT THE MESSAGE OF THE TWO HEADS OF GOVERNMENT WAS MADE CLEAR BEYOND DOUBT. FRANCE AND GERMANY ENJOY A PARTICULARLY CLOSE AND PRIVILEGED RELATIONSHIP. BETWEEN THEM THEY FORM A NUCLEUS OF CALM AND GOOD SENSE IN A WORLD BESET BY TROUBLES AND LACKING IN LEADERSHIP. MUCH OF WHAT THEY HAD TO SAY WAS DIRECTED, IF ONLY IMPLICITLY, AT THE AMERICAN ADMINISTRATION. THE RATIFICATION OF SALT II WAS QUOTE ABSOLUTELY NECESSARY UNQUOTE. THE PRESENCE OF QUOTE CERTAIN TROOPS UNQUOTE IN CUBA DID NOT UPSET THE WORLD STRATEGIC

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/BALANCE

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BALANCE AND SHOULD NOT HOLD-UP RATIFICATION (A REMARKABLY ASSERTIVE STATEMENT BY A GERMAN LEADER WHICH WOULD HAVE BEEN INCONCEIVABLE ONLY 3 OR 4 YEARS AGO). THE CO-AUTHORS OF THE EMS FOUND THAT THEIR BRAIN-CHILD HAD EMERGED WELL FROM ITS FIRST TEST. THE GERMAN ECONOMY WAS IN GOOD SHAPE AND FRENCH ECONOMIC ACTIVITY WAS STABLE AT A HIGH LEVEL. THIS STABILITY, BY IMPLICATION, COMPARED FAVOURABLY WITH THE TROUBLES OF THE AMERICAN ECONOMY AND THE SLIDE OF THE US DOLLAR. DETENTE SHOULD BE PURSUED LOGICALLY AND METHODICALLY ON THE BASIS OF THE HELSINKI FINAL ACT AND QUESTIONS OF MILITARY DETENTE IN EUROPE SHOULD ALSO BE DEALT WITH WITHIN THE FRAMEWORK OF THE CSCE. IT IS CLEAR THAT THE GERMANS EXPRESSED SUPPORT FOR THE FRENCH EDC PROPOSAL.

4. THE VISIT WAS NOT INTENDED AS AN IMPORTANT DECISION-TAKING OCCASION BUT SOME DECISIONS WERE NEVERTHELESS MADE AND POINTERS FOR FUTURE POLICY WERE AGREED UPON. FROM THE BRITISH POINT OF VIEW THE MOST IMPORTANT OF THESE WAS THE AGREEMENT OF SCHMIDT AND GISCARD ON THE PARAMETERS FOR SETTLING THE COMMUNITY BUDGET PROBLEM. BOTH GOVERNMENTS EXPRESSED SYMPATHY FOR AN EASING OF THE BUDGETARY BURDEN ON THE UK. THIS WAS SEEN AS ESSENTIALLY A TEMPORARY PHENOMENON, WHICH REQUIRED TEMPORARY MEASURES TO SOLVE IT. THE PRINCIPLE OF OWN RESOURCES AND THE ONE PERCENT VAT CEILING SHOULD BE MAINTAINED. THERE WAS A NEED TO DISCOURAGE AGRICULTURAL SURPLUSES.

5. FOR THE REST IT WAS AGREED THAT THE PROPOSED NEW ARRANGEMENTS FOR SUPPLIES OF URANIUM TO THE COMMUNITY SHOULD NOT INFRINGE THE BASIC PRINCIPLES OF THE EXISTING EURATOM TREATIES BUT COULD ENABLE ADJUSTMENTS TO BE MADE WHERE THESE WERE ECONOMICALLY SENSIBLE. ON THE NORTH/SOUTH DIALOGUE, BOTH GOVERNMENTS SUPPORTED THE THIRD WORLD PROPOSAL FOR A GLOBAL DIALOGUE ON WORLD ECONOMIC PROBLEMS, TAKING IN ENERGY QUESTIONS: THIS FIELD WAS SEEN AS ONE RIPE FOR PARTICULARLY CLOSE COOPERATION BETWEEN THE FRENCH AND GERMANS. AS REGARDS DEVELOPMENT AND PRODUCTION OF NEW TECHNOLOGY, BOTH COUNTRIES PROPOSED TO STRENGTHEN THEIR COOPERATION IN RESEARCH AND INDUSTRIAL IMPROVEMENTS: IN PARTICULAR THEY WOULD DEVELOP TWO TELEVISION SATELLITES TO LAUNCH IN 1983.

6. I SHALL REPORT ON THESE AND OTHER ASPECTS AFTER WE HAVE HAD AN OPPORTUNITY OF LEARNING MORE OF WHAT TRANSPIRED FROM THOSE WHO WERE PRESENT.

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PRIME MINISTER

Community Affairs

The following are the main developments since the Cabinet last discussed Community Affairs on 13th September.

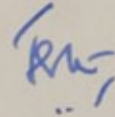
2. The Chancellor of the Exchequer might report on the outcome of the 17th September Finance Council, at which a first discussion took place of the Commission Reference Paper on the Community Budget problem and the Chancellor made clear our need for a corrective mechanism dealing with both our excessive contributions and our inadequate receipts. The debate will be resumed at the 15th October Finance Council, after which the Commission will present their proposals for solution. OD is to discuss a range of possible corrective mechanisms on 8th October. The main object of your visit to Rome will be to impress on the Italian Prime Minister the need to give priority to our budget problem. You will also be seeing Mr. Roy Jenkins on 22nd October.

3. The Foreign and Commonwealth Secretary might mention that the Spierenburg Report on the Commission's organisation has now been published. Inter alia it proposes that the number of Commissioners be reduced to 1 per ~~cent~~ member country. The wider report by the Three Wise Men is expected at the end of October. Both sets of recommendations will need to be considered by OD(E).

4. The Secretary of State for Energy might be invited to report on the outcome of the 20th September Energy Council and the prospects for the next Council on 9th October. Our readiness to accept an export target of 5 million tons of oil in 1985 encouraged others to move and made it possible to agree on individuals national targets compatible with the Community target for 1985 of 475 million tons. The Community was accordingly able to present agreed figures to the 26th September meeting of Tokyo Summit Energy Ministers. The 9th October Energy Council will be devoted largely to coal questions, on which - subject to discussion in OD(E) on 3rd October - the United Kingdom is likely to launch an initiative designed to promote Community financial support for investment in coal production to our benefit.

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5. The Chief Secretary, Treasury might refer to the European Monetary System currency realignment which took place on 23rd September, resulting in a 2 per cent revaluation in the Deutschmark and a 3 per cent devaluation in the Danish krone. The United Kingdom was not represented at the meeting; due probably more to oversight than intention, we were only invited after it had begun. Subsequent adjustments to green rates to offset the effects of this realignment gave the United Kingdom a 1.1 per cent devaluation of the green pound.



(John Hunt)

3rd October 1979

FILE
CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

SIR JOHN HUNT,
CABINET OFFICE.

Community Budget

The Prime Minister has seen your minute to me of 2 October on this subject and the OD paper to which it referred.

As I have already informed Mr. Franklin, the Prime Minister has agreed that Sir Donald Maitland should speak informally and on a personal basis to our contacts in the Commission on the basis of paragraphs 22 and 23 of OD(79)25.

M. O'D. B. ALEXANDER

3 October 1979

CONFIDENTIAL

TR

Euro B



From the
Minister of State
for Consumer Affairs

DEPARTMENT OF TRADE
1 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01 215 5662
SWITCHBOARD 01 215 7877

The Rt hon Sally Oppenheim MP

Ag. Pmt

The Rt hon The Lord Carrington KCMG MC
Secretary of State for Foreign &
Commonwealth Affairs
Foreign Office
Downing Street
London SW1

3 October 1979

D. Pet

Geoffrey Howe wrote to you on 18 September suggesting we might put out a paper describing the background to the British case on the EEC budget. I have seen Ian Gilmour's reply of 25 September.

We have not seen the draft referred to in this correspondence but I wonder whether it will be all that easy or all that desirable not to put out an authoritative statement. The worst of all worlds would be to have to give way to pressure and there may thus be a case for anticipating it.

Of course any document would have to be in low key. We would also need to take care that the difficulties of getting matters put right were also brought out, if only obliquely. The statement would have to be balanced, not polemical, and reflect not only our own problems but also the issue as our principal European colleagues see it. Though difficult to do, this might have positive advantages: we would avoid the charge that we were trying to outdo the previous Administration and might gain some positive credit in the Community for sticking to our point but adopting a distinctive approach of our own.

I entirely agree there is a considerable risk that the anti-Marketeers might make full use of such a paper, especially if we do not achieve all our objectives this time around. But they could just as well pursue us without such a paper.

contd/.....



This seems to me, as I think it would to John Nott, very finely balanced. My inclination, if it were practicable to produce the sort of paper I have outlined, would be to face the risks.

I am copying this letter to the Prime Minister, the Members of OD(E) and to Sir John Hunt.

Yours ever
Sally

SALLY OPPENHEIM

13 OCT 1979



CONFIDENTIAL

Ref. A0351

MR. ALEXANDER

Community Budget

Prime Minister
Appe para 3?
Yes out
Rmt: 2/x

A note by officials OD(79) 25 which deals with possible mechanisms to achieve our Budget objective is due to be discussed in OD on Monday, 8th October when the Chancellor is back from Belgrade. We have learnt however that, at their informal meeting this coming weekend, the Commission will be having a first discussion of our (and the Italian) problem and that the Secretary General of the Commission has asked his officials for preliminary advice on possible solutions. We have good contacts among these officials and it seems important that we should not lose this opportunity to give them some steer.

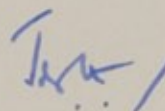
2. The Chancellor of the Exchequer has reservations about two points in the paper. He believes we should have a permanent provision for limiting the United Kingdom's net contribution even if the United Kingdom's GNP rose above the Community average whereas the paper suggests that it might be sufficient to cover this (unlikely) event by a temporary phasing arrangement (paragraph 6). Secondly, he would like to see a quicker acting method of abating our payments than those suggested in paragraph 19. In the Chancellor's absence it will not be possible to resolve these points before the OD discussion next Monday. However, the second point is not one which we need to discuss with the Commission at this stage. As to the first, the Chancellor's position should be protected by making clear that Ministers are still considering whether and, if so, in what form there should be a further provision for limiting the United Kingdom's net contribution even if the United Kingdom ceased to have a below average GNP.

3. I should be grateful to know whether subject to these points the Prime Minister agrees that Sir Donald Maitland should be authorised to speak informally and on a personal basis to our contacts in the Commission on the basis of paragraphs 22 and 23 of OD(79) 25. This at least should avoid the Commission's

Yes out

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discussions getting off on the wrong foot. The Prime Minister will be able to consider on Monday what we should say formally to the Commission about the solutions they are due to propose. I hope that, if at all possible, you will be able to consult her overnight: we only received the Chancellor's reactions earlier today.



(John Hunt)

2nd October, 1979

CONFIDENTIAL

OD(E)

DSG



FILE

cc: FCO
(Chanc. of Ex)
Lord Pres.
Lord Privy Seal
MAFF
D/Trade
Att.General
+C.O.

European Policy

10 DOWNING STREET

From the Private Secretary

1 October 1979

COMMUNITY BUDGET: CHANCELLOR'S PROPOSAL FOR A PUBLICATION

The Prime Minister has seen a copy of your letter of 20 September to Paul Lever, and a copy of the Lord Privy Seal's letter of 26 September, about a possible Treasury publication on our case for a more equitable Community Budget contribution.

She believes that the Lord Privy Seal has made out a strong case against the publication of such a document. As to Parliament, an appropriate Explanatory Memorandum accompanying the Commission's reference document if and when it is deposited would probably meet the case. The question could be reconsidered if there was strong pressure from the House for a Government Paper or if, for any reason, the Commission's paper is not formally made public by the Commission.

I am sending copies of this letter to the Private Secretaries of the members of OD(E) and to Martin Vile (Cabinet Office).

M. O'D. B. ALEXANDER

M. A. Hall, Esq.,
H.M. Treasury.

CONFIDENTIAL

DSG

FROM THE PRIVATE SECRETARY



HOUSE OF LORDS,
SW1A 0PW

28 September 1979

CONFIDENTIAL

NBPA

Arnold

Dear Martin,

UK COMMUNITY BUDGET CONTRIBUTION

The Lord Chancellor has seen the paper OD(79)25 on the subject of UK Community Budget Contribution: Corrective Mechanisms. Since he is sitting judicially in the House of Lords for the next fortnight, it is likely that the Lord Chancellor will not be able to attend the meeting of OD at which this paper is discussed. He has however seen the paper and has commented that the Government must do something to correct the imbalance; in the end if nothing is done Britain's continued membership of the EEC will be in jeopardy.

The Lord Chancellor thinks that he can only trust the experts on how the Government is to set about doing this ; but the imbalance is desperate.

I am sending a copy of this letter to the Private Secretaries to all members of OD Committee.

Yours sincerely,
William Arnold.
W ARNOLD

Martin Vile
Cabinet Office

5-1 OCT 1979

12 1 2 3 4
5 6 7 8 9 10 11

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CONFIDENTIAL

Ref. A0323

Prime Minister

PRIME MINISTER

Apex Draft?

Yes out.

Paul

Community Budget: Chancellor's Proposal for a Publication

Your Private Secretary has received copies of the correspondence between the Chancellor of the Exchequer (his Private Secretary's letter to the Foreign and Commonwealth Secretary's of 20th September) and the Lord Privy Seal (his letter of 26th September) about a proposal for a Treasury publication setting out our case for a more equitable Budget contribution.

2. We have scored a success with the Commission's reference document. There is no longer room for argument about the nature or extent of our problem: what we are concerned about now is a solution. To publicly restate our case in the way that is proposed might imply that it had not been established, and certainly any inconsistencies would be used against us. Nor should we obscure the Budget issue at this stage with other questions such as the trade cost of the CAP. The Lord Privy Seal is also probably right therefore in thinking that such a publication would hinder rather than help the negotiations themselves.

3. It remains to be seen whether, when Parliament is back, pressure builds up for such a statement of the Government's position. It seems likely that the Commission's reference document will be published at some stage. If so we shall have to deposit it with Parliament accompanied by an Explanatory Memorandum. This might be sufficient to meet the case.

4. I attach a draft letter for your Private Secretary to send to the Chancellor of the Exchequer's.

John

(John Hunt)

28th September, 1979

CONFIDENTIAL

Letter

DRAFT MINUTE FROM MR. ALEXANDER TO MR. HALL,
TREASURY

Community Budget: Chancellor's Proposal
for a Publication

The Prime Minister has seen a copy of your letter of 20th September to Paul Lever, and a copy of the Lord Privy Seal's letter of 26th September, about a possible Treasury publication on our case for a more equitable Community Budget contribution.

Issue.

2. She believes that the Lord Privy Seal has made out a strong case against the publication of such a document. As to Parliament, an appropriate Explanatory Memorandum accompanying the Commission's reference document if and when it is deposited would probably meet the case. The question could be reconsidered if there was strong pressure from the House for a Government Paper or if, for any reason, the Commission's paper is not formally made public by the Commission.

3. I am sending copies of this letter to the Private Secretaries of the members of OD(E) and to Martin Vile (Cabinet Office).

Paul

Civil Service Department,
Whitehall,
London, SW1A 2AZ

*With the Compliments
of the
Lord President of the Council*



Evans P. O.

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

27 September 1979

The Rt Hon Sir Geoffrey Howe, QC, MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Dear Geoffrey,

I have read your letter of 18 September about the possibility of an official publication setting out our case on the EEC Budget. I have also seen Ian Gilmour's reply.

This is just to say that I agree with his points and the reasoning behind them.

I am copying this to the Prime Minister, members of OD(E) and Sir John Hunt.

Yours ever
Christopher

SOAMES



28 SEP 1979



Foreign and Commonwealth Office
London SW1

25 September 1979

Her Majesty,

You wrote to Peter Carrington on 18 September about the possibility of bringing out an official publication setting out our case on the Community Budget.

We have seen the draft paper prepared by your officials in July which you suggest might be used as a model. This was a useful statement of the problem as it was seen at that time. But I have strong reservations about the wisdom of publishing any sort of official position paper on our budget problem in the run-up to the Dublin European Council.

I believe that informed British public opinion is already aware of the facts and figures. There was good coverage in this week's Economist, for instance. I doubt whether an official paper would add to the general understanding of our case. There is indeed a risk that any points on which our paper differed from the Commission's reference paper would be picked up by our opponents and used to cast doubt on the reliability of both papers. I think we should stick to the Commission's figures which support our case and have the merit of being seen to be neutral.

Moreover an official statement of the British case would constitute a yard-stick against which what we achieve at Dublin would be judged. A published paper could turn out to be a valuable quarry for the Government's critics as well as for the anti-Europeans. There is also a danger that a move of the kind you contemplate would be seen by our partners as an attempt to inflame British public opinion in

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street SW1P 3AG

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advance of discussion at Dublin. That is not the kind of tactic they would respond to.

It is becoming clear in bilateral meetings that the strength of our case is acknowledged, but that the decision to do something about it will be taken only at Head of Government level. The Anglo-French and Anglo-German summits will be crucial. These must be backed up by a series of bilateral contacts at Ministerial and official level. This is the pressure point; and I believe our energies should be devoted primarily into putting our case over to the other Governments rather than at home.

I recognise that there may be Parliamentary pressure for the publication of some kind of statement of our position. But I hope this can be resisted.

I am copying this letter to the Prime Minister, Members of OD(E) and Sir John Hunt.

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28 SEP 1979

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10 DOWNING STREET

From the Private Secretary

MR. VILE
CABINET OFFICE

Community Budget

The Prime Minister has seen Sir John Hunt's minute of 20 September on this subject. She has not commented in detail on the minute but she has noted that a lot more work needs to be done.

I am sending a copy of this minute to Roderic Lyne (FCO).

M. O'D. B. ALEXANDER

24 September 1979

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ELH



Handwritten: Hmt - 24/5

Handwritten: Prime Minister

Handwritten: 2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Handwritten: Hmt 21/5

Handwritten: M.J.

PRIME MINISTER

You will have seen the telegrams reporting the outcome of the Finance Council on Monday. You may care to have, in addition, my own reflections about the next stage in our pursuit of a sensible solution of our budget problem.

2. The meeting was successful - from our point of view, more successful than at one time seemed possible. Despite a last-minute threat by the Italians to block the whole debate until their own case had been more fully presented (which I managed to head off in prior talks with Pandolfi and the Presidency) and despite delaying tactics by others, we have managed to maintain the momentum of the Strasbourg remit, and we have both the Presidency and the Commission firmly committed to the preparation of solutions in good time for decisions at Dublin. With the help of the Commission's reference paper, I have been able to state the UK case for equitable treatment - its nature, scale and urgency - in terms which cannot reasonably be refuted or brushed aside. And I have fulfilled our part of the European Council remit by indicating both those solutions which would be inadequate, and those which could give us what equity demands.

3. This, I consider, is good progress and better than par for the course. But the most difficult work is still ahead. Indeed, we can expect the going to get tougher from now on precisely because our problem and our position, and its implications for the others, are now so clear.



4. We must now follow up vigorously on what we have gained. By the end of this week, we shall be sending supplementary factual material to the Commission (following Ortolli's general invitation) to refute the argument that the budgetary picture fails to take account of non-budgetary factors: we can show that the non-budgetary factors make our own position even worse than the budgetary picture alone indicates. We are also inviting Italian officials to London to help them with the presentation of their non-budgetary problem.

5. Next, the remit from OD to prepare more detailed work on possible solutions is being discharged. This will provide us with the necessary basis for further discussion with the Commission in the course of the preparation of their paper on solutions. In the procedural conclusions of Monday's Finance Council, this work by the Commission is supposed to await the further discussion of the reference paper at the October Finance Council, but the Commission are under no illusions that, in practice, they will have to start work straight away if they are to meet the Strasbourg deadline. And (as with the reference paper) we shall be in close informal contact with their work to make sure that their thinking is on the right lines and that their ideas for solutions are commensurate with the problem.

6. Above all, we must maintain the initiative through bilateral talks at Ministerial and official level. Your own meetings with Schmidt, Giscard and Cossiga will have a vital part to play. I have in mind a programme of visits which I might make to key Finance Minister colleagues as soon as I can arrange them after Malta, Belgrade and the Party Conference. Influencing the French will be vital and I shall try to see Monory and perhaps Barre: indeed, our strategy should be to lose no opportunity to convince French Ministers and officials of the seriousness of our concern over the Budgetary issue. The Germans seem likely to be



considerably more helpful than the French. Also important will be the smaller countries - the Dutch, the Belgians and the Danes: they may not be ready or able to help much, but their potential for obstruction is considerable. As for the Italians, we must continue to be as sympathetic as possible for as long as possible, if only to reduce the risk of their holding up our own progress; but in the long run we must beware of too close involvement in solutions for Italy which could be expensive for us.

7. A final note on the decision of the Council to conclude the EMS review. This was at German instance, said to be to calm speculation that major changes, either in the mechanisms or in the pivot rates themselves, were in prospect. I expressed some doubts about the justification for or wisdom of such an unexpected statement, but the participants were unanimous in supporting the German proposal. It could be said that the conclusion of the review removes one answer to those who may wish to press us for a decision whether or not to enter. But the fact that the participants, after a review of some elements of the system, have decided that, in the light of experience so far, there seems to be no need to alter the machinery at present has very little to do with the fundamental considerations which will underlie our own choice, and Monday's statement should not subject us to any serious new pressure.

(G.H)

G.H.

21 September 1979

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NBPN

Paul

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000
20th September, 1979

Dear Paul,

OUR EEC CONTRIBUTION:
POSSIBLE PUBLICATIONS

The Chancellor's letter of 18th September to the Foreign and Commonwealth Secretary should have contained a copy of the Treasury paper referred to in the third paragraph. I now attach a copy.

.....

I am copying this letter to Michael Alexander, to the Private Secretaries to members of ODE, and to Martin Vile.

Yours ever,

MA

(M.A. HALL)
Private Secretary

P. Lever, Esq.,
Private Secretary,
Foreign & Commonwealth Office

1. In his Budget Speech the Chancellor of the Exchequer said:

"The European Community can, and should, be a source of stability and strength for its members. In one important area, however, present EEC policies are seriously hindering our efforts to help ourselves. At present the United Kingdom and Italy, which are among the poorer members of the Community, are transferring substantial resources, chiefly through the Community Budget, to richer member states. We have already made it very clear to our partners that this situation cannot be allowed to continue. It is plainly unfair. And it is against the interests of the Community itself, which cannot expect to progress on such an insecure foundation."

2. This paper explains how the present pattern of resource transfers within the Community has arisen, and why the Government considers the results for our budgetary contributions to be inequitable.

Introduction

3. Discussion of the economic impact of the European Community naturally tends to concentrate on particular policies and measures which have been adopted as the Community has developed. But it has become increasingly clear that it is also necessary to consider the impact of all these policies taken together. This is now sufficiently important to have a significant effect on economic development in some countries. The United Kingdom is one of these countries.

4. The range of policies pursued by the European Community causes resources to be transferred between Member States. As the pattern which emerges is a reflection of the individual policies, resources are not redistributed according to relative prosperity of the various Member States. The UK and Italy transfer resources on a significant scale to countries which have a substantially higher level of GNP per head.

5. In the British case, the quantity of resources which we transfer to other EEC countries can to a large extent be measured by our net

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contribution to the Community Budget. Figures published by the European Commission for the first time early this year show that in terms of hard cash paid across the exchanges the United Kingdom is already the largest net contributor. Moreover, the situation is deteriorating. If nothing is done to correct it, the UK will in 1980 be paying well over £1,000 million a year net to the rest of the Community. We will be far and away the largest contributor through the budget to European policies.

6. Any community, if it is to be successful, must in its economic relations as elsewhere have regard to the principles of mutual concern and of equity. The original six members of the Community recognised this in 1971, when they acknowledged that if unacceptable situations should arise in relation to the budget "the very survival of the Community would demand that the institutions find equitable solutions."

7. A number of arguments are advanced against action to redress the UK budgetary situation: that it is wrong to consider the total resource impact of Community policies; that total transfers through the budget are too small to affect significantly individual economies; and that the published figures for budgetary transfers do not provide an accurate guide to the resource flows in the Community.

Budgetary Transfers

8. It is natural to begin an analysis of resource transfers in the Community with an examination of the budgetary flows. The revenues that Member States contribute to the budget are the most obvious and most readily quantified economic costs of Community membership. Expenditure by the Community in any particular country is likewise the clearest pointer to the economic benefit that that country receives from the Community. The pattern of net contributions (contributions less receipts) summarizes the gains and losses to individual Member States through the Community budget. This year the European Commission has for the first time issued figures which make it possible to compare the position of member countries.

TABLE 1: Net budgetary transfers in 1978, £ million (1)

	Absolute figure(3)	As % of GDP	GDP per head
Belgium/Luxembourg	+ 252.6	+ 0.50	129
Denmark	+ 411.9	+ 1.44	145
Germany	- 281.4	- 0.09	139
France	- 55.0	- 0.02	117
Ireland	+ 356.0	+ 5.63	50
Italy	- 499.5	- 0.40	56
Netherlands	+ 146.4	+ 0.25	124
United Kingdom	<u>- 625.8</u>	- 0.44	73
TOTAL(2)	- 294.8		

NOTES: (1) Converted from European Units of Account (EUA) at the average exchange rate for the year.

(2) The net transfers do not sum to zero because all Member States maintain accounts in the name of the Commission; the balances on these accounts changed during the year.

(3) After full refunds under the transitional arrangements (Article 131 of the Treaty of Rome). The fourth quarterly refund for 1978 was paid in the first quarter of 1979, and does not appear in the figures for 1978 issued by the Commission.

9. Table 1 reproduces the Commissions' figures showing the net budgetary transfers that arose out of the 1978 budget. These figures are expressed both in absolute terms and as a proportion of Gross Domestic Product (GDP) for each country concerned. The first column provides an indication of relative prosperity, as measured by GDP per head at market exchange rates (see paragraphs 32-35 below).

TABLE 2: Net budgetary transfers in 1978 excluding the effect of the transitional arrangements

	£s million
Belguim/Luxembourg	+ 275.8
Denmark	+ 411.9
Germany	- 141.8
France	+ 31.5
Ireland	+ 343.8
Italy	- 446.7
Netherlands	+ 176.2
UK	- 945.3

10. The figures for 1978 are not however a reliable guide to the situation in future years. In 1978 the UK was still benefitting from the transitional arrangements negotiated at the time of its entry into the Community. These were designed to limit its gross contribution to the Community budget in the early years of membership and they expire at the end of 1979. To get a better idea of the likely pattern of net budgetary transfer in 1980, it is necessary to look at the 1978 figures as they would have been in the absence of the transitional arrangements. These figures are reproduced in Table 2, which shows even more clearly than Table 1 the inequitable effects of redistribution through the budget.

TABLE 3: UK contributions to the Community Budget (gross and net) since accession (1)

	Gross Contribution	Receipts	Net Contribution
1973	181.1	78.7	102.4
1974	180.5	149.9	30.6
1975	341.7	397.7	- 56.0
1976	462.8	295.5	167.3
1977	736.8	368.4	368.4
1978	1348.3	544.5	682.2

NOTE: (1) These figures incorporate Public Sector receipts only and the 1978 figure therefore differs from that shown in Table 1.

Table 3 shows that the UK's gross and net contributions have risen rapidly since entry. There are three reasons for the increase in its gross contribution. The first is the growth in the size of the Community budget: this has increased from £2.3 billion in 1973 to an estimated £10.8 billion in 1980. The second is the phasing-out of the transitional arrangements. The third is the nature of the Community's revenue-raising system. The Community receives the yield of the levies on agricultural produce entering the EEC and of customs dues paid on other goods under the Common External Tariff. This system bears more heavily on economies which have a large share of GNP in external trade and which, for reasons of geography and history, have extensive trade outside the EEC. The yield of tariffs and duties levied in the UK in fact exceeds by over 25% its share in the Community's Gross National Product.

12. Britain's unfavourable net position results also from the dominant part played in Community expenditure by the price support mechanisms of the Common Agricultural Policy (CAP). The CAP regularly absorbs 70-75% of the Community's total expenditure. As a major food importer, contributing only marginally to the Community's agricultural surpluses, the UK can only recoup a small proportion of its contribution to the CAP. The more than proportionate share of expenditure it secures from the Regional and Social Funds at present does little to offset this burden; the two combined make up less than 10% of total Community expenditure (see Table 4).

TABLE 4: Breakdown of Community Budget by spending area

	EUA			
	1978	As % of total	1979	As % of total
Research and Investment	194.0	1.6	196.4	1.4
Social Fund	538.8	4.4	502.5	3.7
Regional Development Fund	525.0	4.2	499.0	3.6
CAP Expenditure				
Guarantee Section	8695.0	70.3	9582.1	69.9
Guidance Section	423.5	3.4	396.3	2.9
Other expenditure	1996.1	16.1	2539.5	18.5
TOTAL	12372.6	100.0	13715.7	100.0

NOTE: Expenditure totals do not sum due to rounding.

The Trade Costs of the CAP

13. The figures for net transfers through the Community budget do not provide a complete picture of the resource transfers caused by Community policies; especially those generated by the CAP. The objectives and operation of the CAP are discussed in a companion paper and are therefore not set out in detail here. It is enough to note here that the CAP pursues its objectives by establishing guaranteed prices for the main Community crops. In order to raise farm incomes and to stimulate production, these guaranteed prices have generally been fixed at levels higher than those prevailing on world markets - hence the need for levies on agricultural produce entering the Community to bring its price up the CAP level.

14. This system means that the main burden of supporting farm incomes in the Community falls directly on the consumer rather than on the budget. The budgetary costs of the CAP arise only to the extent that the prices it maintains stimulate additional production and discourage consumption to the point where it generates surpluses in the Community. Through the price guarantee provisions of the CAP, the Community subsidises the sale of this surplus production on the world markets and compensates Member States for any storage costs they may incur before disposal. These subsidies and the storage costs together make up the budgetary cost of the policy.

15. The budget therefore bears the cost only of that addition to farmers' incomes which stems from production they cannot sell within the Community at guaranteed prices. The bulk of their production is sold within the Community at guaranteed prices.

16. Under this system countries which consume more foodstuffs than they produce (the net importers) transfer income to those which produce more than they consume (the net exporters). The pattern of gains and losses between social groups is everywhere the same as it is bound to be in a system of agricultural support; consumers transfer income to farmers. But the total gain exceeds the total loss for the countries which are net exporters; the reverse is true for the net importers.

The non-budgetary transfers that result from the CAP have been discussed in the companion paper mentioned above. Table 5, which is taken from that paper sets out the estimated non-budgetary transfers in 1977 and 1978. The Netherlands, Denmark and Ireland emerge as major beneficiaries. France, whose budgetary position was approximately neutral, also gains. The principal losers are Italy (which is a heavy importer of the northern agricultural products covered by the price guarantee mechanism), Germany and the UK. The effect is to transfer income from two of the less prosperous countries - Italy and the UK - to others which have a higher GNP per head.

TABLE 5: Summary of the food trade effects of the CAP \$million

	Higher cost of imports from rest of EEC		Higher value of exports to rest of EEC		Net food trade: cost (-) or benefit (+)	
	1977	1978	1977	1978	1977	1978
Belgium/Luxembourg	375	460	365	440	+ 10	- 50
Denmark	15	10	225	285	+210	+275
France	360	420	820	995	+460	+575
Germany	760	890	405	460	-355	-430
Ireland	55	55	220	240	+165	+185
Italy	530	640	45	55	-485	-585
Netherlands	265	320	815	925	+550	+605
United Kingdom	290	400	120	275	-165	-110

Note: for a detailed account of the derivation of these figures see [the companion Green Paper].

The Treatment of Monetary Compensatory Amounts (MCAs)

18. It is frequently argued that the figures for net budgetary contributions reproduced in Table 1 do not provide a good indication of the direction and extent of resource transfers through the Community budget. One argument concerns the attribution of Monetary Compensatory Amounts (MCAs) in the budgetary figures.

19. MCAs have their origins in the exchange rate events of the late 1960s. It is a key feature of the CAP that Community Agriculture Ministers agree annually on a common price level for the principal

rops grown in the Community. These prices are expressed not in any single national currency, but in a neutral accounting unit, the Unit of Account (now the ECU). In the first decade of the Community's existence, these prices were converted into national currencies at the fixed market exchange rates prevailing at the time.

20. This system worked satisfactorily as long as exchange rates remained broadly stable. But when the franc was devalued and the D-mark revalued in 1969, it was regarded as undesirable that these events, which largely reflected the relative performance of the two economies in sectors other than agriculture, should affect the agreed level of common prices as expressed in francs or D-marks. It was therefore agreed that for a limited period conversions from Units of Account into these currencies should be made at the old conversion rates. As the exchange rate movements continued, this system of "green rates" became more pervasive. It permitted agricultural prices in the different states to drift apart so that at one point during 1978 German prices (the highest) were more than 40% above UK prices (the lowest).

21. To allow the CAP to function in these circumstances, measures were needed to keep the markets in different countries separate and thus to prevent produce from low-price countries from travelling around the Community in search of the highest support prices. The mechanism invented took the form of levies and subsidies on agricultural produce traded within the Community; the levies raise the price of low-price produce entering a higher price country; the subsidies lower the price of produce moving in the opposite direction. These levies and subsidies are known as MCAs.

22. In discussing the pattern of budgetary transfers arising from CAP policies, it is sometimes argued that the MCA subsidies paid to cover the difference between the price level operated in a relatively low price country and the common price are in effect a subsidy to consumers in that country. This argument leads to the conclusion that these MCAs should be counted as receipts to the importing country when calculating its net contribution to the Community budget.

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23. The two net importing countries whose prices are below the Community average, though still above world prices, are the UK and Italy. If MCAs were attributed in this way the net contributions they make to the Community budget as a whole would be reduced.

24. As the MCAs on UK and Italian imports have since 1976 been paid in the exporting Member States this attribution would not conform to the Community's general accounting convention, which is to treat as receipts to a country all Community expenditure which arises there.

25. However, the real arguments against attribution to the importing country are economic. The first of these is that the effect of the MCAs is merely to allow exporters in higher cost countries to compete with indigenous producers on the lower price markets in Italy and the UK. They are an export subsidy. The consumer is still paying above the world price.

26. Secondly, the two forms of attribution make no difference to the transfers between the countries. For the importing country the difference is simply that fewer transfers are scored through the budget and more outside it. As the previous section has shown, the economic effect of the CAP is to transfer resources from countries which are net importers of products covered by its price support mechanisms to those which are net exporters. The balance of payments loss to the net importers is the same irrespective of the treatment of MCAs. The increase to their import bill remains the same regardless of whether they import at the higher Community price and then receive an inflow of Community funds which partly offset the cost of the imports, or whether alternatively, they buy initially at the lower, MCA-inclusive, price and do not receive the budgetary inflow. In the first case, the accounts show a higher non-budgetary cost and a lower net contribution to the Community budget, in the second, the reverse, but the total is the same in either case.

27. In any full analysis of resource transfers in the Community, therefore, the presentation of MCAs adopted effects only the breakdown of the total resource cost of the CAP to the net importer between the budgetary and non-budgetary elements. The "exporter pays" presentation now used in the Community accounts for MCAs paid on

UK and Italian imports means that the figures for budgetary transfers capture a larger proportion of the overall resource effects.

28. With the recent rise in sterling the question of the treatment of MCAs has become less important for the UK in the discussion about the budget. It is however still the view of the UK Government that MCAs should not be treated as budgetary receipts of the importing countries and that the presentation now used in the Community accounts for MCAs paid on UK and Italian imports is therefore right.

Other Non-budgetary Transfers

29. A highly industrialised country like the UK might expect to recoup some of the resource losses resulting from the operation of the CAP in its trade in manufactures. The years since the UK joined the EEC have indeed witnessed a rapid reorientation of its pattern of trade towards Western Europe, a process that had already begun before membership. As a result the proportion of UK exports going to the original EEC 6 increased by 50% between 1967 and 1977. In the same period UK imports from the EEC 6 as a proportion of its total imports have risen from 28% to 41%. This is the most dramatic change in trade pattern towards the Community of any of the present nine members in this period.

30. There are problems in trying to establish the pattern of resource gains that has resulted from the growth of trade between the UK and the rest of the Community. In general it is likely that the promotion of trade by the average reduction in tariff and non-tariff barriers has raised efficiency. That there has been a gain for Europe as a whole seems highly probable, though very hard to establish conclusively. But there is no evidence that the UK has gained a marked advantage in this field, beyond that derived by other Community partners, which ought to be set against the transfers it makes through the Budget. The benefits of increased trade have been mutual. British manufacturers have benefitted from the UK's membership of the EEC, but so have their counterparts elsewhere in the Community.

Other Areas

31. It is sometimes argued that the UK secures other unquantifiable

● t significant benefits from Community membership. It is suggested, for example, that in relation to international trade negotiations, the UK enjoys the advantage of belonging to one of the largest economic blocs in the world. It may well be that there are resource gains of this broad kind associated with Community membership. But these gains are in principle common to all members. They are not something which justifies a disproportionate net budget contribution from the UK.

Relative Prosperity

32. This paper shows that the UK is a substantial net contributor of resources to the rest of the EEC, both through the Community budget and more widely. It has also been suggested that these resources tend to go to countries which ^{are} more prosperous than Britain.

33. No measurement of relative prosperity can be absolutely precise. But it is generally accepted that GDP per head provides the best available yardstick. It is a yardstick widely used by international organisations, among other things, for the determination of national contributions to the United Nations and its agencies. It is also used as a yardstick in the Community's special financial mechanism agreed in Dublin in 1975 under which, in certain very restricted circumstances, the UK can obtain a refund of part of its gross contribution to the budget.

34. The normal approach for making international comparisons of GDP per head is to use market rates of exchange to convert domestic GDP per head to a common international base. It is sometimes argued that a closer approximation to relative standard of living is obtained by using "purchasing power parities", on the ground that these take more account of the prices of goods and services which do not enter into international trade.

35. On either bases the UK emerges as less prosperous than most other members of the Community which are receiving net transfers through the budget. Using data from the EEC Statistical Office, Table 6 ranks Member States in order of relation of prosperity on both bases.

TABLE 6. GDP per head as a percentage of the EEC 9 average, using market exchange rates and purchasing power parities in 1978.

<u>Market Exchange Rates</u>		<u>Purchasing Power Parities</u>	
Denmark:	145	Germany:	120
Germany:	139	France:	113
Belgium/Luxembourg:	129	Denmark:	111
Netherlands:	124	Belgium/Luxembourg:	108
France:	117	Netherlands:	106
UK:	73	UK:	94
Italy:	56	Italy:	72
Ireland:	50	Ireland:	62

The Nature of the Community Budget

36. It is sometimes argued that it is wrong to look at net contributions to the Community budget and ask how these relate to Member States' relative prosperity. Those who put this case maintain that the Community budget is simply the means of financing, through the Community's own agreed sources of revenue, the policies adopted from time to time by the Community's leaders. They hold that it is wrong to consider the overall economic impact of the budget, when each policy must be justified on its own merits and when Community competence is so much more extensive in some areas, especially in agriculture, than in others. In their view, a budget as narrowly-focussed as that of the Community cannot rightly be compared with national budgets and should not be judged by its redistributive effects.

37. It is true that the present pattern of Community expenditure is very lop-sided and that this lop-sidedness in part reflects the varying degree of Community involvement in different fields. But the preamble to the Treaty of Rome lists amongst the Community's primary objectives the strengthening of "the unity of their [Member States'] economies" and ensuring "their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions". It is hard to see how the present pattern of transfers in the Community can be squared with this wider objective of the Treaty, however successful the Community's individual policies. Indeed, it must impede the efforts of many national governments to achieve through their policies the improvement in their economic performance that both

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ey and the founders of the Community regarded as necessary.

38. Some who acknowledge that the present position of transfers in the Community is inequitable see the solution in an extension of Community activity and an expansion of the Community budget, so as to increase expenditure on the Community's non-agricultural policies.

39. There may be scope for the UK to secure higher net benefits from the Regional and Social Funds, or from Community involvement in fields of activity such as urban renewal and transport infrastructure where it has not previously operated.

40. But plans to increase Community expenditure have to be seen also in relation to the objective of national governments in containing public expenditure. The "own resources" available to the Community are not limitless. There is a strong case for the Community to consider stringently the appropriateness of all its policies and to redistribute expenditure. But this would at best be a gradual process. It could not meet the UK's need for an early amelioration of the net budgetary position.

The UK and the Community Budget

41. The United Kingdom wishes to participate fully in the task of making the Community a success in the 1980's. The inequitable position in which the United Kingdom finds itself on the budget is an obstacle to that and is indeed an unintended impediment to the well-being of the Community. The United Kingdom is confident that this situation can be remedied in the near future with the understanding and cooperation of its partners.



10 DOWNING STREET

Prime Minister.

This was in last night's
box but I am not sure
whether in fact you saw it.

Re: 1

We need to do a
lot more work yet.

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(2)

Handwritten signature

PRIME MINISTER

Community Budget

At its meeting on 12th September OD Committee commissioned some further work, both on the United Kingdom budget problem itself and on the way in which we might play the hand. This is in hand: but there are several strands in the build up to what we all know is going to be an extremely difficult negotiation, and you may find it helpful to know what work is going on and see how it fits together.

2. First, as to dates: you are going to Rome on 4th-5th October and will be in Luxembourg on 18th-19th October. The ECOFIN Council will meet again on 15th October and we should get the Commission's second paper containing proposals shortly thereafter. Your bilateral with Chancellor Schmidt is on 31st October; this will come immediately after meetings of the Foreign Affairs Council and the Fisheries Council. Your meeting with President Giscard on 19th-20th November will also coincide with meetings of ECOFIN and probably the Foreign Affairs Ministers at which final preparations for the European Council in Dublin (29th-30th November) will be made. So far as you are concerned it is the bilateral meeting with Chancellor Schmidt which is the crucial one. If you cannot reach some understanding with him, the prospects for the Dublin meeting will be bleak. Conversely his support would be invaluable for your subsequent meeting with President Giscard. (The two of them will certainly have been in touch beforehand.)

3. This means that you ought to have some idea before the end of October about the cards which you will have to play when it comes to the Dublin meeting. You have already called for a paper from the Foreign and Commonwealth Secretary on the threats which could if necessary be used in order to get our way. This will cover not just ways of turning off the tap (where the Chancellor of the Exchequer is already looking into the legalities) but the range of possibilities for blocking progress in other areas of Community activities (new expenditures,

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CAP prices, and the 1 per cent VAT ceiling etc.). But we also need to prepare ourselves on other issues where we may come under pressure to make concessions in exchange for a budget deal. Here you and your colleagues will have to consider whether this pressure, if it arises, has to be resisted or whether there is any room for movement in the context of a satisfactory budget deal. The three issues which have so far been mentioned by one or more of our Community partners are energy, EMS and fisheries. The position on these is as follows:-

- (i) OD(E) at its meeting on 13th September called for a further paper from the Secretary of State for Energy on what scope there might be within the energy sector (including the possible use of long-term contracts) for being helpful without damage to our national interest.
- (ii) You will shortly be getting a paper from the Chancellor on EMS which you have agreed should in due course go to OD. This should enable decisions to be taken by mid-October about whether or not the United Kingdom should enter the exchange rate mechanism and, if so, when.
- (iii) Fisheries. You have called for a report from the Minister of Agriculture about his consultations (Mr. Pattison's letter of 9th August refers) and this should be ready by the end of September or very early in October. This is probably the trickiest issue and you may want to discuss it again informally before putting it to OD(E), or more probably OD under your chairmanship.

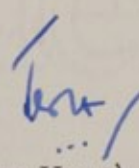
4. Finally, there is the need to keep an eye on the whole range of Community business during the coming weeks so that, while defending legitimate British interests, we do not necessarily sour the atmosphere or dissipate the goodwill which you and your colleagues have established. The European Secretariat of the Cabinet Office is preparing a paper on the prospects for Community business during the remainder of this year which will go to OD(E). We need to be on the look out for minor items where we could be helpful. It

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may make sense to allow issues to come to the European Council in Dublin if this helps other Heads of Government to justify in domestic political terms doing something for us on the budget.

5. I think these various pieces of work will provide the necessary background for preparing for your visit to Bonn. We can see nearer the time whether it is sensible to take them at OD or during your briefing meeting. Even if there is no scope for direct links, the defence issues which will come up in Bonn will also be important to the atmosphere of the discussions on the budget. It will only be after the bilateral with Schmidt and Giscard that the tactics for Dublin can be finally decided.

6. I am copying this minute to the Foreign and Commonwealth Secretary in his capacity as Chairman of OD(E).


(John Hunt)

20th September 1979

Euro Pol
M

COMMUNITY BUDGET

1. I took the opportunity of calling on Mr Tugendhat while I was in Brussels for the Foreign Affairs Council. Miss P Neville-Jones was present.
2. I said that the ECO/FIN Council had gone very much as Mr Tugendhat had predicted during his meeting with the Prime Minister last Thursday. We regretted that the discussion had to run over to the October Council but, provided this timetable was strictly adhered to it would still allow decisions to be taken in Dublin. I asked what M Ortoli had in mind in saying that the Commission would wish to prepare its position for the 15 October meeting.
3. Mr Tugendhat said he thought the outcome of the ECO/FIN discussion had been satisfactory. The Chancellor had made an impression and we had said enough to make our position clear. The German intervention arguing against linking the budget with other issues had been helpful. The Dutch intervention, which he had expected to involve a direct link with the 1 per cent VAT ceiling had, in the event, been couched more in terms of finding ways of reducing expenditure so as to accommodate the cost of doing something for the UK. He believed that M Ortoli's intervention had been related to the Italian problem and that he had no intention of advancing the Commission's position on our budget contribution before the 15 October Council. In the follow up, it would be important for the UK not to re-open discussion of the Commission's reference paper e.g. by challenging the mca figures. Equally it would not in his view be in the UK's interests to provoke too much controversy over e.g. the resource costs of the CAP although he accepted that we would be bound to support the Italians by providing some data ourselves. So far as he was concerned, the Chancellor's statement had given the Commission enough material and, while we might wish to put it in written form and

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elaborate on it somewhat, there was no need for us to feel that we had to go into much greater detail. It would be important to use the extra time for the UK to pursue intensive bilateral contacts at the highest possible level and Miss Neville-Jones mentioned in particular the need to talk to the Danes who could be extremely awkward.

4. I said that I thought the meeting with the Prime Minister, the Chancellor and the Lord President last week had been very useful and Mr Tugendhat would have seen a reflection of his advice in the way the Chancellor had spoken in the ECO/FIN Council. There was however one point which I felt I should draw to his attention. At the meeting he had deliberately not mentioned any figure of what he thought we might achieve but had referred to his written brief, copies of which he had left with the Prime Minister and the Chancellor. If he had said at the time that we were likely to get a reduction in our net contribution from 1500 meua to about 800 meua I was quite confident that there would have been a strong reaction from UK Ministers. Although, as the Chancellor had told him, the Government had taken no decision, I was sure that the figure he had mentioned in his document would not be acceptable. I did not know what figure at the end of the day we could accept - this would in any case be influenced by whether it was a fixed figure or a proportion of a growing budget and for how long the commitment would last, but even if he had chosen to mention a figure half as large as the one quoted I did not believe it would have been greeted with any enthusiasm at all. The stated aim was a broad balance and any outcome would have to be consistent with that. Mr Tugendhat said what I had told him came as no surprise: he wanted only to stress that the figure had been "illustrative".

5. Finally, in reply to my question, Mr Tugendhat said that during the next stages of preparing a Commission position on solutions it would be important for us to cultivate (apart from our contacts with the two British Commissioners) M Ortoli who had so far been remarkably helpful,

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Mr Natali who would be watching the Italian interests but was basically well disposed and M Davignon whose opinion was much respected by the President. Mr Gundelach was also important and might, at the next stage, be brought into the small group of Commissioners charged with pursuing this dossier.

Handwritten signature

M D M FRANKLIN

19 September 1979

cc ✓ Mr Alexander (No 10)
Mr Lever (FCO)
Mr Battishill (Treasury)
Mr Buckley (Lord President's Office)
Sir K Couzens (Treasury)
Mr Butler (FCO)
Sir D Maitland (UKREP)

19 SEP 1979

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5 6 7 6 5
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OFFICE OF THE UNITED KINGDOM
PERMANENT REPRESENTATIVE
TO THE EUROPEAN COMMUNITIES
ROND-POINT ROBERT SCHUMAN 6
1040 BRUSSELS
TELEPHONE 736 99 20

19 September 1979

M Alexander Esq
No 10 Downing Street
London

Dear Alexander,

I have been asked to forward the enclosed letter to the Prime Minister. It is a thank-you letter following Mr Tugendhat's meeting with her last week. *- in box -*

Yours etc.

R P D Chatterjie.

R P D Chatterjie

Enc

CHRISTOPHER TUGENDHAT
MEMBER OF THE COMMISSION
OF THE EUROPEAN COMMUNITIES

RUE DE LA LOI 200
1049 BRUSSELS - TEL. 735 80 40

Prime Minister

(2)

Ph...

25/9

PERSONAL

18th September 1979

My dear Prime Minister

L.S.

I should like to thank you for giving me so generously of your time, especially after returning from Lancaster House, when we met last week. I should also like to say how much I appreciated your putting Geoffrey beside me, so that we sat round the Cabinet table instead of facing each other across it.

I found the conversation immensely useful and I came away with a much better understanding of what is worrying you in the Community and what you would like to do. I hope you found my advice of some use. We will have a lot to do over the Budget but I think we have made a reasonable start. I thought Geoffrey handled the ECOFIN Council very well, but each stage of the struggle will be harder than the last, and your task in Dublin will certainly not be easy. Nonetheless I think a satisfactory settlement will be secured.

I know how busy you are and it will obviously be impossible for us to meet as often as when you were in Opposition. But I think it would be useful if we could meet from time to time to discuss Community issues of major importance to the U.K.

I look forward to seeing you at the Party Conference. I shall be talking to a Bow Group lunchtime meeting, but otherwise behaving just like an ordinary delegate, as I did in 1977.

With best wishes

Yours ever
Christopher

ant

The Rt. Hon. Margaret Thatcher M.P.,
10 Downing Street,
London SW 1.

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NRPN

15/9

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

18 September, 1979

Dear Peter

There is one aspect of our relations with Europe on which I think we can and ought to make rapid progress. This is the possibility of some sort of official publication setting out the background to the British case for more equitable treatment in respect of its net contribution to the EEC Budget.

The recent Reference Paper on Budgetary Questions will be very helpful as the facts in it emerge. I understand that there is also a possibility that it will be published in full for the European Parliament. But it still does not constitute a statement of the arguments and figures which support our case in the way in which we would want them to be understood in Europe. And it is certainly not in either language or numbers which could be readily comprehended in the UK.

The Treasury prepared a paper in July which gives an indication of the sort of document which we might publish. It has not been revised to take account of the figures in the Commission's Reference Paper which arrived in September. Nor does it reflect recent discussions in Europe. But it should suffice to show the sort of publication which might be helpful.

If any such publication is to play a part in the general presentation of our case, we need to move pretty quickly because it is clearly more relevant to the early rather than the later stages of the discussions on which we have embarked. I therefore suggest that officials in EQR should consider the Treasury draft and bring it to a suitable state where we could publish it if we agreed that it was worthwhile.

I have said nothing about the form of publication, because I do not think we have to take a definite decision

The Rt.Hon. The Lord Carrington, KCMG., MC

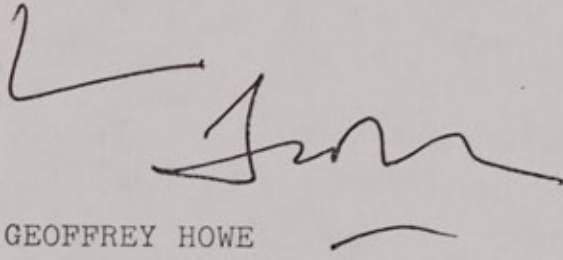
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on that now. But I am inclined to think that something fairly low key is required - not a White or Green Paper - but perhaps a special Treasury publication.

I should also say that I am not sure whether the paper contains enough material on the resource costs of the Common Agricultural Policy. It would be difficult to expand the Treasury paper to include more without making it imbalanced. But I should like to have a word with Peter Walker before making any suggestions about whether anything more could be done.

I am copying this letter to the Prime Minister, the members of OD(E) and Sir John Hunt.


GEOFFREY HOWE



19 SEP 1979

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NO 10 DS

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FRAME ECONOMIC

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FM UKREP BRUSSELS 172100Z SEPT 79

TO IMMEDIATE FCO

TELEGRAM NUMBER 4722 OF 17 SEPTEMBER

AND TO DUBLIN

INFO IMMEDIATE ROME, PRIORITY BRUSSELS, COPENHAGEN, THE HAGUE,
PARIS, BONN, WASHINGTON, ROUTINE LUXEMBOURG.

DISTRIBUTION SELECTORS
FILE COPY

M.S.

FINANCE COUNCIL, 17 SEPTEMBER

ITEM: CONVERGENCE

SUMMARY

Pamie Minister:
I am sorry that you have not seen
this earlier: our copy of the telegram
went astray.
Amul 20/5

1. THE COUNCIL HELD AN EXCHANGE OF VIEWS ON THE COMMISSION REFERENCE PAPER, BUT AGREED THAT THERE SHOULD BE A SECOND DISCUSSION ON 15 OCTOBER, BEFORE THE COMMISSION DREW UP PROPOSALS FOR THE EUROPEAN COUNCIL. MEMBER STATES WERE INVITED TO SUPPLY, OR ASK FOR, ANY FURTHER FACTUAL INFORMATION NEEDED BY 21 SEPTEMBER. THIS ASPECT WILL BE EXAMINED BY A WORKING GROUP UNDER COREPER. MEMBER STATES' OPINIONS AND "REQUESTS IN CONCRETE FORM" SHOULD BE CIRCULATED TO THE COUNCIL AND COMMISSION BY END SEPTEMBER. THE CHANCELLOR GAVE A FULL STATEMENT OF THE UK'S OPINIONS AND REQUESTS (SEE MIFT).

DETAIL

2. AFTER AGREEMENT, WITHOUT OBJECTION FROM THE ITALIANS, AT THE INFORMAL LUNCH THAT THIS ITEM WOULD REMAIN ON THE AGENDA, COLLEY (IRISH PRESIDENCY) INVITED VIEWS.

3. PANDOLFI (ITALY) SAID THAT DISCUSSION IN THE COMMUNITY ON THE OVERALL IMPACT OF COMMUNITY POLICIES HAD BEGUN AT REMEN AT THE SAME TIME AS THE INITIAL DECISION ON THE EMS, AND THE TWO SUBJECTS HAD BEEN PURSUED IN PARALLEL. ITALY HAD BEEN RELUCTANT TO JOIN THE EMS, BUT HAD BEEN INFLUENCED BY THE CONVERGENCE STUDIES. HIS GOVERNMENT HAD ALWAYS INSISTED THAT

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COMMUNITY POLICIES HAD CONSEQUENCES WHICH DISADVANTAGED ITALY. THE SITUATION SINCE 1978 HAD BECOME MORE FAVOURABLE, BUT THE ARGUMENT WAS STILL VALID. ITALY DID NOT CALL IN QUESTION THE INTERESTS OF OTHER MEMBER STATES OR THE BASIC PRINCIPLES OF THE CAP; BUT SOUGHT TO FOCUS ATTENTION ON THE BURDEN WHICH THE LATTER IMPOSED. ITALY HAD POINTED TO IMBALANCES IN EXISTING COMMUNITY POLICY. THE DIRECTION OF COMMUNITY ACTION SHOULD BE CHANGED SO AS GRADUALLY TO REMOVE THESE IMBALANCES, EG BY DEVELOPING NEW POLICIES. OTHER MEMBER STATES SHOULD BEAR IN MIND THAT ITALY'S DECISION TO PARTICIPATE IN THE EMS HAD BEEN TAKEN WITH GREAT DIFFICULTY AND HAD CONTRIBUTED TO A POLITICAL CRISIS IN WHICH THE GOVERNMENT HAD FALLEN. THE POLITICAL PROBLEM STILL EXISTED. THE DECISION TO JOIN EMS WAS NOT REGRETTED, BUT HAD BEEN TAKEN FOR REASONS OF COMMUNITY SOLIDARITY. THE COUNCIL MUST NOW THEREFORE ASK ITSELF HOW TO HELP BRING ABOUT CONVERGENCE IN THE ITALIAN ECONOMY.

4. AGAINST THIS BACKGROUND THE COMMISSION TEXT WAS NOT COMPLETELY IN LINE WITH THE EUROPEAN COUNCIL'S REMIT. UNLESS THERE WERE FURTHER EFFECTIVE ACTION BY THE COMMISSION THERE COULD BE SERIOUS DIFFICULTIES AT DUBLIN. THE COMMISSION SHOULD NOT THEREFORE PROCEED IMMEDIATELY TO MAKE PROPOSALS. BUT SHOULD PREPARE A MORE INTEGRATED DOCUMENT WHICH GAVE A FULLER TREATMENT TO THE ECONOMIC AND SOCIAL ASPECTS COVERED IN SECTION 4. HE EMPHASISED AGAIN THAT ITALY'S OBJECTIVE WAS GRADUAL REFORM.

5. ANDRIESSEN (NETHERLANDS) SAID CONVERGENCE WAS ESSENTIAL TO EUROPEAN INTEGRATION AND WAS ONLY POSSIBLE WITH THE FULL COOPERATION OF ALL PARTNERS. THE COMMUNITY GAVE REASONABLE ADVANTAGES TO ALL MEMBER STATES. "OWN RESOURCES" REVENUES, IN PARTICULAR CUSTOMS DUTIES AND LEVIES, WERE OBTAINED IN A NEUTRAL WAY. IT WAS TRUE THAT THE UK'S VAT CONTRIBUTION WAS NOT LINE WITH ITS GDP SHARE. BUT IF GDP WAS COMPARED ON A PURCHASING POWER PARITY BASIS THE PICTURE WAS VERY DIFFERENT AND LESS ALARMING. POSSIBLY THE FINANCIAL MECHANISM COULD BE IMPROVED. BUT PROGRESSIVITY IN OWN RESOURCES MUST BE REJECTED FOR FUNDAMENTAL REASONS. THE EXPENDITURE SIDE WAS MORE COMPLICATED. THERE WAS AN ELEMENT OF INEQUITY FOR THE UK. BUT THE FIGURES DID NOT PROPERLY REFLECT THE ECONOMIC EFFECTS, EG OF AGRICULTURAL INTERVENTION. THE REAL BURDEN OF THE UK'S NET CONTRIBUTION WAS LESS

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THAN THE 1500 MEUA CLAIMED. BUT HE WAS ALARMED BY THE DEVELOPMENT OF CAP EXPENDITURE: AND THERE COULD BE DIFFICULTIES AS A RESULT OF THE 1 PER CENT LIMIT ON VAT. THERE SHOULD THEREFORE BE A CRITICAL LOOK AT ALL EXISTING EXPENDITURES. HE DOUBTED WHETHER THE PROGRAMME OF WORK COMMISSIONED AT STRASBOURG COULD BE COMPLETED BY DUBLIN. THE PROBLEM TOUCHED THE VERY IDEA OF THE EUROPEAN COMMUNITY AND THERE WAS A RISK OF MOVING TO EUROPE QUOTE A LA CARTE UNQUOTE. FURTHER ANALYSIS WAS NEEDED OF THE POLICY IMPLICATIONS ON BOTH THE EXPENDITURE AND RECEIPTS SIDE OF THE BUDGET. PERHAPS THE COUNCIL SHOULD SET UP AN AD HOC WORKING GROUP TO PREPARE MEANINGFUL PROPOSALS FOR DUBLIN.

6. ANDERSEN (DENMARK) SAID THAT THE COMMUNITY COULD NOT SOLVE NATIONAL ECONOMIC PROBLEMS, ONLY HELP WITH THEIR SOLUTION. COMMUNITY EXPENDITURES WERE THE RESULT OF COMMON POLICIES. THERE WAS A NEED FOR THE COMMUNITY TO CONTRIBUTE TO GREATER CONVERGENCE. BUT THE BUDGET WAS ONLY ONE ASPECT WHICH SHOULD NOT BE TREATED IN ISOLATION. HE COULD NOT AGREE TO CHANGES IN CAP OR IN THE OWN RESOURCES SYSTEM. PROGRESSIVITY WAS UNACCEPTABLE. THE UK'S PROBLEM SHOULD BE SOLVED IN THE CONTEXT OF OTHER COMMUNITY POLICIES.

7. FOR THE UK THE CHANCELLOR THANKED THE COMMISSION FOR THE SPEED WITH WHICH THEY HAD PRODUCED THE REFERENCE PAPER, THOUGH HE AGREED WITH ITALY THAT IT DID NOT DEAL ADEQUATELY WITH CAP RESOURCE TRANSFERS. AS REGARDS PROCEDURE THE COUNCIL SHOULD DO NOTHING TO INTERRUPT THE PROGRAMME LAID DOWN AT STRASBOURG WHICH ASKED THAT THE COMMISSION SHOULD, IN THE LIGHT OF ANY GUIDANCE FROM THE COUNCIL, PRESENT PROPOSALS QUOTE SUFFICIENTLY EARLY TO ENABLE DECISIONS TO BE TAKEN AT DUBLIN. UNQUOTE THE ITALIAN PROBLEM COULD BE MET IF THE COMMISSION WORKED IN PARALLEL ON BOTH THE BUDGETARY AND RESOURCE TRANSFER ASPECTS, IN THE LIGHT OF ANY FURTHER REQUESTS BY ITALY, SO THAT PROPOSALS ON BOTH SHOULD BE READY FOR DISCUSSION AT THE OCTOBER ECOFIN COUNCIL, AND FOR DECISION IN DUBLIN.

8. FOR THE UK, HOWEVER, HE WAS READY TO PRESENT OUR OPINIONS AND QUOTE REQUESTS IN CONCRETE FORM UNQUOTE IN ACCORDANCE WITH THE STRASBOURG REMIT. THE REST OF THE CHANCELLOR'S FIRST INTERVENTION IS CONTAINED IN MIFT.

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9. GEENS (BELGIUM) SAID THE COMMISSION PAPER WAS INCOMPLETE. THE BUDGETARY ASPECT SHOULD NOT BE TREATED IN ISOLATION. THE UK PROBLEM MIGHT DIMINISH OVER TIME. HE WARNED AGAINST THE QUOTE JUSTE RETOUR UNQUOTE. HE AGREED WITH THE NETHERLANDS THAT THE 1 PER CENT VAT LIMIT WAS CLOSE. HE COULD NEVER AGREE TO PROGRESSIVITY. HE DISPUTED THE ATTRIBUTION OF ADMINISTRATIVE EXPENDITURE AS A BENEFIT TO BELGIUM ON FAMILIAR LINES. HE SUPPORTED THE DUTCH IDEA OF AN AD HOC GROUP.

10. LAHNSTEIN (GERMANY) SAID THAT THE COMMISSION HAD DONE WHAT THE STRASBOURG EUROPEAN COUNCIL HAD ASKED. BUT DISCUSSION ON CONVERGENCE DID NOT END WITH DISCUSSION OF THE REFERENCE PAPER. THE FIGURES IN THE PAPER SHOULD BE TREATED WITH CAUTION. HE SHARED DUTCH DIFFICULTIES OVER THE CONCEPT OF NET CONTRIBUTIONS. MUCH OF THE UK'S PROBLEM AROSE FROM THE DOMINANCE OF CAP GUARANTEE EXPENDITURE. HE ASKED WHETHER THIS PROBLEM MIGHT NOT BE DEALT WITH BY ACTING ON THE EXPENDITURE SIDE OF THE BUDGET. HOWEVER, WITH THE BEST WILL POSSIBLE, A SOLUTION TO A CAP PROBLEM COULD NOT BE REACHED BY DUBLIN. HE ASKED THE UK TO DROP ITS INSISTENCE, ON A PERMANENT SOLUTION. THE NET BUDGETARY POSITION WAS DIFFICULT TO DEFINE AND A SOLUTION ON A NET BASIS THEREFORE DIFFICULT. IN THE FIRST INSTANCE THE COMMUNITY SHOULD LIMIT ITSELF TO A STUDY OF THE DUBLIN FINANCIAL MECHANISM., WHICH PROVIDED THE BEST BASIS FOR A SOLUTION. THERE WAS NO NEED FOR AN ENTIRELY NEW MECHANISM OR FOR PROGRESSIVITY IN OWN RESOURCES. HE WAS NOT INCLINED TO SEE A SOLUTION WHICH OPERATED ON RECEIPTS.

11. LAHNSTEIN ADDED THAT THIS PROBLEM SHOULD NOT BE OVERLOADED WITH OTHER SUBJECTS SUCH AS NORTH SEA OIL OR FISHERIES. HE DISAGREED WITH THE NETHERLANDS ON THIS. AS REGARDS ITALY THE PROBLEM SHOULD BE SOLVED THROUGH THE DEVELOPMENT OF EXISTING COMMUNITY FUNDS (RDF, ESF, EIB AND MEDITERRANEAN PACKAGES).

12. FOR FRANCE NANTEUIL (MONROY HAVING LEFT) GAVE PRELIMINARY VIEWS. THE DEBATE WAS ONLY BEGINNING TODAY. THE CONCEPT OF A QUOTE NET CONTRIBUTION UNQUOTE, WAS NOT ACCEPTABLE. THE UK'S DEMAND FOR QUOTE BROAD BALANCE UNQUOTE SOUNDED LIKE THE JUSTE RETOUR. THE COMMISSION'S EXERCISE WAS FRAGILE, TAKING NO ACCOUNT OF NON- BUDGETARY FACTORS, EG PRIVATE CAPITAL MOVEMENTS AND LOANS. HE REFERRED ON FAMILIAR LINES TO NORTH SEA OIL, THE UK'S FAILURE

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TO REORIENT TRADE ETC. THERE SHOULD BE A FURTHER DISCUSSION AT THE NEXT COUNCIL.

13. MUHLEN (LUXEMBOURG) AGREED THE BUDGET SHOULD NOT BE VIEWED IN ISOLATION. OTHER POLIES (RESEARCH, ENERGY, INDUSTRIAL, RESTRUCTURING) WERE RELEVANT. THE BUDGETARY FIGURES SHOULD BE TREATED WITH CAUTION. HE AGREED WITH GEENS THAT ADMINISTRATIVE EXPENDITURES WERE NOT OF BENEFIT.

14. O'DONOUGHUE (IRELAND) AGREED WITH ITALY THAT THE ISSUE WAS THE WIDER PROBLEM OF CONVERGENCE IN THE CONTEXT OF THE EMS. ON THE TIMETABLE HE SAW FORCE IN THE UK'S DEMAND FOR URGENT ACTION ON THE BUDGET PROBLEM, THOUGH THE COUNCIL AS A WHOLE MUST DECIDE. BUT THE BUDGETARY BALANCE SHOULD NOT BE VIEWED IN ISOLATION. FOR EXAMPLE IRELAND HAD SUFFERED HEAVY INDUSTRIAL UNEMPLOYMENT DURING THE RECESSION. HE AGREED THAT PART OF THE UK'S EXCESS CONTRIBUTIONS AROSE FROM ITS TRADING PATTERNS. HE ASKED THE UK NOT TO INSIST ON A PERMANENT SOLUTION. MORE GENERALLY, MEMBER STATES SHOULD NOT EXPECT ALL ISSUES TO BE SETTLED IN DUBLIN, BUT SHOULD LOOK PRAGMATICALLY FOR POSSIBLE AREAS OF SOLUTION.

15. THE CHANCELLOR IN A SECOND INTERVENTION WELCOMED THE IRISH AGREEMENT ON THE URGENCY OF THE UK'S PROBLEM. IN REPLY TO LAHNSTEIN AND OTHERS HE SAID HE HAD ASKED NOT FOR A "PERMANENT SOLUTION" BUT ONE WHICH WOULD "ENDURE AS LONG AS THE PROBLEM", WHICH AT PRESENT WAS GETTING WORSE. AS REGARDS "OWN RESOURCES" PARAGRAPH 19 OF THE REFERENCE PAPER MADE IT CLEAR THAT ALL REVENUES, INCLUDING DUTIES AND AGRICULTURE LEVIES, WERE INCLUDED IN THE ASSESSMENT UNDER THE FINANCIAL MECHANISM OF WHETHER A MEMBER STATE WAS BEARING A DISPROPORTIONATE BURDEN IN FINANCING THE BUDGET. (THERE WAS NO "ROTTERDAM/ANTWERP PROBLEM" FOR THE UK). OUR TRADE HAD UNDERGONE THE BIGGEST REORIENTATION TOWARDS THE COMMUNITY OF ANY MEMBER STATE SINCE 1972, TO THE CONSIDERABLE BENEFIT OF OUR PARTNERS. THIS REORIENTATION WOULD NO DOUBT CONTINUE, BUT EVEN AT THE PRESENT RATE OF PROGRESS COULD NOT HELP WITH OUR IMMEDIATE BUDGET PROBLEM. THE "JUSTE RETOUR" HAD BEEN CRITICISED. BUT OUR CASE WAS THAT THERE WAS AN UNJUST BURDEN. COLLEAGUES SHOULD BE IN NO DOUBT ABOUT THE SERIOUSNESS OF THE SITUATION. HMG WAS FULLY COMMITTED TO THE COMMUNITY, BUT THIS COMMITMENT WOULD BE DIFFICULT TO SUSTAIN UNLESS THE INJUSTICE WERE REMOVED.

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16. ORTOLI (COMMISSION), DEFENDING THE PAPER, SAID THAT THE FACT THAT IT HAD SHOWN NET CONTRIBUTIONS AND RECEIPTS NEED NOT RAISE THE PRINCIPLE OF THE JUSTE RETOUR. THE DUBLIN FINANCIAL MECHANISM HAD BEEN ANALYSED, BUT NO CONCLUSIONS DRAWN. THE PAPER HAD EMPHASIZED THAT THE REGIONAL ASPECT SHOULD BE TAKEN INTO ACCOUNT IN COMMUNITY POLICIES AND THAT THE COMMISSION WAS COMMITTED TO REDUCING CAP SURPLUSES. AT THIS STAGE HE HAD NO COMMENTS ON SOLUTIONS WHICH HAD BEEN PUT FORWARD. THERE WAS A NEED FOR FURTHER DISCUSSION BEFORE THE COMMISSION CONSIDERED SOLUTIONS. THE COMMISSION COULD NOT AMEND THE REFERENCE PAPER BUT COULD SUPPLY MORE INFORMATION. A COREPER WORKING GROUP COULD CONSIDER WHAT FURTHER INFORMATION WAS NEEDED. THEN EACH MEMBER STATE SHOULD SEND IN ITS OPINIONS AND "REQUEST IN CONCRETE FORM".

17. COLLEY (IRISH PRESIDENCY) SUMMED UP. THERE WAS A CONSENSUS THAT THE BUDGETARY PROBLEM SHOULD NOT BE CONSIDERED IN ISOLATION FROM OTHER ECONOMIC AND SOCIAL ASPECTS. SOME CAUTION HAD BEEN EXPRESSED OVER THE MAGNITUDE OF THE BUDGET PROBLEM AND PARTIAL SOLUTIONS MIGHT BE DESIRABLE. HE SUPPORTED ORTOLI'S SUGGESTION OF A WORKING GROUP: BUT THERE SHOULD BE A TIME LIMIT ON ITS WORK. IN ADDITION, MEMBER STATES MUST PUT IN THEIR CONSIDERED VIEWS BY THE END OF SEPTEMBER. PANDOLFI AND NANTEUIL SUPPORTED ORTOLI'S PROPOSAL, THE LATTER ARGUING THE TIME LIMIT WAS TOO SHORT. THE CHANCELLOR STRONGLY SUPPORTED THE END OF SEPTEMBER DEADLINE FOR CONSIDERED VIEWS IF THE EUROPEAN COUNCIL TIME-TABLE WAS TO BE KEPT: TODAY HAD ALREADY PROVIDED ONE OPPORTUNITY FOR DEBATE. LAHNSTEIN AGREED, THERE SHOULD THEN BE A FURTHER DISCUSSION ON 15 OCTOBER AND THEN PROPOSALS FROM THE COMMISSION IN GOOD TIME FOR DUBLIN. COLLEY CONCLUDED THAT THERE WAS AN AGREEMENT ON THE LINES SET OUT IN THE SUMMARY ABOVE.

FCO ADVANCE TO:

FCO - P/S SOFS: P/S LPS: P/S MR HURD: P/S PUS: BUTLER: FRETWELL:
SPRECKLEY: HAZLE

CAB - FRANKLIN: WALSH

TSY - P/S CHANCELLOR: COUZENS: JORDAN-MOSS: MRS HEDLEY-MILLER:
ASHFORD: MICHELLE: THOMSON

NO 10 - ALEXANDER

B/E - MCMAHON: BALFOUR: BULL

WATLAND

FRAME ECONOMIC
E.I.D.

{ADVANCED AS REQUESTED}

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10 DOWNING STREET

From the Private Secretary

17 September 1979

OSG
Euro Pol.

CALL BY MR. CHRISTOPHER TUGENDHAT

As you know, Mr. Christopher Tugendhat, the EEC Budget Commissioner, called on the Prime Minister on Thursday, 13 September. I enclose a record of their conversation.

I apologise for the delay in the appearance of the record. My absence for the middle part of the discussion somewhat complicated the note-taking arrangements!

I am sending copies of this letter and its enclosure to Tony Battishill (HM Treasury), Garth Waters (Ministry of Agriculture, Fisheries and Food) and Martin Vile (Cabinet Office).

M. O'D. B. ALEXANDER

KAR

G. G. H. Walden, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

QZ 01227

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*AR. Pse type to
Issue.*

MR ~~ALEXANDER~~

MEETING WITH MR TUGENDHAT

Print

1. I have suggested a few additions.
2. You may feel that the note should indicate that the Prime Minister was absent from the discussion recorded from the middle of page 3 to the end of page 5.
3. I have added a second additional paragraph on page 5 about what Mr Tugendhat (in the Prime Minister's absence) actually said about the eventual outcome. What the annex to Mr Tugendhat's brief reveals is that he thinks that "if the UK could cut her deficit in half (in 1980 from 1500 MUCE to, say, 800 MUCE) she would be doing very well". The Prime Minister will not have seen this document but I think you should draw her attention to this assessment. It is certainly not good enough and I hope to have the opportunity during my visit to Brussels today and tomorrow to tell Mr Tugendhat so. But you will wish to consider whether this exchange should be included in the circulated record or not. In view of its sensitivity you may prefer to exclude it.

MDM

M D M FRANKLIN

17 September 1979



10 DOWNING STREET

Mr Franklin (about office)

Herewith combined
notes of Messrs Alexander
& Lancaster. Corrections
or additions gratefully
received.

MA

14/9

Mr. Alexander.

~~I have suggested
some changes. Should you
not indicate that the
Prime Minister was absent for
"pages 3 & 5"? W.A.B.~~

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ce Master set
Fishing Ind
Euro Pol CAP.

RECORD OF THE PRIME MINISTER'S TALK WITH MR. CHRISTOPHER TUGENDHAT
AT 10 DOWNING STREET ON 13 SEPTEMBER 1979 AT 1500 HOURS

PRESENT

Prime Minister
Chancellor of the Exchequer
Lord President
Sir K. Couzens
Mr. M. Franklin
Mr. M. O'D. B. Alexander
Mr. T. P. Lankester

Mr. Christopher Tugendhat
Miss P. Neville-Jones

Community Budget: Italian Attitudes

In reply to a question from the Prime Minister, Mr. Tugendhat said that the hostile Italian reaction to the Commission's reference paper on the Community Budget had been motivated by disappointment on two counts. Despite warnings to the contrary, the Italians had assumed that their budgetary deficit, like that of the United Kingdom, would continue. They had been shocked to learn from the reference paper how seriously they had miscalculated. The improved Italian performance resulted both from a reduction in their contribution to the Budget following the switch from a GNP-based assessment to a VAT-based assessment and from an increase in their receipts as a result of Community action, e.g. on the Regional Fund. The Italians also considered that the second half of the mandate from the European Council in Strasbourg had not been implemented.

Mr. Tugendhat said that he sympathised with the second Italian complaint but that it was not easy to see what could be done about it. They claimed with some justice that the Community tended to operate in a way that benefited the weaker parts of the strong countries at the expense of the stronger parts of the weaker countries.

/(Mr. Franklin

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(Mr. Franklin said the Italians also complained that the CAP favoured agricultural products produced in Northern Europe as opposed to those produced in Southern Europe). The British budgetary problem was relatively clear cut. But it was difficult to envisage a solution to the Italians' difficulties. Moreover, there was little sympathy for the Italians in the Commission at present. The Commission considered that, as the budgetary figures showed, the Italians had done very well in the last couple of years and should not now be asking for more.

Mr. Tugendhat said it would be important for the UK to handle the Italians carefully. There was a risk that in their general irritation they would try to discredit the reference paper and thereby seriously damage British chances of getting a decision in Dublin. There was already a tendency on their part to regard the reference paper as a British paper. The recent story in the Financial Times might well have been the result of a leak by the Italians. It would be important to assure them that HMG recognised their problem and were not seeking to isolate them, but on the contrary, wished to cooperate with them. Bridges needed to be built. Otherwise the Italians, even if they did not succeed in stopping discussion of the reference paper, would certainly sour the atmosphere.

Community Budget: British Tactics

The Prime Minister said that despite any difficulties the Italians might make, it was essential that the Strasbourg timetable should be honoured. HMG were not prepared to put up with the present inequities of the Community Budget any longer. Mr. Tugendhat said that most representatives of the Presidency seemed determined to push ahead with discussion of the reference paper and to try to complete it on 17 September. But there was also some feeling that two meetings might be required. Provision had been made, he thought, for a further ECOFIN meeting on 8 October. As regards the presentation of the British case, Mr. Tugendhat said that it was important to present the British problem as a unique anomaly requiring a sui generis solution. Solutions which appeared to open the door to a general redistribution or to question the underlying philosophy of the Community should be avoided. Arguments which either focussed

/ on the fact

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on the fact that Britain was less prosperous or which suggested that contributions and receipts had to be in balance should be avoided. Arguments in the first category would be resisted because they might set precedents which would be used again by new and less prosperous members of the Community such as Spain. Arguments in the second category tended to undermine the theology of the Community which saw the Budget as no more than a reflection of an agreed range of Community policies.

Mr. Tugendhat believed that the UK should concentrate on the claim that the present situation was inequitable and that a temporary arrangement was required to secure a flow-back of funds. There was no need to define how long "temporary" might be. Its effect might be the same as a permanent solution. The Prime Minister and the Chancellor of the Exchequer pointed out that if there was to be a flow-back into the United Kingdom there would inevitably either have to be a cut in Community programmes or the other members would have to pay more. Mr. Tugendhat accepted this but said that the other members felt now - as they had not felt six months ago - that it was worthwhile to make an effort. They might be prepared to go along with a sui generis solution which would of course need to be clothed in Community language. But they would wish to know soon what sort of solution we envisaged. We should start, e.g. in bilaterals to give some idea of what we had in mind. We should also begin to give an indication of the figure we had in mind, i.e. that we wanted to secure a "broad balance".

At this point the Prime Minister left the meeting to meet the delegates to the Constitutional Conference at Lancaster House.

Mr. Tugendhat reiterated that we should do our best to sympathise with the Italians without giving them any opportunity to hold us up. In his view, the Commission would not be able to bring forward its second paper on solutions while the Council was still discussing the analysis. The Commission had been told to produce its proposals "in the light of the debate". If ideas had not been mentioned by us during the debate it would be very difficult for the Commission to include them in their proposals.

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This second paper would be extremely difficult to get through the Commission. This time the Italian members would be active and probably more effective.

The Chancellor said that the British budgetary problem was now established both as a fact and as to its scale. But the French still did not seem to understand the position. He wondered what would be his best tactics at the forthcoming ECOFIN meeting. He understood from what Mr. Tugendhat had said that it would be desirable to set out rather precisely the UK objectives. But would it also be helpful to deal with the "qualitative" arguments which the French tended to introduce against the British position? He also wondered when it would be best for him to speak.

Mr. Tugendhat replied that it would be very desirable if the Chancellor were to shoot down the French arguments in his statement. It was important that the British position was made absolutely clear, and that we could not be accused of not answering the arguments which the French put forward. It would probably be best for the Chancellor to speak early, and definitely before the Italians. Lord Soames added that it would be worth consulting with Mr. Colley before the meeting on this.

Sir Kenneth Couzen's suggested that the Chancellor might indicate what the UK wanted and how it might be achieved. But he might go on to say that the Commission had been entrusted to find a solution. They should now come up with a solution, and they should put a price on the various options. He wondered if this would be a helpful approach. Mr. Tugendhat responded that the Chancellor should certainly refer to the Financial Mechanism and indicate ways in which it can be improved. The Commission had been considering the possibility of weighting the amount of the refund according to relative GNP per capita, and the Chancellor might refer to this. He might also propose the removal of the balance of payments constraint. But he should also make it clear that it was extremely doubtful whether improvements in the Mechanism alone would satisfy our objectives; these could only be a start and more was needed. It was crucial to get this point across. As regards the
/ idea

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idea of the Commission putting forward costed options, this was unlikely to be a helpful suggestion from the UK's point of view.

Lord Soames said that if the UK succeeded in achieving its budgetary objectives, the French and the Germans would of course be paying more. They would presumably need to be able to show that they had obtained something in return. He asked whether there were any particular quid pro quos which they might be looking for.

Mr. Tugendhat said that a concession on fish would certainly be looked for. In addition, they would find some positive statements on energy helpful; but these should be gestures rather than specific concessions. The French would welcome some positive remarks about nuclear energy.

The Chancellor then asked whether the UK was doing enough to persuade and educate our partners. Mr. Tugendhat replied that we should be doing more, but this needed to be at the highest political level. In particular it was essential that Giscard and Schmidt should be fully seized of the importance that we attach to the budgetary problem. The UK's attitude with our partners should be - "regret at a common danger"; we should not make threats nor talk about "renegotiation". In this context, the British Press with their rather hostile approach on the budgetary issue were not at all helpful. He understood that there was not much that Ministers could do about this; on the other hand, it would be worth taking great care in briefing the Press after Monday's meeting. The more the British Press carried stories like the sale of butter to the Russians, the more the French Press would be provoked to run stories about the cost to the Community of importing New Zealand butter.

The Prime Minister rejoined the meeting at this point.

Common Fisheries Policy

Mr. Tugendhat said that the argument over the CFP presented major dangers. It could seriously impede British chances of securing a satisfactory solution on the budgetary problem. In his

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view a fisheries settlement was a necessary but not a sufficient condition for solving the budget problem. He warned that the French might simply be lulling us if they gave the impression that they were not in a hurry on fish. The Prime Minister said she was not prepared to make any concessions on the CFP. The fisheries situation was already sufficiently unsatisfactory without our making further concessions. The so-called reciprocity of historic rights was meaningless since the French had fished out their own waters and British access to those waters was worthless. She was in any case not prepared to pay a price in order to correct the demonstrably inequitable situation on the Budget.

Agriculture

Mr. Tugendhat said that there was some suspicion among other members about British intentions on agricultural prices. In the past we had been able to argue for limitations in price rises in the Community while giving our own farmers price rises through the devaluation of the Green Pound. But this escape route was no longer open: a Community price freeze now meant a price freeze in the UK. Since it seemed that HMG wished to expand domestic production, it was being asked in Europe whether we would not in the end follow the Germans in accepting price rises. This suspicion could make for difficulties in Dublin since it would not be understood if we appeared to be attempting to push up overall Budget expenditure in defence of sectoral interests while reducing our own net contribution.

The Prime Minister said that she was ready to tell British farmers that food prices would not be allowed to rise in the next two years. The farmers had done very well in the last two years and her concern was now less for them than for the housewife.

Mr. Tugendhat welcomed what the Prime Minister said and expressed the hope that arrangements would be made to ensure that her views became known. He referred to his intention to try to get the Finance Ministers more involved in the fixing of agricultural prices. He hoped that it would be possible to arrange

/ a "guidance debate"

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a "guidance debate" in which the Finance Ministers could examine the consequences for the Budget as a whole of any given set of agricultural price proposals, and set a global financial limit within which the Agriculture Council would have to operate. (The Prime Minister commented that this was a very good idea). The proximity of the Budget to the 1 per cent VAT ceiling - which would certainly be reached in 1981 and might on some assumptions be 1980 - provided a good reason for pressing for the involvement of Finance Ministers. While he would not do so before the Dublin meeting, the Commission would have to bring forward proposals for raising the 1 per cent VAT ceiling before the New Year.

The discussion ended at 1645.

Paul

17 September 1979

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TELEGRAM NUMBER 4626 OF 13 SEPTEMBER

AND TO IMMEDIATE ROME

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COMMITTEE OF PERMANENT REPRESENTATIVES (AMBASSADORS): 13 SEPTEMBER.

PREPARATION FOR FINANCE COUNCIL

REFERENCE PAPER ON BUDGET CONTRIBUTIONS.

SUMMARY.

1. ITALIANS ARGUED THAT COMMISSION REFERENCE PAPER WAS SO INADEQUATE THAT NO DISCUSSION SHOULD TAKE PLACE AT SEPTEMBER ECO/FIN COUNCIL, PRESIDENCY, WITH EFFECTIVE SUPPORT FROM US, THE GERMANS, DUTCH, DANES AND COMMISSION ARGUED STRONGLY THAT FULLEST POSSIBLE DEBATE WOULD GIVE ITALIANS BEST PLATFORM FOR THEIR CASE. PRESIDENCY MADE IT CLEAR THAT MINISTERS WOULD BE ASKED TO INCLUDE THE PAPER ON MONDAY'S AGENDA.

WOULD GIVE ITALIANS BEST PLATFORM FOR THEIR CASE. PRESIDENCY MADE IT CLEAR THAT MINISTERS WOULD BE ASKED TO INCLUDE THE PAPER ON MONDAY'S AGENDA.

DETAIL.

2. DILLON (IRISH CHAIRMAN) RECALLED THE TIGHT TIMETABLE LAID DOWN BY STRASBOURG EUROPEAN COUNCIL. THE COMMISSION SHOULD AIM TO PUT FIRM PROPOSALS TO THE OCTOBER ECO/FIN COUNCIL ON THE BASIS OF AN EXCHANGE OF VIEWS ON MONDAY. EVEN IF THE DEBATE WAS NOT CONCLUDED THEN, THE COMMISSION WOULD SURELY HAVE ENOUGH MATERIAL FROM IT TO ENABLE IT TO START WORK IMMEDIATELY. HE RECALLED THAT THERE WAS NO QUESTION OF MINISTERS BEING ASKED TO TAKE FIRM DECISIONS ON MONDAY.
3. PLAJA (ITALY) SAID THAT HIS MINISTER WOULD INSIST THAT THE BUDGET CONTRIBUTIONS PAPER BE EXCLUDED FROM THE AGENDA AND WOULD FORCE A VOTE IF NECESSARY. THERE COULD AT MOST BE A DISCUSSION OVER LUNCH OR A GENERAL EXCHANGE OF VIEWS IN COUNCIL. HIS AUTHORITIES WISHED TO MAKE IT CLEAR THAT THEY CONSIDERED THE DEBATE WAS EVOLVING IN SUCH A WAY AS TO MAKE IT IMPOSSIBLE FOR THE DUBLIN EUROPEAN COUNCIL TO TAKE DECISIONS. HIS INSTRUCTIONS HAD BEEN CAREFULLY CONSIDERED AT THE MOST COMPETENT LEVELS IN ROME AND HE WAS LEFT WITH NO ROOM FOR MANOEUVRE. HE ALSO NOTED THAT THE IMPORTANT PAPER ON METHODOLOGY REFERRED TO IN PARA 4 OF THE PAPER WAS NOT YET AVAILABLE.
4. IN RESTRICTED SESSION, DILLON ARGUED THAT EVERYTHING PLAJA HAD SAID POINTED TO THE FULLEST POSSIBLE DEBATE AS EARLY AS POSSIBLE IN COUNCIL. HE MADE IT CLEAR THAT THE PRESIDENCY WERE NOT PREPARED TO TAKE THE ITEM OFF THE AGENDA.
5. PLAJA SAID THAT HIS AUTHORITIES CONSIDERED THE COMMISSION'S DOCUMENT DID NOT REPRESENT A FULL REPLY TO THE STRASBOURG MANDATE. IT COVERED, AS ITS TITLE INDICATED, ONLY THE BUDGETARY CONSEQUENCES OF MEMBERSHIP OF THE COMMUNITY. IT VIRTUALLY IGNORED THE REQUEST OF THE STRASBOURG COUNCIL TO GIVE EQUAL IMPORTANCE TO THE OVERALL SOCIAL AND ECONOMIC CONSEQUENCES OF THE COMMUNITY. IT WAS WELL KNOWN THAT HIS AUTHORITIES ATTACHED GREAT IMPORTANCE TO THIS SECOND ASPECT, BUT THE MORE ACCEPTABLE LANGUAGE IN EARLIER DRAFTS OF THE COMMISSION'S PAPER HAD BEEN SYSTEMATICALLY EXCLUDED, DESPITE REPRESENTATIONS FROM HIS AUTHORITIES. IT WAS IMPOSSIBLE TO PROCEED TO THE SECOND STAGE OF THE DEBATE IF THE BASIC DOCUMENT WAS FUNDAMENTALLY FLAWED. THE COMMISSION SHOULD BE ASKED TO REVISE ITS DOCUMENT AND RESUBMIT IT.
6. I SAID THAT I SHARED THE PRESIDENCY'S VIEW BOTH ON THE QUESTION OF THE TIGHT TIMETABLE AND ON THE NEED FOR FULL DISCUSSION ON MONDAY. I WAS GRATEFUL TO THE COMMISSION FOR THE SPEED WITH WHICH

DOCUMENT AND RESUBMIT IT.

6. I SAID THAT I SHARED THE PRESIDENCY'S VIEW BOTH ON THE QUESTION OF THE TIGHT TIMETABLE AND ON THE NEED FOR FULL DISCUSSION ON MONDAY. I WAS GRATEFUL TO THE COMMISSION FOR THE SPEED WITH WHICH THEY HAD PRODUCED THEIR DOCUMENT.

7. RIBERHOLDT (DNEMARK)
ERE FROM PARA 7 AGEN

7. RIBERHOLDT (DENMARK) ARGUED ON PREDICTABLE LINES THAT THE DEBATE HAD STRAYED TOO FAR FROM CONVERGENCE AND TOO CLOSE TO A NARROW BUDGETARY VIEW. HE REITERATED THE DANISH VIEW ON "NATIONAL CONTRIBUTIONS", AGRICULTURAL POLICY AND THE NATURE OF OWN RESOURCES. ON PROCEDURE, HE WAS QUITE HAPPY TO SEE THE PAPER DEBATED ON MONDAY, THOUGH A SECOND DISCUSSION MIGHT ALSO BE NECESSARY.

8. VAN SWINDEREN (NETHERLANDS) UNDERSTOOD THAT ITALY HAD DIFFICULTIES WITH THE PAPER. IT DID NOT ENTIRELY SATISFY HIS AUTHORITIES EITHER. BUT IT WAS ALL THE MORE IMPORTANT FOR A FULL DISCUSSION TO TAKE PLACE IN COUNCIL. HE TOO REFERRED TO THE POSSIBILITY OF A SECOND COUNCIL DISCUSSION.

9. SIGRIST (GERMANY) SAID THAT THE DEBATE SO FAR HAD ALREADY PROVIDED A GOOD IDEA OF THE SORT OF DISCUSSION THAT WOULD TAKE PLACE IN COUNCIL AND EMPHASIZED HOW NECESSARY SUCH A DISCUSSION WAS. IT WAS POSSIBLE TO ARGUE THAT THE PAPER WAS NOT BALANCED IN THE WAY THAT THE STRASBOURG MANDATE HAD FORESEEN, BUT THE INTRODUCTORY REMARKS OF THE COMMISSION SURELY SET THE BUDGETARY QUESTION IN PERSPECTIVE. IT WOULD PERHAPS ALSO BE USEFUL FOR THE TEXT TO STATE CLEARLY WHAT MEMBER STATES THOUGHT AND WHAT STEPS THEY WISHED TO SEE TAKEN. THERE COULD PERHAPS BE A SECOND DEBATE IN OCTOBER, AFTER WHICH THE COMMISSION COULD START TO WORK ON SOLUTIONS.

10. DILLON SAID THAT THE TIMETABLE WOULD HARDLY ALLOW THE COMMISSION TO BEGIN WORK AFTER A SECOND DEBATE IN OCTOBER. HE REEMPHASISED THAT IT WAS NOT UP TO THE COUNCIL TO TAKE DECISIONS ON THE "REFERENCE PAPER". HE DID NOT RULE OUT THE POSSIBILITY THAT WORK MIGHT HAVE TO PROCEED IN PARALLEL, BUT HE FELT IT POSSIBLE THAT THEY WOULD DERIVE ENOUGH FROM

HE REEMPHASISED THAT IT WAS NOT UP TO THE COUNCIL TO TAKE DECISIONS ON THE "REFERENCE PAPER". HE DID NOT RULE OUT THE POSSIBILITY THAT WORK MIGHT HAVE TO PROCEED IN PARALLEL, BUT HE FELT IT POSSIBLE THAT THEY WOULD DERIVE ENOUGH FROM MONDAY'S DEBATE.

11. I INTERVENED BRIEFLY TO STRESS THE IMPORTANCE OF THE TIMETABLE AND TO ARGUE THAT IT WAS POSSIBLE TO ADHERE TO IT, PROVIDED THE COUNCIL BORE IN MIND THE NATURE OF THE DEBATE. I REMINDED THE COMMITTEE THAT THE ISSUES IN THAT PAPER HAD ALREADY BEEN UNDER DISCUSSION IN THE COMMUNITY FOR EIGHTEEN MONTHS.

12. PLAJA SAID THAT THE INTERVENTION OF COLLEAGUES MERELY UNDERLINED THE DIFFICULTIES WHICH HIS AUTHORITIES FACED. THE ITALIAN MINISTER WOULD BE UNABLE TO PUT HIS ARGUMENTS ON MONDAY BECAUSE THEY WERE EXCLUDED FROM THE COMMISSION DOCUMENT.

13. THE COMMISSION (AUDLAND) STRONGLY SUPPORTED THE PRESIDENCY ARGUMENTS THAT, WHATEVER THE MERITS OF THE DOCUMENT OR ITS SUPPOSED DEFICIENCIES, THE NEED WAS FOR THE FULLEST POSSIBLE DEBATE ON MONDAY, AND THAT THERE WAS NOTHING TO STOP THE ITALIANS SETTING OUT THEIR "CONCRETE REQUESTS" IN FULL. IF THEY ALSO WISHED TO SUBMIT A PAPER TO THE COMMISSION SETTING OUT THEIR VIEWS IN DETAIL, THE COMMISSION WOULD BE GLAD TO RECEIVE IT. THE METHODOLOGY PAPER WOULD BE CIRCULATED TODAY.

14. DILLON, WHO KEPT A TIGHT AND HELPFUL REIN ON PROCEEDINGS THROUGHOUT, SUMMED UP TO THE EFFECT THAT MINISTERS WOULD HAVE A BRIEF SUMMARY OF TODAY'S ARGUMENTS BEFORE THEM AND WOULD BE ASKED TO INCLUDE THIS ITEM ON THEIR AGENDA. IT WAS IMPORTANT TO REMEMBER THAT NO DECISIONS WERE CALLED FOR AND THAT THE PAPER OF THE COMMISSION WAS A REFERENCE DOCUMENT ONLY. THE FACT THAT IT DID NOT CONTAIN FULL REFERENCES TO ALL ARGUMENTS DID NOT PREVENT MINISTERS FROM RAISING THEM ON MONDAY. NOR NEED THE DEBATE NECESSARILY END WITH MONDAY'S DISCUSSION. BUT IT WAS IMPORTANT THAT THE COMMISSION SHOULD BE ABLE TO FORM THE FULLEST POSSIBLE VIEW IN ORDER TO ENABLE THEM TO PROCEED WITH SOLUTIONS.

12 September 1979

MR. TUGENDHAT

p.a.
And
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Call on the British Prime Minister, Mrs. Thatcher at
10, Downing Street, Thursday 11 September 1979 at 3 pm

INTRODUCTION

No 10 and the Foreign Office, which will be briefing, are aware that you want a wide ranging, rather discursive discussion with the Prime Minister. Their briefing will cover the points below which were suggested by you. I have laid most emphasis on the first two items since these are the most urgent but less on institutional questions, since in the absence of the report from the Wise Men, this will inevitably be a less well focussed discussion. We have also been warned that the Prime Minister may raise the question of British staffing in the Commission. This is a familiar subject, and Mr. Pratley will supply briefing on latest developments for your call on Lord Soames.

I THE REFERENCE PAPER ON BUDGETARY MATTERS

2. This is a good paper from the UK point of view. It brings out the facts concerning the UK net deficit, its causes and shows clearly that the existing financial mechanism, though never designed to offer a complete return to parity, is not, and is not likely, to provide even the partial compensation intended. It points clearly towards a revised mechanism. The study is a good base for the next stage, the presentation of proposals by the Commission, though much work will have to be done between now and then by the UK in whose court the ball now lies. The utmost importance of the skilful presentation of the UK case should not be underestimated: discussion of the reference paper in the Commission has already shown how hard it will be to get out proposals satisfactory from the UK point of view: this is the mere reflection of an attitude that will be even tougher in capitals and in the Council.

3. Timing of a solution and the tactics leading up to it

Before getting down to details of tactics in the Council, you need to go over a number of relevant background factors.

4. The United Kingdom needs a solution urgently and it is right

to make the Dublin Summit the target. It would be unwise on the other hand as regards timing to become impaled on a hook in public so that the pressure of domestic public opinion forces HMG to take less than they might otherwise have got had they been able to bargain for somewhat longer. An agreement in principle at Dublin, with the details finally agreed at the next European Council - the solution however back dated to 1 January 1980 - may prove a more realistic aim. The important thing is for the government to retain some freedom of manoeuvre on timing.

5. The pressures from other Member States will of course be to spin matters out; and attempts will be made to link the solution of the UK problem to any one, or a combination of the following :

- (a) the exhaustion of the existing resources of the Community and the introduction of a new own resource;
- (b) control of the CAP;
- (c) the entry of Greece.

HMG will not find it difficult to resist following these suggestions though, since it is in the UK interest to maintain a positive attitude on all three topics, the tactics pursued to keep the solution of the UK budget problem separate will have to be skilful.

6. The following considerations are relevant. As regards the exhaustion of own resources: when the ceiling on existing financing is reached, as will happen by the latest in 1981, it seems most unlikely that the Council will by then have agreed on a new one. This means that compulsory expenditure, notably FEOGA Guarantee, will have to take precedence over non compulsory expenditure (regional, social funds) and for a period at least, the UK imbalance would be likely to get even worse. Reaching the ceiling on own resources and sticking there does not therefore offer ready financial relief to the UK. When a new resource is agreed, even if it does involve progressivity i.e. a criterion assessing ability to pay, the degree of progressivity likely to be agreed would only offer marginal relief to the UK. Solutions are not to be looked for here. You are responsible for making the proposal on a new own resource and will not do this until after the Dublin Summit, precisely to reduce the chances of the two issues being confused. Delay beyond the end of this year will however be impossible.

7. As regards control of the CAP, there are already signs that attempts will be made to link solution of the UK budget problems to this. The UK must resist this, on timing grounds alone. Equally, HMG must continue to work actively for changes in the CAP (see below paragraphs 17 -20). Since however there is an undeniable link between excessive FEOGA guarantee expenditure and the size of the UK deficit, the best tactic would be to occupy the enemy territory by arguing that the UK wishes to see major changes in the CAP, that these are in the interests of the whole Community and are a matter of urgency. The UK recognises that with the best will in the world they will however take a bit of time to bring about, and rather longer for the budgetary savings to be felt. Until such time therefore as these budgetary effects begin to have a significant impact,

/ and

and until there is a better balance in Community expenditure, the UK needs a special budgetary arrangement that deals with its particular problem. If the UK can present its special needs as being of temporary, if indefinite, duration, it has a correspondingly greater chance of obtaining more generous terms. A three or five year review clause would be a price worth paying for a solution which made a significant immediate dent in the deficit.

8. As regards enlargement, it is unlikely that an explicit link will be made between the UK budget problem and the entry of Greece in 1981 and subsequent enlargement. It is nevertheless a consideration that will be in the forefront of Ministers' minds since what is now conceded to the UK will inevitably be a precedent. There is no guarantee, on the basis of present Community expenditure (or indeed likely future patterns) that Greece, and more particularly Spain, can be absolutely sure of always being a net beneficiary from the Community budget or even in balance. It is for this reason, among others, that you are strongly against the UK trying to get her partners to accept, either in public or in private, the principle that member states with below average GNP per caput income should not be net contributors to the Community budget. While this is entirely logical, it is not politic. A bid for a special, temporary arrangement (from which Italy can also be legitimately excluded) will involve fewer presentational difficulties for the UK's partners. It also has European Parliamentary advantages (see paragraph 26 below), as well as advantages in relation to Greece which now has the right of consultation and has already, if unsuccessfully, tried to extract assurances about future rights in relation to EMS related interest subsidies.

9. Tactics in the Council and with member states

This is the background against which the Council discussion will take place. We can be certain that other member states will seize all opportunities available either to undermine the validity of the paper by querying its methodology or its calculation or to obfuscate the subject by introducing extraneous considerations. Or both. The UK must make certain therefore that its side of the case is clearly heard. The UK has been asked to "present (their) requests in concrete form". While the UK does not have to present every detail of its request on 17 September in the ECOFIN Council, it cannot and should not try to postpone any longer at least giving an outline.

10. There are two aspects to the request: the method of the solution and the amount involved. In your view at the next ECOFIN Council the Chancellor should state the type of solution the UK wants (see annex attached) but should not name a figure. The figure which will obviously be more ambitious than the UK is likely to achieve should be revealed subsequently in confidential bilateral meetings which it is essential take place at Ministerial level in all capitals before the ECOFIN Council 15 October when the matter is bound to come up again. (Given the early appearance of the study, two bites at the cherry in Council is virtually inescapable.)

11. The UK should bear in mind that other member states, while beginning to accept that the UK budgetary deficit cannot be allowed to continue in its present proportions, are still thinking in terms of rectifications whose extent is much smaller than anything HMG is

likely to regard as adequate. In your view, the UK has already left it dangerously late to do an education job in capitals (you would have liked to have seen lobbying in July). Now that the Commission study is out however you cannot stress too much the urgency and importance of intensive high level contacts between HMG and her Community partners. They are not going to make concessions without a great deal of persuasion and without some counterpart (see paragraph 29 below). HMG must prepare this as well for Dublin.

12. Types of mechanism

Because of the system of own resources whereby customs duties, agricultural levies and up to 1% of VAT levied on a uniform base belong to the Community as of right, with the member states acting only as agents in their collection, it is not possible for the UK simply to decide either unilaterally or in conjunction with its partners to pay less. Its share in Community financing being a figure automatically arrived at, the only way in which the UK can achieve a lower net contribution is by getting money back.

13. This is what happens in the case of the existing financial mechanism. The chief drawback of this mechanism from the UK point of view, apart from its internal limitations, which are set at levels which have effectively prevented it from operating in the past and are likely to continue to do in the future, is that it works solely in relation to the gross contribution, thus in no way touching the problem of an inadequate return on Community expenditure. Since this is a good half of the problem, and since no early solution to an improved UK 'take' is in sight the new solution should ideally operate directly on the net deficit i.e. the gap between contributions and expenditure. This should be the UK's aim but it will not be achieved without a struggle. The existing financial mechanism broke new ground in so far as it was an explicit recognition that a member state's contribution to the financing of the Community could be disproportionately greater (the language of the regulation) than its ability to pay as measured in GNP terms. It did not however constitute any recognition, explicit or implicit, of the idea that financial benefits received could legitimately be assessed against financial contributions made, it always being asserted that Community policies are for specific purposes and that the concept therefore of the juste retour is neither legitimate nor indeed relevant. The UK is bound to encounter tough resistance on a long standing and deeply held doctrinal point. The best way of countering it is not to meet it head on, but to deflect it by the firm statement that the UK is only looking for an arrangement of temporary duration - "arrangement", or a word akin to it, would be preferable to the use of the words "solution" - (though the mechanism itself must be capable of being permanent, as well as automatic in its operation).

14. Possible mechanisms are dealt with in more detail in the Annex.

15. The Italian angle

The reference paper shows clearly that unlike the UK,

/ Italy's

Italy's budget deficit of 1978 was not the result of structural factors but rather was anomalous and unlikely to be repeated in the foreseeable future when Italy can expect to be in growing surplus. The Italian Government is nevertheless reported to be very dissatisfied with the paper as it has emerged largely because of the feeble effort made by the Commission to fulfil that part of the Council's mandate of particular interest to Italy i.e. that concerning the economic and social impact on the country of Community membership. There appears to be some disposition to attribute this outcome, which has made the Italians feel very isolated, to a British plot. (The real reasons for this failure on the part of the Commission, which you can go into if necessary, are partly political and partly derive from the inherent difficulty of such a study made virtually impossible by the speed at which the paper has had to be produced). Whether such a study, if done, would produce the result expected by the Italians i.e. that Italy does less well out of the Community than say France or Germany, is an open question. It might well. The Italians do however have a legitimate complaint in so far as the Commission has not proved able to fulfil the mandate adequately.

16. As a result the Italian Government appears to be in a mood where it could well seek to undermine the credibility of the paper when it is discussed in Council on 17 September. HMG would be well advised therefore to talk to the Italians beforehand to seek to :

- (a) reassure them of a continued desire to work together in the whole area of convergence (redistribution etc);
- (b) offer them help in getting the sort of study they want done properly;
- (c) get them, in return, to be helpful to the UK over the budget contribution and, in particular, not join in a general destruction of the reference paper.

It is unlikely that with the best will in the world the Commission could do a really adequate study of the sort demanded by the Council in the time available - just over a month (such a paper would have to be out by the beginning of November) and it might be worth trying to persuade the Italians to take such a large subject in slower time. If however they are insistent that an adequate study be produced in time for the European Council, the UK should offer support.

II CONTROL OF THE CAP

17. Controlling and then reducing surplus production has been an urgent task for the Community for some time. Other member states are at last beginning to recognise this though, as last year's price settlement showed, they are not yet sufficiently willing to accept the consequences to rein in the agricultural ministers. Control of CAP is a policy priority with which the UK is closely associated and, despite the changed situation of UK agriculture (green pound now much the same value as sterling), HMG must continue to push actively for it if they are to retain credibility - not least in relation to the issue of the budget contribution.

18. Does Mrs Thatcher's government intend to pursue the previous government's policy of expanding UK agricultural production? If so, some of the increase is bound to take place in products in surplus

/ in the

in the Community. Despite UK comparative advantage in agriculture and the small size of the UK agricultural sector, its expansion, in surplus products at least, will not be regarded by other member states - or the Commission - as compatible with a policy of bringing surpluses under control. It also needs to be remembered that British farmers can now only be awarded significantly higher prices to compensate for more intensive farming, increased costs etc, by increases in the common price. In other words the time when greater financial rewards to encourage expansion of UK agricultural production could be given without affecting common price levels is now over. As regards prices therefore the British farmer now finds himself in more or less the situation in which the German farmer has been for some time, but without the latter's low cost inflation rate. Indeed maintaining common price levels will almost certainly hit the UK farmer directly and harder than his less intensive continental or Irish counterpart. There may be some hard choices in store.

19. Much the same considerations apply in relation to continued access for New Zealand dairy products. Support for this access, which displaces Community production and costs the Community budget some 250 meua, will be viewed as incompatible with expansion of UK production in surplus products.

20. Bringing the CAP under control will not be easy and some solutions more radical than a price freeze will almost certainly have to be sought (separation of production and social costs and the introduction of income maintenance payments). A first step in institutional terms however will be to bring the agriculture Ministers into some more coherent relationship with other Councils, notably the Finance and Budget Ministers. If HMG is serious about bringing Community expenditure not only under control but also in to better relationship with Community priorities, they, as well as other governments need to devote a lot more attention to and attach more importance to, the Budget Council. The budget process at present conducted, with agricultural prices being fixed quite separately and without regard to other expenditure, does not properly reflect or contribute to the ordering of the Community's priorities.

III INSTITUTIONAL MATTERS (see also preceding paragraph 20)

21. Immediately before the publication of the report of the Three Wise Men (and the Spierenburg report) is not a particularly good moment to attempt a sustained discussion of institutional matters. You might offer to write to the Prime Ministers on this subject after the reports have appeared.

22. In addition to the point about greater coherence between the work of the different Councils (not a new point, though possibly not one the Prime Minister has focussed on previously) you might mention :

- (a) size of the Commission;
- (b) attitude to a role of the Parliament.

23. Size of the Commission

I do not suggest you spend much time on this point if you

/are

are going to write later. Your views have not changed since the Spring, when you took the line :

The Commission is the object of particular attack in the United Kingdom and it is widely claimed to be in the UK interest to see the number of Commissioners reduced to one per country, thus depriving the larger member states of their second Commissioner. This analysis of UK interests appears to spring from two hypotheses: an exaggerated view of the power of the Commission to encroach upon the sovereignty of the UK on the one hand and an overestimate of the capacity of the UK to take care of its interests by itself on the other. Whatever the intentions of the Founding Fathers, it is now the case that the balance of power between Community institutions has shifted decisively in favour of the Council of Ministers away from the Commission which, these days, far from having too much power has barely enough to discharge its role as guardian of the Treaties and initiate proposals with the necessary integrity. A really weak Commission, defenceless against pressure from the stronger member states will be a politically biased Commission. This is no more in the UK interest than in that of any other member state. Indeed it is less in the UK's interest than in that of some. The UK is not among the strongest member states economically and she needs the Commission, the only institution whose avowed purpose it is to embody the Community rather than the national interest, to hold the ring against pressure against some of the stronger member states. In addition, she is demandeur on a number of issues where important changes in the conduct of Community policy are required if the UK interest is to be satisfied. The necessary proposals will have to come from the Commission. None of these considerations therefore are ones which lead to the conclusion that it is sensible for the UK at this juncture either to weaken the Commission as a whole or to give up the advantage which she possesses within it of having two Commissioners instead of one.'

24. Despite the fact that our preview of the Spierenburg report shows that he challenges these views (rather effectively) your analysis remains valid so far as the UK interest in relation to the Commission is concerned. The point you need to get across to HMG is :

- (a) that it requires unanimity in the Council to change the size of the Commission;
- (b) the UK interest in relation to the Commission is not the same as that of either France or Germany and the UK should not be beguiled into thinking so.

25. Attitude to the European Parliament

It would be a pity if the UK were to join those member states, notably France, which pursues a policy of deliberately and continuously snubbing the European Parliament. This is not consonant with British traditions or behaviour and the UK is unlikely therefore to do it with conviction or well. In any case, in the next few months HMG needs the help, or at a minimum, the neutrality of the Parliament over the budget issue.

26. Any settlement of the UK budget problem is likely to have

/financial

financial implications of a kind that the Parliament is entitled by law to be consulted over. The old Parliament was not consulted until after the event concerning the existing financial mechanism and they protested. The new Parliament is already on the look out. The budgetary powers of the Parliament and the political appetite of the directly elected assembly have grown apace since then and a failure to consult could be counterproductive from the UK's point of view. The Commission will therefore let the Parliament have all the relevant documents. Even those Parliamentarians friendly on the substance would be alienated by a failure to respect the institution's rights. A hostile resolution in plenary could in turn be exploited in capitals against the UK interest. The most helpful role to be played by HMG would be to ensure that the Conservative delegation in the European Parliament does its best to keep the atmosphere sweet and does not aid and abet an aggressive assertion of Parliamentary rights.

IV THE UK'S FUTURE IN THE COMMUNITY

27. You will want to draw out the Prime Minister's thinking on this. Since entry into the Community, the UK has remained on the fringe. This is partly the result of the legacy of painful years of negotiation; partly the fact that the UK's economic performance has not equipped her for a leadership role. The rest has been politically self inflicted; since entry ^{the UK} has been at best neutral and at worst hostile to Community initiatives. The UK's partners have come to expect the UK merely to react and seldom, if ever, to propose. The UK's geographical position also means that unlike France or Germany, it is possible for the rest of the Nine to a great extent to ignore the UK if it chooses not to play a constructive role.

28. The present government is thus faced with a considerable leeway to be made up. A good start has been made and a testing period is now ahead. The UK expects a positive response from her partners over her budget contribution; the UK in turn must expect to have to offer some counterpart - something that the rest of the Nine can take back to sell to their respective domestic opinion as part of a worthwhile bargain. The time is also coming when it would be opportune for the UK to begin to take bigger initiatives unrelated to her immediate requirements so as to justify her claim to be one of the "big" countries of the Community.

29. The Counterpart

There are a number of possibilities of which the most obvious is a fisheries settlement. This is likely to be high on the French list of requirements - President Giscard has more or less said as much. In your view the UK will not get a better deal through further significant delay - rather the opposite. Willingness on the part of the UK to settle over fish thus enabling a common fisheries policy at last to be put in place would be a useful weapon in clinching the budget deal.

30. EMS

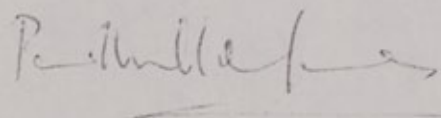
The situation as regards EMS has changed somewhat since the government came to power and for reasons unconnected with any

/feeling

feeling of altruism towards the UK there is for the time being likely to be little pressure in either France or Germany on HMG to enter the system in full. It nevertheless remains an aim of the Community that the EMS should become a central instrument of Community policy to which all member states should belong. It is not therefore in the UK's partners' minds, a question of whether the UK should enter but only when. The UK should continue to adopt a friendly stance towards the system and, in the context of the budget settlement, it would do no harm and some good explicitly to underline British willingness to enter the system as soon as possible. If the UK were able to enter the system at the time of the Dublin European Council, this would be an offer the rest could not refuse.

31. Energy

There is probably little scope for major initiatives here either in the context of the budget question or more generally. The UK could still however assume a higher profile and more active role and seek to lead the debate more than it does. Without hurrying after the French on the question of the revision of the Euratom Treaty (given German sensitivities, the French should be left to make their own running) the UK could come down more firmly than in the past in favour of the development of nuclear energy. This would please the French and help tilt the balance away somewhat from the strong anti-nuclear lobbies in Germany and the Netherlands in particular.



Pauline Neville-Jones
12 September 1979

POSSIBLE BUDGETARY MECHANISMS

1. Any mechanism has to operate via a payment to the UK (i.e. it cannot simply cut the UK contribution. Possible kinds include the following :

- (a) mechanism on the contribution side (i.e. like the present financial mechanism;
- (b) a mechanism on the expenditure side (e.g. the "enhanced receipts" formula;
- (c) a mechanism operating on the net difference between contributions and expenditure (the net deficit mechanism);
- (d) a combination of (a) and (b) each operating separately on its own side of the budget;
- (e) an "override" or budget equalisation mechanism.

2. Of these possibilities (e) is not discussed. This is because attractive in theory though the idea is of having an equalisation mechanism operating on the final budget outturn whereby, for the sake of argument countries below average Community GNP per caput receive a top up proportionate to their relative poverty to be paid for on a sliding scale by those member states having above average GNP per caput, it suffers from so many drawbacks and objections that it would never be considered by the richer member states. It offends against the doctrines of the specificity of Community spending; it is the epitome of the juste retour, it assumes that budget flows are the most important guide to the benefits of Community membership and lastly, but not least, it would be a very expensive open ended commitment for the richer member states to take on, especially in an enlarged Community. Moreover, in an enlarged Community, and depending on how the scales were set, the UK might not stand to benefit greatly from such a system in so far as her per caput GNP began to approach the average more closely.

3. On the other mechanisms, the following general comments can be made. It is in the UK interest to preserve the rule in relation to any mechanism whereby net beneficiaries do not benefit from the mechanism. If the UK were ever to get into this desirable position (unlikely on present expectations) her gross contribution, whatever its dimensions, should be tolerable. Conversely, by lifting the rule, the door would be opened to the Irish, Italian, as well as Greek, Spanish and Portuguese begging bowls. Secondly, part of the price of a renegotiated mechanism might well be that other less prosperous member states did not contribute to its financing. The UK should obviously not oppose this and should seek to get herself excluded also. A mechanism working through the budget would therefore have to provide for rebates on the model of the EMS related

/subsidies.

subsidies. A settlement outside the budget (there is a precedent in Article 131) which would avoid acceleration towards the 1% ceiling as well as reducing the role of Parliament, would have the further advantage in a situation in which not all member states were contributing to the financing of the mechanism of allowing an ad hoc financing key to be worked out. This could enable the Germans, who will inevitably bear the largest burden to push some of it in the direction of countries like Denmark. This is a point for a relatively late stage in renegotiation.

4. As regards the existing financial mechanism, its greatest advantage is that it already exists. Adaptation is always easier than creation. In its present form it has evident shortcomings however. Its most serious constraints are the balance of payments rule and the 3% ceiling. It will be essential, if the mechanism is to have any value at all while the UK can expect balance of payments surpluses to get the first limitation lifted. The 3% rule only becomes relevant however if other intervening constraints are also removed notably the abolition of the tranche system. On the basis of the 1980 draft budget, the lifting of these constraints would result in a gross payment to the UK in 1981 of 630 meua (520 net). If at the same time the UK could persuade her Community partners to introduce some progressivity into the initial base (e.g. by weighting member states GNP shares by their relative GNP per caput) then the sums of money which would flow would become significant. The gross figure of 630 meua would be roughly double. An innovation such as progressivity (the term itself should be avoided) would encounter strong resistance both on financial and doctrinal grounds and its temporary applicability might well have to be accepted. The UK would be well advised not to try to remove the provision limiting refunds to the equivalent of the VAT contribution since this would offend against the doctrine of own resources - a current sacred cow of the dogmatists (the Commission would also be extremely unhelpful on this point).

5. A mechanism on the expenditure side is only of interest if combined with a mechanism on the contributions side like that described above. The existing financial mechanism has already revealed the disadvantage of a correction which works only on one side of the budget. To swap a corrective mechanism on the contributions side for one on the expenditure side (approximately half, but only half of the UK deficit arises on the expenditure side) would not make sense. (d) above is therefore the only real option.

6. The advantages of a mechanism like "enhanced receipts" is that it can be linked to an existing mechanism on the contributions side. This however is probably its only advantage. A proposal to top up the budget receipts of member states with below average GNP per caput and below average receipts from the budget by a system involving contributions from member states with above average GNP per caput offends directly against the specificity of Community

/ expenditure

expenditure policies: the richer member states are resolutely opposed to allowing the budget to become a vehicle for transfers - without-strings. Since it would be difficult in an expenditure context to apply a net beneficiary rule, all below average GNP per caput member states would almost certainly be entitled to participate and, to be of dimensions which would contribute much to the UK receipts deficit, the scheme would inevitably be costly to those member states called upon to bear them. The mechanism suffers from many of the disadvantages inherent in the override mechanism (without however being as effective). In the nature of things, the actual financial benefit to be gained would vary from year to year in accordance with the pattern of expenditure and the benefits to be had would be more difficult to predict than in the case of a mechanism on the receipts side. The relationship between two separate mechanisms each operating on different sides of the account would also be difficult to organize: attempts would be made to subject the operation of one to the other. Certainly it would be difficult to produce net balance from a combination of the two.

7. A net deficit mechanism is the best of the solutions that lies within the bounds of possibility, though it will still be extremely difficult to get it adopted since it involves at least an implicit acceptance of the juste retour. (On the other hand it can be designed to be limited in its practical operation to the UK.) Under such a mechanism, the starting point would be the net difference between a country's contribution to the budget and the total of Community expenditure taking place in it. It would thus act on both halves of the problem simultaneously enabling the UK's financial position to be assessed with accuracy. On the basis of criteria to be worked out (they would inevitably be similar in kind to those governing the existing financial mechanism) the country concerned would receive a rebate. The net deficit mechanism would provide the technically surest method of producing net balance for the UK, but if this is to be the UK's starting point in negotiation with her partners - and it is as capable of being defended as any other starting point - HMG should nevertheless realise that they are most unlikely to get a settlement anything like as generous as this. Principle will be adduced in support of parsimony; it will be argued that no member state should be totally relieved of the financial consequences of the mix of Community policies. (The existing financial mechanism, it will be recalled, is deliberately only partial in its compensation.) If the UK could cut her deficit in half (in 1980 from 1500 meua to, say, 800 meua) she would be doing well. The easing of the constraints discussed above possibly combined with some progressivity (which could for instance be applied to only part of the calculation) would come quite close to this result. A radical revision of the existing mechanism could prove to be an acceptable fallback position.

8. Any other offers

No doubt many attempts will be made to buy the UK off with proposed actions on the expenditure side of the budget which will be of doubtful value and of little certainty. Offers of loans,

/ cheap

cheap or otherwise will also be made. The UK will not find it difficult to resist these blandishments at least in the early stages, but should perhaps be more discriminating when it comes to clinching a deal. For the sake of argument, a radically revised corrective mechanism combined with a commitment of principle from Heads of Government that within a given deadline a system of nationally financed income support grants would be gradually introduced to subsidise inefficient farmers could be an acceptable bargain. Substantial reductions in FEOGA guarantee expenditure would offer a real prospect of a significant diminution of the UK deficit on Community expenditure. Such a package would have the virtue of being presentationally reasonable and would delay the moment when a new own resource became unavoidable.

9. Presentation

Apart from the considerations outlined in paragraph 7 of the brief, thought should also be given to presenting the UK's goal and fall back positions in terms of the financial burden borne by other member states of the Community. For instance a net deficit of 800 meua would still represent to the UK a burden over 10% greater than the German net deficit would become for Germany on the basis of a mechanism which was financed on the budget key.

10. Points on which the UK will need especially careful defence of its case include (this list is not necessarily exhaustive but reflects points where difficulty was encountered inside the Commission):

- (a) Why the Community should renegotiate Renegotiation;
- (b) why a country with a balance of payments surplus (and North Sea oil) cannot bear a net deficit;
- (c) why the UK should not be expected to adapt the pattern of her trade faster (as Denmark and Ireland have done) so as to reduce customs duties and agricultural levies from third countries;
- (d) why loans are not the answer;
- (e) why the UK should not have attributed to her direct benefit such aspects of the Community's commercial policy as the sugar agreement which took over the Commonwealth Sugar Agreement and access for New Zealand butter (combined cost in 1980 estimated at 650 meua).

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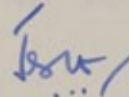
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PRIME MINISTER

Cabinet: Community Affairs

The Chancellor of the Exchequer may wish to report on the meeting of the Budget Council on Tuesday attended by the Financial Secretary. The meeting was to discuss the Community's draft budget for 1980 (which now has to be discussed with the European Parliament) but the Financial Secretary took the opportunity of underlining the seriousness of our budget contribution problem. This will be the main item for discussion at next Monday's meeting of the Finance Council, and the Chancellor may wish to outline the approach he intends to take as decided upon at OD.

2. There could be questions about the newspaper reports on further sales of butter to the USSR. The Minister of Agriculture will probably confirm that fresh butter (not the stockpile) is being exported with the aid of the Community's normal export refund and say that we do not have the power to stop it. But it does serve to underline the urgency of reducing the milk surplus in the Community. In the short run, it is one of the cheapest ways of reducing the surplus (current stockpile 342,000 tons of which 51,000 tons in the United Kingdom).



JOHN HUNT

12th September, 1979

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Excerpt from the Prime Ministers talk with
the PM of Belgium, M W Martens - 12.9.79
at No 10.

Community Budget

The Prime Minister said that the United Kingdom had not entered the Community in the expectation of getting back every penny that it contributed. Partnership did not work like that. But it was essential that every member was given a fair and reasonable deal. Britain's per capita GNP was lower than that of Belgium. But, as the Commission's Reference Paper had made clear, our net contribution would be the highest made by anyone this year. The situation would deteriorate progressively in subsequent years. It was unacceptable that the third poorest member should be the largest contributor. The budget problem was creating substantial political difficulties in this country. If the excess contribution to the Community budget was available to the Government, it would be possible to bring tax levels down towards the levels existing in France and the Federal Republic. The electorate were being told that the Government were having to economise on housing, education, social security and the like at the same time as ever more money was being paid into the Community budget. The biggest single increase in this year's national budget had been our contribution to the Community budget. Consciousness of this situation was causing resentment and would have an increasingly adverse effect on attitudes towards the Community.

The Prime Minister said that her Government fervently supported the Community. There was no question of their determination to remain members. If the Community did not exist, the future of democracy would be significantly more doubtful than it now was. She felt strongly that the free countries had to stick together and work together.

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The Prime Minister recalled that she had raised the question at the European Council in Strasbourg. She had made it clear that if the United Kingdom did not get fair and reasonable treatment there would be trouble. For the moment the principal requirement was that the agreed timetable should not slip. The Reference Paper should be dealt with by the ECOFIN meeting on 17 September. Thereafter the Commission should put forward ^{ideas for a} reasonable and equitable solution in good time for decisions to be taken in Dublin in November.

M. Martens said that he valued the attitude of the present British Government towards the Community. He was aware of the problems raised for the United Kingdom by the Community budget. He agreed that the European Council's timetable must be observed. His Government would examine the Commission's Reference Paper objectively. But the Paper posed a problem for them: they did not accept that Belgium derived a benefit, in terms of resource transfer, from the location of the Community's administrative headquarters in Brussels. The Chancellor of the Exchequer said that disagreements about the Commission's analysis would no doubt be subject to discussion. What mattered was that Finance Ministers should soon address themselves to the question of identifying solutions to the major problem.

M. Simonet said that the question of Britain's contribution to the Community budget was a major political issue. Britain had embarked on a programme of economic and industrial rationalisation which would necessitate sacrifices on the part of a major section of the population. At the same time increased contributions to the Community were being called for. This undoubtedly posed a substantial problem for the British Government and hence for the Community as a whole. Moreover, it came at an unwelcome moment in the evolution of the Community. At the very least HMG was entitled to see that the timetable was kept. M. Simonet said that he would argue in favour of this in the Foreign Affairs Council where, he thought, the issue would probably arise since he doubted whether agreement would be found at the technical level. A political solution would be required and this would have to be prepared by the Foreign Ministers.

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/M. Simonet

M. Simonet went on to say that the budget issue evoked three major questions:-

- (a) The United Kingdom's conception of its contribution called in question the "own resources" system. This was a major issue of principle;
- (b) A solution of the British problem would require that other members of the Community should pay more to the budget than they did at present. Belgium would be happy for other Governments to increase their contribution but would be reluctant to do so herself at a time of retrenchment. No doubt other Governments would feel the same;
- (c) Much ill-will had been generated by the policies of the previous British Government. Some other members of the Community had concluded that the Community was a one-way street. It was inevitable that they would look for a gesture ^{from HMG} /in other areas, e.g. on energy policy, in return for making a move on the budget.

M. Simonet concluded by saying that the budget issue should certainly be tackled on its merits but that the other aspects which he had mentioned would have to be discussed in Dublin. The Lord Privy Seal said that he had reminded M. Simonet earlier in the day that the present Government's attitude was very different from that of its predecessor. There was no question now of a one-way street. Nor was the United Kingdom seeking to overturn the own resources system. But the present working of the budget was clearly wrong. The own resources system would be more soundly based if the budgetary problem had been resolved.

The Prime Minister concluded the discussion of the Community budget by saying that her Government was passionately committed to Europe but that it was coming under attack because of the inequities of the budget. Members of the Community should not be deflected from the timetable. It was tempting to delay decisions

/but

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but on this occasion they had to be taken. A fair and reasonable deal and equity among partners was all that was being asked for.

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Ref. A0209

PRIME MINISTER

EEC Budget Contribution: The Next Steps

(OD(79) 24)

The Chancellor of the Exchequer's paper (OD(79) 24) seeks approval to the next steps in the negotiations to reduce our net contribution to the Community budget. In one respect (see paragraph 4 below) I find it very disappointing.

2. The Commission has now produced its "reference paper" in response to the first stage of the Strasbourg remit. The final version omits conclusions which were favourable to our case and includes sections designed to muddy the waters. But it still retains the essential figures and, as Le Monde says, assures us, at the outset of the great debate, of "un avantage incontestable". The key figures are set out in a table attached. They show our net contribution in 1980 as 1,814 million EUA (if MCAs are attributed to the exporting country), compared with 1,048 MEUA for Germany. The Italians emerge as major net beneficiaries.

3. The "reference paper" will be discussed at the Finance Council next Monday. The Chancellor sets out the line he proposes to take in paragraph 12 of his paper. By spelling out the magnitude of the problem as we see it, discussing a number of false or unacceptable routes to its solution and saying clearly that some form of corrective mechanism dealing both with our excessive contribution and our inadequate receipts he hopes to respond to the invitation from the Strasbourg Council to "present our requests in concrete form" without pinning ourselves down prematurely to one particular form of solution.

Paragraphs 12(iii)-(v) are the most important sections.

4. I think this is all right for the Finance Council on Monday. Nevertheless it seems to me extraordinary (and all the more unfortunate in view of the Chancellor's forthcoming absence from the country from 25th September to 3rd October) that the Treasury can still make no concrete recommendation on what solution would suit us best (in all probability that in his paragraph 16 ~~(ii)~~ (iii). If we are to keep to the timetable, the Commission will need to come forward with its proposals for solutions by end-October at the latest and ideally before the next

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Finance Council on 15th October. It is vital that the Commission's proposals come as close as possible to satisfying the Chancellor's conditions (paragraph 12(iii)) -

- (a) act on our net contribution
- (b) last as long as the problem
- (c) avoid increased Community expenditure

and we shall need to feed our own preference into the Commission soon. The Chancellor suggests merely that officials should sound out our contacts in the Commission before the Government makes up its mind. I suggest that you emphasise that it will be vital to do this well before the Finance Council on 15th October.

5. Besides working on the Commission, the Chancellor suggests further bilateral discussions leading up to your bilateral meetings with Chancellor Schmidt and President Giscard. The Italians present a difficulty. Since they no longer appear to have a budget problem, they will criticise the Commission's reference paper because it says too little about the resource costs of the CAP to them. Some Italians want to hold down CAP prices (we agree); others to concentrate on expanding Italian temperate production (less helpful); all of them to get yet more support for Mediterranean agriculture (expensive). In any case the Chancellor is suggesting (paragraph 13) that we should not get in the lead on the CAP. His suggested line with the Italians (paragraph 10) is that at least we should avoid knocking each other.

6. Looking further ahead, it is too soon to decide what the tactics at the November European Council in Dublin should be or what other cards should or may be on the table. But you may feel that the time has come to call for work on what leverage we might have. The Chancellor has already told you that he is looking into the legal possibilities of withholding our contributions, but there may be other ways of putting on the pressure. This work needs to be done discreetly but you may want to ask the Chancellor and the Foreign and Commonwealth Secretary to make sure that, by the time of the Dublin Summit, you at least know what the possibilities are.

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HANDLING

7. When the Chancellor of the Exchequer has introduced his paper, you might focus discussion first on the line to be taken at the Finance Council. The Foreign and Commonwealth Secretary may suggest that the United Kingdom objective should be a "broad balance" rather than the blunt formulation in paragraph 12(iii) that "the United Kingdom should not be a net contributor". The point is that no country could rule out being a net contributor in all circumstances: what we cannot tolerate is being a persistent large net contributor in our present circumstances. The Lord President may also have views. Does the Committee agree that paragraph 12(v) goes far enough at this stage?

8. You might then turn to follow-up action. The Committee will presumably agree that vigorous lobbying at Ministerial level is necessary. But how do we handle the Italians? We risk losing their support if we argue that the budget issue must be settled first; but if we accept that they will need to see parallel progress on their claims, this could lead to delays and be expensive for us. And does the Committee agree with the Chancellor's line on the CAP?

9. On the method of solving our problem, does the Committee agree that officials should explore the options without commitment? When does the Chancellor expect to be ready to report back (this should be if possible before he goes to the IMF but failing that immediately on his return)? Has the time come to commission work on what weapons we might eventually use in order to get our way?

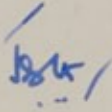
CONCLUSIONS

10. Your summing up will need to cover -

- (a) The Chancellor's line at the Finance Council (paragraph 12 with any changes agreed in discussion).
- (b) Authority for officials to explore possible mechanisms and the Chancellor to report back as soon as possible with his recommendations.
- (c) Bilateral Ministerial meetings. The programme in paragraphs 18 and 19 could be agreed. With the Italians, the best we can hope for is not to get in each other's way.

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- (d) Chancellor and Foreign and Commonwealth Secretary to consider, -
discreetly - what means we could if necessary deploy to put pressure
on our partners.


J OHN HUNT

11th September, 1979

TABLE: COMMUNITY BUDGET 1979 AND 1980
ESTIMATED CONTRIBUTIONS AND RECEIPTS BY MEMBER STATE

EUROPEAN UNITS OF MILLIONS
ACCOUNT (EUA) - THOUSANDS

	Belgium	Denmark	Germany	France	Ireland	Italy	Luxembourg	Netherlands	UK
1979									
Gross Contribution	871	327	3,992	2,607	98	1,579	18	1,251	2,291
Receipts (a)	1,209	551	2,837	2,285	463	2,333	269	1,323	1,764
Receipts (b)	1,239	782	2,974	2,517	676	2,060	269	1,480	1,037
Net Contribution (-) or Receipt (+) (a)	+ 338	+ 224	-1,155	- 322	+ 365	+ 754	+ 251	+ 72	- 527
Net Contribution (-) or Receipt (+) (b)	+ 368	+ 455	-1,018	- 90	+ 578	+ 481	+ 251	+ 229	-1,254
1980									
Gross Contribution	922	368	4,578	3,037	137	1,750	20	1,270	3,113
Receipts (a)	1,460	651	3,471	2,917	573	2,621	312	1,629	1,561
Receipts (b)	1,472	738	3,530	3,018	650	2,484	312	1,692	1,299
Net Contribution (-) or Receipt (+) (a)	+ 538	+ 283	-1,107	- 120	+ 436	+ 871	+ 292	+ 359	-1,552
Net Contribution (-) or Receipt (+) (b)	+ 550	+ 370	-1,048	- 19	+ 513	+ 734	+ 292	+ 422	-1,814

NOTE

(a) If UK and Italian import Monetary Compensatory Amounts (MCAs) are attributed as a benefit to the UK and Italy.

(b) If UK and Italian import MCAs are attributed as a benefit to the exporter.



10 DOWNING STREET

Prime Minister.

(a) Chemullo's claim that our net contribution in 1982 will be £1500 m EVA is a national estimate. The Tugendhat may not agree.

(b) 1% VAT limit may be reached in 1981 rather than 1982 but it may not be wise for UK to attempt to precipitate discussion of the issue too soon.

Ann's
11/9

PRIME MINISTER

(1)

YOUR MEETING WITH MR. TUGENDHAT

I attach the briefs for your meeting with Mr. Tugendhat on Thursday 13 September at 1500 hours. They cover the two specific points which Mr. Tugendhat has said he hopes to discuss with you, viz the Community Budget and the Common Agricultural Policy. More generally, Mr. Tugendhat said he hopes to hear your views on Britain's role and position in the Community in the longer term.

I shall, if you agree, sit in on the meeting to take a note. You may think it would be helpful for one other official, e.g. Mr. Franklin or Mr. Butler, to sit in on the meeting.

ant
ant

11 September 1979



Foreign and Commonwealth Office

London SW1A 2AH

*La
Vint
13/9*

10 September 1979

Dear Michael,

Prime Minister's Meeting with Mr Tugendhat

///

I am attaching three briefs on the main subjects which Mr Tugendhat's cabinet have told us he is likely to raise with the Prime Minister on 13 September.

Yours etc

Paul

(P Lever)
Private Secretary

M O'D B Alexander Esq
10 Downing Street
LONDON

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11 SEP 1979

CALL OF MR TUGENDHAT ON THE PRIME MINISTER: 13 SEPTEMBER

COMMUNITY BUDGET

POINTS TO MAKE

1. Problem

The Commission reference paper confirms all that we have been saying about the scale and gravity of the problem of our budget contribution. A net contribution of something approaching, even on the Commission's figures, £1,000 million for 1980 is quite incompatible with our position as seventh out of nine in terms of per capita GDP. A solution must be found quickly, to take effect on the 1980 Budget.

2. Timing

The Strasbourg European Council agreed that a solution should be found at the meeting of the next European Council. If this is to be done - and it can only be done on the basis of proper preparation - Finance Ministers on 19 November and Foreign Ministers (whose duty it is to prepare European Council meetings) on 20 November will need to see the paper putting the issues to Heads of Government. Working backwards this means that the Commission's proposals for a solution should if possible be available at the time of the 15 October Finance Ministers meeting. It is accordingly vital that the 17 September Finance Ministers meeting should complete discussion of the reference paper and invite the Commission to prepare a draft on solutions. Were the Commission representative to be well disposed, he could help to achieve this by intervening at the end of the discussion to propose that the Commission now start work on proposals. Who is the representative likely to be? Mr Jenkins? Mr Ortoli?

3. Solution

Given our position as a Member State with below average GDP per capita, we could logically seek a net benefit but what we are in fact seeking is a broad balance. We are flexible on the precise nature of a solution, though we do know what will not do:-

/(a)

- ← (a) minor tinkering with the existing mechanism (which up to now has proved totally inadequate);
- (b) increased Community programmes - these will not operate quickly enough or on the requisite scale;
- (c) loans: they have to be repaid. Interest is payable on them and they can anyway be obtained elsewhere. They are not a permanent transfer of resources in the way that our budget contribution is.

The only effective answer we see is a corrective mechanism dealing both with our unfairly large gross contribution and our inadequate receipts and free from the deficiencies of the present financial mechanism. Does he agree? And if so, what form of mechanism is most likely to prove acceptable?

← 4. Commission Reference Paper

Thank Mr Tugendhat for considerable efforts made by him and his Cabinet; unhelpful last-minute changes not his fault.

5. Inability of Commissioners to agree a conclusions section regrettable, but much of the paper still supports our arguments and the tables of net contributions show our position to be as bad as we had expected.

6. Most worrying aspect of recent developments is extreme hostility of our opponents in Commission: what effect is this likely to have on finding a consensus on a solution?

/FACTUAL BACKGROUND



The first part of the report deals with the general situation in the country. It is a very interesting and detailed account of the political and social conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

The second part of the report deals with the economic situation. It is a very interesting and detailed account of the economic conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

The third part of the report deals with the social situation. It is a very interesting and detailed account of the social conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

The fourth part of the report deals with the political situation. It is a very interesting and detailed account of the political conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

The fifth part of the report deals with the cultural situation. It is a very interesting and detailed account of the cultural conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

The sixth part of the report deals with the educational situation. It is a very interesting and detailed account of the educational conditions. The author has done a great deal of research and has gathered a wealth of material. The report is well written and is a valuable contribution to the study of the country.

THE UNIVERSITY OF CHICAGO PRESS

1971

FACTUAL BACKGROUND

1. Our latest thinking on the Community Budget problem is contained in a memorandum by the Chancellor of the Exchequer [which has now been seen by the Prime Minister].
2. The Commission Reference Paper which came out on 7 September contains tables which confirm the gravity of our Budget problem; we are estimated to be the largest net contributor to the Budget in 1979 and 1980 when MCAs are attributed to exporters (at 1245 mEUA and 1814 mEUA - £780 million and c£1,125 million respectively). The text of the paper, however, is less helpful for while it acknowledges that we have a problem, it also contains a number of red herrings introduced by M. Ortoli: e.g. the pattern of the Budget is simply the result of common policies; resource transfers are negligible when compared with the total size of Community GNP; those who complain about the effects of the Budget are failing to take into account important general benefits of Community membership. These unhelpful disclaimers, written into the paper at a late stage, are likely to be cited by those unsympathetic to the UK line when this paper is discussed in the Finance Council on 17 September. Nevertheless, the figures provide an incontrovertible case that there is a major UK problem, and the paper acknowledges that the Financial Mechanism will not give us a significant level of refund to balance our excessive level of gross contribution and our lack of receipts.
3. Recent bilateral contacts have revealed a widening recognition of the existence of our problem, though a considerable reluctance to do anything significant about it. Present net recipients like the Netherlands who are in principle sympathetic have budgetary constraints and are concerned about the size of the bill arising from a solution. The Irish, in the Presidency, are theoretically disposed to be helpful, but are in fact apprehensive that any solution is likely to be damaging to their position as the major net recipient. The French are now ready to recognise the existence of the problem, but will be firm in defending their own interests. The Italians acknowledge that their problem is of a different kind (i.e. non-budgetary resource transfers): as far as the Budget is concerned, the Commission estimates that they will be major net recipients in both 1979 and 1980. However, they have made clear to us in recent bilateral contact at official

/level

level that they are keen to maintain an understanding with the UK. The problem will be finding adequate common ground to keep this alliance alive.

Foreign and Commonwealth Office
London SW1

10 September 1979

18.

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CALL MR TUGENDHAT ON THE PRIME MINISTER: 13 SEPTEMBER

COMMON AGRICULTURAL POLICY

POINTS TO MAKE

1. (a) We must continue to keep the issue of CAP reform separate from the immediate UK budget problem. Clearly the two are related in that the CAP accounts for three-quarters of the Community budget. But our case for a more equitable financial arrangement stands on its own, as does the case for a reduction in the cost of the CAP.

(b) The first priority is to reduce the structural surpluses which are the main cause of the excessive cost of the CAP. The only effective means of doing this is to hold down the prices guaranteed to producers over a period so that they will fall in real terms with inflation. The price settlement this year was a useful first step. We need to continue this process until surpluses are eliminated.

(c) Milk is the most serious problem - it accounts for 40% of Community agricultural expenditure. This year's freeze on prices was a major step but production is still rising and further action is needed to cut the level of producers' support. Whatever the Commission propose, it is essential that they should not discriminate against the larger and more efficient producers; we could not accept such discrimination. Mr Tugendhat may argue that the UK did not accept the Commission's proposed producer co-responsibility levy in the last price negotiations. If so the Prime Minister could say that the UK was the only country to stand firm in support of a milk price freeze, and she could remind Mr Tugendhat that we told Mr Gundelach that, because of its discriminatory nature, it would have cost the UK more to accept the co-responsibility levy than to reject it.

(d) For sugar it is vital that the Commission seize the opportunity of the renegotiation of the Community regime to put forward proposals which will effectively reduce surplus production - currently running at more than one-quarter of Community consumption.

(e) The imminent exhaustion of own resources when the 1% VAT ceiling is reached should help to impose some discipline on the CAP. How does Mr Tugendhat best think this opportunity can be exploited?

/Defensive

Defensive

2. [If Mr Tugendhat suggests that UK is likely to be weak on CAP prices in future because the reduction in our MCA leaves us little scope to increase our prices through a green pound devaluation]

The strength of the pound makes no difference to our determination to control the cost of the CAP, and for it to operate in such a way that food importing countries like Britain do not have to pay a vast cost to subsidise less efficient agriculture in exporting countries.

3. [If Mr Tugendhat suggests that the UK was soft in the 1979 price fixing negotiations - an idea promoted by the Agricultural Commissioner Gundelach]

This is an absurd suggestion. We were firm in support of the Commission's proposals for price freezes in milk products - much the most important area and this was achieved. We would have preferred to see a price freeze on all products in surplus, but the eventual package achieved was in our view the best negotiable. We regard the Commission's estimate of the cost to the Community Budget of the price fixing (1300 mEUA or £880 million) as unrealistic. This high estimate arose mainly because the Commission, in presenting their Budget for 1980, had assumed receipts of 880 mEUA (£595 million) from a very heavy tax on milk producers which was contained in the Commission's original proposals but was never likely to be acceptable to the Council, in conjunction with a price freeze.

CALL BY COMMISSIONER TUGENDHAT ON THE PRIME MINISTER:

12 SEPTEMBER

COMMUNITY ISSUES: STAFFING

POINTS TO MAKE

1. Remind Tugendhat HMG concerned at imbalance against UK nationals in middle senior grades (A4-A7) of Commission: we ~~shall seek to improve position~~ whenever possible, eg. in implementation of Spierenburg proposals.

FACTUAL BACKGROUND

2. Tugendhat is Commissioner responsible for staffing of the Commission. Lord President has raised with him orally and in writing significant imbalance against UK nationals in middle/senior (A4-A7) staffing grades of Commission (see attached table). Tugendhat recognises problem but offers little hope of immediate prospect for correction by appointment of external candidates. Increasingly Commission favour internal promotions rather than external appointments, except at most senior grades. While all recognise informally that balanced quotas need to be respected, in practice this is not always easy to achieve except for the top grades.

3. Report by Commission Internal Review Body (Spierenburg Committee) due to Commission 24 September. Body appointed by Commission end of 1978 to examine internal staffing and structure of Commission. Likely to recommend radical solutions, in particular, reduction number of Commissioners and Directorates General, and numerous detailed staffing changes aimed at improving internal career structure, mobility, rational use of personnel, etc. Implementation of proposals may be opportunity for UK to begin to rectify imbalance against us.

FOREIGN AND COMMONWEALTH OFFICE

10 September, 1979

Officials and temporary staff by nationality, category and grade
Situation at 31 December 1978

Administrative appropriations + research appropriations

Category and grade	EEC D	%	UK	%	F	%	H. I	%	BNL						DK	%	IRL	%	Other	%	Total
									B	%	N	%	L	%							
A1	7	16.3	7	16.3	8	18.6	8	18.6	6	14.0	3	7.0	1	2.3	2	4.7	1	2.3	—	—	43
A2	24	16.7	22	15.3	30	20.8	26	18.1	16	11.1	12	8.3	5	3.5	5	3.5	4	2.8	—	—	144
A3	74	19.9	55	14.8	68	18.3	64	17.3	45	12.1	27	7.3	11	3.0	11	3.0	14	3.8	2	0.5	371
A4	189	25.1	81	10.8	137	18.2	137	18.2	116	15.4	51	6.8	20	2.7	4	0.5	11	1.5	7	0.9	753
A5	174	21.8	81	10.2	119	14.9	220	27.6	90	11.3	47	5.9	20	2.5	22	2.8	17	2.1	8	1.0	798
A6	70	17.6	53	13.3	75	18.8	85	21.4	64	16.1	19	4.8	8	2.0	13	3.3	7	1.8	4	1.0	398
A7	47	13.7	66	19.2	87	25.3	50	14.5	40	11.6	14	4.1	5	1.5	19	5.5	12	3.5	4	1.2	344
Total A	585	20.5	365	12.8	524	18.4	1 590	20.7	377	13.2	173	6.1	70	2.5	76	2.7	66	2.3	25	0.9	2 851
B1	112	20.6	21	3.9	110	20.2	85	15.6	113	20.7	51	9.4	37	6.8	9	1.7	2	0.4	5	0.9	545
B2	161	22.4	22	3.1	132	18.4	134	18.7	160	22.3	67	9.3	31	4.3	4	0.6	2	0.3	5	0.7	718
B3	122	21.1	48	8.3	85	14.7	128	22.2	125	21.7	32	5.5	16	2.8	14	2.4	6	1.0	1	0.2	577
B4	51	10.5	33	6.8	65	13.3	135	27.7	123	25.3	40	8.2	10	4.1	11	2.3	8	1.6	1	0.2	487
B5	34	13.8	19	7.7	27	10.9	45	18.2	70	28.3	17	6.9	15	6.1	12	4.9	7	2.8	1	0.4	247
Total B	480	18.6	143	5.6	419	16.3	527	20.5	591	23.0	207	8.0	119	4.6	50	1.9	25	1.0	13	0.5	2 574
C1	105	13.2	8	1.0	101	12.7	272	34.3	218	27.5	43	5.4	42	5.3	3	0.4	1	0.1	—	—	793
C2	193	13.3	10	0.7	154	10.6	484	33.3	472	32.4	57	3.9	80	5.5	1	0.1	2	0.1	2	0.1	1 455
C3	96	10.1	57	6.0	95	9.9	189	19.8	339	35.5	43	4.5	55	5.8	34	3.6	32	3.4	15	1.6	955
C4	28	7.1	33	8.3	24	6.1	103	26.0	129	32.6	12	3.0	27	6.8	25	6.3	11	2.8	4	1.0	396
C5	9	4.3	32	15.2	9	4.3	40	19.0	65	31.0	2	1.0	25	11.9	16	7.6	9	4.3	3	1.4	210
Total C	431	11.3	140	3.7	383	10.1	1 088	28.6	1 223	32.1	157	4.1	229	6.0	79	2.1	55	1.4	24	0.6	3 809
D1	18	8.1	1	0.4	10	4.5	111	49.8	67	30.0	7	3.1	9	4.0	—	—	—	—	—	—	223
D2	1	0.8	3	2.5	1	0.8	67	55.4	42	34.7	—	—	6	5.0	—	—	—	—	1	0.8	121
D3	5	4.1	6	5.0	5	4.1	46	38.0	34	28.1	2	1.7	20	16.5	1	0.8	1	0.8	1	0.8	121
Total D	24	5.2	10	2.2	16	3.4	224	48.2	143	30.8	9	1.9	35	7.5	1	0.2	1	0.2	2	0.4	465
LA1																					
LA2																					
LA3	3	20.0	2	13.3	4	26.7	—	—	—	—	2	13.3	1	6.7	1	6.7	—	—	2	13.3	15
LA4	38	25.0	15	9.9	27	17.8	23	15.1	19	12.5	24	15.8	2	1.3	4	2.6	—	—	—	—	152
LA5	59	23.6	25	10.0	29	11.6	40	16.0	36	14.4	33	13.2	2	0.8	20	8.0	1	0.4	5	2.0	250
LA6	22	10.9	42	20.8	9	4.5	34	16.8	45	22.3	18	8.9	—	—	24	11.9	4	2.0	4	2.0	202
LA7	50	13.5	62	16.8	34	9.2	66	17.8	48	13.0	30	8.1	3	0.8	54	14.6	7	1.9	16	4.3	370
LA8	11	10.7	31	30.1	6	5.7	17	16.5	13	12.6	4	3.9	2	1.9	12	11.7	2	1.9	5	4.9	103
Total LA	183	16.8	177	16.2	109	10.0	180	16.5	161	14.7	111	10.2	10	0.9	115	10.5	14	1.3	32	2.9	1 092
Grand Total	1 703	15.8	835	7.7	1 451	13.4	2 609	24.2	2 495	23.1	657	6.1	463	4.3	321	3.0	161	1.5	96	0.9	10 791
Local Staff	32	4.4	21	2.9	81	11.2	162	22.4	233	32.2	17	2.3	54	7.5	12	1.7	6	0.8	106	14.6	724

NOTE OF A DISCUSSION OVER LUNCH AT NO. 10 DOWNING STREET, ON
WEDNESDAY 5 SEPTEMBER 1979

PRESENT

Prime Minister	The Taoiseach
Foreign and Commonwealth Secretary	Mr. G. Colley (Tanaiste, Minister for Finance and Minister for the Public Service)
Chancellor of the Exchequer	
Secretary of State for Northern Ireland	Mr. M. O'Kennedy (Minister for Foreign Affairs)
Lord Privy Seal	Mr. A. O'Rourke (Secretary, Department of Foreign Affairs)
Mr. M. D. M. Franklin	
Mr. M. O'D. B. Alexander	Mr. D. Nally (Deputy Secretary, Taoiseach's Office)

The Community Budget

The Prime Minister, introducing the discussion, said that the United Kingdom was at present grossly over-contributing to the Budget. Although the third poorest member of the Community in GDP terms, the United Kingdom was the largest net contributor, considerably ahead of France and the Federal Republic. This situation had to be corrected. HMG accepted that Ireland should be a net gainer from the Budget. But a British contribution on the present scale made no sense. HMG attached considerable importance to the maintenance of the timetable established by the European Council at its last meeting. The Presidency should ensure that this timetable was adhered to.

The Foreign and Commonwealth Secretary stressed the political dimension. HMG still had a problem with public opinion in this country. Since coming to power in May, they had demonstrated their European credentials, e.g. by lifting a number of outstanding reservations. (Mr. Colley acknowledged HMG's helpfulness in this regard). If the UK received no satisfaction on the Budgetary issue, the political situation would become markedly more difficult.

Mr. Colley said that he wished to keep to the European Council's timetable but pointed out that any member country of the Community had the ability to impose delay. The Irish Government accepted the existence of the imbalance described by the Prime Minister but, like other members of the Community, did not see the situation solely in Budgetary terms. The question was

not simply one of contributions to and receipts from the Budget. There was the question of convergence. What value should one place on the provisions of the Rome Treaty for free trade in industrial products? The Prime Minister pointed out that the present arrangements meant that access was easier for the industrial products of other EEC members coming into the UK than for British agricultural products moving in the other direction. Mr. O'Kennedy repeated that it was wrong to look at the Community simply in terms of the Budget and to ignore the other benefits that it had brought. Its impact in the social and economic spheres had to be taken into account.

Mr. Colley said that there was a further problem. The Budget was approaching the ceiling imposed by the 1 per cent VAT limitation. It was important to take into account how the difficulties to which this would give rise would be faced. The problem could not be ignored in considering adjustments to the Budget of the kind sought by HMG. The Chancellor of the Exchequer said that the own resources problem was a real but separate issue. It needed to be looked at. The UK position was that the 1 per cent ceiling should not be raised. But for the moment it was important to concentrate on reform of the Budget. With 16 per cent of the GDP of the Community, the UK was paying 20 per cent of the contributions to the Budget and only receiving 10 per cent of the receipts.

Mr. O'Kennedy said that the Irish Government had inherited with the Presidency a set of themes and priorities. They wished to stick to those priorities and to take decisions wherever possible. They did not know the views of all their partners but so far things were going according to plan. Mr. Colley repeated that any one member country could prevent progress but that it was his intention to do everything possible to get the Budgetary issue to the Summit in a shape where decisions would be possible. Mr. Lynch, concluding this part of the discussion, said that the Irish Government recognised the problem and wished to adhere to the European Council's timetable.

/The EMS

MR. ALEXANDER

EWOPN
*Chris Stephens: I have spoken
to Mr Lever.*

Paul

I spoke today to Christopher Tugendat's Private Secretary in Brussels. He mentioned that Mr. Tugendat wishes to discuss the following subjects during his meeting with the Prime Minister next Thursday:

1. British Budget contribution paper and the subsequent follow-up in Council.
2. Common Agricultural Policy. Controlling cost of it.
3. Mr. Tugendat would be interested to hear the Prime Minister's views on longer term thinking about the British role and position in the Community.

Bryan Cartledge wrote to Paul Lever on 27 July requesting briefing but without mentioning anything very specific. Would you like me to contact the FCO, Treasury and Ministry of Agriculture on these subjects?

C.J.

5 September 1979



With the compliments of

THE PRIVATE SECRETARY

K.A.
Munt
- 5/9

FOREIGN AND COMMONWEALTH OFFICE
SW1A 2AH

4.9.79.

Cluzel

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RECORD OF A MEETING BETWEEN THE SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS AND THE FRENCH FOREIGN MINISTER AT BLEDLOW ON 3 SEPTEMBER 1979 AT 10.30AM.

Those present:

- | | |
|----------------------------|-------------------------|
| The Rt Hon Lord Carrington | M. Jean Francois-Poncet |
| Sir Ian Gilmour | M. Bernard-Reymond |
| Sir R Hibbert | M. Sauvagnargues |
| Mr M D Butler | M. Paye |
| Mr J L Bullard | M. Siefert Gaillardin |
| Mr G G H Walden | M. Cluzel |

EUROPEAN COMMUNITY

1. M. Francois-Poncet said that he would like to discuss the UK budget contribution; the CAP; the Three Wise Men; Euratom; Fish; and Energy. Lord Carrington said that the only other problem he would like to include was Gibraltar. He could not see how Spain could join the Community with a closed frontier with Gibraltar. He hoped to see the Spanish Foreign Minister in New York during the General Assembly. A dialogue was needed on Gibraltar with the Spanish, aimed to persuade her to end restrictions. Sir Ian Gilmour explained that the Spanish had missed the opportunity of General Franco's death to do this, and now needed a new pretext to satisfy their public opinion. M. Francois-Poncet said that he would like to be kept informed about this

M. Walden

See some amendments + a marginal comment on para 13.

WJ

4/9

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- PS/Sec of State for Energy
- PS/Lad President
- Sir R. Heston

(Rev) Sir D. Maitland (UKREP EC)

problem. The Spanish Prime Minister was visiting France towards the end of the year, and the subject could arise then.

UK BUDGET CONTRIBUTION

2. M. Francois-Poncet said that he had not yet seen the Commission's paper, though he had some indication of its possible contents. He would therefore like to restrict discussion to general views of the problem, and to procedure. As President Giscard had told Mrs Thatcher, the French were studying the issue with an open mind, and with a desire to find a solution. They were also very encouraged by the general attitude of the new Conservative Government towards Europe, which they found positive. However, there were fairly substantial differences between the way Britain and France looked at the problem. The British seemed to see the budget as separate from the economic environment of the Community as a whole, and from the philosophy which had underlaid the Community from the beginning. It was true that the UK contributed 20% to the budget, although her GNP was only 16% of the EEC total. However, the UK's contribution was made up to a greater extent than that of other states by customs and agricultural levies, especially on imported industrial goods. These accounted for 26% of the EEC total. In a sense therefore we were not playing the Community game, but were still pursuing an outward-looking commercial policy. Our contribution to the budget would be smaller if we bought less abroad. It was therefore unfair of us to ask for a greater return on our contribution. This would only encourage us to import more from outside the Community. The EEC did not have a closed attitude to the rest of the world; but European preference was a cornerstone of the Community.

3. He had expressed himself in strong language on this subject, since he wanted to make the French position clear. The first problem was however to get the figures straight. These changed each year. Now, for example, the United Kingdom's MCAs were disappearing. There was also the question of whether loans should be included in the figures or not. But the Community's philosophy should also be taken into account. He understood the British viewpoint; but we must understand that there was another way of looking at things. The next problem was what we should do about the issue. The French had no ideas yet. But in their view the most pragmatic solution, which changed the basis of the present system least, would be best. Such a solution should also be limited in time. Three countries were awaiting entry into the Community, and any longer term solution could affect them. Whatever we claimed could be claimed by them too. Such a situation could change the whole basis of the Community. Greek entry was already costing the Community, which had been very generous, a lot of money, not to speak of Spain and Portugal.

X

4. Lord Carrington said that there were two levels to the problem. The first was political. There was a strong sense of injustice in the United Kingdom about our ^{net}~~net~~ contribution. This spilled over into popular attitudes to the Community as a whole. In the last four months the new Government had adopted a more positive attitude and had removed the niggling reservations placed by the last Government on a number of issues. We wanted to concentrate now on more fundamental questions. However, the sense of injustice over our budget contribution made it more

/ difficult

difficult for us to take a more positive attitude to the Community as a whole. It should not be forgotten that Little Englanders still existed. M. Francois-Poncet had delicately omitted to point out that the problem was ultimately of our own making in the sense that we were not running our economy properly. This ^{would} have been a legitimate point to make, but it was also true that excessive budget contributions would not help us to put our economy right.

5. We recognised of course that if we paid less, others must pay more. But the burden on us was very real. Our receipts of total Community expenditure was between 7% and 8%. We were not looking for a juste retour, but the imbalance had reached a stage when something would have to be done. We too were in favour of a pragmatic approach but we could not wait until Spain and Portugal joined the Community.

6. M. Francois-Poncet said that he was not suggesting that we should wait until Spanish entry, but that we should look for solutions on a short term basis, which would not involve major changes. It was not the French view that nothing should be done. Lord Carrington said that our Treasury had reached the conclusion that some form of corrective mechanism, different from the present mechanism which was too restrictive, was needed. He gathered from Sir D Maitland that the Commission's paper had concluded that ^{on} the figures on our contribution were about right. Mr Butler said that there were two parts to the problem. The first concerned ^{UK} receipts from the Community. Because 70% of the budget was devoted to agriculture, we received little of it relative to our GNP. The existing corrective mechanism only dealt with excessive ^{gross} contributions and not

with receipts ^{inadequate} / ^{which were the bigger part of the problem.}

As regards M. Francois-Poncet's point about United Kingdom imports from outside the Community, ^{our done} the share of trade ^{with the EEC} had risen fast since we had joined, from about 30% to 40% in 6½ years. ^{During the} 1980s we should ^{come} be closer to the EEC average. ^{In any case, an excessive} ~~But this was only a~~ ^{small} part of the problem of Britain's excessive ^{gross} budgetary contribution. Sir Ian Gilmour said that it was not true that we saw the budget separately from the economic environment of the Community as a whole. £1,000 million across the exchange rates was an indisputable fact, which was more important than philosophy if one happened to be paying this sum. ~~This~~ problem could not be explained away. In view of the UK's economic situation she should not be a net contributor to the budget.

6. M. Francois-Poncet said that he understood our sense of injustice, ~~But~~ the Community's budget was only a reflection of economic policies applied in each country. Community preference was a fundamental aspect of the EEC which was first and foremost a customs union. It was wrong to look at the Community only from the point of view of receipts. The fact was that French sensitivity ^{was} differed from those of the British. Some people in France asked what the point of the Community would be if there were no system of preference.

7. Lord Carrington said that he was happy with philosophy provided its results did not get out of hand. Sir Ian Gilmour suggested that the Community's philosophy was simply not working. M. Francois-Poncet had suggested a solution which would be limited in time. But any solution must continue for as long as the problem existed. Lord Carrington said that a corrective mechanism which dealt with the problems of others as well as our own would be

If the results of philosophy were to cost us £100 million or so, that would might be one thing. £1000 million was another & must be put right

X
X

acceptable to us. M. Francois-Poncet said that the French were ready to look at ways to change the corrective mechanism. If difficulties were encountered, Article 131 may offer a way of getting over the 1980 hurdle. Mr Butler said that the problem with this approach was that any change to Article 131 would need ratification. Moreover, after the history of negotiations on this problem at the time of the UK entry, and again in 1974/75, it would be undesirable to set a new deadline to examine the problem again in two to three years' time when Spain and Portugal were due to join. The problem would not last for ever, as our share of the tariffs came down, ^{and because} something must also be done ^{about} ~~to~~ ^{take} the CAP a smaller share of the budget.

8. Lord Carrington said that it was difficult to take the discussion any further at the moment, though he would like to go on talking about it both in Brussels and bilaterally with the French. Mr Butler raised the problem of timing and procedure. If the subject were to be dealt with at the November European Council, it would have to be properly prepared by the Finance and Foreign Ministers Council meetings, which would have to set out options for decision in Dublin. It was therefore important that the Foreign Affairs Council on ^{the} ~~the~~ ^{on solutions} should commission work ^{to be completed} ^{at} by the end of October. ~~He~~ ^{He} hoped that the Economic and Financial Council meeting on 17 September would instruct the Commission to press ahead. M. Francois-Poncet said that there might just be time to complete the work before Dublin, though it would be difficult to move so quickly on such a delicate issue. The closer we moved to a long-term solution with a new set of rules, the harder it would be to stick to the timetable.

to C.A.P.
Proposals
which would result in

But the
solution
must give the
interests of
the Community,
last as long
as the problem.

Which meant
that we needed the
Commission
proposals
by mid-October
we

CAP

9. M. Francois-Poncet said that he saw no ready solution to the problem of the CAP. He was however very conscious of the need to do something about surpluses, and especially milk. In general, he thought that it was not necessarily best to think in terms of solving the problem by prices. The Ministers of Agriculture would decide what the answer was. But he thought that one solution might be for a certain amount of each surplus to be nationally financed. Freezing agricultural prices over a long period was a simplistic solution. Imagination was needed to do something to eliminate the size of the surpluses. These were much larger in Germany and the Benelux countries than in France at the present stage.

10. Lord Carrington said that we shared much of the French view on this problem, and were not out to wreck the CAP. But the danger was that the CAP would destroy itself if it continued as at present. When the 1% VAT ceiling was reached shortly, this would concentrate minds on the CAP problem. President Giscard had agreed with Mrs Thatcher that we should not think in terms of endlessly developing the budget to balance it once the 1% ceiling was breached. We needed to do something before that point was reached. People outside the Community also resented the surpluses, which they saw as interfering with their trade when they were sold off. Australia and certain Pacific countries had complained. ~~to us.~~ M. Francois-Poncet said that it was bad for the Community's reputation to operate a policy which seemed to be ~~observed~~ ^{absurd}. But we must deny that the Community was protectionist. The Americans were much more protectionist, especially in agriculture. The Community was the least.

protectionist body in the world. Indeed, in view of the industrial development of certain parts of the Third World, we may soon have to ask ourselves whether the Community could live ~~as~~ without any steel or textile industry at all. The rest of the world must get used to the fact that the Community was and would remain ~~agricultural~~ exporters of both raw and ^{increasingly} manufactured agricultural products. Lord Carrington said that what they did not like was Community subsidisation of agricultural exports. M. Francois-Poncet said that the structure of the EEC subsidies was different from ~~or to~~ ^{that in} the rest of the world.

THREE WISE MEN

12. M. Francois-Poncet said that he did not expect the report of the Three Wise Men to be revolutionary on ~~the~~ Community institutions. He gathered that the report would be modest - perhaps too modest in the case of institutions. The French would like to discuss this during the Franco-British Summit. They were reasonably satisfied about the Commission's role: it was not and should not become a scarce of major executive decision but should have the role of a sort of super Secretariat. Major Community advances in recent years, eg on European elections, energy, and the monetary system, had all been decided at Head of Government level. Decisions would not have been taken if any other ~~channel~~ ^{channel} gathering had been used. We should think about the consequences of an enlarged Community, and what this would mean for ^{the} rotating chairmanship. Britain, Germany and France would each be chairman once every six years. What would this mean for major Community initiatives? These could hardly be brought to fruition in six months. This was a real problem. It was necessary to promote Europe's presence and political will in the world. It was difficult to imagine
/a Community

a Community presided over by eg Luxembourg, as having any serious weight. The French did not know what the solution was, but were convinced that we should think and talk about the problem. They were not in favour of changing the Treaties, which could affect the sensitivities of the smaller countries. But the Heads of Government meetings were not covered by the Treaties. We should therefore perhaps think of doing something in this area. The question was whether there was any more rational and efficient way of organising matters without antagonizing the smaller countries.

12. Lord Carrington said that he agreed on the importance of not antagonizing the smaller members. He did not expect much to come from the Three Wise Men's report, except perhaps in the procedural field. There was also the problem of the number of Commissioners after enlargement. There was no room for an increase of Commissioners with no real job to do. ^{On the other hand,} to reduce the numbers to one per country would also be inconvenient for the United Kingdom, where it was useful to have one Conservative and one Socialist seat. He agreed on the need for the larger countries to show leadership, and favoured bilateral meetings between ourselves, the French and the Germans, though these would need to be pursued delicately to avoid any appearance of ganging up on the others.

13. M. Francois-Poncet suggested that one solution might be for the President of the European Council to change every two years rather than every six months, and for the President to be designated by the European Council on the basis of his capacity rather than by rotation. The present situation contained the seeds of paralysis. Sir R Hibbert suggested that the Troika principle might be worth considering, especially if Greece were spelt with an 'E' to place it

[Did this
come out as
clearly as
this? I
thought not]
Yes. See 4/7

between Portugal and Spain. M. Francois-Poncet said that another solution might be to have a double Presidency: once dealing with protocol and the second a sort of Director~~ate~~-General.

EUROPEAN COURT

14. Lord Carrington said that there had been strong reactions at the informal meeting of Foreign Ministers at Chateau *Mercus*... when M. Francois-Poncet had criticised the European Court. The British shared French anxieties. M. Francois-Poncet said that the institutions of the Community had not developed as many people had hoped, and the European Court saw itself as having taken over the flame of the Community. They felt that they should produce imaginative decisions, and the dangers of this attitude were well illustrated by the position the US Supreme Court had come to occupy. Europe would only develop through the executive decisions of its governments. Anything else would lead to conflict. Some decisions of the European Court had been staggering. They seemed to have concluded that there were areas where European states were no longer sovereign.

/The Court

The Court seemed to think that there was a "European Constitution" which could no longer be changed. The French believed that States could undo what had been done. He had deliberately spoken out at Chateau ~~Mercu~~ in the hope that the Court would come to hear of his remarks. A new Europe could not be built on court decisions.

16. Mr Butler said that the Court had adopted a dangerous attitude on Community competence. Its view was that the Community either had exclusive competence or none at all. In fact both the Community and its Members needed to operate in harness. We should seek to counteract the Court's actions by avoiding the Commission referring too many questions of competence to it. Lord Carrington said we should also seek to settle as many differences as possible out of court.

M. Francois-Poncet said that the smaller countries had different views. Mr Butler said that both Benelux and Denmark were also ^{officials} ~~critical of the Court's actions~~ ^{worried out the position on Community competence}. It was not a question of seeking to reverse the Court's judgement, but to build up a body of opinion amongst officials and Ministers that it was on the wrong lines and that

European Parliament

16. M. Francois-Poncet said that he was afraid that there would soon be trouble with the European Parliament. The first problem would probably be this year's budget. We should all remember the experience of last year and adhere to the decisions taken then on the budget. Each country ^{would} ~~will~~ be tempted to play off the Parliament against other Members. We should therefore work closely together to avoid this, especially since some smaller countries tended to use the European Parliament to reverse decisions.

17. Lord Carrington said that there were already signs of

/ hostility

Competence questions must be settled pragmatically by agreement rather than reference to the Court.

hostility and resentment between British MPs at Strasbourg and Westminster. This could happen in other countries too (though M. Francois-Poncet pointed out that 50% of French Members of the European Parliament were also Members of the Assemblée. Sir Ian Gilmour said that there were already difficulties, eg about allowing MEPs into the House of Commons. Lord Carrington said that such grievances could encourage MEPs to inflate their own importance. M. Francois-Poncet said that one Franco-British problem had emerged in Strasbourg. When Mme Veil had been elected as President of the European Parliament it had been agreed that Britain would have the Chairmanship of the Parliament's Agricultural Committee. The French Government had subsequently been bitterly attacked by M. Chirac and the Communists for selling out French agriculture to buy Mme Veil her seat. The French Ministry of Agriculture was especially worried. Lord Carrington said that he would not worry if he knew how pro-European Sir Henry Plumb was. M. Francois-Poncet said that the problem lay in the UK's image rather than in Sir Henry Plumb's personality. He wondered whether there might be some understanding whereby Britain would relinquish ~~the~~ Chairmanship of the Agricultural Committee after 2½ years when Mme Veil was due to leave the Presidency. Lord Carrington said that by that time Sir Henry Plumb may have proved his European credentials. There were also dangers of linking the two appointments even more closely. In any event it was not the business of Governments but of the parties to sort this out. He hoped the French would support Sir Henry Plumb's candidature.

Euratom

18. M. Francois-Poncet said that the French had deposited

/ a memorandum

X
a memorandum in Brussels about changes to ~~Chapter 7 of~~ the Euratom Treaty. There was no basic difference between the British and French attitudes. He had however heard it said that the British were refraining from supporting the French until there was some progress on the budget. Lord Carrington said that no such idea was in our minds. We were against linkage of this kind. M. Francois-Poncet said that he therefore hoped we could get together on Euratom. He would like to send someone to London to discuss the problem. The French did not want to destroy Euratom. The Community could and must do something in the nuclear field. Britain and France ^{also} shared a military nuclear potential. The Commission wanted to retain some of the powers they had inherited from the Treaty. If something were not done we could face a major political problem. The French were ready to refuse to apply a court decision if it went against them. They looked forward to open and deep bilateral discussions.

29. Lord Carrington said that it was absurd that we could not secure uranium in a legal way under present arrangements. M. Francois-Poncet said that the French would not have agreed (as Britain had done with Australia) that our bilateral agreement would be superceded by any Community arrangements. It was impossible to separate military and ^{civil} national use of uranium, and the French would insist on being free to utilise any uranium she purchased as she wished. We should examine the question together in detail to see how the Commission's competence could be reconciled with our national needs. The French were ready to sign a Euro/Australian agreement, providing it did not supercede bilateral agreements. The French were going for fast / breeders.

breeders. Both the Uk and France would need advance agreement to enrich uranium when purchasing it. It may be possible to achieve such agreements in parallel to a Community agreement. Lord Carrington said that he welcomed the French offer of discussions, and agreed to receive a team including energy experts and representatives of the Quai d'Orsay.

Fish

20. The Secretary of State said that Mr Walker was pursuing his bilateral meetings with all his opposite numbers. It was important to get an agreement on fish. Everyone might have to give a bit to achieve this. One awkward development was that we had been obliged, after some delay, to put into effect national conservation measures. Given the temperament of fishermen, there was a possibility of a row at some stage. It would be important for us all to keep our tempers should this happen. Fish was politically difficult for both sides. M. Francois-Poncet commented that fish would become even more difficult after Spanish entry. We needed to find a way through the problem before enlargement.

EMS

21. M. Francois-Poncet asked when we would decide whether or not to become full members of the EMS. The Secretary of State said that we would decide on our position after the review of the EMS operation during its first nine months in October. Mr Butler asked whether there was a feeling in France that autumn would not be a good time for the pound to join the exchange rate mechanism. M. Francois-Poncet stressed that decisions on this subject in France were taken by the President personally and that this was definitely not his view. M. Francois-Poncet had spoken to the President

recently on this subject and M. Giscard d'Estaing remained in favour of British entry.

*f.w.
4/9*

24 SEP 1978

9876543210

This is a copy. The original

has been extracted from Prime Minister: You asked me and retained under Section 3(4) this morning for a note of where we stand in preparation for the Finance Ministers' forthcoming discussion of the Community Budget. You will see (para 4) that the Chancellor's paper is still in preparation.

(2)

fg
Pmt
4g

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PRIME MINISTER

Community Budget

Pmt 3/9

The Foreign and Commonwealth Secretary mentioned in Cabinet last Thursday that, thanks to good British contacts inside the Commission, we knew something about how the Commission's "reference paper" called for by the European Council in Strasbourg, was shaping up. This paper, you will remember, is to bring out the likely Budget allocations in 1979 and 1980 and report on the operations of the Financial Mechanism. It is due to be presented to the Council for discussion at the Finance Ministers meeting on 18 September. Only after that will the Commission get down to the second part of their remit which is to produce proposals for solutions. We have been pressing the Commission very hard to keep to the timetable laid down in Strasbourg and one of the objects of your EEC discussion with Mr Lynch on Wednesday will be to see that the Irish Presidency sticks to it as well. The Commission were due to consider the draft paper at their regular Wednesday meeting on 5 September but, in view of Mr Roy Jenkins' wish to attend the Mountbatten Funeral, the discussion has been brought forward to tomorrow, Tuesday. The draft will no doubt then be subject to modification and the figures themselves may be revised. I will see that you are informed about the outcome before your meeting with Mr Lynch.

* ~~~~~ *

2. As drafted, the Commission paper showed a UK net contribution in 1980 (1979 is less important because we are still on the transitional arrangements) of 1368 million EUA, or £845 million at the current exchange rate. This makes us far and away the largest net contributor with Germany's net contribution only about £520 million. The Commission's figures will also suggest that Italy will become a large net beneficiary which, if confirmed, will mean that we can no longer count on Italian support in getting a change in the budget mechanisms. The Commission figures are

* sentence deleted and retained under Section 3(4)
WJWland
19 November 2009

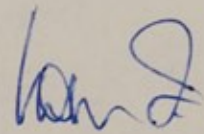
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lower than our calculations for two reasons. First, they attribute MCAs to the benefit of the UK and Italy and probably over estimate the likely level of UK MCAs. Secondly, administrative costs and aid expenditure have been excluded on the grounds that they do not benefit any particular Community country. There is also a slight difference in the treatment of our (small) refund under the Financial Mechanism. But generally it seems that we and the Commission are likely to be pretty close on the figures.

3. As to the text of the report (of which we have not seen an actual copy) there may be some disposition to challenge the argument that the balance of payments effect of the net contribution acts as a significant drag on UK domestic economic policies. On the other hand, the report, as at present drafted, does expressly acknowledge that the UK's large net contribution constitutes a serious anomaly in the Community's finance and, very helpfully, recognises that that is due not only to our making an excess contribution but also (and in fact to a greater extent) because our receipts are so much below the Community average. These are indeed very significant elements and, if maintained in the final version, will provide an important and indeed essential basis for us to argue our case.

4. The Chancellor of the Exchequer will be preparing a paper, which should probably come to OD rather than OD(E), about the Commission's document and about the line he should take at the Finance Council on 18 September. The main purpose there will be to get an acknowledgment of the reality and magnitude of our problem. It is clear that some new mechanism will be necessary but whether we should put precise proposals on the table or feed our ideas into the Commission will be a matter for consideration.

*The Chancellor
informed.*



3 September 1979

M D M FRANKLIN

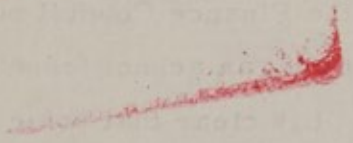


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Euro PA
✓ MAD

Mr J Houston
Commission of the European
Communities
Rue de la Loi 200
1049 Brussels

Your reference

Our reference

Date 31 July 1979

Don J.H. -

This note is merely to confirm that a meeting between the Prime Minister and Mr Tugendhat has been arranged for Thursday 13 September at 3 pm.

Yours ever,
G R Wilson -

G R Wilson

blind c.c.
Mr Patterson, Prime Minister's ✓
Appointments Office
Mr Crowe



Handwritten: Euro
Pol.

10 DOWNING STREET

From the Private Secretary

27 July 1979

Handwritten: BF 79.79

Call on the Prime Minister by Commissioner Tugendhat
on 13 September

Mr. Christopher Tugendhat, Commissioner for the Budget, is to call on the Prime Minister on Thursday 13 September at 1500. His purpose is to discuss with the Prime Minister the UK approach to the EEC budget issue.

I should be grateful if briefing for the Prime Minister's discussion with Mr. Tugendhat could reach me not later than 1700 on Friday, 7 September.

I am sending copies of this to Martin Hall (HM Treasury) and Martin Vile (Cabinet Office).

Handwritten: B. G. CARLETON

Paul Lever, Esq.,
Foreign and Commonwealth Office.

Handwritten: 9B

h. cc Sir J Hunt
✓ Mr Whitmore
Sir M Palliser
Mr Fretwell
Mr Elliott
Mr Walsh
Mr Thomas

QZ 01181

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FOREIGN AND COMMONWEALTH SECRETARY

M. Alexander
EEC: the First Three Months *John* *ebin*

1. You felt early on that the firm statements of the Government's commitment to the Community made by the Prime Minister and yourself would need to be reflected in some action. OD(E) called for an immediate review of minor Community issues where the UK was isolated; and a review of areas where we might take some initiatives. The attached paper, which has been agreed interdepartmentally, sets out in detail what steps have been taken in response to these two remits.
2. This minute tries to assess the results so far. We have lifted UK reserves on several outstanding issues. We made considerable efforts to reach Community solutions in the Lome negotiations and more recently over interest rate subsidies within the EMS. We made considerable efforts at the Tokyo economic summit to maintain the Community's position on energy and to protect the interests of the non-Summit EEC countries. We have shown flexibility in arriving at Community positions eg during the closing stages of the MTNs and over textile negotiations with third countries. We are also making considerable efforts to find a way out on steel aids and to meet the Commission over restructuring of the shipbuilding industry. We must take credit for all these moves as well as for the unexpected settlement of the CAP price package in Luxembourg in June. Finally, we made a positive gesture towards the Community in agreeing to exchange reserves against ECUs. Nor should it be forgotten that Government decisions over regional and employment aids and over exchange control restrictions, while taken primarily for internal policy reasons, will substantially ease our relations with the Commission.
3. All this has substantially relieved the growing sense of frustration which our Community partners had been feeling. The better climate has been reflected both in bilateral Ministerial meetings and in the attitude towards the UK in the Council.

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4. At home, too, the Government's stance on Europe has been registered by the media and by public opinion generally. No sea change in public attitudes has yet taken place as a result, but it seems that at least the old controversies have been damped down. The inherent conflict between our firm commitment to the Community and the pursuit of our national objectives on the budget, fisheries and the CAP, has not come into the open, though difficulties on this front or others like North Sea oil policies could restore to the anti-Market lobbies a popular base for attack. The direct elections campaign also passed off without arousing any upsurge of anti-Market feeling. The debates on Community topics have so far likewise created no difficulties for the Government: indeed the fact that the debate on the Community Budget produced a bi-partisan line can be scored as a useful reinforcement for the Government in the negotiations ahead.

5. Relations with the Commission have improved, although Mr Gundelach, who felt let down over the agricultural price settlement, may fear that we are going to cause him a lot of trouble over fisheries. The Prime Minister has established a good relationship with Mr Jenkins who has not only realised the seriousness of the Budget problem but seems determined to throw his weight behind a settlement. Mr Tugendhat is also being helpful. This may lead to tension with Mr Ortoli who will need to be carefully nurtured if he is not to remain obstructive on the Budget issue. Commissioner Vouel is always a difficulty not only because of his personal sensitivities but because of the range of policies and hence UK Ministers with whom he has to deal. He may not yet have fully realised how close the economic philosophy of the Government comes to the one which he is paid to defend. The current dispute with him over the Interest Relief Grants for the offshore industry may end up in the European Court.

6. It would be wrong to look for immediate dividends from this changed climate. Shifting the UK's position on a number of relatively minor issues was a necessary part of the process of convincing the Community that we

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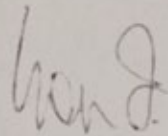
were ready to play a more constructive role. It was the least that was expected of us. Nevertheless some success can be noted. The Commission gave way on the Harland and Wolff ferry order. We have at last secured their approval for the uranium safeguards agreement with Australia. Above all, the European Council was persuaded to take the Budget problem seriously and to commit itself to a procedure which, implicitly if not explicitly, recognised that something would have to be done for us. On the CAP, more important than the positive elements in the Luxembourg price settlement is the growing recognition by other member states that it is in their interests as well as ours that the rising cost of surplus disposal is brought under control. The imminence of the 1 per cent VAT ceiling is also focussing their minds on the need for specific remedies. On the other hand, we have made no progress towards settling the fisheries issue. Thanks to the French Presidency, the issues remained as polarised as before and the threat of unhelpful rulings from the European Court looms nearer.

7. It can thus be said that, with the exception of fisheries, the period up to the summer recess has been well spent in clearing the decks. The rest of the Community is now convinced that things have changed. They also know that the budgetary imbalance poses a major problem for us and hence for them. But the testing time will come in the autumn. The positive gestures which we have made and expect to make in no way balance our tough requirements on the budget and fish. We have set ourselves an extremely tight timetable to achieve such a formidable objective as to reduce our net contribution of over £1,000 million to something like balance. Other major issues will be facing the Community in the autumn on energy, agriculture and the EMS where our performance will inevitably reflect one way or another on our other objectives even if

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our partners do not try to make direct links. And we have a major problem of handling the fisheries dispute in such a way that it does not get entangled with the budget problem.

8. I am sending copies of this minute to the Lord Privy Seal and the Lord President of the Council. You may feel that, in some form, it should be circulated to members of OD(E).



M D M FRANKLIN
CABINET OFFICE SW1
27 JULY 1979

POSITIVE MOVES TAKEN BY THE GOVERNMENT IN REGARD TO THE EUROPEAN COMMUNITY

The Government affirmed in The Queen's Speech on 15 May their strong commitment to the European Community and intention to play a full and constructive part in its further development and enlargement. In subsequent bilateral and multilateral meetings with the leaders of other Community states they have emphasised the positive approach which they, in contrast to their predecessors, take towards the Community.

2. As an indication of their positive approach, the Government have ceased to block Community proposals on competence grounds alone where the competence implications have no practical significance. This had previously been a fertile source of irritation to other members of the Community. Examples of movement are the directive on aircraft noise on which the UK indicated its willingness to lift its reserve in June and Community accession to the Bonn Agreement and the Barcelona and Oslo Convention on Marine Pollution. In the latter case we had no quarrel on any aspects of the substance but feared that accession might entail an extension of Community competence. We have now proposed a suitable entry in the Council minutes to which the Commission and all other Member States except Denmark have agreed. The Danes have asked for legal clarification. While the matter is not, therefore, yet entirely resolved, the United Kingdom is no longer the Member State causing delay.

3. Another competence issue on which Ministers decided on 15 June they wished to move, subject to confirmation from the Law Officers that approval would not prejudice our legal position in the light of the European Court's judgement 1/78, is the UK reserve on three Commission communications on studies of radioactive waste disposal, fast breeder reactors and nuclear reprocessing. The Law Officers are still considering the implications for the 1/78 Court judgement.

4. In the course of the last phases of the negotiations of the Lomé Convention, the United Kingdom held out against an increased offer for aid under the Fifth European Development Fund (EDF V) over and above the offer made to and rejected

by the African, Caribbean and Pacific (ACP) states in May. We eventually accepted an increase of 100 million units of account (mua) to 850 mua in our share of EDF V and agreement with the ACP was reached on that basis on 26 June.

5. At the European Council on 21-22 June the Prime Minister informed her colleagues that the Government had decided to participate in the deposit of reserves on a swap basis with the European Monetary Cooperation Fund in exchange for European Currency Units (ECUs). The first such deposit was made on 6 July. This action demonstrated the Government's desire, whatever our decision in due course on participation in the exchange rate mechanism of EMS, to be closely involved in the evolution of the ECU and of European monetary institutions. At the Finance Council on 16 July the Chancellor of the Exchequer lifted the UK reserve on the EMS Interest Rate Subsidies Regulation. The Regulation provides interest rate subsidies of 3 per cent on loans to those less prosperous member countries which participate fully in the European Monetary System. For the time being the subsidy will be split $\frac{2}{3}$: $\frac{1}{3}$ between Italy and Ireland.

6. Two significant steps towards meeting in full our obligations under Treaty Article 67 to liberalise capital movements have been taken since the Government assumed office. The second step, announced by the Chancellor on 18 July, included allowing unlimited official exchange for outward direct investment and also for outward portfolio investment in securities denominated in currencies of the EEC countries.

7. The Government's critical approach to industrial and employment subsidies is more closely in line with the Commission's attitudes to state aids than was that of its predecessor. Since coming into office the Government has abandoned the previous administration's proposed Employment Development Scheme which was running into difficulties with the Commission. It has announced that the Offshore Supplies Interest Relief Grant Scheme will be closed to applications as from 31 March 1980, although this may not entirely satisfy the Commission who in a Reasoned Opinion of 2 May had requested us to end the scheme within two months on grounds of its incompatibility with the EEC Treaty. There is still a risk we may be taken to the European Court. The Government's announced restructuring of UK Regional Development Policy on more selective

lines has been welcomed by the Commission. The United Kingdom with Italy and the Republic of Ireland are taking a much more positive line on the European Regional Development Fund than a majority of the other Member States. We have supported the Commission on an increase from 945 million ECU this year to 1200 million ECU for 1980, while indicating that we are prepared to come down to a level not lower than 945 million ECU. The other Member States are all supporting very substantial reductions in the one part of the EEC Budget which guarantees redistribution of resources to the less prosperous countries, including the UK, through national quotas. The Government's approach to contraction of the Shipbuilding Industry is likely to be regarded by the Commission as an improvement on previous policies and may make the task of obtaining Commission approval of continuance of the Intervention Fund easier.

8. We have also responded to Commission warning of possible infraction proceedings by deciding to withdraw circulars issued to local authorities in 1975 encouraging them to purchase British clothing, textiles and footwear. The Commission had claimed that these circulars were discriminatory. The Minister of Transport has written to his colleagues proposing that we should comply with the Commission's request that the UK's national type approval procedures for cars should be opened up to our Community partners. We also intend shortly to inform the Commission that we intend to drop certain charges we make for veterinary inspection and supervision of live animals imported into the UK from other member states for sale or exhibition which the Commission had challenged on the grounds that they were equivalent to customs duties and therefore contravened the EEC Treaty.

9. Other issues on which the Government intend/hope to move when certain points have been clarified are :

a. State aids for Steel

We have persuaded the Commission to offer amendments to the steel aids decision which overcame our legal difficulties, and Ministers at OD(E) on 19 July agreed to accept the decision, subject to prior debate in the House of Commons during which both legal and political considerations would be explained to the House by Ministers.

b. Ship inspection

We have no difficulties with the substance of a draft decision on this subject but are concerned about the effect adoption might have on our ability to play an independent role in IMCO. We are discussing with the Commission a suitable wording for an entry in the Council minutes which hopefully will remove this stumbling block.

c. Driving Licences

Department of Transport are reviewing the possibilities of a more forthcoming UK attitude towards a Community driving licence.

d. VAT directives

Three draft directives on aspects of VAT, known respectively as the Recovery Directive, the Eighth Directive and the Assistance Directive, are currently under consideration in the EEC. We no longer have difficulty with the Recovery Directive. The problem of the Eighth Directive seems on the verge of solution. Discussions will take place on our amendments to the Assistance Directive and it is anticipated that the going will be hard. If, however, agreement is reached, the three directives which are being treated as a single package can be approved.

10. In addition Ministers have asked for an examination of the scope for constructive initiatives in the field of energy, social and transport policy within the Community. The Energy Secretary circulated to colleagues on 24 July proposals for a UK initiative on a Community coal policy based on aid to investment in coal rather than subsidisation of intra-Community trade in coal which is the basis of the Commission's current proposals. He will also as soon as the ENOC review is complete be reporting to OD(E) on the scope for long term oil contracts with Community companies. Ministers reviewed in OD(E) on 19 July the scope for constructive initiatives in the field of social policy. While the scope for initiatives was limited, our approach was to be as constructive as possible eg by seeing whether we could adapt some of our training schemes to make them more readily eligible for Social Fund support. The Minister of Transport is preparing a paper for OD(E) on transport issues.

Cabinet Office
26 July 1979

27 JUL 1979





10 DOWNING STREET

PRIME MINISTER

Could you please confirm that you would be happy to see Christopher Tugendhat in September. I attach a telex which is self-explanatory.

F-UK Ref
Bureau No 3823
of 13.7.79

C.S.

Yes

25 July 1979

cc Euro PR (3/2/79)
May 79

Ref. A09998

PRIME MINISTER

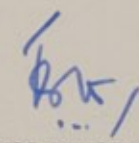
Cabinet: Community Affairs

You may wish to tell the Cabinet that the Three Wise Men called on you and the Foreign and Commonwealth Secretary on 16th July. They will be reporting in October. You told them that two meetings of the European Council per year were enough; and that you favoured one Commissioner per country for the enlarged Community.

2. The Chancellor of the Exchequer might be invited to report on the outcome of the 16th July Finance Council, at which the Commission were pressed to produce their reference paper on the budget problem in time for the 17th September Finance Council. We lifted our reserve on the payment of EMS interest rate subsidies to Ireland and Italy after securing agreement to an entry in the Council minutes which safeguards the United Kingdom position for the future.

3. The Lord President of the Council might be invited to give an account of the inaugural session of the European Parliament on 17th-18th July, at which he represented the United Kingdom.

4. The Ministerial Sub-Committee on European Questions (OD(E)) will have met just before Cabinet to discuss the legal and Parliamentary handling at home of the Commission's draft Decision on state aids for steel. The Foreign and Commonwealth Secretary may wish to report the conclusions reached.


JOHN HUNT

18th July, 1979

CONFIDENTIAL

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FM UKREP BRUSSELS 131651Z JUL 79

TO ROUTINE FCO

TELEGRAM NUMBER 3823 OF 13 JULY

FOLLOWING FOR PS NO 10

UK CONTRIBUTION TO EEC BUDGET

MR TUGENDHAT'S CABINET APPROACHED US TODAY FOLLOWING THE DISCUSSION HE HAD WITH THE PRIME MINISTER ON THIS SUBJECT AT THE BUCKINGHAM PALACE GARDEN PARTY. THE CABINET TELL US THE POINT THAT HE WAS MOST CONCERNED TO PUT ACROSS TO HER WAS THAT THE UK SHOULD NOT SACRIFICE SUBSTANCE FOR SPEED IN TRYING TO GET THE COMMISSION'S REFERENCE PAPER COMPLETED TOO QUICKLY. THE PRIME MINISTER AND TUGENDHAT AGREED THAT HE SHOULD COME AND SEE HER ABOUT THE SUBJECT IN EARLY SEPTEMBER.

2. TUGENDHAT'S CABINET HAS NOW PROPOSED THE WEEK BEGINNING 10 SEPTEMBER. (TUGENDHAT WOULD ONLY JUST HAVE RETURNED TO BRUSSELS, THE PRECEDING WEEK AND SO WOULD PREFER TO AVOID IT). BECAUSE OF THE COMMISSION MEETING ON THE WEDNESDAY, TUGENDHAT COULD NOT MANAGE THEN OR, CONVENIENTLY, TUESDAY AFTERNOON. HE COULD MANAGE THURSDAY OR FRIDAY, 13 AND 14 SEPTEMBER. BUT IT WOULD BE PREFERABLE IF THE MEETING COULD BE ON MONDAY OR TUESDAY MORNING (10 OR 11 SEPTEMBER), SINCE THE MORE TIME TUGENDHAT HAS TO FEED THE PRIME MINISTER'S VIEWS INTO COMMISSION DELIBERATIONS, THE BETTER.

3. GRATEFUL TO KNOW WHEN THE PRIME MINISTER WILL BE ABLE TO SEE TUGENDHAT.

FCO ADVANCE TO :-

FCO - PS/SOS, PS/LPS, PS/PUS, BUTLER FRETWELL SPRECKLEY

NO 10 -

P/S

TSY - PS CHANCELLOR, COUZENS, JORDAN MOSS, MRS HEDLEY MILLER

MAITLAND
FILES
HD/KID.(1)
PS
PS/LPS
PS/PUS
MR BUTLER
MR FRETWELL

[ADVANCED AS REQUESTED]

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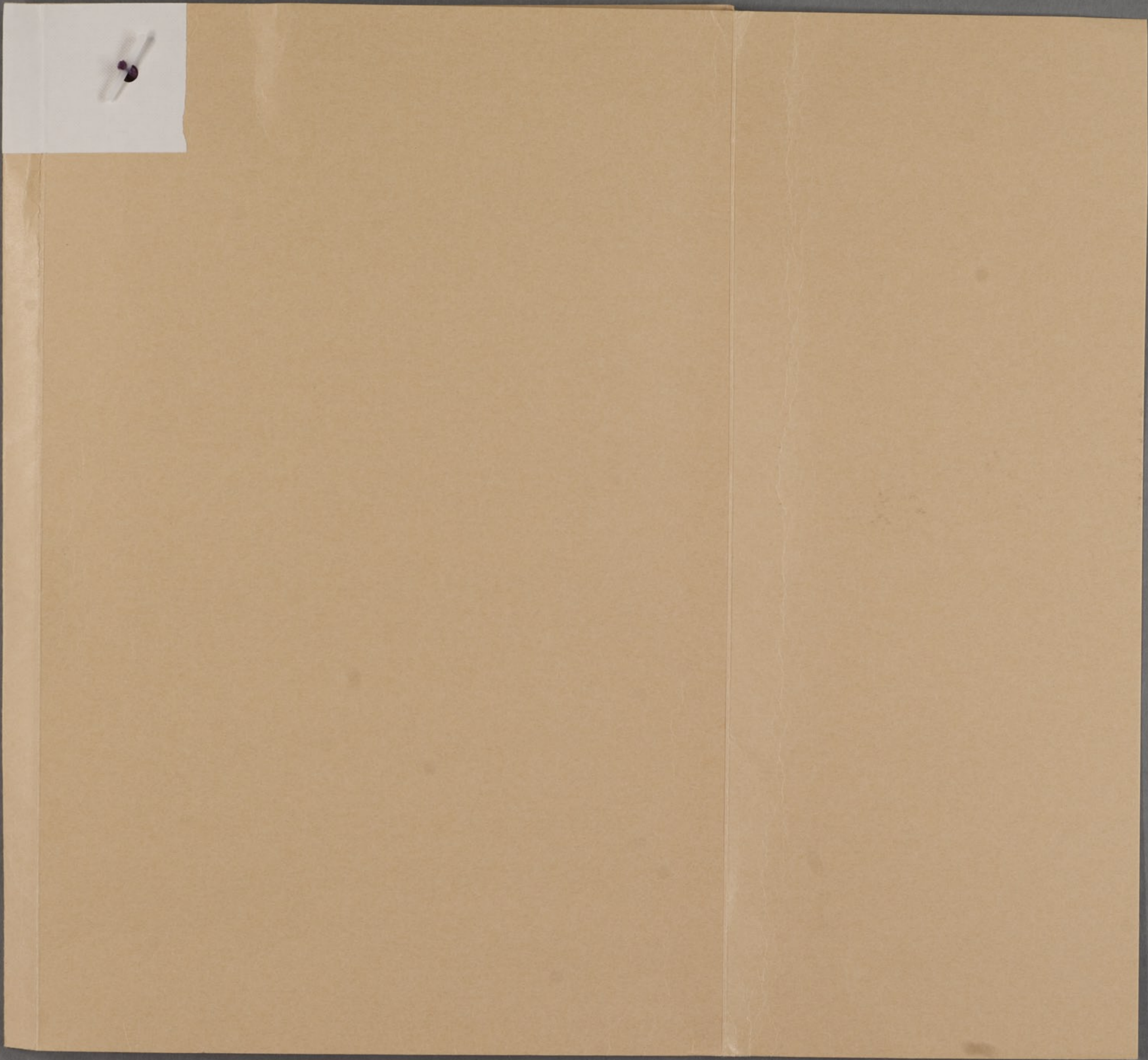
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PART 2 begins:-

Brussels to Fco Tel 3823 13.7.79

PART 1 ends:-

OD(E) (79) btl Mtg 12.7.79





END

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February 2010