PREM 19/227

MT

PART 9

Confidential Filing

The Community Budget. Additionality and ~~the use~~ of community funds.

EUROPEAN POLICY

Part 1: May 1979
Part 9: June 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~5.6.80~~							
~~10.6.80~~							
~~12-6-80~~							
~~16.6.80~~							
~~19.6.80~~							
~~23.6.80~~							
~~24.6.80~~							
~~9.7.80~~							
~~11.7.80~~							
~~14.7.80~~							
~~16.7.80~~							
~~28-7-80~~							
~~30.7-80~~							
~~11.8.80~~							
~~26 8 80~~							
~~16-9-80~~							
19.9.80							
ENDS							

PREM 19/227

PART 10 begins:-

FCO to ~~[illegible]~~ MOD 25/9

PART 9 ends:-

PM/Giscard Mtg note.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(80) 23rd Conclusions, Item 3 (Extract)	11/06/80
CC(80) 24th Conclusions, Item 3 (Extract)	19/06/80
OD(E)(80) 18	11/07/80
OD(E)(80) 9th Meeting, Minutes	15/07/80
EQS(80) 33	05/08/80
EQS(80) 43	19/09/80

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 AWayland Date 31 March 2010

PREM Records Team

NET CONTRIBUTIONS TO THE COMMUNITY BUDGET 1976-80

ANNEX A

(EUA million)

	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	United Kingdom
(1) "Exporter-~~pays~~ benefits" MCAs								
1976	+358	+379	-1015	+102	+194	+210	+295	-238
1977	+378	+520	-1292	- 47	+409	- 66	+286	-624
1978	+393	+620	- 347	- 33	+531	-723	+237	-1122
1979*	+619	+455	-1018	- 90	+578	+481	+229	-~~1254~~ 1250
1980*	+842	+370	-1048	- 19	+513	+734	+422	-~~1814~~ 1813
(2) "Importer-~~pays~~ benefits" MCAs								
1976	+346	+294	-1054	+ 58	+155	+248	+221	- 90
1977	+329	+293	-1467	-310	+212	+294	+ 86	+126
1978	+350	+381	- 520	-321	+320	-305	+ 57	-407
1979*	+589	+224	-1155	-322	+365	+754	+ 72	-~~527~~ 849
1980*	+830	+283	-1107	-120	+436	+871	+359	-~~1552~~ 1683

+ net beneficiary, - net contributor
Source : Commission studies (*"reference paper" forecasts) doc. 9093/79
Note : The figures for 1976-78 and 1979-80 are not strictly comparable as the forecasts for 1979 and 1980 exclude contributions to financing EEC aid expenditure, which are included for the earlier years. These are as follows:

(EUA million)

	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	United Kingdom
1979	- 34	- 12	- 152	-100	- 4	- 60	- 48	- 87
1980	- 39	- 15	- 186	-124	- 6	- 71	- 52	-127

Source : Commission's additional information to "reference paper" (doc 9721/79)

SECRET

TABLE A

NET CONTRIBUTIONS TO THE 1980 ALLOCATED BUDGET (Importer Benefits basis for MCA's)

	March Commission estimates	Revised Net Contributions*	Effect of 100 Meua change in UK net contribution on net contributions of other member states	
			If all members contribute	If Italy and Ireland do not contribute
		-588		
UK	-1683	-269	∓100.0	∓100.0
Germany	-1116	-1677	±39.7	±46.3
France	+ 41	-382	±29.9	±35.0
Italy	+ 754	+568	±13.2	± nil
Netherlands	+ 358	+254	± 7.4	± 8.6
Belgium	+ 469	+392	± 5.4	± 6.3
Denmark	+ 388	+344	± 3.1	± 3.6
Ireland	+ 502	+482	± 1.1	± nil
Luxembourg	+ 287	+284	± 0.2	± .2

* To bring the UK net contribution into the same relationship with the French as the respective UK and French GNP per head.

– = net contribution

\+ = net benefit

SECRET

·EXTRACT FROM MEETING NOTE. PM v FRENCH PM AT THE MATIGNON 19.9.80.

the new Commission, but this was not a matter to which she had so far given a great deal of thought. Britain would be keeping on Mr. Tugendhat and she was consulting Mr. Callaghan about candidates for the second British post. Britain would want one of the two financial portfolios. We were not seeking the agriculture post.

M. Barre said that neither was France bidding for the agriculture portfolio. Both M. Ortoli and M. Cheyssen had been Commissioners for eight years and they would be replaced.

Restructuring of the Community Budget

The Prime Minister said that Britain, France and Germany were the three Members of the Community who should be most concerned to see the Budget restructured since all were now net contributors. Germany in particular felt deeply that she was carrying an unduly heavy burden and she especially resented the fact that her contribution financed countries which were as rich as or even richer than her. There was, however, little likelihood of progress on restructuring the Budget until the German and French elections were out of the way. The changes in the Commission would also hold things up. This meant that if the timetable was to be adhered to, a lot of work on reforming the Budget and the CAP would have to be done very quickly next year.

M. Barre said that the problems raised by restructuring should be discussed closely between Governments. The Commission had a useful role in making proposals, but it was Governments which must discuss and settle these matters. Above all, it was essential to improve the management of the CAP. His personal view was that it would be very difficult to change the principle of 'financial solidarity'. Nor was he sure that ceilings could be put on the contributions of Member states; and ceilings on receipts would cause many difficulties. Hitherto our management of agricultural prices had been very bad. We had to agree upon new prices for meat and cereals which took account of international prices. We must develop mechanisms for reducing prices when quantities increased. We could not give guaranteed prices for unlimited quantities. He wanted to solve the problem of agricultural surpluses, though this would cause difficulties for other Members of the Community. But any reform of the CAP must safeguard European agriculture for both social and security reasons. It was quite likely that in future food resources outside the Community would prove to be inadequate, and it made good sense to have sufficient resources of our own on the soil of the Community. But this objective must be attained without spending too much money. The Community had to accept the 1% VAT ceiling.

The Prime Minister said that she agreed with what M. Barre had said about surpluses. It was the build up of surpluses which gave rise to increased receipts. Equally, she was very pleased to hear what M. Barre had said about the 1% VAT ceiling. Britain would stick firmly to the ceiling.

M. Barre said that he understood the British position on the Community Budget and he did not blame her for seeking to limit her contribution. He had seen in 1972 that the problem would arise. What was important was for Britain and France to find solutions to the problem of restructuring the Budget which did not threaten the CAP. He was more concerned with the political aspects of the problem than with the economic ones. The French Government had had a very difficult time with French farmers over the last few months. For twenty years they had lived with an expansionist view of the CAP and now that they saw that times were changing, there was a crisis of confidence amongst them. Britain appeared to them to be threatening what was important in the Community, and this explained their strong feelings towards Britain. He wanted to avoid antagonism of this kind and at the same time to correct the causes of the Community's problems and

/not simply

not simply to treat the symptoms. We had to find solutions which avoided another huge burden for Britain. He was responsible for the global management of the French economy and he knew well the burden of the French contribution to the Community Budget. France was not seeking large financial benefits from the Community. He was against protectionism and valued membership of the Community for the increased competition it provided.

NATIONAL ECONOMIES OF FRANCE AND BRITAIN

The Prime Minister said that there was no way of avoiding the present world recession which was largely due to increases in the price of oil and to the problem of recycling the increased revenues of the OPEC countries. The Western countries simply had to get through the recession as well as they could. Britain was struggling hard to defeat inflation. The restriction of the growth of the money supply was bearing harder on the private sector than on the public, and the loss-making nationalised industries were a major difficulty for the Government. Britain had failed to adapt these industries in the past and they were having to be changed now, even though we were in the middle of a recession. Britain had been, for example, slower than France to deal with over-manning in her nationalised industries and to reorganise her steel industry. The British Government would continue to follow orthodox policies which would bring down the inflation rate still further. Interest rates had been at a very high level for a long time now: indeed, they had been kept up for much longer than might have been thought possible at the beginning of the year. The high exchange rate was helping to make firms more efficient, and exports were holding up well.

M. Barre said that France was facing two major problems. First, every year about 250,000 extra people came onto the labour market. He refused to try to treat unemployment by means of a global economic policy. Instead, he was concentrating

/ on the

Europol: Budget: Pt 9.

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EXTRACT FROM MEETING NOTE PM AND FRENCH P.M AT THE MATIGNON 19 SEPT 1980.

30 May Budgetary Agreement

M. Barre said that although agreement had not yet been reached on the regulations to implement the agreement on 30 May, he thought it should be possible to find a solution without difficulty.

The Prime Minister said that if the budget agreement was not being implemented by the end of 1980, this would cause major problems within the Community.

Sheepmeat

M. Barre said that France was ready to accept the European Commission's proposals on sheepmeat which Mr. Gundelach thought would deal satisfactorily with all the outstanding problems. France's concern was to avoid a diversion of trade between Great Britain and France in favour of New Zealand. Such a diversion of trade would occur if Britain sold on the continental market New Zealand sheepmeat in a way which was "independent of the normal currents of trade." The Commission were ready to propose the implementation of Article 115 of the Treaty of Rome to prevent such a diversion of trade. For the rest France fully accepted the result of the negotiations between New Zealand and the Community on tariffs and quantities.

The Prime Minister said that she did not understand how New Zealand sheepmeat might distort the normal patterns of trade within the Community since it normally arrived when there were few British lambs on the market. She too saw no reason why the problem of New Zealand sheepmeat should not be finally settled now that the Commission had obtained the agreement of most Members of the Community on the tariff.

Zimbabwe and the Lome Convention

The Prime Minister said that Rhodesia had originally had an annual quota of 25,000 tonnes of sugar under the Commonwealth Sugar Agreement. Zimbabwe was now seeking a

CONFIDENTIAL / similar

QZ 01746

CONFIDENTIAL

SIR ROBERT ARMSTRONG

cc Mr Lever
Mr Gomersall
Sir M Palliser
Mr Alexander

Anglo-French Summit: Article 235

I have sent you a copy of the note recording my talk with Achard yesterday.

2. It is clear that the differences between us on the procedure for approving programmes to qualify for Community finance as part of our budget refund, and the attempt by M Francois-Poncet to make a link with progress on fisheries will need to come up during the Anglo-French summit meeting. As you will see I suggested to M Achard that the Prime Minister might want to raise it at the plenary session if the two Foreign Ministers were unable to reach a satisfactory understanding. But this was to encourage him - and others who think like him to try to shift Francois-Poncet's position before Friday. The joint meeting when the Foreign Ministers join the Heads of Government might be a better occasion, but we can discuss this at the Prime Minister's briefing meeting this afternoon.

3. On the Regulation itself, we should not agree to any deliberate staging of the payments. The reason is not so much that it might provide the French with another opportunity to make trouble but simply that, in an inflationary world, delay costs money. However, we have to recognise that the final instalment of what is due to us can only be calculated when all the figures for 1980 are available and this, as we have always known, will take us beyond the end of our financial year. We could, if necessary, agree that the consultation procedure should apply to this part of the process, although our aim will be to ensure that enough programmes have already been approved to make it as mechanical as possible.

4. As to the approval procedure, the Prime Minister did not feel that we should shift from the Commission's original proposal that the Member States should merely be consulted and the decision left to them. The

The compromise which the Chancellor and the Lord Privy Seal felt that we could safely accept, viz. a voting procedure which would require a majority to reject the Commission's proposal, is now officially on the table having been put forward by the Presidency at the Foreign Affairs Council yesterday. Although there was only a preliminary discussion, it is clear that most other delegations would accept such a solution. No doubt the French will argue for the majority to operate the other way, but I believe they could be brought to accept the negative procedure if we could agree to it. The Germans, provided we can satisfy them on the separate question of advances, - which I believe we can - will fall in with the French although they too are still arguing for unanimity. Even though the European Parliament will probably vote in favour of a purely consultative procedure, I do not believe we could push the French and Germans that far. A compromise might therefore consist of :-

(i) a negative voting procedure but with a strict timetable so that other Member States cannot procrastinate;

(ii) no staging of payments but a procedure for consultation on the final instalment if necessary.

5. But we should make no move at all on the procedure unless the French will drop the link with fisheries. We need to have the Regulation adopted at the October Council otherwise:

(a) public opinion in this country will believe the French have ratted on the 30 May agreement;

(b) we shall have difficulty in completing the administrative procedures for getting the bulk of the money early next year;

(c) there would be no chance of getting an advance in 1980 - which if there turns out to be some headroom in the 1980 Budget would suit everyone.

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6. I suggest the points to be made to Giscard, Barre and Francois-Poncet are:-

(i) any suggestion that the implementation of the 30 May budget agreement was being deliberately held up would put the Community back into a political crisis. Is that what they want?

(ii) we cannot sensibly negotiate on fish under threat. That would make agreement on fish more difficult. We do not need to be threatened. Like them, we want to get fish settled;

(iii) linkages in the Community can be a two-edged weapon, whether one is thinking of fish or agricultural prices.

M D M FRANKLIN

17 September 1980

CONFIDENTIAL

Ck & Po

Euro Pol.

10 DOWNING STREET

From the Private Secretary

16 September 1980

ARTICLE 235 SUPPLEMENTARY MEASURES

The Prime Minister has seen the Chancellor of the Exchequer's minute of 12 September about the approvals procedure for Community Budget refunds under Article 235. She has also seen the Lord Privy Seal's minute of the same date on the same subject.

The Prime Minister discussed this issue briefly with the Foreign and Commonwealth Secretary yesterday. She told him that she was extremely reluctant to agree to the negative qualified majority procedure. She considered that we should be robust in supporting the Commission's original proposal and to resist any alternative approach - if necessary openly.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

A. J. Wiggins, Esq.,
H.M. Treasury.

NPGM
(Copy to Walden [illegible] from C. PS)

CONFIDENTIAL

No - the procedure is ridiculous. Its whole purpose is to demean Britain. Be robust in supporting the Commission's original proposal. We must fight this one - if necessary openly. We can always withhold now that the Council agreed on rebate mech.

CONFIDENTIAL

Prime Minister
Agree para 8?
[initials]

(1)

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

PRIME MINISTER

EC BUDGET REFUNDS UNDER ARTICLE 235 SUPPLEMENTARY MEASURES SCHEME: APPROVALS PROCEDURE

We discussed briefly on Monday the continuing negotiations in Brussels on the draft Regulations to implement the 30 May budget refunds agreement. The main area of difficulty at present in these negotiations is not differences of view over additionality between the Commission and ourselves, as suggested in the Sunday Times article, but the approvals procedure for refunds due to us under the Article 235 supplementary measures scheme. The present deadlock on this issue threatens to hold up agreement on the Regulation for an indefinite period, and we cannot obtain the refunds due to us until agreement has been reached. We need therefore to consider whether there is any intermediate solution which we could accept in order to resolve the deadlock.

2. The question at issue is - who should (a) approve the programmes which we have submitted for assistance under the scheme and (b) decide on the amounts to be paid in respect of each programme? The Commission's original draft Regulation envisaged that the Commission itself would take these decisions, the former after consultation with the Regional Policy or Energy Committees acting in an advisory capacity. We have strongly supported the Commission's proposal. At the other extreme, the French have continued to insist, with German support, that the refunds must be subject to unanimous approval by the Council of Ministers.

3. From our point of view, a requirement for unanimous Council approval must be totally unacceptable. It would give each and every member state a power of veto over payment of the refunds due to us, even though these have been specifically agreed in the 30 May settlement. It is clearly a nonsense that unanimous Council agreement should be required for implementing a decision already taken, and this would be contrary to established Community procedures. The veto power appears, however, to be exactly what the French want: some elements, at least, in the French Government appear still to believe, despite the Foreign Secretary's personal intervention with the French Foreign Secretary in July, that they can use the threat of a veto on our refunds to make us accept the kind of farm price settlement which they want ahead of next year's Presidential election.

4. The Commission's original proposal, whereby implementation of the refunds agreement would be left to the Commission and ourselves, after consultation with other member states in the Regional Policy Committee, is clearly the best from our point of view. But some kind of intermediate solution will evidently be needed if the deadlock is to be resolved in time to enable us to receive some payments in the form of advances this year, as a charge against the 1980 Community budget.

5. The Commission themselves have now indicated that they would be prepared in the last resort to agree to the intermediate solution of a negative qualified majority "management committee" procedure. Now that this proposal is on the table, I am reluctantly persuaded that we should if necessary be prepared, at the appropriate moment in the negotiations, to go along with it. Under a negative qualified majority procedure, a committee of member states

(probably an ad hoc committee rather than the Regional Policy Committee) would be able to reject the Commission's proposals on our refunds, but only if opponents of the proposals could muster 41 votes between them (45 from January next - see annex for voting strengths). The Commission would then have either to amend the proposals or to withdraw them or to appeal to the Council. What this means in practice is that the French and Germans could not block our refunds on their own: they would have to convert to the cause the Italians plus at least three of the smaller countries as well.

6. Another intermediate solution would be approval by positive qualified majority. In that case, however, two big countries acting together, or one big country plus two or three of the smaller countries, or the smaller countries as a block could each block the refunds. This would be somewhat better than a requirement for unanimity. But it would put us in the hands of the Germans and the French acting together.

7. There are important related issues as well, such as whether the Council or a lesser Committee should approve the programmes and whether the approval should apply to the next three years as a whole or to one year ahead only. We should continue to press for approval of programmes over a three year period, and for minimum Council involvement. But the key issue remains the form of the approvals procedure.

8. Subject to your views and those of the Foreign Secretary, therefore, I suggest that we should be prepared if necessary to agree to a negative qualified majority "management committee" procedure as part of an overall solution to the impasse on the supplementary measures

regulation. The timing will need careful consideration. We should not make the concession unless we are as certain as we can be that it would clinch agreement on the regulation as a whole in an acceptable form. It is just possible that this stage will be reached at next week's meeting of the Foreign Affairs Council - that will be for the Foreign Secretary to judge - but as of now this looks unlikely.

9. I am copying this minute to the Foreign Secretary and to Sir Robert Armstrong.

Approved by the Chancellor and signed in his absence, R.I. Tolkien (Private Secretary)

(G.H.)

12 September 1980

EUROPEAN COMMUNITY : VOTING STRENGTHS OF MEMBER STATES

	Present Position	Position from January 1981 (after Greek accession)
No. of members	9	10
Belgium	5	5
Denmark	3	3
Germany	10	10
France	10	10
Ireland	3	3
Italy	10	10
Luxembourg	2	2
Netherlands	5	5
UK	10	10
Greece	-	5
Spain	-	-
Portugal	-	-
TOTAL	58	63
Qualified Majority	41	45

CONFIDENTIAL

Mufaxed to Chequers

Prime Minister

APPROVALS PROCEDURE FOR EC BUDGET REFUNDS UNDER ARTICLE 235 REGULATION

I have seen a copy of the Chancellor of the Exchequer's minute to you of today's date.

I agree with the Chancellor's conclusion that we should be prepared to agree to a negative qualified majority procedure if this will clinch an overall solution.

I think that it is important to get some new momentum back into this negotiation, and there are signs at the eleventh hour, that the French and Germans are willing to move from their previously unhelpful positions.

There will be a meeting between the Foreign Secretary and the French Foreign Minister on Monday afternoon at the latter's request. French officials have hinted privately at a more forthcoming line. Herr von Dohnanyi has also indicated that he would like to talk with the Foreign Secretary before the Council. It is therefore possible that the stage could be set for the simultaneous solution of the major points of disagreement in spite of the fairly unpromising discussion in COREPER this week.

In these circumstances we should be in a position to accept the negative qualified majority procedure, which is what the Luxembourg Presidency have proposed, if this will secure rapid agreement.

I am copying this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong.

I.H.G

12 September 1980

CONFIDENTIAL

Euro Pol 2

PRIME MINISTER
You asked for a fuller note about this. I hope this offering will help
MJS 26/8

VAT: COMPARISON OF UK BASE AND COMMUNITY HARMONISED BASE

1. The Prime Minister has asked for a fuller explanation of the difference between a 1% rate of VAT applied in the UK and a 1% rate applied to the harmonised base used to calculate the European Community VAT Own Resources.

2. There are effectively three bases to be considered:

   a. the VAT own resources harmonised base,
   b. the UK national VAT base (which includes zero-rated supplies),
   c. the UK positive rate base (which does not include zero-rated supplies).

The difference between b. and c. springs from the fact that the zero rate in the UK is technically a rate of tax - unlike exempt supplies which are excluded from the tax base. (From this it follows that traders making zero-rated supplies are registrable for VAT and may deduct input VAT charged on purchases for their business whereas traders making only exempt supplies are not registrable and may not deduct input tax.)

3. In detail the different tax bases are as follows:-

   a. <u>The VAT own resources harmonised base</u>
   The EC Sixth VAT Directive defines the supplies of goods and services which are to be regarded throughout the Community as taxable for own resources purposes. The VAT exclusive value of all such supplies forms a notional tax base to which the Community VAT rate of up to 1% is applied. The actual base does not necessarily coincide with the coverage of VAT in any Member State, though in the UK the difference is not very great.

In the calendar year 1979 the value of the harmonised base in the UK amounted to £108,600 million. One percent of this is £1,086 million.

b. <u>The total UK national VAT base</u>

This represents the VAT-exclusive value of all supplies in the UK of taxable goods and services (ie including zero-rated supplies as well as supplies taxable at positive rates).

In the calendar year 1979 the value of the total UK national tax base amounted to £107,500 million. One percent of this is £1,075 million.

c. <u>The UK positive rate VAT base</u>

This represents the tax-exclusive value of all supplies in the UK of goods and services chargeable at positive rates of VAT. At present this covers all supplies of goods and services chargeable at the standard (15%) rate of VAT. The difference between this tax base and the total national VAT base represents the value of supplies of zero-rated goods and services, which account for some 40% of the total base.

In the calendar year 1979, the value of the positive rate VAT base amounted to £65,000 million. One percent of this is £650 million.

MT

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CHANCELLOR OF THE EXCHEQUER

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

22 August 1980

N. Sanders, Esq.,
Private Secretary,
10, Downing Street

Dr Nick,

VAT OWN RESOURCES IN THE EC

Further to your letter of 11 August to
.... Richard Tolkien, I enclose a further
note by Customs and Excise.

NJS 26/8.

Yrs ever,

M.A. HALL

10 DOWNING STREET

PRIME MINISTER

Here is a note from Sir Robert Armstrong about the legal implications of reaching the 1% ceiling on the Community Budget.

This is linked to an earlier submission on Community finances which was in your box for Switzerland. I asked the girls to ensure that this went with your Chequers luggage, as you may want to have both papers to hand for your discussion with the Financial Secretary.

MAP

21 August 1980

MAP

MS

Ref. A02903

PRIME MINISTER

Community Budget

In my minute of 1st August, I said that I would let you have further advice on the legal implications of reaching the 1 per cent ceiling. I attach a note which has been agreed with the Foreign and Commonwealth Office, the Ministry of Agriculture, Fisheries and Food and the Law Officers' Department.

2. As you will see the position is complicated even within the agricultural sector alone. This is untried legal territory; but, if the advice given in this note is correct, Member States would have an obligation to meet some forms of expenditure but not others. Thus Chancellor Schmidt's statement that national Governments would have an obligation to meet financial claims if the Commission were unable to do so seems to be partly true and partly not true. It would be worth while exchanging views with the Germans in the course of our bilateral contacts. What does seem likely is that the degree of legal uncertainty would be such that some attempt would be made in the Council to provide legal cover for national Governments who wanted to meet the claims of their farmers and traders for payments in those cases where their ability to do so was in doubt. This would put us in a good position, although we would be under some pressure ourselves. But at the end of the day, if an agreement proved impossible, and Member States were left to decide whether or not to make payments without legal cover, the situation could work out to our financial advantage. At least we would not be paying for other people's intervention purchases.

3. I am sending copies of the note (but not of this minute) to the Foreign and Commonwealth Secretary, the Lord Privy Seal, the Chancellor of the Exchequer, the Minister of Agriculture, the Attorney General and, in view of your meeting on 23rd August, to the Financial Secretary.

4. It is possible that, at that meeting, the Financial Secretary will refer to the Community draft budget for 1981. I am therefore also sending you a copy of a recent Treasury submission recommending the general line we should take when the Commission's proposals come to be discussed by the Budget Committee and the Budget Council in September. I understand that the Financial Secretary agrees with recommendations in paragraphs 11 and 12 except that he thinks we should not be too active in supporting the Commission's proposals for increasing the size of the Regional and Social Funds. While accepting that we want to keep the Commission's goodwill and show our interest in shifting the balance of the budget towards expenditure on things like the Regional and Social Funds from which we get a net benefit, we do need to show our interest in strict control of public expenditure.

RTA

ROBERT ARMSTRONG

15th August, 1980

LEGAL IMPLICATIONS OF THE EXHAUSTION OF OWN RESOURCES

Introduction

1. The interim report by officials of 31 July 1980 on "The Community Budget, the approach to the 1 per cent ceiling" raised the question of what happens when own resources run out but claims for payment continue to be made. Community law, not surprisingly, does not specify how the rights and obligations of individuals and Member States would be affected in such a situation. Although definite conclusions are not possible, this note tries to assess the legal implications of the present legislation. It is addressed in particular to the proposition mentioned by Chancellor Schmidt that the 1 per cent VAT ceiling would not be an effective check on spending, because it would fall to Member States to meet the claims when Community funds ran out.

2. This note deals with the legal consequences of the exhaustion of own resources in the agricultural sector only, clearly the most important, given the amount of Community expenditure on the Common Agriculture Policy (CAP). Legal issues of a similar nature may be expected to arise in other sectors, where a legal entitlement to payment exists, but these are being examined.

Claims by individuals against the Crown

3. In certain circumstances, Community law provides that identifiable sums shall be paid to individuals. These provisions confer directly enforceable rights on individuals which must be protected by the domestic court. The agricultural regulations in question do not use a consistent formula in specifying the responsible body in the Member State to whom a claim should be addressed. They speak for example of "Intervention Agencies", "the competent authority", "Member States" or are silent. HMG has a general responsibility for carrying out the United Kingdom's obligations under the CAP and has in most cases designated the Intervention Board for Agricultural Produce (IBAP) to discharge its duty. IBAP, under Section 6 of the European Communities Act 1972, is a Government department and it would, therefore, seem not to be material for the purposes of proceedings brought by an individual in the

United Kingdom courts whether the obligation to pay rests on IBAP or otherwise on the Crown. The essential question then is to determine whether in default of Community funding there is an obligation on the Crown to make payments to individuals.

4. There are three cases which must be distinguished in this connection: cases where payments are prefunded by the Community under existing legislation, cases where payments are made by the national authorities subject to reimbursement by the Community and cases where a transaction is effected by the national authorities out of national funds subject to eventual reimbursement by the Community for the loss made on the transaction. Examples of prefunding arising in the Guarantee Section of the CAP are export subsidies, production subsidies and consumption subsidies. Examples of payments subject to reimbursement are the structure grants paid out of the Guidance Section of the CAP. Examples of the last listed cases are intervention purchases and sales; here the obligation to meet the initial cost of purchases into intervention rests on the Member State. When it later sells the produce out of intervention, it recoups any loss incurred from the Community.

5. There seems to be a fairly strong legal argument for maintaining that in the case of prefunded payments Member States are under no obligation to make payments in default of Community funding. Council Regulation No 729/70 provides in Article 4.2 that:

> "The Commission shall make available to Member States the necessary credits so that the designated authorities and bodies may, in accordance with Community rules and national legislation, make the payments referred to in paragraph 1 (ie. export refunds and storage charges incurred during intervention). The Member State shall ensure that those credits are used without delay and solely for the purposes laid down".

and there are other indications in this Regulation which point to the conclusion that payments may be made only out of Community funds. It is also arguable that Member States have no right in these circumstances to make payments. Strictly, it would follow from this that if a Member State were to make payments out of its own funds in a crisis to meet these claims, it might not be able to recover the sums expended from the Community.

6. The situation is different in relation to payments made subject to reimbursement and to intervention purchases and sales. Here, the Community Regulations in question impose an obligation on the Member State, or its Intervention Agency, to make payments in defined circumstances and go on to provide that the Member State will be reimbursed or will receive some payment out of Community funds. At first sight, it might seem possible to argue that the Member State's obligation to pay is so closely tied to its right to Community finance that if the Community funds are clearly not going to be available the obligation to pay is abrogated. However, the Member State cannot possibly know that it will not receive Community funds. For example, when it purchases products into intervention it does not know when it will sell them or whether it will do so at a loss, and consequently cannot foretell whether and when the obligation on the Community to make payment to the Member State will arise. Thus, it will not know into which budget year or which part of a budget year the right to Community funds will fall.

7. It could be argued that as, within the structure of the CAP, prefunded payments are closely linked to purchases into intervention the suspension of the obligation to make prefunded payments would necessarily release the Member State from the obligation to make such purchases. However, even if so close a nexus between the two types of payment could be established, this argument is double edged. It could be argued that as we were bound to continue payments in respect of reimbursement schemes, there would be an obligation to continue prefunded payments from domestic funds.

8. If the arguments in paragraph 5 to the effect that there is no obligation and perhaps no right for a Member State to make prefunding payments and in paragraph 6 that there is an obligation in relation to continuing

purchases into intervention were accepted and acted on by a Member State it could lead to significant practical consequences. If export refunds were not available, sales into intervention might rise dramatically; in other words there could well be a massive switch from areas where payments could be denied to areas where they were not. However if a situation then came about where it was physically impossible to store all the produce sold into intervention it might be argued that the obligation to buy into intervention must then come to an end. Admittedly this argument depends on the acceptance of the doctrine of supervening impossibility in Community law, a novel proposition for which there is no existing authority.

9. Assuming that the individual could establish that some obligation rested on the United Kingdom to make payments in default of Community funding, it is possible that the United Kingdom could plead in its defence that the obligation did not arise at once and that it was not required to make payment immediately. Relatively few Community Regulations specify payment within a certain period; in particular, those on export restitutions do not. Where a period is specified, there is no uniformity from one Regulation to another. Intervention purchases of butter and skimmed milk powder are to be paid for within 40 to 70 days, monetary compensatory amounts within two months but the suckler cow premium only within 12 months.

10. If proceedings were brought against HMG they would undoubtedly be complicated and lengthy and might well involve a Reference to the European Court under Article 177. By the time the claimant had obtained a final ruling, a political settlement might be in sight.

11. Even if the individual eventually succeeded, the Crown is not liable to enforcement procedures. It would, however, be quite unprecedented for the Crown not to give effect to a declaratory judgment of the court.

Claims by an individual against the Commission

12. An individual might have a claim against the Commission in the domestic courts, depending on the Community instrument in question. It is difficult,

however, to see what could be gained by an individual in such proceedings, as all they would establish would be that the Commission owed a debt.

Attitude of the European Court of Justice

13. However plausible the arguments may be that a Member State would be released from some of its obligations to make payments, it is unlikely that European Court of Justice would be attracted by them - in any event if the Commission were arguing the contrary. The outcome might depend on the way in which the issue came before the court; there being a number of possibilities:

a. A domestic court faced with proceedings taken by an individual against his Government for failure to make a payment in default of Community funding might refer the case to the European Court under Article 177 EEC.

b. A Member State might decide to make payments and the Commission might make reimbursement leading to a challenge being brought against the Commission by another Member State.

c. A Member State might decide to make payments and the Commission might then refuse reimbursement, leading to a challenge being brought against the Commission by that Member State.

It is thought that the chances of the Court finding against the right of a Member State to make the payments and/or to obtain reimbursement are not high in any of these, best in (c) and least in (b).

Conclusions

1. There are legal arguments that a Member State is not obliged and has no right to make payments which would normally be prefunded by the Community.

2. There is a strong argument that in the case of purchases into intervention and payments subject to reimbursement by the Community Member States

are under an obligation to continue to provide national funds.

3. If the Commission reimbursed a Member State in respect of sums expended in default of Community funding, it is likely that the European Court would uphold the actions of the Member State and the Commission.

Cabinet Office
14 August 1980

C Mr Franklin

CONFIDENTIAL

1981 PRELIMINARY DRAFT BUDGET OF THE EUROPEAN COMMUNITY

Provisional Analysis by HM Treasury

1. The Annex to this note contains an interim assessment of the Commission's preliminary draft budget (PDB) for 1981. The supporting documents containing the Commission's detailed proposals with their justification have only just been received in London. Our assessment may change when these documents have been properly studied.

2. A start was made with the examination of the Commission's proposals by the Council's Budget Committee in Brussels in the last week before the holiday season. The examination will continue in September in the Budget Committee and Coreper and the Budget Council will "establish" the draft budget on 23 September for transmission to the European Parliament.

Brief Commentary

3. Tables showing the breakdown of the payments and commitments appropriations in the PDB are attached to the Annex. The payments appropriations total 20,051 MEUA (about £12,190 million at current rates of exchange). This is just within the own resources ceiling. The rate of VAT required to finance this total is estimated at 0.95% and the Commission has left a headroom within the 1% ceiling of 550 MEUA (about £335 million).

4. The commitment appropriations total 21,732 MEUA (about £13,211 million). Both payment and commitment appropriations show a big increase over the 1980 budget:-

Payments 28%

Commitments 25.5%

This is very much higher than the rates of growth between 1978 and 1979: and between 1979 and 1980. It is also very much higher than the rates of growth of the national budgets of the Member States.

5. Part of the explanation (but only a small part) is that the Commission have included in the PDB full provision for payments to the UK under the 30 May agreement in respect of our contribution to the 1980 budget, plus 100 MEUA as an advance payment of the refund due in respect of the 1981 budget.

6. The high rate of growth is not explained by the CAP. In fact, the provision for the Guarantee Section of FEOGA, 12,941 MEUA, is suspiciously low. We think that a figure of 13,500 MEUA would be more realistic. (As is customary, these figures make no allowance for the 1981 price fixing.)

7. A major part of the explanation of the large increase in the payments appropriations is the provision for the three structural funds - Regional, Social and Guidance Section of FEOGA. The rates of increase shown in the relevant table are deceptive. In 1980 the payment appropriations for these funds were cut back because large sums were carried over unspent from the payment appropriations in earlier budgets. It is probable that the sums carried over will be exhausted in 1980 so that a big increase in the payments appropriations in the 1981 Budget will be needed to preserve a steady pattern of expenditure.

8. The big increase in the commitments appropriations is not explained by any such special phenomenon but seems to result from a general expansionism on the part of the Commission. Part of their motive, no doubt, is to provide a substantial increase in non-obligatory expenditure so as to please the European Parliament and further the goal of restructuring the budget. Total non-obligatory expenditure in the PDB (on the definition used by the Council) is 5,045 MEUA in commitment appropriations and 3,513 MEUA in payment appropriations. These represent increases of 31% and 54% respectively. The "maximum rate" of increase for non-obligatory expenditure (as calculated by the macro-economic criteria listed in Article 203 of the Treaty) is 12.2%. (The maximum rate is applied separately to commitments and payments.) An attempt to hold the increase in non-obligatory expenditure within this maximum rate - whether for commitments or for payments - would involve very large cuts in the Commission's proposals.

9. If this year's discussions follow the usual pattern, a majority in the Council will want to cut the Commission's proposals and a majority in the Parliament will want to restore the cuts - possibly going beyond the Commission's proposals.

The final outcome is likely to be a compromise somewhere between the Commission's and the Council's figures.

UK Attitude - General

10. The chief UK objective in the discussions on the PDB must be to ensure that full provision is included for the refunds due to us under the 30 May agreement in respect of 1980 plus a worthwhile sum for advances in respect of 1981. If the Parliament rejected the draft Budget as they did last year, the payment of these refunds would be likely to be seriously delayed. We therefore have a particular interest in avoiding confrontation between the Council and the Parliament this year. Despite the 30 May agreement, we retain an interest in preserving the Commission's proposals for increases in the provision for types of expenditure which are of net benefit to the UK, in particular the Regional and Social Funds. Even though the 30 May agreement has reduced the net benefit we gain from these Funds, it has not eliminated it. We must also avoid giving other Member States and the Commission the impression that the effect of the 30 May agreement has been to make us lose interest in Budget restructuring. These arguments point to a policy of support for the Commission's figures, at least during the initial round of discussions.

UK Attitude - Particular

11. The main conclusions that emerge from the discussion in the Annex for our initial reaction to the Commission's proposals are:-

(i) Although the provision for the Guarantee Section is probably too low, we should not challenge it. We should instead aim to exploit this low provision as a way of increasing our chances in 1981 of getting a modest price increase or national financing or genuine economies in the CAP - para. 9.

(ii) Similarly, we should not challenge the Commission's estimates of the yield of levies and duties even though we suspect they are excessive - para. 3.

(iii) Our chief objective must be to protect the provision for refunds to the UK under the 30 May agreement - paras. 4-6.

(iv) We should, at least during the initial round of discussions, support the Commission's figures for the Regional and Social Funds - paras. 12-21.

(v) We need not worry if the provisions for the Guidance Section of FEOGA (including fish) and the aid programme are cut - paras. 10-11 and 22-23.

12. At a later stage in the autumn negotiations our policy may need to be adapted in response to the position reached in the Council of Ministers and by the European Parliament.

15 AUG 1980

Euro PS1

RH

BF 22/8/80

11 August, 1980

The Prime Minister has seen your letter to Tim Lankester of 5 August about VAT own resources in the European Community. She has commented that she would like to see a much longer explanation, and that the note you supplied is not clear because it is so compressed.

I should be grateful if you could let me have a fuller explanation, to reach us here by Friday, 22 August.

N. J. SANDERS

R I Tolkien, Esq
HM Treasury

GE

vb

11 August 1980

Thank you for your letter of 6 August, with a note on European Commission staff requests in the preliminary draft budget for 1981.

The Prime Minister has noted the explanation provided.

MAP

R.I. Tolkien, Esq.,
H.M. Treasury.

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CHANCELLOR OF THE EXCHEQUER

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

6 August 1980

Prime Minister

You asked for an explanation of these staff increases.

MA 6/8

M Alexander Esq
Private Secretary
No.10 Downing Street

Dear Michael,

EUROPEAN COMMUNITY: PRELIMINARY DRAFT BUDGET FOR 1981

Following your letter of 21 July to Paul Lever, FCO, I attach a note on the Prime Minister's request for information on the Commission's staff requests in the 1981 PDB.

Yours,

Richard.

R I TOLKIEN

MT

EUROPEAN COMMUNITY PRELIMINARY DRAFT BUDGET FOR 1981

COMMISSION STAFF REQUESTS

1. The Commission have requested an additional 324 posts for 1981.

2. 173 of these result from Greek accession, and of these posts 40 result from the necessity to add an extra language to the translation services, the other language sections being of this size. The remaining posts requested take account of increased work in the Commission because of Greek accession (eg a 17% increase in documents) and also extra work for other language sections which will have to handle translation and interpretation from Greek.

3. The other 151 posts amount to only 1.7% of the existing staff complement of the Commission. Some of these are requested for expansion of present work, including 40 for implementation of the new GATT code and for anti-dumping work; these are areas of concern to the UK.

4. The Commission's request will be vigorously scrutinised by all Member States in the Budget Committee and COREPER, and it is highly unlikely that the subsequent Budget Council will give the Commission as many as the extra 151 posts that they seek.

020

Prime Minister 4

This came up when we discussed the PESC presentation of our EEC budget contribution.

TL 6/8

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

5 August 1980

Tim P Lankester Esq
Private Secretary
No.10 Downing Street

Dear Tim,

At her meeting with the Chancellor on 11 July, the Prime Minister asked about the differences in yield from a 1% rate applied to the harmonised base used to calculate the Community's VAT own resources and a 1% rate of VAT applied in the UK.
.... I attach a note setting out the information.

I am sending copies of this letter to George Walden, David Wright, and Mike Eland.

Yours,

Richard.

R I TOLKIEN

VALUE ADDED TAX AND VAT OWN RESOURCES

1. VAT own resources are not a separate, identifiable tax; the yield derives from the application of a given percentage rate to the final expenditure on the "harmonised base". The harmonised base is a range of goods and services, the same for all member States, which was agreed in 1977.

2. The range of goods and services included in the harmonised base is very similar to the range making up the UK base for VAT; this is the position in other member States too. Expenditure in the UK on the goods and services included in the harmonised base is approximately one per cent more than the expenditure which makes up the UK VAT base. In 1979, the total expenditure in the UK relating to the two bases was:-

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	£ million
Harmonised based	108,600
UK national VAT base	107,500

Applying a one per cent rate to the harmonised base in 1979 would therefore have given, for the UK, VAT own resources of £1,086 million. The equivalent figure for the UK national VAT base would be £1,075 million.

?

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3. In 1979, when the positive rates of VAT were 8 and $12\frac{1}{2}$ per cent for part of the year and 15 per cent for the remainder, the revenue to the Exchequer from each one per cent was on average about £650 million. This was substantially less than one per cent of the UK VAT base (£1,075 million) which includes goods and services (eg food, new construction etc) on which the rate of VAT charged is zero.

Further explanation please.

MT.

Recess Box

Ref. A02791

MAP 8/8

PRIME MINISTER

FUTURE COMMUNITY STRATEGY

In his letter to Mr Wright of 16 July, Mr Alexander said you would like to have a progress report for the summer recess on the restructuring of the Community budget. I attach a paper which has been prepared by a group from Treasury, Foreign and Commonwealth Office, and Ministry of Agriculture, Fisheries and Food under Cabinet Office chairmanship. As you will see, it tries to set the scene and concentrates on the shorter term issues which will arise in connection with next year's agricultural price fixing and the approach of the 1 per cent VAT ceiling. It identifies some of the issues we shall have to face, but suggests that it would be premature to try to fix our line until the further work on longer term remedies have been completed. As regards the legal position, I hope to let you have a note shortly on the powers and obligations of national governments if and when Community financial resources run out. This will be relevant to the discussion you are intending to have with the Financial Secretary (Mr Alexander's letter to Mr Wiggins of 21 July refers).

2. I am sending copies of this minute and the progress report to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food.

RA

(ROBERT ARMSTRONG)

1 August 1980

THE COMMUNITY BUDGET: THE APPROACH TO THE 1% CEILING

INTERIM REPORT BY OFFICIALS

INTRODUCTION

1. This interim report describes the outlook for the Community Budget, own resources and the economies of the member states in 1981 and 1982, and their implications for the budget restructuring review agreed at the 29/30 May Foreign Affairs Council; sets out the key stages in the Community's negotiating timetable; and considers how we and the other member states might react to the situation that expenditures are tending to exceed the resources available under the 1 per cent VAT ceiling introduced by the 1970 Own Resources Decision. While the report draws a number of provisional conclusions, it should be stressed that our strategy can only finally be settled when the studies now in hand on our long-term objectives have been completed. It will be important to ensure that the options which we press for the short-term are compatible with our longer-term objectives.

COMMUNITY BUDGETARY AND ECONOMIC DEVELOPMENTS IN 1981 AND 1982

1981 Community Budget

2. The 1981 Preliminary Draft Budget (PDB) prepared by the Commission provides for total expenditure of 20,051 MEUA (about £12,200M), an increase of 28% over 1980. Total revenue from levies, duties and other revenue is estimated at 8913 MEUA (about £5,400M), leaving 11,138 MEUA (about £6,800M) to be financed by VAT contributions for the nine existing member states and a financial contribution from Greece. The latter is estimated at 180 MEUA (about £110M) and thus leaves 10,958 MEUA (about £6,700M) to be financed by VAT which represents a rate of 0.9520% of the harmonised base. The product of a 1% rate of VAT own resources for the nine existing member states is estimated at 11,510 MEUA (about £7,000M) which implies that there would be about 550 MEUA (about £335M) headroom within the 1% ceiling.

/3.

3. Within this total, agricultural spending in the FEOGA Guarantee Section is estimated at 12.9 billion EUA, an increase of about 12% from the revised 1980 provision of 11.6 billion EUA. This is less than the initial estimate used in the Public Expenditure Survey (PES) based on past trends, namely 14.7 billion EUA. The main difference is that the Commission forecast a standstill on spending in the milk sector, relying chiefly on the Council's commitment to introduce a super levy on milk if production continues to increase. It is likely that other member states, notably Germany, will try to cut other items in the Budget because of the imminence of the 1% ceiling. We must ensure that they do not in the process reduce the provision for the UK's budget refund, which is one of the explanations for the high rate of increase in the 1981 draft Budget. It represents 7.7% of the total Budget. Without our refund, the increase over 1980 would be only about 20% and not 28%.

4. Given the limited headroom, any proposals from the Parliament for additional expenditure could result in the 1% ceiling becoming a constraint on the size of the 1981 Budget. But on balance it is unlikely that proposals which would take the Community over the 1% ceiling will be made in the negotiations on the 1981 Budget or that, if they were made, a majority of the Council would support them. This does not, however, exclude the possibility that the Community might come up against the 1% ceiling during 1981 through a miscalculation of the expenditure implications of its agreed Budget.

The growth of own resources in 1981 and 1982

5. The yield of own resources within the 1% ceiling will reflect the recession in Community economies in this period: the Community VAT base is likely to grow by only 10% a year in cash terms, the yield from import duties by about 7% a year, and agricultural levies by about 5% a year. Taking these trends together, we expect own resources within the 1% ceiling to grow by about 8-9% a year.

6. Assuming that the yield of own resources in 1982 were 22,200 MEUA (ie the Treasury PES forecast), the headroom or shortfall would depend almost entirely on what assumption is made about the rate of growth of CAP expenditure. For there to be any headroom at all in 1982, its rate of growth would have to be approximately halved, whereas if past trends continued there would be a shortfall of possibly some 4,500 MEUA.

/Growth

Growth and domestic public expenditure in the Community

7. The Treasury do not expect Community GDP to grow by more than $1\frac{1}{2}$-2% in real terms a year in 1980-82, compared with the 1973-79 average of $2\frac{1}{2}$-3%. Unemployment will rise, and the Commission estimates that real earnings per head in the Community will grow on average by only $\frac{1}{2}$-1% in the years 1980 and 1981, compared with an average annual increase of about 3% between 1973 and 1979. The Commission further expects that the average annual growth of government expenditure in member states will slow to about $12\frac{1}{2}$% nominal between 1979 and 1981, compared to an average annual rate of some 15% between 1973 and 1979. The rate of growth of Community expenditure has also tended to slow down, but it has still been growing faster than national expenditure. This is mainly due to the growth in the cost of the CAP (although there has also been some substitution of domestic by Community expenditure as a result of the development of the Social and Regional Funds). Thus, if the member states were to exercise the same restraint on the Community Budget as on national public expenditure, this would create major difficulties for the farming community, since it will involve a sharp reduction in the rate of growth of total public expenditure (Community plus national) on agriculture.

Implications for agricultural policy

8. The general slowing-down in the economies of the member states is likely to affect their attitudes to CAP expenditure. The recent rate of growth of 23% in Guarantee Section expenditure posed few problems for our partners so long as their economies were growing reasonably fast and a major and increasing share of the cost was borne by the UK. But with the recession biting, total own resources growing at only 8-9%, and the redistribution of the budgetary burden following the 30 May agreement, this high rate of growth may not be tolerated in the future. The recession could also be expected to inhibit governments from transferring more of the cost of the CAP from the Budget to consumers.

9. At the same time a sharp fall in the rate of growth of CAP expenditure would cause problems for the farming communities and for governments that have traditionally been concerned to keep up farm incomes. Even the rate of growth in the late 1970s failed to prevent the increase in real income per head in farming falling behind the increase in income per head of the

/Community

Community economies as a whole. Moreover, any further movement off the land into cities by marginal farmers will be unwelcome, since it will add to the problems of urban unemployment. Governments are likely to face this dilemma in an especially acute form when it comes to the 1981 CAP price fixing.

THE TIMING OF COMMUNITY DECISIONS

10. We now have an indication of how the present Commission propose to put in hand the mandate under the 30 May agreement to produce proposals by June 1981 on the development of Community policies to achieve restructuring. The present Commission does not intend to leave all the work to its successor, although it is clear that the making of proposals will be left to the new Commission under Mr Thorn. A group of Commissioners has been set up and will have its first meeting on 4 September. The whole Commission will then have a brainstorming section on 11/12 October. Given the widely differing interests and views of member states, what the Commission does will be of considerable importance; we shall attempt to influence the Commission's work through our normal informal contacts.

11. Normally, the Commission would make its agricultural price proposals before the end of the year, but with the change in Commission this may be left until the beginning of 1981. However, the present Commission may make some suggestions in the Autumn designed to show how CAP economies can be made. The French will be anxious to give farmers price increases before their elections in May 1981. The 1 per cent ceiling could therefore emerge as a substantive and critical issue in this context. Chancellor Schmidt's and President Giscard's resolve to remain within the 1% ceiling will be tested against the pressures exerted by their domestic agricultural lobbies, who will be affected by the factors mentioned in paragraph 9 above. Even if efforts are made to accommodate price increases with the 1% ceiling for 1981, the agricultural price fixing will seriously affect the preparation of the draft 1982 Community Budget. This will be under consideration at about the time that the Commission proposals are due under the 30 May restructuring mandate. This sequence of events suggests that the intense negotiating activity over the 1981 CAP price-fixing may raise, and that over 1982 Community Budget very probably will raise, some of the issues which are due to emerge from the budget restructuring review.

ACTION TO STAY BENEATH THE 1% CEILING

12. The following paragraphs do not go into depth about ways to restructure the Community Budget in the longer term so as to keep expenditure beneath the

/1%

1% VAT ceiling, but concentrates on short-term methods. The following types of action are considered:-

(i) measures to raise revenue;

(ii) measures to postpone expenditure;

(iii) measures to reduce CAP expenditure;

(iv) measures to reduce non-CAP expenditure.

(i) Short-term Expedients to Raise Revenue

13. Increases in customs duties and levies. Article 28 of the Treaty provides for the possibility of a temporary increase in customs duties. But in most cases the compensation for third countries required under the GATT rules would offset any revenue benefit. The few exceptions would yield only a small increase in revenue, so this route is unlikely to be pursued. The same is broadly true of increase in agricultural levies (other than those which would follow from any decision to raise agricultural prices).

14. Advances. Article 10.2 of the Own Resources Regulation 2891/77 authorises the Commission to invite member states to advance the payment of own resources, other than VAT, by one month to meet a revenue deficiency but not an expenditure over-run. At present levels of payment, this would bring forward by one month some 700 MEUA of revenue. Although the process could be repeated, so that payments of customs duties and agricultural levies were always running one month ahead of schedule, the benefit would be once-for-all. We shall need to examine the Commission's estimates to see whether they have deliberately over-stated the likely yield of own resources in 1981 so as to be able to claim advances as a way of financing a higher rate of expenditure in that year.

15. Borrowing. Under Article 12 of Regulation 2891/77, the Commission have what is in effect an overdraft facility: if their cash needs to meet expenditure approved in the Budget exceed the amounts in their accounts with member states, they may draw more than their current balance in proportion to each member state's average contribution share. The provision was included in the Regulation to cater for a short-term revenue shortfall and we do not believe that it could be used to enable the Commission to borrow to finance excessive expenditure.

16. More generally, the Commission have no powers to borrow from the market to balance the Budget, nor the Community to create own resources other than under the Article 201 procedures, which require ratification in each of the member states.

/Postponement

(ii) Postponement of Expenditure

17. The Community has obligations, which could not be postponed, to pay the staff of the institutions. It also has contractual obligations, which could probably not be deferred, on things such as rent and insurances. On other administrative expenditure, the Commission could delay entering into new commitments and, to some extent, slow down its rate of payments, at least temporarily.

18. However, these are small items compared with agricultural expenditure under the FEOGA Guarantee Section. Short-term savings eg by cutting the rates of export restitutions are within the Commission's competence through the Management Committee procedures. But this would tend to drive more goods into intervention and add to the budgetary costs of disposal in the following year (this is considered in more detail in paragraphs 22 and 23 below). There are legally binding commitments under the Community's structural funds (the Regional Development Fund, Social Fund, CAP Guidance Section and funds for aid to developing countries). In these areas appropriations in the Budget of a particular year normally go to finance expenditure late in the year, or are carried forward to finance expenditure in the following year. If the Commission knew that they were likely to run short of funds, they could defer virtually all the payments to which they were committed in these fields, amounting in the 1980 Budget to some 1,100 MEUA (approximately £670 million) and transfer this sum to FEOGA. Because the commitment to payment at some future date would remain, the transfer is likely to be criticised as inappropriate. Because it would involve a transfer from non-obligatory to obligatory expenditure the agreement of the European Parliament would be essential. The Commission cannot therefore rely on such a solution to prevent the exhaustion of money for FEOGA.

19. Such transfers would significantly increase the UK's unadjusted net contribution in the year in which they took place because they would move expenditure from schemes from which we benefit substantially to the CAP. However, in subsequent years, they would reduce our net contribution as the deferred payments were made. Whether or not this would be in the UK's interest would depend on:-

(i) the Community's willingness to implement the 30 May agreement in full and to compensate the UK through its special refund for its increased net contribution;

/(ii)

(ii) the availability of funds in later years to make good the deferred payments; and

(iii) any impact that the reduction in the UK's unadjusted contributions in future years might have on the outcome of the review of the Community's policies and budgetary arrangements.

(iii) Short-term Action to Reduce CAP Expenditure

20. The following measures could all be used to meet a short-term crisis, though most also have important long-term implications and need accordingly to be assessed with those implications in mind. Some of them (eg increases in co-responsibility levies, the planned introduction of national financing) would require a decision of the Council of Ministers, others (ie those described in paragraphs 22 and 23) could be taken by the Commission. If measures of the first kind are sought, the ability to block them in the Council would give us leverage. Commission action would require prior discussion in a Management Committee composed of representatives of the member states. But it is not possible to block action proposed by the Commission in Management Committee unless a qualified majority of member states is opposed to it; and even then the Commission may report the matter to the Council and proceed unless the Council takes a different decision within one month.

21. The main possibilities for achieving a sizeable short-term effect on the budgetary cost of the CAP are:-

(a) further co-responsibility levies - which the Germans in particular favour - would not be acceptable to us if accompanied by price increases as in the past or if they discriminated against the UK more than the present co-responsibility levy on milk. In considering any proposals to raise more revenue from this source we would need to be satisfied that not only the Budgetary implications but also the resource implications were acceptable. These will be examined in a later paper. This leaves

(b) action by the Commission to influence the timing and level of expenditure;

(c) national financing.

22. Action by the Commission to Effect CAP Economies. Most CAP expenditure is incurred in the day-to-day market management for the main northern products and significant savings could accordingly be sought in the same area. But the Commission are constrained by the need to avoid a cutback in one item which simply leads to increased expenditure in a different form. This applies most

/obviously

obviously to subsidies for surplus disposal, whether by export to third countries or internally. If these are reduced beyond a certain point, goods will be driven into intervention and, although the expense (other than for financing and storage) will initially fall upon the member states, the stocks will eventually have to be disposed of at the expense of the Community.

23. If cuts in subsidies were not to lead to a build-up of intervention stocks, the cuts would need to be accompanied by measures to make intervention less attractive, which in turn implies a weakening in support for producers. This would be feasible, though it would be strongly opposed by several member states. One way would be to delay payment for sales into intervention, along lines recently introduced by the Commission for the milk sector. The effect would be to reduce the financing costs falling on FEOGA and, more important, to discourage offers. It would be possible to go further and pay for purchases only when the produce was actually sold out of intervention again. This would automatically become a greater deterrent if stocks increased and the element of uncertainty would also discourage traders. Other ways in which the Commission could discourage intervention would be to insist on higher quality standards; to restrict the form in which produce could be offered; to reduce the number of points where delivery would be accepted; and to reduce Community finance for storage to member states.

24. National Financing. National financing could come about because the Commission had run out of money. If national funds were to be used in these circumstances, it would amount to the *de facto* introduction of a form of national financing. Whether or not this would be legal relates to the question which Chancellor Schmidt raised about whether persons in member states who have claims on the CAP could enforce them against national Governments if Community funds had run out. The Commission believe it would not be within Community law to meet claims out of national funds. A separate note on this issue, incorporating the considered advice of the legal advisers to the Departments concerned, will be submitted later. But there is no doubt that individual member states would come under compelling pressures from persons who had claims outstanding, to meet these. This would put national Finance Ministries in an extremely awkward position because they would have no internal budgetary provision for making such payments. This would create a situation in which the Council would at least try to agree on a positive decision rather than allow the haphazard introduction of some form of national financing in each member state. The most obvious approach would be for the Community to reimburse member states for CAP expenditure at some rate less than the present 100 per cent so that

/national

national funds would automatically bear a proportion of the total cost.

25. Partial national financing would be likely to be to our advantage as compared with the same volume of expenditure being funded wholly through the budget, though the benefit might be subject to reduction because of the risk-sharing formula under the Budget settlement. However, national financing of part of the cost where it fell would create an incentive for the net exporting countries to export their surpluses to other member states, and this might be disadvantageous to the UK, and more particularly, to Germany. Other forms of national financing are also under consideration.

(iv) Expenditure Reductions Outside the CAP

26. It is likely that some other member states would want the economies to fall on other Communities' expenditures rather than on the CAP. This would not suit us. Our first priority would be to safeguard our refund under the 30 May agreement. Subject to that, we should also want to resist cutbacks in Regional and Social Fund expenditure, since they could prejudice our future receipts from Community policies and would not square with our long-term policy of reducing the proportion of the Community Budget spent on agriculture.

CONCLUSIONS

27. The provisional conclusions emerging from this interim report are that:-

(i) It is likely that the 1981 Community Budget can be adopted within the 1% ceiling although the possibility of reaching it during 1981 because of an over-run on expenditure cannot be ruled out. The ceiling will however exert an influence on the 1981-82 agricultural price-fixing, and very probably be a constraint in the preparation of the Community Budget for 1982;

(ii) The period of negotiation will begin in the autumn as member states attempt to influence the Commission in the execution of their mandate on restructuring. It will intensify from the spring of 1981 onwards as the 1981-82 CAP price-fixing discussions come to a head, and when the Commission produce their proposals for the 1982 Community Budget and for restructuring; all three subjects could become linked. In this period we may be faced with decisions whether to accept possibly unwelcome expedients in order to defer the onset of the ceiling or whether to reject them, the sooner to exploit the leverage which the ceiling offers;

/(iii)

(iii) The slower rate of economic growth in the Community will limit the growth in Own Resources over the next few years. The scope for raising extra revenue or postponing Community expenditure is probably not great enough to allow the 1982 Budget to be adopted within the 1 per cent ceiling unless major reductions in the growth of Community financed CAP expenditure are achieved.

(iv) From the UK's point of view it is important that any short-term action to cut the cost of the CAP is consistent with our longer-term objectives for CAP prices. Of the possible measures, the introduction of an element of national financing and action to cut subsidies and make intervention less attractive, would suit us best.

(v) In considering possible cuts in expenditure in the 1981 and 1982 Budgets, we should give first priority to cuts in agricultural expenditure. Only if it were necessary to protect our Budget refund, would we accept cuts in the Regional and Social Funds. We would not accept a cut in our Budget refund.

These conclusions must remain provisional until our longer-term objectives have been established by Ministers on the basis of studies yet to be completed.

Cabinet Office
31 July 1980

MFJ

5

SECRET

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SIR ROBERT ARMSTRONG

The Prime Minister has seen your minute to me of 28 July about bilateral talks with the Germans on future Community strategy. She is content that our representative in any such talks at official level should be Mr. Franklin.

MODBA

30 July 1980

SECRET

4

①

SECRET

Prime Minister

Agree A?

Yes no

Ref. A02729

MR. ALEXANDER

28/7

In a minute which I sent you on 14th July, I reported what the Federal Chancellor had said when I saw him on 11th July about bilateral talks at official level on future Community strategy.

2. The Prime Minister said, after receiving that report, that she had envisaged that the bilateral talks would not begin until after the German elections, and that she did not particularly want them to begin before that; but that, if the Chancellor pressed for them to begin in September, we could go along with that.

3. In order to round the matter off, I propose (with the agreement of the Foreign and Commonwealth Secretary) to signify accordingly to Herr von Staden.

A. If the Prime Minister is content, I will indicate that our representative in any bilateral talks would be Mr. Michael Franklin. If the talks are more than one a side, he would be joined by a member of the Foreign Office. The Foreign Office are content with this.

RTA

(Robert Armstrong)

28th July, 1980

SECRET

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(2) (3)

SECRET

Prime Minister

You will be receiving a fuller account of the Foreign Secretary's meeting with his French & German colleagues.

MA Rd

PM/80/58

PRIME MINISTER

EC Budget

1. As you know, I propose to visit Brussels on 21/22 July in order to participate in at least part of the last Foreign Affairs Council before the holidays. There is a long agenda, which includes a number of important questions but there is only one with which I think I ought to trouble you and about which I spoke yesterday.

2. The Council will be discussing, on the basis of drafts prepared by the Commission, the regulations necessary to implement the agreement the Council reached on 30 May on our budget contribution. It will not be possible for the Council actually to adopt the regulations because the European Parliament will not deliver its opinion on them until September. In any case there are a number of outstanding questions to be resolved on them. I do not take too tragic a view of this delay and nor, I believe, does Geoffrey Howe. But I will do my best to maintain the momentum towards agreement on these regulations and I shall make it clear at the Council that we expect decisions soon after the holidays.

3. Many of the problems are of a technical nature. There are, however, disturbing indications that the French are still working for a link between the payment of the money, for which the 30 May agreement provides, and the negotiations on next year's prices; and that they may be getting some support from the Germans. I therefore thought it wise to discuss this aspect of the regulations on 16 July at the second of my private dinners with Jean Francois-Poncet and Hans Dietrich Genscher (the existence of which we are, as you know, trying to keep completely confidential) and I shall be following it up with them.

/4.

4. I am sending a copy of this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office
21 July 1980

Euro Pol.

File

ds

cc HMT.

10 DOWNING STREET

From the Private Secretary

21 July 1980

BF 29/7/80

European Community :
Preliminary Draft Budget for 1981

The Prime Minister has seen John Wiggins' letter to me of 11 July on this subject, a copy of which was sent to you. She has asked, in regard to paragraph 9 of the enclosure to John Wiggins' letter, why the Commission are seeking an increase in their staff of 323 and why 173 of them will be Greek. I should be grateful if you could let me have a note on both points.

M. O'D. B. ALEXANDER

Paul Lever, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

21 July, 1980.

Supplementary Expenditure in the United Kingdom under Article 235 of the Treaty of Rome

The Prime Minister has seen the Foreign and Commonwealth Secretary's minute to her of 18 July on this subject.

The Prime Minister agrees with the general policy outlined by the Foreign and Commonwealth Secretary. She has commented that local authorities must certainly be excluded from among those benefitting from supplementary expenditure unless the rate support grant can be reduced by an equivalent amount to that which they would receive. She has also expressed the hope that Community participation will be possible in some programmes outside the Assisted Areas.

I am sending copies of this letter to the Private Secretaries of the recipients of the Foreign and Commonwealth Secretary's minute.

M. O'D. B. ALEXANDER

Paul Lever, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

cc
FSO
FCO

Euro PSD

10 DOWNING STREET

From the Private Secretary

21 July 1980

Prime Minister's Meeting with Chancellor Schmidt:
1% Ceiling

The Prime Minister has seen your letter to me of 15 July about the approval of a Supplementary Budget in November 1979. She has expressed concern about the way the detailed arrangements for Community funding operate and has asked that the Financial Secretary should give her a briefing on the subject at some convenient moment during the Summer Recess. I will get in touch with you about the timing.

I am sending copies of this letter to Paul Lever (Foreign and Commonwealth Office), Stephen Locke (Financial Secretary's Office) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

A.J. Wiggins, Esq.,
HM Treasury.

820

CONFIDENTIAL

Prime Minister ②

No.

PM/80/56

PRIME MINISTER

Supplementary Expenditure in the United Kingdom under Article 235 of the Treaty of Rome

1. The sub-Committee on European Questions of the Defence and Oversea Policy Committee met yesterday to consider a paper by the Chancellor of the Exchequer (OD(E)(80)18), and in particular the recommendations in paragraph 28 of the accompanying Note, concerning the modalities of implementing the Article 235 measures for reducing our net contribution to the Community budget. Colleagues from spending Departments and the Secretaries of State for Scotland, Wales and Northern Ireland attended.

2. We took as our guiding principle that there can be no additionality, in the sense that the Government cannot be obliged by the Article 235 Regulation to incur public expenditure that it does not wish to undertake. We recognised that the avoidance of additionality could well create special problems for the Secretary of State for Northern Ireland because of the risk that Mr Hume and Rev. Ian Paisley would exploit the visible absence of new monies for political purposes. However, given the imperative need to reduce public expenditure, it was recognised that spending Departments could not use the existence of a Community funded programme under this Regulation as a reason for seeking extra funds from the Treasury. On the other hand, it could truthfully be said that public expenditure on all such programmes might well have been lower without our budget refund.

3. We further agreed that monies received from the Community should only be passed on in cases where we had effective means to ensure that there would be no de facto additionality. This appears to exclude local authorities where it is not possible to guarantee that they would not use the savings on interest payments (the Community money will take the form of grants not loans) to increase current expenditure or reduce rates. Once the negotiations in the Council

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/over the

Local authorities must be excluded in any event unless we can reduce the RSG by an equivalent amount.

over the text of the Regulation are further advanced, we will therefore press the Commission to confine Community participation to central government and nationalised industry programmes. Officials will now work out the details and ensure that the programmes which we eventually submit give a proper regional spread and adequately cover different types of expenditure.

Also that they include areas outside the Assisted Areas.

4. Subject to these overriding public expenditure considerations, we were agreed that the flow of Community money into the United Kingdom under this Regulation should be given suitable publicity in order to increase public support for our membership of the Community. A Community label can be put on those programmes which are eventually included. Again we have instructed officials to advise on how this can best be done, and to report back to the Sub-Committee on all these questions with their recommendations.

5. I am sending copies of this minute to the other members of OD(E), to the Secretaries of State for Industry, Employment, the Environment, Scotland, Wales, Northern Ireland and Energy, the Chief Secretary to the Treasury, the Minister of Transport and Sir R Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office

18 July 1980

CONFIDENTIAL

Ref. A02638

PRIME MINISTER

Cabinet: Community Affairs

There are no major Community developments to discuss.

2. The Chancellor of the Exchequer might report on the outcome of the 15th July Finance Council, which approved a new tranche under the Ortoli loan facility and reviewed economic conditions in the Community.

3. The Minister of Agriculture has had bilateral talks on fisheries with several of his counterparts, including Herr Ertl. There is a Fisheries Council on Monday, 21st July.

4. There is a Foreign Affairs Council next week with a long agenda including pre-accession aid for Portugal; and the Article 235 Regulation to give effect to our budget settlement, on which you have received a minute * from the Foreign and Commonwealth Secretary reporting the outcome of the OD(E) discussion on 15th July.

RtA

(Robert Armstrong)

16th July, 1980

* This minute has not in fact arrived yet. It is in the Foreign Secretary's box tonight. I attach the minutes of the OD(E) meeting instead.

Rich 16/7

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10 DOWNING STREET

From the Private Secretary

16 July 1980

B/F 11-8-80

FUTURE COMMUNITY STRATEGY

The Prime Minister has seen Sir Robert Armstrong's minute of 11 July to her on this subject.

She has agreed that the programme of work summarised in paragraph 8 should proceed. She would be grateful to have at the beginning of the summer recess a paper, or papers, on the point then reached and on the main issues that have by then been identified.

As regards our response to Chancellor Schmidt and our approach to President Giscard, the Prime Minister is anxious that matters should not be rushed. She regards it as essential that we should be clear about our own objectives before becoming deeply engaged with our partners. While, therefore, she is content that Chancellor Schmidt's office should be informed of our interest in having bilateral talks with the Germans on future Community strategy, she does not wish to press for such talks to take place before the German elections. If the Germans pursue the idea of earlier talks, the Prime Minister would be content for us to agree. If our own position had not been finalised, such talks could, of course, only be exploratory.

The Prime Minister would prefer an approach to the French to be postponed until later in the year.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), John Wiggins (H.M. Treasury) and to Garth Waters (Ministry of Agriculture, Fisheries and Food).

M. O'D. B. ALEXANDER

D. J. Wright, Esq.,
Cabinet Office.

CONFIDENTIAL

KB

cc Mr Ingham

Weekend Box

Prime Minister

Pnd - 16/7

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000 15 July 1980

M O'D B Alexander Esq
Private Secretary
Prime Minister's Office

When Parliament has risen would the F.S. come & give me a tutorial on the detailed arrangements for Community finance. The more I read, the more puzzled I become. MT.

Dear Michael,

PRIME MINISTER'S MEETING WITH CHANCELLOR SCHMIDT:
1% CEILING

In your letter to Paul Lever of 7 July you recorded the Prime Minister's question about the authority under which we made funds available to CAP claimants from national sources when the European Parliament delayed approval of a Supplementary Budget in November 1979. I am replying on this point as it falls more within the province of the Treasury than the FCO.

The Financial Secretary agreed to the provision of Exchequer interest-free loans for this purpose in a letter to the Minister of Agriculture of 30 November which was copied to other members of OD(E). The arrangements were announced to the House by the Minister in a written answer on 4 December (O.R. Vol.975 No.81 Col.139). The announcement indicated that Parliamentary approval for the service would be sought in a Supplementary Estimate and that, pending that approval, a repayable advance would be made from the Contingencies Fund. Parliament subsequently approved the service in a Spring Supplementary Estimate for the appropriate MAFF Vote.

The decision to make temporary Exchequer funds available followed a precedent set in 1975 when a similar problem of temporary unavailability of Community advances arose.

There were two main reasons for taking action:

(a) If payment of export rebates which had been taken into account by traders in their contracts were disrupted this would reduce

/confidence in the

confidence in the system leading to increased sales into intervention. Intervention buying is not pre-funded by the Community and has to be initially financed from national funds, with member states only being reimbursed in arrears in respect of storage and financing costs and losses when products are subsequently sold out of intervention. Hence any substantial move towards traders selling into intervention, eg because of difficulties in securing financing for exports, would have led to an increase in public expenditure.

(b) For certain schemes even a temporary interruption of funds could have caused widespread difficulties. For example, the butter subsidy is paid as supplies enter the distribution chain and holding up payments could have held up supplies to the shops.

The action was also only taken given the near certainty that a renewed flow of Community finance would shortly be available which could be used to replace the temporary Exchequer finance. This was because, even if the European Parliament failed to approve the Supplementary Budget before then, the Commission had powers to make advances before the end of 1979 in respect of the 1980 Budget. These funds did indeed become available in mid-December, so the loans were repaid very quickly and the exercise probably produced a saving in expenditure by avoiding additional intervention costs. As the Foreign Office paper pointed out, there was no doubt in the 1979 case about the availability of Community funds within the 1 per cent ceiling, so that the case cited by Chancellor Schmidt is scarcely analogous.

I am copying this letter to the recipients of yours.

yours ever

John Wiggins

A J WIGGINS

16 JUL 1980

2

SECRET AND PERSONAL

Ref. A02605

Discussed with the the Prime Minister. Letter to Mr Wright. [illegible] [illegible] 16/7/80

MR. ALEXANDER

I have recorded separately most of what passed when I saw the Federal Chancellor on 11th July.

2. At one moment I said that the Prime Minister had been much interested in his idea that there should be bilateral discussions to pursue the problems of Community Budget and CAP restructuring, and I thought that she would be responding positively to this proposal. The Chancellor agreed that such discussions would not now start until September, though he said that they need not wait until after the German election - which he seemed quietly confident of winning. He said that any bilateral discussions should be kept very secret, and should be one a side only. They should not involve or include Ministries of Agriculture. He would be ready to suggest a name of somebody to represent him after the holiday.

RTA

(Robert Armstrong)

14th July, 1980

MH

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

NBPM yet. Paul

The Rt Hon Sir Geoffrey Howe QC MP
The Chancellor of the Exchequer

14 July 1980

Dear Geoffrey,

In your minute of 17 June to the Prime Minister you stressed the need to ensure that the refund from the European Community is used to reduce the PSBR and interest rates, and not to finance additional projects. I am sure that that should be our objective. But as Michael Heseltine has pointed out, finding the right procedures to enable us to achieve it could present some difficult problems.

Attention until recently has been focussed on obtaining agreement to the Regulation. We must now seek to ensure that it is not drafted and implemented so as to force us to distort our programmes in undesirable ways, or to add to bureaucracy. At the same time, we shall have to find ways of handling the refund which will further our objective of improving the image of the Community in the United Kingdom.

Michael Heseltine has suggested that one option would be to retain the refund in the Exchequer. There would be some clear advantages if we could achieve this. But it would be presentationally difficult, both at home and abroad, and we might find it difficult to get the co-operation we needed from local authorities and nationalised industries to obtain the payments. On the other hand, passing on the grant would also have difficulties. To do so without allowing local authorities and the nationalised industries the financing advantage from substituting grant for loan, as would be required if the doctrine of no additionality were strictly adhered to, would seem perverse. It is not easy to see how they could be persuaded to co-operate on those terms. And passing on would inevitably mean more complex accounting arrangements and bureaucracy.

I agree with Michael Heseltine that we need to discuss these issues. I understand that officials are working on them. As events are now moving fast I think it is important that we should see their proposals soon.

I am copying this letter to the recipients of yours.

Yours ever
Norman

NORMAN FOWLER

cc. Press Office

Prime Minister
I thought you would like to see an analysis.
Mike

(2)

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

11 July 1980

M.O'D.B. Alexander, Esq.,
No.10, Downing Street

Dear Michael,

EUROPEAN COMMUNITY : PRELIMINARY DRAFT BUDGET FOR 1981

I understand that the Prime Minister has asked for a short note on the Commission's Preliminary Draft Budget for 1981, which Mr. Tugendhat outlined to the European Parliament yesterday. The attached note, summarizing the key features, is based on the best information available to us at present. We will of course inform the Prime Minister if the version presented formally to the Budget Committee differs significantly from Mr. Tugendhat's expose.

I am copying this letter to Paul Lever.

Yours ever

John Wiggins

A.J. WIGGINS

EUROPEAN COMMUNITY:
PRELIMINARY DRAFT BUDGET FOR 1981

The Commission outlined its Preliminary Draft Budget (PDB) for 1981 on 10 July. Full details will not be available until the Commission introduces the PDB in the Budget Committee at either the end of July or the beginning of September. The first meeting of the Budget Council is scheduled for 23 September.

Size of Budget

2. Total appropriations in the PDB, with the increase over the 1980 provision, is as follows:

	Commitments		Payments	
	MEUA	£m	MEUA	£m
Provision	21,734	13,678	20,053	12,620
Increase on 1980 (%)	25.5%		27.9%	

Headroom within Own Resources Ceiling

3. This implies a VAT rate of 0.95%, leaving headroom of 559 MEUA (£352m)* within the expected Own Resources yield of 20,612 MEUA (£12,972m).

Agricultural expenditure

4. The PDB makes no allowance for an agricultural price settlement during the course of the Budget year, but on present market forecasts, it envisages an increase in price support expenditure (Guarantee Section) of 12.7% over the 1980 provision. This contrasts with the trend rate of growth in the late 1970s of 23% per annum.

5. Total spending on agriculture and fisheries amounts to 13,514 MEUA £8,505m). This represents 67.4% of the Budget, as against 75.7% in the 1980 Budget.

* see next sheet

UK refund

6. The Commission have provided for payment from the 1981 Budget of the full amount of the refund to which the UK is entitled in respect of 1980 (1175 MEUA/£740m)*. They anticipate that 469 MEUA (£295m) will be paid through the Financial Mechanism and the balance under the new supplementary expenditure regulation. The provision of 1444 MEUA (£909m) for the latter includes the sum needed to compensate the UK for its contribution to the cost of the measures through its Own Resources contributions.

7. The PDB also includes 100 MEUA(£63m) for advances to the UK of the payments to which it will be entitled under the supplementary expenditure regulation in respect of 1981.

Regional and Social Funds

8. The Regional and Social Funds together account for 1480 MEUA (£931m) of payments appropriations and 2600 MEUA (£1636m) of commitments. These represent respectively 7.4% and 12.00% of total appropriations.

Commission staffing

Why?

9. The Commission are seeking an increase in their own staff of 323, of whom 173 would be Greek.

Preliminary reaction of the European Parliament

10. When Mr Tugendhat introduced the Budget in the European Parliament, the Chairman of the Parliament's Budget Committee (M Lange) stated that although the initial reaction of the Budget Committee had been favourable, he nonetheless expected considerable conflict between Parliament and Council over its passage.

* The Rate of Exchange used in this note is £ = 1.58894 EUA which is the official Budget rate for 1981 (ie the rate on 1.2.80) and which is the rate that will be used in the Explanatory Memorandum which will be laid before Parliament in due course. The current rate is £1 = 1.64 EUA.

1

Prime Minister.
Broadly, two questions :-
(a) Do you agree with the programme of work summarised in para 8;
(b) Do you agree that we should reply to the Germans as proposed in para 9 & thereafter speak to the French?
R 11/7

Ref: A02600

PRIME MINISTER

I feel we are missing the long-term

Future Community Strategy

1. I held a meeting of Permanent Secretaries on 24 June to consider the implications of the budget settlement for our future Community strategy. This minute sets out our conclusions, describes the work we have put in hand for the coming months, and seeks your agreement to the procedure proposed for bringing this work to Ministers and establishing bilateral contact with the French and Germans.

2. We agreed that the first requirement was to get the settlement implemented. This involves getting the Regulations for the amended Financial Mechanism and the Article 235 measures brought forward, cleared with the European Parliament, and adopted as soon as possible. Then we face the task of getting agreement to the infrastructure programmes that will benefit from Community finance under the Article 235 Regulation without increasing our previous public expenditure plans. Ministers will be considering this shortly. Because the European Parliament will not give its opinion on the Regulations before the Summer Recess, they are unlikely to be adopted by the Council before October. Despite German budgetary difficulties on which the Chancellor reported to Cabinet, we are taking steps to get during this year advance payments of part of the money due to us in respect of 1980.

3. The next requirement is to use the respite given us by the budget deal to exploit to the full the Community's commitment to structural changes aimed at preventing the recurrence of unacceptable situations for any member state. My meeting agreed that we now have a better opportunity than ever before to work for reforms designed to give the United Kingdom a firmly and equitably based economic stake in the Community. The problem, and the responsibility for solving it, is now explicitly acknowledged to rest with the Community as a whole and not with the United Kingdom alone. This time we have the 1 per cent VAT ceiling to help ensure that the whole Community gets to grips with the problem. And, as Chancellor Schmidt's recent utterances have indicated, the fact that the budget settlement will shift the major part of any future increase in agricultural expenditure on to the Germans has given them an added

incentive to tackle the cost of CAP surpluses, although we have still to discuss with them the best way of doing so, and we may not always see eye to eye with the Germans - or with the French - on that.

4. Our main objective in the restructuring negotiations must be to consolidate the gains made in the budget settlement, so that our net contribution can never again rise to unacceptable levels. We should exclude no possibility at this stage, but examine the potential for change in the three main areas: the own resources system itself, reforming and reducing the cost of the CAP, and developing the Community's non-agricultural expenditure policies in such a way as to give us a built-in net gain. Besides cutting the budgetary cost of the CAP, we also need to tackle its resource costs, whilst taking account of the effect on our own farmers.

5. Although, as you noted in Cabinet on 19 June, the negotiations may not get very far before the German and French elections, we need without delay to translate these broad objectives into a detailed negotiating strategy in the context of the own resources ceiling, to identify the mechanisms which offer the best means of achieving them, and to consider the tactical problems and opportunities which we are likely to encounter on the way.

6. The negotiations on the restructuring pledge will in principle fall into two main phases. The first phase will probably last until the new Commission produce their proposals around May or June 1981. We shall want to use this period to probe the thinking of other member states in bilateral contacts and to influence both the preparatory work the present Commission intend to do and the thinking of the new Commissioners when they are appointed. We should be ready to do some kite-flying in the autumn of this year. The second phase will begin next summer, when the Commission's proposals are tabled and the draft 1982 Budget comes forward, although the final crunch is unlikely to come until later. Chancellor Schmidt has said that he does not expect agreement to be reached until well into 1982; but a great deal of the work will probably fall during the United Kingdom Presidency in the second half of 1981.

7. This timetable could be influenced by other factors. The accession negotiations with Spain and Portugal will present difficulties, especially on agriculture, and the prospect of further enlargement will be relevant to the restructuring exercise. The 1981 CAP price fixing discussions may be at their height just before the French Presidential elections in May of that year, in which event the French will be under even greater pressure to satisfy their farmers than this year. This, and the need to face up to the 1 per cent ceiling, could precipitate a financial crisis before the restructuring exercise has got very far. We need to be ready to turn this situation to our account as well, bearing in mind both the political and financial implications for us of how President Giscard fares in the elections.

8. Against this background we have commissioned a range of papers (listed at Annex) from Departments designed to produce answers to the two main questions that events are likely to pose in the period ahead -

i. What means are open to the Community to postpone the exhaustion of own resources under the 1 per cent VAT ceiling, and which among them would best suit British interests?

ii. How can we best exploit the longer term restructuring review, in terms of possible budget corrective mechanisms, changes in the operation of the CAP and increased Community expenditure in the United Kingdom which takes into account our special needs such as industrial restructuring?

These papers will be brought together by a group under Cabinet Office chairmanship, and I will consider the results with Permanent Secretaries immediately after the summer break. We will bring the results of this work forward to Ministers shortly thereafter. This programme will enable Ministers to reach preliminary decisions in time for us to influence the thinking of our partners and the Commission as the first exploratory phase of the restructuring negotiations is beginning in the autumn.

9. My meeting also considered the proposal put to you by Chancellor Schmidt in Venice on 12 June that we, the French and the Germans should set up small bilateral task forces to work out ideas on restructuring. It seemed to us

After the German election. Not until Oct. in the year

that it would be to our advantage to agree to such bilateral meetings, which could at worst be used to establish where our interests coincided or differed and to draw out more clearly our partners' objectives. We therefore concluded that we should respond promptly and positively to Chancellor Schmidt's suggestion. If you agree, I accordingly suggest that the Foreign and Commonwealth Office should arrange for Sir Oliver Wright to inform Chancellor Schmidt's office that, having considered this idea further as you promised, you now wish to pursue it. Sir Oliver might suggest an early meeting between officials, who on our side would be drawn from the Cabinet Office, the Foreign and Commonwealth Office, the Treasury and, as appropriate, the Ministry of Agriculture. We should also tell President Giscard's office that we should like to have bilateral talks with the French Government on a similar basis. We shall need also to talk at official level to other member states, who will be greatly affected by any radical re-casting of the present budget system; and of course to the Commission. We might begin with the Germans; discuss with them how best to get things started with the French; and be ready to have bilateral talks with our other partners and the Commission as well.

10. I am sending copies of this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food.

RA

ROBERT ARMSTRONG

11 July 1980

FUTURE COMMUNITY STRATEGY: PROPOSED PROGRAMME OF WORK

(Q. they are now ready)

1. The series of papers in Section A below will be prepared by 11 July for consideration in EQR in mid-July. The second series of papers in Section B below should be ready by end-August, for discussion in EQS in early September. In the light of these discussions a paper or papers will be prepared for a further meeting of Permanent Secretaries.

A. SHORT TERM ECONOMIES AND OTHER DEVICES FOR REMAINING WITHIN THE 1 PER CENT VAT CEILING

Paper A i. The Economic and Financial Background (Treasury)

Coverage of Paper

a. 1981 Community Budget figures and prospects for 1982; headroom under the ceiling.

b. Prospective rates of growth of Community expenditure without policy changes compared with the prospective rates of growth of public expenditure in the UK and other member states.

c. Buoyancy of Own Resources in the short/medium term.

Paper A ii. Short-term Savings in the CAP (MAFF) (in consultation with IA1 Division, Treasury)

a. Genuine economies in operating CAP market support operations (including handling of 1981 price-fixing).

b. National financing of CAP expenditure.

c. Scope for reducing export subsidies.

d. Scope for postponing CAP expenditure until the next financial year.

e. Making the producer pay (co-responsibility levies etc).

f. Making the consumer pay (tax on vegetable oils etc).

Paper A iii. Short-term Savings in Non-CAP Expenditure (Treasury) (in consultation with FCO Legal Advisers, Departments of Trade and Industry and Customs and Excise).

Coverage of Paper

a. Scope for cutting non-CAP expenditure - pro rata or selective.

b. Revenue raising (non-agricultural taxes etc).

B. LONGER TERM RESTRUCTURING OF THE COMMUNITY BUDGET

Paper B i. Correcting the System of Contributions to and Receipts from the Community Budget (Treasury)
(in consultation with the Departments of Energy and Industry)

Coverage of Paper

a. The Giscard/Schmidt proposals for limits placed on net benefits from the Community Budget and contributions to Own Resources, according to some criterio such as GDP per head.

b. Other reforms of the Own Resources system, including taxes raised from the Energy Sector.

Paper B ii. Reform of the CAP (MAFF)
(in consultation with IA1 Division, Treasury)

Coverage of Paper

a. Statement and assessment of objectives: financial effects, resource costs, surpluses, effects on consumers.

b. The implications for agricultural policy of confining the rate of growth of CAP expenditure to the rate of growth of Own Resources as at present defined.

c. Price restraint.

d. Selective income support for farmers (including United Kingdom farmers).

e. National financing of proportion of CAP expenditure according to a key, eg according to where the surplus is produced, GDP per head, total agricultural production, number of producers. Consequences for funding IBAP.

f. National aids.

g. Ways of preventing expenditure on Mediterranean agriculture from increasing.

h. Standard quantities/quotas.

i. More private storage and less intervention storage.

j. Making the producer and/or consumer pay.

k. Others.

Paper B iii. <u>Increased Community Expenditure in the United Kingdom/ Increased Stake in Community Policies</u> (FCO) (consulting as necessary)

a. Energy sector expenditure (eg coal and energy research).

b. Transport infrastructure.

c. Expanded Regional Fund/Social Funds (restricted to less prosperous countries?) Criteria favourable to the United Kingdom (eg peripherality).

d. Others.

Paper B iv. <u>The Negotiating Scenario: Political and Tactical Implications</u> (FCO)

2. All papers will examine the objectives and proposals of our partners as well as our own. A separate paper on the issues arising from the accession of Spain and Portugal will be coming forward after the holidays, but nonetheless papers under heading B above will take account of the implications of enlargement to a Community of 12 in their respective fields.

ROBERT ARMSTRONG

Cabinet Office

11 July 1980

Euro Pol.

CONFIDENTIAL

Ref. A02584

PRIME MINISTER

Cabinet: Community Affairs

There have been no developments in the Community during the last week calling for discussion by the Cabinet.

2. This is perhaps the shortest brief I shall ever submit to you.

RA

(Robert Armstrong)

9th July, 1980

Econ Pol (Pub Ex) Pt 20

Discussed

f.a. Rud 14/7

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

9 July 1980

M.O'D.B. Alexander, Esq.,
No.10, Downing Street

Dear Michael,

PRESENTATION IN THE PUBLIC EXPENDITURE SURVEY OF THE UK CONTRIBUTION TO THE COMMUNITY BUDGET

This letter and its enclosures amplify the attached figures and explanations in my letter of 2 July about the UK contribution to the Community Budget.

The material falls into two parts, and is summarised in the two tables attached.

Table 1 is concerned with PESC figures. It starts with the last published figures in Cmnd 7841 for our net contribution. It then revises these figures to take account of all developments since publication, other than the refunds under the 30 May Agreement. Finally it applies those refunds. The main feature of this table is the effect of the time lag on our refunds, even though it assumes that we secure an advance payment of £135 million (300 meua at 1979 outturn prices) before the end of 1980. (We shall not know what advance we will get in 1980 until after the German elections.)

Table II reconciles the familiar Commission figures for our net contribution after the 30 May agreement with the PESC figures at the foot of Table I. It shows how the figures in the 30 May Agreement, which describe the intended outcome in respect of the years 1980 and 1981, need to be adjusted in order to show the expected cash flow in 1980 and 1981.

The main features of Table II are first, the effect of the lag in refunds as in Table I; secondly, that our estimates

/of our

of our net contributions are higher than those made by the Commission; and thirdly, that our contribution to the unallocated Budget is added back. The higher estimates of our net contribution take account both of a higher estimate of Community expenditure and a forecast of higher UK VAT contributions (in mua) attributable to the strong exchange rate, though these extra VAT contributions will be payable in arrears (line 7).

Most of these points will be familiar to the Prime Minister. The reporting telegram sent by Sir M. Butler following the 30 May Foreign Affairs Council (Telno 2654 of 30 May) recorded the Council decision, paragraphs 5 and 6 of which set out the general arrangements that had been agreed about the timing of payments. The Chancellor's minute of 12th May, before the Council, reminded the Prime Minister that the Commission's definition of our net contribution excluded the UK's share of the unallocated Budget (para.10) and he called attention to the presentational problems this might cause. The Annex to that minute set out the Treasury's latest forecasts of our unabated contribution for 1980 and 1981, which, at that stage, were significantly higher than the Commission's. (The latest figures which underlie the Public Expenditure Survey are in fact a little lower than we were then forecasting.)

in folder 10/7/80

Our total refund in respect of the two years 1980 and 1981 was quoted in the 30 May Agreement as the equivalent of £1570 million. The counterpart in Table I of this figure is the sum of the refunds shown against the three calendar years 1980, 1981, 1982:-

£ million
135
495
145
663
1438

We expect the £1570 million refund to be increased by the triggering of the risk sharing formula to give a cash refund of £1780 million. When converted to 1980 Survey prices (1979 outturn prices) this £1780 million becomes £1438 million. Lagged payments are smaller payments in PESC terms.

I should like to make two other points. First, while the present estimates reflect our most up-to-date assessment, it is virtually certain that they will change in the light of subsequent developments and information, before we come to publish the next Public Expenditure White Paper.

/Secondly,

Secondly, my earlier letter may have given the impression that the new estimates relating to the UK net contribution to the Community Budget were in the Public Expenditure Survey Report itself. I am sorry if it did. They are not in the Report, but underly the figures in the paper by Treasury officials on the "main issues" C(80)39.

I am sorry that all this is so complicated, but there is no other public expenditure programme so beset with complexities. This one involves change from an attributable basis and calendar years to a cash flow basis and financial years; a currency conversion; forecasts of total Community expenditure and timing of payments, that is guesses at decision-taking in a 10 Member international organisation; and estimates of imports and consumption not only in the UK but in the 8 (shortly 9) partner countries.

I am sending copies of this letter to George Walden (FCO) and David Wright (Cabinet Office)

Yours ever

John Wiggins

A.J. WIGGINS

TABLE 1 OLD AND NEW FIGURES ON PESC BASIS: CASH FLOW £m at 1980 Survey Prices (=1979 Outturn Prices)

	FINANCIAL YEARS			CALENDAR YEARS		
	1980/81	1981/2	1982/3	1980	1981	1982
A. NET CONTRIBUTIONS Cmnd 7841 (tables 2.2.1 and 2.2.2)	1061	1200	1350	1057	1150	1300
B. REVISIONS TO Cmnd 7841 FIGURES BEFORE 30 MAY REFUNDS (minus means reduction in our net contribution)						
Revised Own Resources Estimates*	-65	+151		-74	+121	+268
"Carry Forwards" from 1979 Budget/UK share	-50			-50		
Higher CAP receipts, including 30 May Agricultural Package	-97	-122		-90	-116	-138
Other receipts changes	-8	+2		-13	+8	-15
Downward revisions to contributions and receipts to stay within the 1% VAT limit						-102
Refund allowed for under unadjusted financial mechanism	+129	+201			+172	+210
TOTAL OF REVISIONS	-91	+232	n.a.	-227	+185	+223
REVISED NET CONTRIBUTIONS BEFORE REFUNDS UNDER 30 MAY AGREEMENT	970	1432	n.a.	830	1335	1625
C. EFFECT OF REFUNDS						
Net Refunds Paid in Respect of 1980	535	122		135	495	
Net Refunds Paid in Respect of 1981		605	203		145	663
Net Refunds Paid in Respect of 1982						[160]ø
NET CONTRIBUTIONS: CASH FLOW (on the same basis as tables 2.2.1 and 2.2.2)	435	705	n.a.	695	695	700

*Including effect of stronger exchange rate upon timing of UK VAT contributions; and our share of extra CAP costs following the agricultural price settlement.

working assumptions.

TABLE 2 COMMISSION FORECAST FOR UK NET CONTRIBUTIONS CONVERTED TO PESC CASH FLOW BASIS

		1980	1981	1982
A.	CONTRIBUTIONS IN MUA IN RESPECT OF:-			
1.	UK Net Contribution after 30 May Agreement as forecast by the Commission	609	730	[885]∅
B.	CONTRIBUTIONS IN RESPECT OF THESE YEARS IN £m AT 1980 SURVEY PRICES	(=1979 outturn prices)		
2.	Line 1 in £m at 1979 outturn prices	329	362	418
3.	Contributions to Unallocated Budget (Lome etc)	+81	+87	+95
4.	Extra UK Net Contributions expected under risk sharing formula*.	+13	+74	+61
5.	Total Net Contribution in respect of the named years	423	523	574
C.	YEAR TO YEAR REALLOCATIONS (WITH PRICE BASIS ADJUSTMENTS) TO REACH CASH FLOW FIGURES			
6.	Refunds in respect of 1980 paid later	+539	-495‡	
	Refunds in respect of 1981 paid later		+697	-663
	Refunds in respect of 1982 paid later			+757
7.	Adjustments for lagged payment of higher UK VAT contributions due to stronger exchange rate	-134	-30	+131
8.	"Carry Forwards" from 1979 Budget (UK share)	-50		
9.	Article 131 refund in respect of 1979	-83		
10.	Downward revision of Contributions and Receipts to stay within the 1 percent VAT limit			-102
11.	FIGURES FOR PROGRAMME 2.7 (table 2.2.1 basis)	695	695	700

∅Working Assumption.

*Mainly reflects larger Budget estimates than Commission have used but also reflects the effect of the stronger exchange rate in raising our VAT contributions in mua even though the extra payments are delayed to the next year.

‡Differences in price bases mean that £495m at 1979 prices received in 1981, is the equivalent of £539m at 1979 prices in 1980.

Qz 01664

copy Mr Alexander

SIR ROBERT ARMSTRONG

cc Mr Elliott
Mr Walsh
Mr Moore

PRESENTATION IN THE PUBLIC EXPENDITURE SURVEY OF THE UNITED KINGDOM CONTRIBUTION TO THE COMMUNITY BUDGET

1. Not unexpectedly, the Prime Minister has reacted adversely to Mr Wiggins' letter of 2 July to Mr Lankester, copy attached, which shows a level of net contribution to the Community Budget significantly higher than the figures which were discussed at the time of the Budget settlement, and correspondingly smaller savings over the figures in the last White Paper.

2. The Prime Minister has asked the Chancellor for a more detailed explanation, and I am in touch with the Treasury. In the meantime, you may like this preliminary explanation based on further information I obtained from Mr Meyrick in the Treasury last Friday.

3. The first question is why the net contribution for the calendar year 1980 is now shown at £695 million compared with the figure of approximately £328 million, which was the figure given to the Prime Minister after the 30 May settlement. The explanation is basically that our Budget settlement was negotiated on the basis of the position in respect of 1980, whereas the Treasury figures for 1980 are on a cash payments basis. The two bases seem to be capable of reconciliation broadly as follows. The £328 million assumed full repayment to us in this calendar year, whereas the actual repayment willmainly take place in the first quarter of 1981 (ie the last quarter of our financial year 1980/81). Of the full amount of £635 million due in respect of 1980, it is assumed that £500 million will be paid to us in 1981. (If, in the event, no "advances" are paid this year, our net contribution will be £135 million higher this year and the same amount lower in calendar year 1981). On top of this, there are unallocated items of budget expenditure (food aid, etc.) not included in the settlement to which our net contribution is £80 million. These two items totalling £580 million more than account for the difference. Two others have to be subtracted - a payment of about £60 million in respect of 1979 for the transitional arrangements (Article 131) which are included in the PES figures for 1980 but were not included in the Commission figures and approximately £150 million due to the Community for our higher VAT contribution (mainly as a result of the higher exchange rate of sterling) which we now expect to pay only in 1981. The net result of these two pluses (increasing our cash net

contribution) and two minuses (reducing our cash net contribution) accounts for the difference of approximately £370 million in 1980.

4. To some extent, the adjustments for 1981 are the obverse of the adjustments for 1980, but the position is complicated by the risk-sharing arrangements. These depend on the total size of the Community Budget for 1981 (still unknown), and our own gross contributions. I understand that the Treasury now expect our unadjusted net contribution in 1981 to be somewhat higher than they estimated some weeks ago. Although we shall get a chunk of this back under the risk-sharing formula, that is unlikely to show up for PES purposes until 1982. The Treasury are producing a detailed reconciliation.

5. There is a problem of a slightly different kind about how we present the figures for 1982. Because of the lags, these will in fact reflect to a significant extent the amount of the refund due to us in 1981, but we shall also have to be able to say to our Community partners that we have not assumed anything which goes beyond the 30 May agreement. However, on this, as on the presentation of the other figures, we have plenty of time to consider what should be done since the White Paper will not be published for several months yet.

6. There is another aspect not dealt with in Mr Wiggins' letter on which I think the Prime Minister will also need some explanation. This appears in Table I of C(80) 39 - the Chief Secretary's paper on "Public Expenditure: Main Issues". Line 6 shows that, in public expenditure terms, the reductions in our net contributions are in part offset by additional expenditure by the Intervention Board for the benefit of United Kingdom farmers and traders. I am proposing to ask Treasury and MAFF for a note on this too.

M D M FRANKLIN

7 July 1980

CONFIDENTIAL

cc HMT
MAFF
CO.

10 DOWNING STREET

From the Private Secretary

7 July 1980

BF 15/7/80

Prime Minister's meeting with
Chancellor Schmidt: 1% ceiling

The Prime Minister has seen your letter to Clive Whitmore of 27 June on this subject together with the paper which it covered. She has commented that the Chancellor had clearly raised a serious issue and that it is a pity that we have not ourselves sorted the matter out earlier. The Prime Minister wishes the position to be resolved rapidly. I should be grateful if her comments could be taken into account in the drafting which is currently in hand on the general approach to restructuring the budget.

On a specific point, the Prime Minister has asked under what authority we continued to pay claimants from national funds when the Parliament delayed approval of a Supplementary Budget in November 1979 (see the fourth paragraph on page two of the paper enclosed with your letter). She has commented that she was previously quite unaware that this had occurred.

I am sending copies of this letter to Martin Hall (H.M. Treasury), Garth Waters (Ministry of Agriculture, Fisheries and Food) and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

Paul Lever, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

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24

10 DOWNING STREET

From the Private Secretary

7 July, 1980.

Additionality and the Use of Community Funds

The Prime Minister has seen your Secretary of State's undated letter to the Chancellor of the Exchequer on this subject. She has reiterated that there can be no additional expenditure as a result of the Article 235 arrangements. The Prime Minister wishes all money received under these arrangements to go to reduce the PSBR.

I am sending copies of this letter to John Wiggins (HM Treasury), George Walden (Foreign and Commonwealth Office), and David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

Roy Harrington, Esq.,
Northern Ireland Office.

TR

Euro DST.

subject file
Parliament - Opposition
Allowances - Jan 80.

MR LANKESTER

The Chancellor of the Exchequer rang the Prime Minister this morning (0820) to discuss a subject he had "forgotten" to raise earlier - Financial aid to Opposition Parties, in particular the figure of £290,000. The Prime Minister said it was too late as she had already agreed this figure following discussion with the Chief Whip, although she would have preferred £275,000. The Prime Minister felt it best that there should be a separate statement on this.

The Prime Minister then expressed concern about the interpretation of the Euro Budget, especially the unallocated part. Her views on the final settlement were known by the Chancellor and she would be very angry if it came about that she had negotiated the settlement on the basis of information different from that which was emerging now. The Chancellor said he was worried about certain aspects of this and would get on with it.

The Prime Minister then mentioned the TSRB statement. She was recommending that the pension should go up to the 3rd stage - this would only affect those widowed during the year, who would be £100-£200 better off.

S. J. Pike

DUTY CLERK

7 July 1980

cc Econ Pol (Pub Ex) Pt 10.

CONFIDENTIAL

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

We must discuss. I just can't accept these interpretations. MT. (2)

Prime Minister.

This is potentially very difficult. The figures I have ringed in paragraph 6 compare with those in the first sentence of paragraph 3. As you will see, they are broadly double! This will need some very convincing explanation if we are not to be attacked for settling for much less on the budget than we claimed at the time.

2nd July 1980

Prime Minister

The figures in para 6 (particularly the calendar year figures) look less good than those which have been used publicly. The reasons are set out in para 4: I have asked for a more detailed explanation of the extent to which each factor affects the figures. The analysis in this letter will not, of course, become public for many months but the presentation will need careful consideration.

4/7

T.P. Lankester, Esq.,
No.10, Downing Street

5/vii

Dear Tim,

PRESENTATION IN THE PUBLIC EXPENDITURE SURVEY OF THE UK CONTRIBUTION TO THE COMMUNITY BUDGET

1. The Public Expenditure Survey (PES) will be circulated to Cabinet later this week, and will show the benefits of the 30 May agreement concerning the UK contribution to the Community Budget. The Chancellor thought that the Prime Minister might like to have a note about the effects of the agreement on the figures in the survey.

The 30 May Agreement

2. The 30 May agreement specified a UK net contribution of 609 MEUA in 1980 and 730 MEUA in 1981, subject to a sliding scale formula if the estimates on which those net contributions were based should change. For the third year, 1982, it was agreed that the UK net contribution would either be determined by the general review of Budget arrangements commissioned by the Council of Ministers, or there would be a solution "along the lines of the 1980/81 solution".

3. In constant 1980 survey prices, the sterling equivalents of the figures quoted in paragraph 2 for the UK net contribution in 1980 and 1981 are £328 million and £362 million respectively. The price base for the 1980 survey is the 1979 price level, and the conversion factors between the EUA figures and the 1980 survey price figures in sterling quoted above take into account forecast exchange rate changes between the pound and the EUA, and also the forecast changes in prices between 1979 and 1980 and 1981 respectively.

/The Public

*i.e. in the table attached to the Chief Secretary's paper on 'Main Issues': C(80)39

<u>The Public Expenditure Survey</u>

4. The figures in the Public Expenditure Survey* differ significantly from those in the previous paragraph. There are four important differences in coverage between the Commission figures used in the Budget negotiations, and appearing in the 30 May agreement, and those in the survey. These are as follows:-

(a) Some VAT contributions in respect of 1980 will not in practice be paid until 1981. The Commission attribute these to 1980; but in the survey they are attributed to 1981.

(b) The PES figures <u>include</u> refunds paid in 1980 in respect of 1979 under the terms of Article 131 of the Treaty of Accession. These are excluded from the Commission figures for 1980.

(c) The PES figures <u>include</u> the UK's contribution to the unallocated Budget - chiefly Community aid - whereas the Commission figures related only to the allocated Budget.

(d) The PES figures include our best estimates of the effect of the risk-sharing formulae in the 30 May agreement. These provide for the UK to take specified portions of the increases in our net contribution over the basic estimates. We think it likely that these provisions will operate.

5. A further difference arises because the 30 May agreement concerned the net contribution that the UK would make <u>in respect of</u> individual calendar years, but it provided that the refunds would be paid from the <u>following</u> year's Community Budget, except insofar as advance payments were agreed by the Council of Ministers. The PES, on the other hand, attributes financial flows to the years in which they actually occur.

6. The following table gives the figures that will appear in the survey and also shows the reduction in the figures compared with Cmnd 7841, the last published White Paper. The table is on the same basis as tables 2.2.1 and 2.2.2 of Cmnd 7841 and includes Community expenditure on aid, attributed to the aid programme. It contains the stylised assumption that our net contribution in 1982 (when our gross contribution is assumed to be contrained by the maintenance of the 1 per cent VAT ceiling) remains at about the same level as in 1981. This is intended to be a neutral assumption.

/UK

CONFIDENTIAL

UK contributions to and receipts from the Community Budget
(at 1980 survey prices) £ million

Calendar years	Gross Contribution	Receipts	Net Contribution	Savings over Cmnd 7841
1980	1715	1020	695	362
1981	2385	1690	695	455
1982	2550	1850	700	600
Financial years				
80/81	1885	1450	435	626
81/82	2475	1770	705	495
82/83	2550	1850	700	650

These are the figures in the survey.

It will be seen that the differences in coverage and timing explained earlier result in a much larger net contribution for 1980 and 1981 than the figures in paragraph 3.

7. The 1980 figure in the above table will be higher if we do not receive an advance of our 1980 refund of 300 MEUA by the end of this year. Nevertheless, our expectation that the bulk of our refund in respect of 1980 will be received in the first quarter of 1981 means that, as the table shows, the published figure for the financial year 1980/81 will be closer to the figures that were announced after the 30 May agreement; and the figure for the financial year will not be affected if we do not receive an advance payment.

8. The Chancellor intends that the reasons for the differences between the figures in the 30 May agreement and those in the survey will be fully explained in the Public Expenditure White Paper when that is eventually published.

9. I am copying this letter to George Walden and David Wright.

Yours

John

A.J. WIGGINS

CONFIDENTIAL

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

(2)

Prime Minister

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

1st? July 1980

No additional expenditure. All European money to go to reduce PSBR. With NI overspent already. MT.

Dear Geoffrey.

ADDITIONALITY AND THE USE OF COMMUNITY FUNDS

Your minute of 17 June to the Prime Minister sets out the way in which you propose to treat money coming from Brussels to regions under the Article 235 arrangements. I accept that the proper course, endorsed by the Prime Minister in her Private Secretary's note of 20 June, is to reduce expenditure, the PSBR and interest rates, not least because Northern Ireland would benefit as much as any other part of the UK from lower interest rates. I have already made this point to Conservative back-benchers and others who have raised this matter with me.

I am clear however that public references by the Commission and others to additional Community expenditure in Northern Ireland as part of the UK budget contribution settlement have already aroused expectations. There would be bitter disappointment amongst all shades of opinion if Community money allocated specifically for urban renewal, for example, did not lead to additional expenditure for this purpose. Indeed I go as far as to say that in such a situation the Government's position would be politically untenable, and the political initiative which we are about to launch would not be helped. Conversely, I would welcome practical Community support for Northern Ireland at a time when we are trying to revive political life there. Extra funds for urban renewal in Belfast would be welcomed by all parties in Northern Ireland. It is general knowledge that the problems of Belfast have led the Commission to choose it for one of the initial experiments in the Integrated Operations approach.

2/Contd...

CONFIDENTIAL

My reference to the need for extra resources is not to be treated as a firm bid for any particular sum, but rather as a warning marker that the strict application of the line you propose on additionality could land the Government in serious political difficulties in Northern Ireland. I shall certainly wish to propose some additional extra expenditure for the period 1981-82 and 1982-83 when we come to discuss public expenditure programmes for 1981/82 onwards later this month. My officials will be in touch with yours about this.

I note Michael Heseltine's views on the passing-on of receipts from the Community. I certainly agree that the pros and cons should be fully considered before taking a decision and I would like to be involved in discussions. Politically I would prefer that we could pass on.

I am sending copies of this letter to the Prime Minister, other members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

Yours ever

Humphrey

CONFIDENTIAL

2

Foreign and Commonwealth Office

London SW1A 2AH

27 June 1980

This is serious. It's a pity we hadn't sorted it out for ourselves. We must resolve the problem quickly. MT

Prime Minister

It looks as though Chancellor Schmidt's point might have some foundation.

30/6

Dear Clive,

Prime Minister's Meeting with Chancellor Schmidt: 1% ceiling

In your letter of 12 June you requested a note on the point raised with the Prime Minister by Chancellor Schmidt about the extent to which we could rely on the 1% VAT ceiling to control the growth of Community expenditure.

This question raises issues of great complexity. I attach a preliminary note which we have prepared in consultation with the Treasury, MAFF and Cabinet Office. You will see that it concludes in paragraph 11 that, even if claims against national paying agencies could be legally enforced in the absence of provision for these claims in the Community Budget, chaos would result if significant payments were in fact made. This makes it virtually inevitable that the issue would come to the Council for the relevant decision - to restructure the Budget so that the 1% VAT ceiling could be maintained, or to raise the ceiling - before any substantial excess spending could take place. The Council would thus not be taken unawares.

Nobody suggested the Council would be.

Further study is needed and is being put in hand in the context of working out our general approach to the problems raised by the 1% VAT ceiling. Papers will be brought before Ministers as soon as possible.

The Foreign and Commonwealth Secretary was interested to note Chancellor Schmidt's suggestion that Member Governments should set up small bilateral task forces to work up ideas on restructuring the Community Budget and that there should be Anglo-German cooperation on this basis. He is attracted by the idea and will shortly be sending a recommendation for a positive response to Chancellor Schmidt.

I am sending copies of this letter with its enclosure to Martin Hall (Treasury) and David Wright (Cabinet Office) and also to Garth Waters (MAFF).

Yours ever

Paul

(P Lever)
Private Secretary

C A Whitmore Esq
10 Downing Street

CONFIDENTIAL

COMMUNITY BUDGET : EFFECTIVENESS OF THE 1% VAT CEILING

In his conversation with the Prime Minister in Venice on 12 June, Chancellor Schmidt said that he had been advised that the 1% ceiling was not as robust as he had previously supposed. This was because, once the 1% ceiling had been reached and Community funds thereby exhausted, those entitled to receive payments under existing Community law would be able to apply to their national Governments for payments in place of those which would otherwise have been made by the Community.

Scope of the Paper

This paper concentrates on CAP expenditure because this absorbs roughly three-quarters of the budget and is most likely to give rise to claims against national Governments by the large number of farmers, traders and organisations who benefit under the CAP. The Community has other financial obligations, notably:

(a) under the Regional Development Fund and Social Fund, and

(b) for paying its staff wages.

However the majority of payments under (a) go to Governments and Governmental organisations rather than to individuals so the number of likely significant claims against national governments is small. On (b), staff would have a claim in the first instance against the Commission/Council/European Parliament, not against member governments.

How ceiling might be reached

The ceiling might be reached in one of two ways:

(i) It might be clear at the time the budget is drawn up that the ceiling would be reached during the course of the year;

(ii) Alternatively the ceiling might be reached during a budget year as a result of a shortfall of revenue or because inadequate funds were available to meet expenditure obligations fully. This would not be likely to happen until towards the end of a year.

In each case the Council or Commission would have an opportunity to take remedial action. In the case of (i) the budget could not be adopted without Council agreement. In the case of (ii), either a supplementary budget would be needed; which would require Council agreement; or payments could be deferred until the following year (when they would be a first charge on the new budget) or transfers made from underspent parts of the budget (there is in fact considerable flexibility in the timing of payments by the Commission). In other words, in either case the problem would not overtake the Community without the Council having a chance to consider its position.

/Even

Even if the Council failed to agree on what to do in such a situation, the cumulative chaos which would arise as Member States tried to tackle the problem in different ways and claims against national governments and the Commission proliferated, or as payments deferred to the following year mounted up, would result in a rising level of political pressure on governments to find solutions. So the scenario which the German Chancellor appeared to envisage of Member States watching helplessly as existing obligations gobbled up national money is not likely to occur in practice.

Legal Position and Precedents

Nevertheless, the basis of Schmidt's argument is well-founded. The CAP Regulations, which have direct force of law in Member States, confer a legal entitlement to be paid on all persons fulfilling stated conditions. These payments must be funded from the Community Budget and for this purpose the Commission makes a monthly transfer to each national paying agency (the Intervention Board in our case) to finance forecast payments in the month ahead.

However, because such a case has never been brought it has never been established whether, during any such period, claimants could legally enforce a claim against the national paying agencies to be paid from national funds, or whether they would have to wait until Community funds were again available. A full legal study of this aspect will be needed. It is certain, however, that the Commission would incur legal liabilities whether at the instance of claimants or at the instance of the paying agencies.

These are precedents for the Community running out of funds in mid year. For example, in November 1979, the Parliament delayed approval of a Supplementary Budget to meet increases in agricultural spending that had arisen during the Budget year. On that occasion we continued to pay claimants from national funds, but, because of the doubt as to the legal correctness of substituting national funds for Community funds and to avoid any risk that the Commission would refuse to reimburse these payments from the Budget, they were disguised as temporary interest-free loans. The Germans, we understand, simply suspended payments. But this case is not strictly analogous to the case cited by Chancellor Schmidt since money could be advanced in the knowledge that there was room under the 1% ceiling to raise the necessary funds.

X! This is news to me. Under what authority?

Effects of reaching ceiling

If, when the 1% ceiling was reached, the Community simply allowed CAP expenditure to go on growing at current rates, the situation might temporarily be relieved by borrowing. But soon larger and larger sums would have to be carried over from one year to the next; and Governments would inevitably be forced into

/using

using national funds to tide claimants over for the increasingly long period each year when no funds were available from Brussels. Given the disparity between our share of CAP payments and our VAT contribution, such a state of affairs would obviously be better for us than raising the 1% ceiling, since the latter would involve us in contributing to the cost of payments in other Member States as well.

Maintaining the ceiling

This scenario, however, would only be likely to develop if the Council had reached a stalemate on the question of increasing the 1% ceiling and were not prepared to change the CAP regulations with a view to keeping expenditure within the ceiling. Changes of various kinds could be made:

(i) postponing expenditure in particular by reducing subsidies for the disposal of current surpluses and allowing intervention stocks to accumulate;

(ii) genuine reductions in expenditure (which could be pro rata or at the expense of non obligatory expenditure);

(iii) raising additional revenue through "co-responsibility levies" (these do not fall within the definition of own resources, and are treated as direct offsets to CAP expenditure); or

(iv) some degree of "national financing", ie financing a part of expenditure on CAP policy from the Community budget and the balance from the national funds.

The effects of these measures would be various and it is not the purpose of this paper to discuss them. It will however be necessary to examine them in detail in preparation for the 1981 budget review.

CONCLUSION

We draw the following tentative conclusions.

(1) The problem will not overtake the Community without the Council having a chance to consider its position.

(2) The legal position is not clear. It has never been established whether, if funds were not available from the Community Budget, claimants could legally enforce a claim against the national paying agencies to be paid from national funds.

(3) In the short term the problem could be postponed until the following year when the sums concerned would become a first charge on that year's budget.

/(4)

(4) But other expenditure could suffer. And the problem would get cumulatively worse in subsequent years. The resultant chaos would generate political pressure for agreement on restructuring the budget.

(5) The problem would in any case only arise if the Council could <u>neither</u> agree on an increase in the 1% ceiling <u>nor</u> on changes to the CAP Regulations with a view to keeping expenditure within the ceiling.

(6) Our ability to use the 1% ceiling as an effective instrument in getting the budget restructured will be strengthened by the maintenance of the German commitment to it. We could otherwise find ourselves isolated. Bilateral talks with the Germans would be valuable in exploring German thinking on this subject.

Foreign and Commonwealth Office

27 June 1980

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From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

24 June 1980

Dear Geoffrey.

I have seen a copy of your minute of 17 June to the Prime Minister about the question of additionality and the use of Community funds.

I agree with what you say and particularly welcome the statement in the third paragraph about passing on grants to spending authorities for infrastructure projects. This is in line with the existing practice for the Regional Fund.

I am copying this to the recipients of yours.

Yours ever.

Nicki

The Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Europe Pol

SECRETARY OF STATE FOR THE ENVIRONMENT

NBPM yet
[initials]

Prime Minister

ADDITIONALITY AND THE USE OF COMMUNITY FUNDS

Geoffrey Howe's minute of 17 June might give the impression that moneys received under an Article 235 Regulation must inevitably be passed on to the various public authorities which provide the related infrastructure programme.

My understanding is that, as at present drafted, the Regulation itself would not prevent the retention of payments by the Exchequer in the same way as grants for industrial projects from the European Regional Development Fund are already retained. No doubt there are considerable political and procedural pros and cons and special difficulties associated with either alternative, but unless it becomes clear that there are insuperable practical difficulties in the retention of payments, it seems to me right that, before procedures are finally settled, we should have the opportunity to review both options, with their political aspects, any special procedural difficulties and staffing implications, before finally adopting a procedure.

I would, of course, accept that, if grants have to be passed on, they should be subject to conditions on the broad lines suggested by Geoffrey Howe. My hope is that we may

SECRETARY OF STATE FOR THE ENVIRONMENT

yet find an acceptable way of not passing them on at all, but much will no doubt turn upon what procedural arrangements - especially for accountability, can be negotiated in Brussels.

I am copying this minute to members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

MH

23 June 1980

CONFIDENTIAL

copied Econ Pol, Pt 9
Public Expenditure

10 DOWNING STREET

From the Private Secretary

20 June 1980

Additionality and the Use of Community Funds

The Prime Minister has seen the Chancellor of the Exchequer's minute to her of 17 June on this subject. She has commented that the Government must stick firmly to the principle that the increased receipts resulting from the Article 235 arrangements agreed in Brussels on 30 May must go to substitute expenditure which would otherwise have been nationally financed. The receipts must not go to fund "additional" spending.

I am sending copies of this letter to the Private Secretaries to the other members of Cabinet, to Tony Mayer (Department of Transport) and David Wright (Cabinet Office).

A.J. Wiggins, Esq.,
HM Treasury.

CONFIDENTIAL

is copied to Econ Pol, PE9, Public Expenditure

Prime Minister

Agree

We must stick firmly to substituted expenditure. No 'additional' spending.

MT

(2)

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

PRIME MINISTER

ADDITIONALITY AND THE USE OF COMMUNITY FUNDS

We need to settle how we are going to handle, in relation to our public expenditure programmes, proposals for expenditure financed by the European Community under the Article 235 arrangements which are part of the Budgetary agreement reached in Brussels on 30th May.

2. As you said in the House, it is vital that the increased receipts should go to reducing expenditure, the PSBR and interest rates. We had already said in the public expenditure White Paper that the savings in public expenditure there announced will be increased by the reduction in the EC contribution. We must be sure that this is indeed the result. (This was discussed in my letter of 8th February to OD(E) and my letter of 16th April about briefing MEPs.)

3. Accordingly, Departments should wherever possible follow the existing practice for the Regional Fund, under which grants passed on to spending authorities for infrastructure projects are used in substitution for the borrowing or other finance which would otherwise have been necessary.

4. If however, exceptionally, a Department wishes to propose additional expenditure associated with additional EC receipts, I suggest that the Minister responsible should put forward a bid for the expenditure to be financed from the contingency reserve. Treasury Ministers,

/or in cases

CHANCELLOR OF THE EXCHEQUER

or in cases of disagreement the Cabinet, can then consider whether to accept the claim, given the other prospective calls on the reserve. Such bids must be kept to the absolute minimum.

5. Expenditure within the UK on agricultural price support under the CAP is a separate matter. Any prospective increase will continue to be considered in conjunction with the associated effects on our Budgetary contribution as well as the receipts.

6. The 1980-81 expenditure programmes and contingency reserve are firm, and so my proposal would apply immediately. It is likely however that additional expenditure will be very small in the current year, and should be capable of being absorbed in Departments' existing programmes.

7. For the later years we shall be able, in the 1980 public expenditure survey, to take account of any proposals to increase particular programmes. But when we have taken our decisions in the survey, my proposal would apply to any further bids for additional expenditure.

8. I shall assume agreement unless any of my colleagues wish us to discuss the matter, in which case I should be grateful to hear within a couple of weeks.

9. I am sending copies of this minute to members of the Cabinet, Norman Fowler and Sir Robert Armstrong.

(G.H.)

17 June, 1980

(16939) Dd.897300 200m 9/72 G.W.B.Ltd. Gp.863
(17785) Dd.897533 400m 5/73 G.W.B.Ltd. Gp.863

Euro Pol

XY 42

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Department ....

Drafted by (Block Capitals) ....

Tel. Extn. ....

OUTWARD TELEGRAM

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16.6.80.

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(Restrictive Prefix) ....

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TO IMMEDIATE UKREP., BRUSSELS (precedence) (post) Tel. No. .... of ....

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~~PARIS~~

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[TEXT] BONN TELEGRAM NO 473 COMMUNITY BUDGET PROVISION FOR ADVANCE PAYMENTS

The Financial Secretary spoke to Lahnstein this morning about this problem. Lahnstein made the following points: ~~colon dash~~

i He was firm that the Germans had no money to finance their share of advances to the United Kingdom in 1980.

ii He said that this problem would disappear in 1981 and added that we could have the money on 2 January if we needed it.

iii He offered to state in public that the German problem was confined to their difficulties with the 1980 Budget and was in no way an attempt to go back on 30 May agreement.

iv He said that in 1981 the German Government accepted that the United Kingdom could ask for

/an

an advance for that year and they would have no technical problems with it. He added that the French might have a political problem.

2. Contrary to earlier reports ~~comma~~ Lahnstein will be arriving in Luxembourg at about two thirty pm tomorrow afternoon. He and the Financial Secretary agreed to meet again if possible before the meeting with the Parliament for another word before the Council.

3. In MIFT is the draft of the Financial Secretary's brief for the meeting (which is still under consideration here.) ~~Any comments you had could be given to him on arrival in Luxembourg.~~

4. In the meantime you should explain the line we are ~~taking~~ proposing to take to the Tugendhat cabinet and say that ~~it would probably not be helpful for them to try to get~~ we doubt whether they will be able to get the Germans to accept the possibility of a Supplementary Budget later this year. It ~~would~~ might be better to rely on the more general formula given in the Brief. You should ~~make it clear that we do in any way~~ say that we do not regard this [illegible] as in any way creating a precedent for the [illegible] 1981 budget currently under [illegible] in the Commission and now evidently to the Germans. So far as that budget is [illegible] we hope the Commission will include the whole of the money owing to us for 1980 and also a substantial figure for advances. It would be very helpful if Tugendhat [illegible] at the Budget Council [illegible] that this is their intention.

7437 D073836 131M 5/74 Cr.P.C. 839/3

XY 42

File No. ....

Department ....

Drafted by (Block Capitals) ....

Tel. Extn. ....

OUTWARD TELEGRAM

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Precedence: IMMEDIATE

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(Deskby) ....Z

TO IMMEDIATE (precedence) UKREP, BRUSSELS (post) Tel. No. .... of ....

AND TO (precedence/post) IMMEDIATE BONN Luxembourg

PARIS

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3. No prejudice for 1981

[TEXT]

MY IMMEDIATELY PRECEDING TELEGRAM

The following is the text of the Financial Secretary's Brief.

Objectives

One To avoid a vote or any disagreement that will give the impression in public that the 30 May agreement is in danger. ~~stop~~

Two To leave open the possibility of finance being found for advances to the United Kingdom in the autumn including the possibility of a Supplementary Budget after the German Elections ~~dash~~ – but without actually referring to the possibility of a Supplementary Budget because the Germans would be forced to repeat that they could not finance one ~~stop~~.

Line to take at Council

One We appreciate the reasons why the Commission have

/entered

300 MUA in Chapter 100 for advances to the UK. ~~stop~~ The 30 May agreement included a provision for advances. ~~stop~~ Once the regulation is approved and the consequential programme for special measures in the United Kingdom agreed, ~~comma~~ then public opinion in the United Kingdom would expect the money to flow. ~~stop~~

Two On the other hand, ~~comma~~ we also understand the problems of the German Government who do not have provision in their 1980 Budget for a contribution to an advance, on the assumption that the rest of the Community Budget will work out as foreseen by the Commission at the present time. ~~stop~~ Our understanding is that this problem is purely temporary and confined to the budget year 1980 and that the German Government could finance their share of what is due to the United Kingdom for 1980 ~~dash~~ both under the revised Financial Mechanism and under the separate Supplementary Measures ~~dash~~ very early in 1981 and thus within the British financial year which does not end until March. ~~stop~~

Three It seems to us quite possible that, ~~comma~~ by the autumn, ~~comma~~ it will be apparent that money could be transferred to Chapter 58 ~~open bracket~~ (the new chapter for measures to help the United Kingdom) ~~close bracket~~ from some other chapter of the budget because of underspending of other chapters which ~~are~~ is quite usual. ~~stop~~ We also suspect that the Commission may have underestimated the yield of levies and duties. ~~stop~~ If so, ~~comma~~ funds for an advance to the United Kingdom could possibly be provided without calling up more VAT. ~~stop~~

Four There is a good deal of work to do before the United Kingdom will be in a position to request an advance. ~~stop~~ The regulation has to be passed and the programmes agreed. ~~stop~~ The main thing today is that we do not do or say anything that could give the impression that any one is going back on 30 May agreement. ~~stop~~ Therefore I suggest that we put a token entry in chapter 58 and delete the extra provision of 300 MUA from chapter 100. ~~stop~~ We should explain our decision by telling the Parliament and the public that we will reconsider the possibility of an advance in 1980 to finance special measures in the United Kingdom later in the year when the outcome of the Community Budget as a whole can be more confidently predicted. ~~stop~~

NOTHING TO BE WRITTEN IN THIS MARGIN

(17259) Dd.897459 250m 12/72 G.W.B.Ltd. Gp.863
(16941) Dd.897300 250m 9/72 G.W.B.Ltd. Gp.863

personal way the major issues facing the world. The nature of the meetings had changed greatly within recent years, and the Heads of Government were now behaving like Agriculture Ministers. The European Council had now become a piece of machinery like N A T O or the United Nations. The Heads of Government ought to be able to speak their minds alone without a Secretariat. Moreover, the bureaucracy in Brussels was getting out of hand. It was growing all the time and now numbered more than 5,000 people. After enlargement there would, on present plans, be seventeen Commissioners, and this was ridiculous.

The Prime Minister said that she agreed entirely with what Chancellor Schmidt had said. She thought meetings of the European Council should consist of an informal exchange of views between the Heads of Government. She did not like the habit of issuing a formal communique. Moreover, she thought that the Council met too frequently: two meetings a year would be enough. She would be very happy to settle for only one Commissioner for the UK after enlargement. The Commission issued far too many directives which were very detailed: they were seeking standardisation and not harmonisation.

Encouraged by the Prime Minister, Chancellor Schmidt said that he would raise the possibility of reducing the number of European Council meetings to two a year with the other Heads of Government after dinner that evening.

Restructuring of the Community Budget

The Prime Minister said that she was fearful that rather than face up to the difficult task of restructuring the Budget, the Commission would take the easy way out and propose that the 1% VAT ceiling should be breached. If they did that, she would be in a difficult position because she did not want to be isolated again in the Community in saying no.

Chancellor Schmidt said that he thought it important that the U K should not find itself isolated again in the next two years or so. He agreed about the importance of not going above the 1% VAT ceiling, but he had been alarmed to be told in the last week or so that the ceiling was not the clear and firm limitation which he had previously supposed it was. He was advised that if the Community reached a ceiling on its revenues and was thus unable to make payments to those who, under existing Community law, were entitled to receive them, these people could apply to their national governments for payments in substitution, and the latter were obliged, again in accordance with existing Community law, to make such payments. When the Prime Minister suggested that the way of dealing with this situation would be to change the treaties, Chancellor Schmidt said that he did not believe either the Bundestag or the House of Commons would ratify the necessary amendments. He was in any case facing considerable difficulties over the Community Budget in the Bundestag. The German Government had always been willing to make large contributions to Community finances in order to encourage convergence. But he could not persuade either his own party or the FDP that Germany should pay in order to enhance the standard of living in countries like Denmark and Holland which were richer than Germany. He did not know where he was going to find the additional contribution required of Germany as a result of the recent Brussels package. His Government would now have to find DM2½ billion but they had provided for only DM600 million in their forward plans. The Federal Budget was already in deep deficit, and the servicing of it was getting out of hand. His Government could not borrow any more on the capital market because to do so would push up interest rates and this would have a disastrous effect on the German economy. This left him with no alternative but to increase taxes, and he had had to announce the previous week that taxation would be raised to meet the Brussels package on the 1st January 1981. The political

/implications

implications of having to do this four months before the Federal elections did not need spelling out. Against this background, he had it in mind to tell the other Heads of Government after dinner that evening that it was likely that he would demand in about a year's time that ceilings should be imposed on net receipts from the Community Budget as well as on net contributions. He recognised that this approach was a little crude but it might be necessary and it would also help in the restructuring of the Budget.

The Prime Minister said that she entirely understood Chancellor Schmidt's difficulties, and she had pointed out at Luxembourg that it would not be fair to ask Germany to pay substantially more to the Community Budget than they already did. What he had said underlined the importance of getting ahead quickly with the restructuring of the Budget and she wondered whether some steps at least could be taken in time to be incorporated in the 1980 Budget.

Chancellor Schmidt said that that might be trying to move too quickly. The Commission would not come forward with any worthwhile proposals in the next twelve months, and he believed that the impetus would have to come from national governments. But the brake here was the French Government: although President Giscard wanted to see the CAP reformed, he would not be able to do anything, because of the strength of his agriculture lobby, until after the Presidential elections in April and May of next year. This meant that restructuring would have to go ahead very quickly after that and should be completed by the summer of 1982, if it was not to get caught up in the run-up to the French Assembly elections in 1983. He was not saying that the Commission should not make a start on preparatory work straightaway, though he doubted whether they would get very far. In any case he thought that member Governments should set up small bilateral task forces to work up ideas for restructuring. There might, for example, be an Anglo-German task force composed of, perhaps, two aside, and there might be similar Anglo-French and Franco-German groups. It was essential for these groups to work secretly, with no leak of their activities, for otherwise the French would have difficulties.

The Prime Minister said that she agreed that the restructuring of the Budget needed a lot of preparation. She thought that Chancellor Schmidt's idea of bilateral groups was a good one and she would consider it further.

I should be grateful if you could let me have a note for the Prime Minister on Chancellor Schmidt's assertion that those who were unable to get from the Commission payments that were due to them could have recourse, under existing Community law, to their national Governments for payments in substitution.

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

Yours ever,

Clive Whitmore.

Paul Lever, Esq.,
Foreign and Commonwealth Office.

Original =CAR.

CF 6/6

Euro Pol

CC FCO
MAFF

10 DOWNING STREET

THE PRIME MINISTER

12 June 1980

Thank you for your letter of 30 May about the Community budget settlement.

I hope that the details of the agreement and the statements by Ian Gilmour and Peter Walker in the House on 2 June, as well as my own replies to Questions in Parliament on 3 June, have convinced you that we secured a fair and advantageous deal, much better I think than either our friends or opponents believed possible.

On the budget itself, the rebates we have obtained for 1980 and 1981 (at least £710 million and £860 million respectively) are indeed substantial. For 1982 we have a clear commitment on a similar limitation on the level of our net contribution, unless the Community has by then modified its financial arrangements in such a way as to avoid an inequitable burden falling on us. Also of the greatest importance for the long-term is the Community's commitment to structural change through a review of the development of Community policies in 1981. Such a review gives us an unparalleled opportunity to correct the obvious absurdities associated with the CAP and reduce the proportion of the budget absorbed by it.

On the agricultural prices settlement, the Government argued for, and would certainly have preferred, lower increases than the 5 per cent agreed and none at all on products in surplus. But the increases must be seen in perspective, particularly against the 10 per cent average level of inflation in the Community. In real terms they are reductions.

/ Increases for products

Increases for products in surplus are also rather lower than the general average. For the product in largest surplus, milk, which absorbs some 30 per cent of total Community budget expenditure, there was a 4 per cent increase. But this was partially offset by an increase in the basic co-responsibility levy on farmers' deliveries to dairies which also increased from 0.5 per cent to 2 per cent of the price with a further commitment that a supplementary levy will also be introduced in 1981 if deliveries of milk this year increase by more than 1.5 per cent on 1979. Limitations have also been placed on Community support for dairy investment. The two prices settlements for which we have been responsible give only a nominal 1.25 per cent per annum increase in the common price, net of the co-responsibility levy. In real terms, this is a substantial squeeze on dairy farmers' incomes. I accept that continued restraint will be essential if we are to solve the problem of the surplus in milk products permanently.

As far as sugar is concerned, world prices are currently about £80 per tonne higher than those in the Community. Our agreement to an increase in the price for sugar should be seen against this background. While this situation lasts, disposal of surplus sugar on world markets will in fact produce additional income through levies on exports.

On lamb, we successfully headed off the Luxembourg proposals which would certainly have led to the creation of a lamb mountain. The agreement we have reached will bring substantial benefits to our farmers while keeping the price of lamb at reasonable levels and thereby maintaining consumption. There will be no intervention in the UK and the arrangements will prevent UK lamb from being sucked into intervention elsewhere in the Community. The agreement should also ensure that the quantities of lamb from other Member states going into intervention will not be excessive. Our supplies from New Zealand should also be safe. In the longer run, we could obtain up to £100 million per annum from this regime and there will be a public expenditure saving when the Fat Sheep Guarantee scheme lapses.

/ The Government continue

The Government continue to oppose sales of agricultural products at subsidised rates to Russia. Unfortunately some of our partners are not prepared to go as far as we want. We shall continue to press for restrictions and, if possible, the elimination of export rebates on this trade. Whether export rebates to third countries will increase generally as a result of this package will depend very much on trends in world prices.

Our continued ability to refuse to agree to future price settlements which are unacceptable to us remains unimpaired. The agreement reached simply requires all Member states to do their best to take decisions on prices before the subsequent marketing season begins. We intend to play our full part in next year's and subsequent negotiations.

I do not accept that the settlement will have a marked effect on the sterling exchange rate. The initial reaction has of course been contrary to that you feared. As I said in the House, I hope that the refund will help to reduce the PSBR and, in due course, take some of the pressure off interest rates.

(SGD) MARGARET THATCHER

Jock Bruce-Gardyne, Esq., M.P.

CE Original LGR.

10 DOWNING STREET

THE PRIME MINISTER

12 June 1980

CFCO

You sent me a telegram saying that the Ulster Unionist Party were confident that I would stand by my pledges on the Community budget question.

As you will know, from Ministers' statements in Parliament, the Government have agreed to the decisions that emerged from the Foreign Affairs and Agriculture Councils in Brussels last week.

The result of the budget is very satisfactory; a refund of some £710 million this year and a refund of some £860 million next year. This is accompanied by a risk-sharing formula which will set clear limits to any additional financial obligations if the unadjusted net contribution proves to be higher than allowed for in Commission estimates. There is also a satisfactory undertaking which safeguards the position for 1982. Equally important, the agreement provides for a major review of the Community's finances, in which the Community has pledged to resolve the underlying problem by means of structural changes to prevent the recurrence of unacceptable situations for any Member State.

In the Agriculture Council the package agreed offers substantial benefits for the United Kingdom and gives us a net gain of about £37 million in 1980/81. It contains specific advantages for us in the continuation of the butter subsidy, a satisfactory suckler cow premium, refunds on our whisky exports, and an acceptable outcome to the problem of sheepmeat which will be advantageous to Britain and provides protection for the interests of New Zealand. The average 5 per cent increase in the CAP farm

/ prices,

prices, from which British farmers will of course benefit, will produce an increase of only 0.7 per cent on the food price index and 0.15 per cent on the retail price index. In spite of pressure at various stages in the negotiations from our partners, we made no concessions on British interests in fisheries or energy policies.

This Government came to office determined to make a success of our membership of the Community. The first task was to deal with the inequitable budget contribution. That we have now done.

We can now look to the future to work for new common policies in the Community which give Britain and the Community real benefit and which enable us to deal jointly with the challenges facing Europe.

(SGD) MARGARET THATCHER

J.H. Molyneaux, Esq., J.P., M.P.

cc Euro Pol, Venice Summit Pt 4

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

11th June, 1980

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

EEC BUDGET SETTLEMENT: TIMING OF PAYMENTS

In Cabinet this afternoon the Chancellor undertook to let the Prime Minister have a note tonight on the state of play over advances of money under the Budget settlement.

As you know the 30th May agreement provided that credits for the supplementary measures under the new Article 235 Regulation in respect of each calendar year should be inscribed in the budget of the following year. But at our request the Council of Ministers can decide each year to make advances.

Accordingly the Commission have inserted a provision of 300 MUA in their rectifying letter incorporating their proposals for the amendment of the 1980 Budget. Their proposal is that this sum should be inserted in Chapter 100 which means that it will require a further decision of the Council to transfer it to the Chapter dealing with special measures to the UK before the Commission can advance the money to us.

The Germans and the French have said that they will oppose the insertion of this figure.

~~He~~ (the chancellor) discussed this matter with Herr Matthöfer in Bonn on 10th June. At first the latter insisted that the Germans could not make any advance payment to the UK in 1980; but later in their discussion Herr Lahnstein indicated it was not impossible that the German budgetary difficulties might seem less oppressive towards the end of this year and that some payment to the UK might be possible.

All this points to avoiding a row when the Commission's rectifying letter is considered by the Budget Council next Tuesday, 17th June. Our Ambassador in Bonn has seen Herr Lahnstein today and pointed out at the Chancellor's request that the inclusion of 300 MUA in Chapter 100 of

/the 1980 Budget

the 1980 Budget does not necessarily mean that the money will be spent since a formal UK request would still be required followed by a vote to transfer the money to the operative chapter. Lahnstein has agreed to consider this point at an internal meeting in the Ministry of Finance on 13th June.

If this way of avoiding a confrontation does not prove acceptable, our fallback position might be to accept that no sum is entered into the 1980 Budget but merely a token entry in the chapter which provides for the UK solution. We would then have to rely on the Commission proposing a supplementary budget to secure advances later in the year. We might aim to secure the agreement of the Budget Council to a form of words which accepted the possibility of a supplementary budget after the regulations implementing the 30th May agreement had been passed and the consequential infra-structure programmes approved.

The Italian Presidency, in a misguided attempt to be helpful, have suggested as a "compromise" that the 300 MUA be inscribed in Chapter 100 as commitments appropriations and not as payments appropriations. This would be a great deal worse than having no inscription of any amount at all. The whole point of the advances proposal was to secure money for us this year. Payments appropriations are essential for this purpose. Furthermore the acceptance of the principle that the provision for commitments appropriations could be different in any year from the provision for payments appropriations could store up a great deal of trouble for us in the future. We are therefore taking steps to kill off this idea and it would be helpful if this point could be put to the Italians forcibly in Venice.

I am sending copies of this letter to George Walden, Michael Richardson and David Wright.

Yours
John

A.J. WIGGINS

SECRET

cc Master Set
cc Euro Pol, Presidency of Commission
cc Community Budget Pt

File

cc CO
HMT
Euro Pol

10 DOWNING STREET

From the Principal Private Secretary

12 June 1980

BF 23.6.80

Dear Paul, Extract

Meeting with Chancellor Schmidt

The Prime Minister met Chancellor Schmidt at 1445 today in her room in the Hotel Cipriani.

Original on Euro Pol
Venice council Pt 4

c/c Mr Whitmore

CONFIDENTIAL

Ref. A02334

MR. ALEXANDER

European Council: Reactions to the Budget Settlement

The Prime Minister has already been provided with additional briefs covering two questions which may possibly come up in Venice as a result of the Budget settlement: enlargement and the proposed review on budget restructuring. Other points were made in the public statements after the Budget settlement by the French and German Governments. It seems unlikely that these points will be raised in the Council itself but they may be raised in the corridors or by the Press. The attached notes, in the form of a Question and Answer brief together with Background Notes, have been agreed with the Departments principally concerned. They deal with:-

(i) The Budget settlement itself.

(ii) The attempted French link with CAP prices.

(iii) Fisheries.

(iv) North Sea Oil.

2. I am sending copies of this minute and these briefs to the Foreign and Commonwealth Secretary's Private Secretary, to Michael Palliser, Tom Bridges, Julian Bullard and Michael Butler and to Bernard Ingham, No. 10.

(Robert Armstrong)

11th June, 1980

EUROPEAN COUNCIL, VENICE: Q & A BRIEF ON THE OUTCOME OF THE BUDGET NEGOTIATIONS

BUDGET SETTLEMENT

Q. What is the Budget settlement worth?

A. The settlement will yield a total rebate to the United Kingdom of at least £1,570 million over the two year period 1980-1981. On Commission estimates this will reduce the United Kingdom's net contributions in those two years to £370 million and £440 million respectively. Any increase over those levels resulting from higher-than-expected Community spending will be much abated by a risk-sharing formula, under which the United Kingdom will bear only a fraction of the cost of any excess.

The settlement also provices for a radical review of the Community's budgetary arrangements and of the pattern of Community spending. If this review has not of itself solved the United Kingdom's budget problem by 1982, the Community is committed to extending the arrangements negotiated for 1980 and 1981.

Q. What will be the effect on public expenditure?

A. As the latest Public Expenditure White Paper makes clear, the reduction in our Budget contribution will increase the savings in public spending which the Government has already achieved. The amount set aside for contributions to the Community Budget in Table 2.2.1 of the White Paper will be reduced.

The settlement should not be seen as opening the way to increased expenditure on domestic programmes, although it reduces the risk that further cuts in these programmes will be needed to keep public expenditure and borrowing within acceptable limits.

Q. What are the proposals for "Supplementary Expenditure" in the United Kingdom?

A. The new Article 235 regulation will enable the Community to participate in the financing of programmes designed to help with the problems of the disadvantaged regions of the United Kingdom and possibly certain expenditures outside those regions. It has yet to be decided exactly which programmes will benefit from Community assistance.

The next step will be for the Commission to propose a draft regulation to the Council and to the European Parliament. This will lay down the broad criteria under which the programmes will attract Community assistance.

Q. Will this scheme enable the Community to interfere in British policies - e.g. our regional policy?

A. The Commission are proposing that the Community should help to finance the United Kingdom's own national expenditure programmes, not that it should establish a new Community policy, comparable with the CAP.

The Council will approve the broad qualifying criteria which will be embodied in the Regulation. But it will be for the United Kingdom to decide which programmes to put forward for assistance within that framework. There is no reason to suppose that the Community will refuse to assist programmes which satisfy the agreed criteria.

Q. What is the significance of the proposed review of the development of Community policies?

A. In the long term the commitment to review the development of Community policies and the operation of the Budget is perhaps the most important part of the 30 May agreement. Together with the constraints imposed by the 1 per cent ceiling, it will provide the opportunity for the Community to make fundamental structural reforms so as to prevent any recurrence of the British budgetary problem.

The review therefore offers an opportunity which has never been available before, since we joined the Community, to work with our partners for financial arrangements and Community policies, which are equitable, and reflect the interests of all Member States.

ADVANCE PAYMENTS

Q. The Germans have said that they can only finance the 30th May settlement if the 1980 payments are postponed into 1981. Is that acceptable to the United Kingdom?

A. The 30th May settlement made it clear (in paragraph 6) that the possibility of advances was part of the settlement and no exclusion was made for 1980. Even so, we are sympathetic to the current budgetary difficulties of the Federal Government and we are considering whether we can help.

Q. Is it true that the German Government has made a formal request to the United Kingdom that we make no application for advances in 1980?

A. Yes; and we are considering it.

LINK WITH 1981 CAP PRICES

Q. Is it true that the French have sewn up the financial arrangements in such a way as to force us to agree to farm price increases before the beginning of the next financial year?

A. On 30th May all the Member States undertook to do their best to ensure that decisions on agricultural price fixing were taken in time for the 1981-82 marketing season. We fully accept that undertaking. Our aim will be to work with our Community partners before the next marketing season begins for CAP decisions that will take due and proper account of all the Community interests involved.

Q. But will the French be able to deny Britain the money under the Budget settlement until we have agreed farm prices acceptable to them?

A. The 30th May decision incorporates provisions for the payments to the United Kingdom. These were agreed. I am sure that the French Government will honour their commitments under the decision just like all the other Member States.

FISHERIES

Q. Does not Fisheries text prejudice UK position?

A. Not at all. It is a statement of general principles and in no way prejudices the vital interests of our fishermen, which we are determined to safeguard.

Q. Are HMG prepared to stand by Community's timetable of CFP settlement by 1 January 1981? Was this not a concession by the United Kingdom?

A. HMG have regularly indicated they seek early conclusion of an adequate CFP settlement. All EC fishing industries need security of a settlement; absence of Community-wide conservation and management measures in effect threatens the stocks and prejudices the long term livelihood of the fishing industry. Therefore welcome prospect of early progress on fish.

Q. Linkage. Does fisheries text mean that if no progress is made on fish, the United Kingdom will not receive its budget repayment?

A. No. Fisheries text sets the framework, but substance of CFP will now be considered on its merits. Decisions on the budget and other issues have already been taken. Budget settlement provides a satisfactory timetable for the making of payments to the United Kingdom.

Q. Do you agree that the fisheries text confirms the principle of equal conditions of access?

A. No. There is no reference in the text to these words. Certain delegations (Germany, Netherlands) sought this, but the Council chose not to use their language (which is in fact made as a unilateral statement).

Q. Has access preference now been excluded from the CFP package, and left for decision in 1982.

A. On the contrary, the text recognises in paragraph 3 that the current negotiations for the review of the CFP comprise the review (Article 103, Treaty of Accession) of the existing arrangements on access. This paragraph, which refers also to the areas designated in the 1976 Hague agreement, is fully in accordance with our negotiating objectives on access. Now for Fisheries Council to pursue all the CFP issues together, including access.

NORTH SEA OIL

Q. Does UK export enough North Sea oil to EC partners?

A. About half our production exported and over half these exports go to Community. In 1979 it received 22 million tonnes. Germany, largest single importer, received 10 million tonnes. In first quarter of 1980 one third of our total production (two third of total exports) went to the rest of the Community. Quantity exported to other Community countries should continue to rise over next few years.

Q. Are North Sea oil prices too high?

A. Prices follow, not lead, world market for similar high quality, low sulphur crudes. Only 1 per cent of output is sold at spot prices.

Q. Will the United Kingdom increase production in sub-crisis?

A. As we agreed at Luxembourg, the possibility of this is being examined urgently as one component of a study on dealing with short-term supply problems. We should now await outcome of this study. [If necessary] Scope for increasing production from North Sea in short term would at best be very limited.

Q. What is position on HMG's discussions with the Commission on landing requirement?

A. The Commission have confirmed that in present circumstances they are satisfied with our policies and procedures.

Q. Does not North Sea oil make the United Kingdom wealthy?

A. North Sea oil contributed only 2.5 per cent to GNP in 1979 and will contribute only 6 per cent at peak production. We remain the third poorest member of the Community in terms of GNP per capita. We are not yet net exporters.

BACKGROUND NOTES

EFFECT ON PUBLIC EXPENDITURE

1. The situation on "additionality" is delicate. The Government's intention is that our refunds will go to reduce the PSBR. On the other hand, the Commission and our partners would not want expenditure on supplementary measures to be merely a substitute for British public expenditure that would have taken place anyway. We need to be careful about what is said in public on this point. A statement that implied that none of the expenditure on supplementary measures would be additional might create problems when the draft regulation is considered by the Council of Ministers.

"SUPPLEMENTARY EXPENDITURE" IN THE UNITED KINGDOM

2. The main point is that the programmes that will receive Community assistance have not yet been decided. Supplementary expenditure will not necessarily be restricted to the Assisted Areas of the United Kingdom.

COMMUNITY INTERFERENCE

3. There may be difficult discussions ahead on this, when the draft Regulations come to the Council. Our line will be that bureaucracy must be kept to the minimum, and we hope to have the support of the Commission on this point.

THE REVIEW

4. The review is due to be completed before 1982. Commission proposals are to be submitted by mid-1981. The terms of reference are as follows:-

> "The examination should concern the development of Community policies, without calling into question the common financial responsibility for these policies, which are financed from the Community's own resources, nor the basic principles of the Common Agricultural Policy. Taking account of the situations and interests of all Member States, this examination will aim to prevent the recurrence of unacceptable situations for any of them."

ADVANCES

5. On 6 June we received an urgent request from the Federal Government that the United Kingdom should renounce advance payments in 1980. The Chancellor of the Exchequer has been having discussions with German Ministers whom he has seen in Luxembourg and Bonn. He will be making a recommendation to the Prime Minister when he has reflected on what they tell him.

6. The first receipts under the Financial Mechanism for 1980 are not due until the first quarter of 1981 in any case. The sole question therefore is whether we insist on advance payments for the supplementary measures. It seems probable that the Commission would go along with the recommendation that we should get 300 MUA (£180 million) in this way. It is unlikely that the detailed arrangements for the supplementary measures will be completed in time to enable us to receive this money before the last quarter of 1980. The postponement of this sum into the first quarter of 1981 would not be of very great financial significance. In any case, there is likely to be much greater pressure on the PSBR in the financial year 1981-82 than in the current financial year.

7. On the other hand we want to be quite sure that anything we agree to for 1980 is not established as a precedent for later years; and we want to prevent the other Member States from exploiting any delay before we are due for our first payments to create obstacles in the design of and the administration of the supplementary measures scheme. The problem here is that, although the Germans may agree to cooperate in return for our renouncing advances, they cannot by themselves prevent others from exploiting the delay. We also need to think out more carefully the precise implications of the renouncement of 1980 advances for the imminence of the time when the 1 per cent ceiling on Community Budget expenditure will begin to bite.

8. The Chancellor will be considering all these matters before he makes a recommendation to colleagues.

LINK WITH CAP PRICES

9. The only explicit reference to CAP prices in the 30th May decision appears in paragraph 9 which reads as follows:-

"It is important for the future well being of the Community that day to day decisions and policy making should function effectively and this particularly during the period when the review foreseen in paragraph 7 is under way. With this objective in mind all Member States undertake to do their best to ensure that Community decisions are taken expeditiously and in particular that decisions on agricultural price fixing are taken in time for the next marketing season."

10. The French have been putting it about that it is not this paragraph which will prevent the British from being difficult about farm prices in 1981 but the precise arrangements for making payments for supplementary measures. It does not appear to us at present that they have a point. The 30th May agreement clearly committed the Community to payments to the United Kingdom in respect of 1980 and the French have never said that these should be delayed until after the 1981 price review. Unless we ask for an early advance in respect of 1981, the money that we shall be due to receive in the first half of that year - i.e. in the period of the price review - would all relate to 1980. It is difficult to see what argument the French could use to delay payment of that.

11. We have no particular reason for asking for advance payments for 1981 early in the course of that year. If we requested them in the autumn, the issue would not be before the Council of Ministers at the same time as the 1981 price review. In this way we should be able to prevent the French from making a link that would restrict our room for manoeuvre in the 1981 price review.

NORTH SEA OIL

12. The German Cabinet, in agreeing to the budget settlement, included the following paragraph in its statement:

"The Federal Government expects that the British Government will pay appropriate attention to the interests of her partner countries in the EC, in her oil and gas policies and, in particular, in the use of her production potential. This should especially be the case in situations where particular demands can be made on Community solidarity."

The 13 May Energy Council confirmed that the scope for increasing hydrocarbon production should be one element in further examination of possibilities for dealing with short term oil supply difficulties.

PA

MJS

PRIVY COUNCIL OFFICE
WHITEHALL LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

10 June 1980

Dear Martin,

PARLIAMENTARY DEBATE ON THE BUDGET SETTLEMENT

Following our telephone discussions, I write to confirm that the view of the Chancellor of the Duchy is that, if the Opposition continue to press, as they have done, for a debate on the settlement of the problem of the UK net contribution to the EC Budget, he will feel obliged to accept this unless there is some new point of substance which can be advanced to justify proposing a postponement to the Opposition. Such a reason might be found in the forthcoming proposals of the Commission for implementing the Budget settlement; but if the Chancellor of the Exchequer or the Lord Privy Seal (to whose office I am copying this letter) think that there is any such issue of substance, it would be most helpful if this could be discussed directly between an appropriate Minister and the relevant Opposition spokesman in order that the case for any postponement may be properly considered on both sides of the House. I am advised that this kind of technical issue is best pursued in this way rather than through the usual channels.

On the material which might be covered in the debate when it occurs, you may like to know that two documents have been recommended by the Scrutiny Committee for further consideration: COM(80)147 on Convergence and Budgetary Questions and 5437/80 on the Revised 1980 Draft Budget. It may also be that further documents, such as the text of the Conclusions of the Foreign Affairs Council of 29/30 May (which has already been deposited in the Library of the House) should also be taken into account.

I understand that these conclusions have not yet been put into a form in which they can be considered by the Scrutiny Committee, but that this may shortly be done; and that, when these are available, the Commission's proposals for implementing the Budget settlement would also be appropriate to the normal Parliamentary scrutiny procedure. If that is the case, it might be that the requirement for scrutiny of these matters would be relevant to any case which Ministers might wish to develop for putting off the debate. But, as I have said above, the Chancellor of the Duchy would not be happy, if the Opposition continue to regard a debate as a priority, to try to defer this for general, as opposed to specific, reasons.

If it is agreed that the debate should go ahead, I should be grateful to have your Chancellor's views on the content of the debate and the form of motion. It would be helpful to know fairly quickly how your Chancellor and other Ministers see this issue, since the Chancellor of the Duchy will need to be in a position to deal with this when the Opposition return to the charge when discussing next week's business.

I am copying this letter to Nick Sanders (Prime Minister's Office), Michael Richardson (Office of the Lord Privy Seal), to Murdo Maclean and Alison Blackburn (Cabinet Office).

Yours ever,

Robin Birch

R A BIRCH
Private Secretary

Martin Hall Esq
Private Secretary to the Chancellor of the Exchequer
HM Treasury
Whitehall

Ref: A02325

CONFIDENTIAL

PRIME MINISTER

Community Affairs

Last week's Cabinet noted that the 12-13 June European Council would be devoted mainly to Middle East problems and preparations for the Economic Summit on 22-23 June. Unless you want to add anything in the light of your briefing meeting on Monday - for instance, that there may now be some discussion of the recent observations by President Giscard and Chancellor Schmidt about the desirability of delaying the accession of Spain and Portugal - further discussion would not seem necessary at this stage.

2. The Chancellor of the Exchequer might be invited to report on the outcome of the 9 June Finance Council, at which the budget settlement reached at the 29-30 May Foreign Affairs Council was formally adopted. The Council also agreed that, while the Community should consider what contribution it could make to the problem of recycling OPEC surpluses, the main role must continue to be played by the IMF and the IBRD. Finance Ministers were invited to report accordingly to Heads of Government before the Venice European Council, but it was not expected that any discussion of this point would take place there.

3. The Secretary of State for Employment might be invited to report on the 9 June Labour and Social Affairs Council, which agreed a resolution on labour market guidelines. The European Council will be invited to take note. A framework Directive on Health and Safety at Work was also adopted.

4. OD(E) will have met on 10 June to consider a paper by the Foreign and Commonwealth Secretary on Public Attitudes to Europe. The Foreign and Commonwealth Secretary might wish to report the Sub-Committee's conclusions to the Cabinet.

5. Next week, there will be a Fisheries Council on 16 June, an Agriculture Council on 16-17 June and probably a Budget Council on 17 June.

RA

(Robert Armstrong)

10th June 1980

CONFIDENTIAL

PRIME MINISTER

DEBATE ON THE EUROPEAN BUDGET SETTLEMENT
AND RELATED ISSUES

The Chief Whip is likely to touch on the question of a debate on the European budget and related issues when he sees you on Monday morning.

The indications are that the Opposition would like a debate in the week after next, but the Chief Whip has it in mind to suggest that since we expect to get a Regulation from the Commission embodying what was agreed in Brussels in the next couple of weeks or so and the Scrutiny Committee will most certainly recommend that it should be debated, there would be much to be said for waiting for that Regulation and having one debate then.

The Chief Whip and I agreed that if we proceed in this way, there would be a very good case for the Government speakers being the Chancellor of the Exchequer and the Lord Privy Seal.

Agreed
MT

MAP.

6 June 1980

With the compliments of

THE UNITED KINGDOM PERMANENT REPRESENTATIVE

OFFICE OF THE UNITED KINGDOM
PERMANENT REPRESENTATIVE
TO THE EUROPEAN COMMUNITIES
ROND-POINT ROBERT SCHUMAN 6,
1040 BRUSSELS

COMMISSION
OF THE
EUROPEAN COMMUNITIES

The President

200 RUE DE LA LOI
1049 BRUSSELS

TEL: (02) 735 80 40

6th June, 1980

Dear Michael,

Thank you for your letters of 4th and 6th June, with which you kindly enclosed messages from the Foreign Secretary and the Prime Minister. I was very pleased to receive these.

Yours ever,

Roy

Sir Michael Butler, KCMG,
Permanent Representative of the
United Kingdom to the
European Communities.

Copy Private Secretaries
at FCO + No. 10.

9/6

CONFIDENTIAL

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CONFIDENTIAL
FRAME GENERAL
FM ROME 061740Z JUN 80
TO PRIORITY FCO
TELEGRAM NUMBER 378 OF 6 JUNE

M6

YOUR TELEGRAM NO. 274: MESSAGES TO ITALIAN GOVERNMENT

1. I DELIVERED THE PRIME MINISTER'S MESSAGE TO BERLINGUER (DIPLOMATIC ADVISER) AS COSSIGA IS IN THE NORTH ELECTIONEERING. BERLINGUER SAID COSSIGA WOULD BE VERY GRATEFUL AND WOULD SHARE THE PRIME MINISTER'S VIEWS.

2. COSSIGA CONSIDERED THAT THE BUDGET PROBLEM HAD BEEN SOLVED IN THE RIGHT WAY SO AS TO CLEAR THE FIELD FOR THE COMMUNITY TO MOVE FORWARD. HE WOULD HOPE THAT THE EUROPEAN COUNCIL COULD GIVE A NEW IMPETUS TO THE COMMUNITY'S WORK AND DEMONSTRATE ITS UNITY IN THE FACE OF WORLD PROBLEMS. INDEED THE MAIN ITAM FOR DISCUSSION BY THE HEADS OF GOVERNMENT, APART FROM THE MIDDLE EAST, SHOULD BE THE FUTURE OF EUROPE.

3. COLOMBO LAST NIGHT EXPRESSED GRATITUDE FOR YOUR MESSAGE AND SPOKE IN SIMILAR TERMS.

ARCULUS

[THIS TELEGRAM WAS NOT ADVANCED]
[COPIES SENT TO NO 10 DOWNING STREET]

FRAME GENERAL
ECD (I) .

CONFIDENTIAL

Euro Pol.

Foreign and Commonwealth Office
London SW1

5 June 1980

1980 COMMUNITY BUDGET : ADDITIONAL TWELFTHS FOR FEOGA

Thank you for your letter of 2 June to Peter Carrington.

We have no reason now to obstruct the Commission's proposal. Accordingly, I am content to see it go through as you suggest.

I am sending copies of this letter to the recipients of yours.

Nigel Lawson Esq MP
Financial Secretary to the Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

CONFIDENTIAL

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CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary 5 June 1980

EC Budget Settlement: Messages from the Prime Minister

The Prime Minister has seen the draft messages enclosed with your letter to me of 4 June. I enclose the texts in the form in which she has agreed them.

The messages to Chancellor Schmidt and President Giscard have been sent on the direct lines to Bonn and Paris respectively. I should be grateful if you could arrange for the delivery of the messages to Signor Cossiga and Mr. Jenkins.

M. O'D. B. ALEXANDER

George Walden, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

Gc.

5/6/80

MESSAGE FROM THE PRIME MINISTER TO SIGNOR COSSIGA

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T121/80

Dear Signor Cossiga,

The decision of all Member States to confirm the agreement reached at Brussels on the budget and on related issues is most welcome. The invaluable leadership given by the Italian Presidency throughout the negotiations is deeply appreciated in Britain as elsewhere in the Community. I should like to pay tribute to the efforts made by you and your colleagues.

With this agreement behind us I believe that the Community is well placed to make progress both with its internal development and in dealing in a coherent way with world problems.

I look forward to our discussion in Venice. The Middle East will clearly need careful attention as will preparation for the Economic Summit. I hope that we will be able to have informal and forward-looking discussions on these and other issues of common interest.

Yours sincerely,

MARGARET THATCHER

To go on the direct line

5/6/80

MESSAGE FROM THE PRIME MINISTER TO PRESIDENT GISCARD

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T120/80

My dear President,

The decision of all Member States to confirm the agreement reached at Brussels on the budget and on related issues is most welcome. The important role played by the French Government in securing the agreement is well understood and appreciated in Britain.

With this agreement behind us, I believe that the Community is well placed to make progress both with its internal development and in dealing in a coherent way with world problems. It is a source of great encouragement that the Community has demonstrated once again its ability to overcome the most complex problems.

I look forward to our meeting in Venice and to the informal and forward-looking discussions which I hope we shall be able to have there.

Yours sincerely,

MARGARET THATCHER

To go on the direct line

5/6/80.

MESSAGE FROM THE PRIME MINISTER TO CHANCELLOR SCHMIDT

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T119/80

Dear Helmut,

The decision of all Member States to confirm the agreement reached at Brussels on the budget and on related issues is most welcome. The important role played by the German Government in securing the agreement is well understood and appreciated in Britain.

With this agreement behind us, I believe that the Community is well placed to make progress both with its internal development and in dealing in a coherent way with world problems. It is a source of great encouragement that the Community has demonstrated once again its ability to overcome the most complex problems.

I look forward to our meeting in Venice and to the informal and forward-looking discussions which I hope we shall be able to have there.

Yours sincerely,

MARGARET THATCHER

MESSAGE FROM THE PRIME MINISTER TO MR. ROY JENKINS

Dear Roy,

The decision of all Member States to confirm the agreement reached at Brussels on the budget and on related issues is most welcome.

With this agreement behind us I believe that the Community is well placed to make progress both with its internal development and in dealing in a coherent way with world problems. I look forward to the meeting in Venice.

It is a source of great encouragement to us that the Community has demonstrated yet again that it is capable of overcoming even the most complex problems. As always, the role of the Commission has been crucial.

Yours sincerely,

MARGARET THATCHER

Foreign and Commonwealth Office

London SW1A 2AH

Dear Michael

4 June 1980

EC Budget Settlement: Messages from the Prime Minister

The Prime Minister may like to send messages on the lines of the attached drafts to the European leaders whose agreement was crucial for the budget settlement. It would be appropriate to send messages to Cossiga, the role of the Presidency having been genuinely impressive; to Mr Jenkins for the Commission as a whole; and to Schmidt and Giscard, since both Germany and France have agreed to make a large new financial contribution (provisionally about 466 mEUA and 351 mEUA respectively in the first year).

Although one could argue that we ourselves are still paying too much, the political fact of the matter is that both President Giscard and Chancellor Schmidt have exposed themselves to very real domestic criticism by coming as far as they have to meet us. We shall need the continued co-operation of the French and Germans in the determined efforts we plan to make in following up the commitment to restructure the Community budget. A message would clearly be appreciated in Paris and Bonn.

Yours ever

G G H W

(G G H Walden)
Private Secretary

M O'D B Alexander Esq
10 Downing Street
LONDON

Prime Minister.

Are you ready to send these messages?

MAP

4 vi

I don't think it wise to single out the Middle East in my message. It is really a message of thanks.

MT

D 107991 400,000 7/76 904953

XY 42

File No. ....

Department ECD(I)

Drafted by (Block Capitals) W. MARSDEN

Tel. Extn. ....

OUTWARD TELEGRAM

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(Security Class.) .... (Caveat/ Privacy marking) ....

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AND TO (precedence/post) ....

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[TEXT]

DRAFT MESSAGE FROM THE PRIME MINISTER TO SCHMIDT

1. Please convey the following message to the Federal Chancellor Schmidt from the Prime Minister.

Begins:

''The decision of all Member States to confirm the agreement reached at Brussels on the budget and related issues, is most welcome. The important role of the German Government in this is well understood and appreciated in Britain.

With this agreement behind us, I believe that the Community is well-placed to make progress both with its internal development and in dealing in a coherent way with world problems.

I look forward to our discussions in Venice. The Middle East will clearly need careful attention as will preparation for the Economic Summit. I hope that we will be able to have an informal and forward

/looking

looking discussion on these and other issues of common concern.''

Ends.

NOTHING TO BE WRITTEN IN THIS MARGIN

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XY 42

File No.

Department ECD(I)

Drafted by (Block Capitals) W Marsden

Tel. Extn.

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(Time of Origin) ... Z (G.M.T.)

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(Caveat/ Privacy marking)

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TO IMMEDIATE (precedence) PARIS (post) Tel. No. ... of ...

AND TO (precedence/post)

AND SAVING TO

REPEATED TO (for info)

SAVING TO (for info)

Distribution:–

[TEXT]

DRAFT MESSAGE FROM THE PRIME MINISTER TO GISCARD

1. Please convey the following message to President Giscard from the Prime Minister.

Begins:

"The decision of all Member States to confirm the agreement reached at Brussels on the budget and related issues is most welcome. The important role of the French Government in this is well understood and appreciated in Britain. With this agreement behind us, I believe that the Community is well-placed to make progress both with its internal development and in dealing in a coherent way with world problems. I look forward to our discussions in Venice. The Middle East will clearly need careful attention as will preparation for the Economic Summit. I hope that we will be able to have an informal and forward-looking discussion on those and other issues of common concern.

It is a source of great encouragement to us that the

/Community

Community has demonstrated once again that it is capable of overcoming ~~even~~ the most complex problems.''

Ends.

NOTHING TO BE WRITTEN IN THIS MARGIN

D 107991 400,000 7/76 904953 XY 42

File No. ....

Department ECD(I)

Drafted by (Block Capitals) W MARSDEN

Tel. Extn. ....

OUTWARD TELEGRAM

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(Caveat/ Privacy marking) ....

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TO IMMEDIATE (precedence) ROME (post) Tel. No. .... of ....

AND TO (precedence/post) ....

AND SAVING TO ....

REPEATED TO (for info) ....

SAVING TO (for info) ....

Distribution:–

Copies to:–

[TEXT]

MESSAGE FROM THE PRIME MINISTER TO SIGNOR COSSIGA

1. Please convey the following message to Signor Cossiga from the Prime Minister.

Begins:

" The decision of all Member States to confirm the agreements reached at Brussels on the budget and related issues is most welcome.

~~As you may know from our public statements here and in Brussels,~~ The invaluable leadership given by the Italian Presidency throughout the negotiations is deeply appreciated in Britain as elsewhere in the Community. I should like to pay tribute to the efforts of you and your colleagues.

With this agreement behind us I believe that the Community is well-placed to make progress both with its internal development and in dealing in a coherent way with world problems. I look forward to our discussion in Venice. The Middle East

/will

will clearly need careful attention as will preparation for the Economic Summit. I hope that we will be able to have informal and forward-looking discussion on these and other issues of common interest.''

Ends

NOTHING TO BE WRITTEN IN THIS MARGIN

D 107991 400,000 7/76 904953

XY 42

File No. ....

Department ECD(I)

Drafted by (Block Capitals) W MARSDEN

Tel. Extn. ....

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[TEXT]

MESSAGE FROM THE PRIME MINISTER TO MR R JENKINS

1. Please convey the following message to Mr Jenkins ~~with out delay~~.

Begins:

''The decision of all Member States to confirm the agreements reached at Brussels on the budget and related issues is most welcome.

With this agreement behind us I believe that the Community is well-placed to make progress both with its internal development and in dealing in a coherent way with world problems. I look forward to our discussions in Venice.

It is a source of great encouragement to us that the Community has demonstrated yet again that it is capable of overcoming even the most complex problems. As always the role of the Commission has been crucial.''

Ends

CONFIDENTIAL

QZ 01599

PRIME MINISTER

Cabinet 5 June: Community Affairs

1. Following the full Cabinet discussion on the Community Budget on 2 June the only immediately outstanding question is the decision of the German Cabinet, on which the Foreign and Commonwealth Secretary might be invited to report. Work is now in hand to get the budget settlement implemented as soon and as effectively as possible. Two new regulations have to be adopted. We shall aim to get some financial relief before the end of this calendar year and under the agreement we get the remainder before the end of our financial year. The Chancellor of the Exchequer is circulating a note to colleagues explaining the procedures and how to deal with the question of "additionality".

2. Before next week's Cabinet there will be a Finance Council and a Labour/Social Affairs Council on 9 June, and an informal meeting of Industry Ministers on 10/11 June, but none of them call for discussion now. Your briefing meeting for the Venice European Council on 12/13 June will take place next Monday.

M D M FRANKLIN

4 June 1980

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

Mily Clerk -
Could I have a copy for retention please.
Rut

4th June 1980

R. Prescott Esq.
Private Secretary to the
Paymaster General
Cabinet Office
70 Whitehall
LONDON
SW1

Dear Richard,

EUROPEAN COMMUNITY BUDGET SETTLEMENT

... In accordance with the conclusions of the Cabinet on 2 June (CC(80)21st meeting), I attach an explanatory note on the budgetary settlement.

Copies of this letter and enclosure go to No.10, to the Private Secretaries to all members of the Cabinet, the Minister of Transport and the Chief Whip, and to Sir Robert Armstrong.

Yours ever,

MH

M.A. HALL
Private Secretary

COMMUNITY BUDGET SETTLEMENT

A. Value of the Settlement

The settlement will yield a total rebate to the UK of at least £1,570 million over the two year period 1980-81. On Commission estimates this will reduce the UK's net contributions in those two years to £370 million and £440 million respectively. Any increase over those levels resulting from higher-than-expected Community spending will be much abated by a risk-sharing formula, under which the UK will bear only a fraction of the cost of any excess.

2. The settlement also provides for a radical review of the Community's budgetary arrangements and of the pattern of Community spending. If this review has not of itself solved the UK's budget problem by 1982, the Community is committed to extending the arrangements negotiated for 1980 and 1981. So the total value of the settlement over all three years is unlikely to be less than £2.5 billion.

(For a more detailed account of the settlement, see Annex A.)

B. Effect on public expenditure

3. As the latest Public Expenditure White Paper makes clear, the reduction in our Budget contribution will increase the savings in public spending which the Government has already achieved. The amount set aside for contributions to the Community Budget in Programme 2.7 of the White Paper will be reduced.

4. The settlement should not be seen as opening the way to increased expenditure on domestic programmes, although it reduces somewhat the risk that further reductions in these programmes will be needed in order to keep public expenditure and borrowing within acceptable limits.

C. Effect on the PSBR

5. The reduction in public spending that will follow from the settlement will certainly assist our efforts to contain the PSBR. The effect on the PSBR may be a little less than the overall change in our net contribution. This is because the associated agricultural price settlement, which will also produce a reduction in our net contribution in 1980-81, will involve a matching increase in doemstic public spending.

D. Effect on the balance of payments

6. The effect on the settlement will be to improve the current balance by slightly more than the value of the refund. This is because the extra sheepmeat and whisky receipts will probably exceed slightly the extra cost of our food imports from the Community.

E. Effect on the domestic money supply, and on the Government's need to sell gilts

7. A cut in our EC contribution which is used to reduce the PSBR will help to ease the pressure on the monetary target. With the exchange rate determined by market forces, the Government's need for sterling finance will be reduced. Its need to sell gilts to stay within the monetary target will be less. It should therefore be possible to meet the target with lower domestic interest rates than would otherwise have been necessary. It is not possible to say precisely what the size of this effect will be though it is likely to be small. But since we are not expecting the major part of the refund until the end of the year, it is not realistic to look for an immediate effect on domestic monetary conditions.

F. Effect on the exchange rate

8. The effect on the exchange rate is likely to be small. There are two influences which work in opposite directions:-

(a) the cut in the contribution will tend to push sterling up, because it will be improving the current account;

(b) lower interest rates (see E) will restrain the rise.

Method of payment

9. The money will be provided by improvements in the operation of the 1975 Financial Mechanism, and through supplementary Community spending in the UK, under a new Article 235 Regulation.

(For details of the existing Financial Mechanism and the proposed amendments to it, see Annex B.)

H. Operation of Article 235 arrangements

10. The new Article 235 regulation will enable the Community to participate in the financing of programmes designed to help with the problems of the disadvantaged regions of the UK and possibly of certain expenditures outside those regions. It has yet to be decided exactly which programmes will benefit from Community assistance.

11. The next step will be for the Commission to propose a draft regulation to the Council and to the European Parliament. This will lay down the broad criteria under which the programmes will attract Community assistance.

I. Undue Community influence over UK expenditure priorities and decisions?

12. The Commission are proposing that the Community should help to finance the UK's own national expenditure programmes, not that it should establish a new Community policy, comparable with the CAP.

13. The Council will approve the broad qualifying criteria which will be embodied in the Regulation. But it will be for the UK to decide which programmes to put forward for assistance within that framework. There is no reason to suppose that the Community will refuse to assist programmes which satisfy the agreed criteria.

. Timing of payments

14. The main receipts will accrue to the UK in the first quarter of next year. We expect the bulk of what is due for 1980 to be paid before the end of the 1980-81 financial year.

(For details of payment arrangements see Annex C)

K. The review

15. In the long-term the commitment to review the development of Community policies and the operation of the Budget is perhaps the most important part of the package. Together with the constraints imposed by the 1% ceiling, it will enable the UK to press for the lasting reform needed to prevent any recurrence of the British budgetary problem.

16. The review therefore offers an opportunity which has never been available before, since we joined the Community, to work with our partners for financial arrangements, and Community policies, which are to the advantage of all Member States, as befits a Community of equals.

L. What happens if 1% ceiling is reached before 1982?

17. That would be a Community problem to which a Community solution would have to be found. The Council will need to take action to cut the increase in the expenditures which are causing the problem.

M. Would our refund be cut back?

18. Our refund is a prior commitment. But if the expenditures are contained, the cost of the refund will be contained too.

●. Effect of exchange rate movements on the settlement

19. The value of our settlement, expressed in European Units of Account, will not be greatly affected by any movement in the £/EUA exchange rate. The value in sterling terms will of course reflect any changes in this exchange rate.

20. The figures the Government has quoted are based on an £/EUA rate of 1:1.65.* If the £ falls against the EUA this sterling value will increase - by around £6 million for every 1 per cent rise in the sterling rate. If the £ rises, the sterling value will fall by a similar amount.

O. Comparison of figures with those published in the Public Expenditure White Paper

21. The figures quoted are the outcome of negotiations about transfers between the Member States. The figures in /Table 2.2.1 of/ the Public Expenditure White Paper include, in addition, our contribution to certain transfers to countries outside the Community which are financed through the Community Budget. These are perhaps best regarded as part of our aid programme rather than as part of our contribution to the Community.

22. There are other differences - for example, the latest figures are more up-to-date than those incorporated in PEWP, which was published in March, and the price bases of the estimates are different.

23. The exchange rates used are also different. The figures now quoted used 1.65EUA = £1 which is roughly the current market rate. The Public Expenditure White Paper used 1.55EUA = £1 because sterling was less strong when the Public Expenditure survey was carried out.

* roughly where it stands at present.

ANNEX A

SIZE OF REFUND : DETAILED FORMULA
(as announced by Lord Privy Seal on 2 June)

The first element in the solution is the following formula:

- for 1980, provided that our net contribution, before the formula is applied, does not exceed £1,080 million, there will be a ceiling on our net contribution, after adjustment, of £370 million.

- for 1981, provided that our net contribution, before the formula is applied, does not exceed £1,300 million, the ceiling will be £440 million. (All these sterling figures are converted at a rate of 1.65 European Units of Account to the £.)

2. This will result in a total rebate to Britain over the two year period of £1,570 million, implying a UK payment $\frac{1}{3}$ of what had been expected.

3. A further element of the solution is a risk-sharing formula. Should the amounts of the United Kingdom's uncorrected net contribution in 1980 and 1981, as estimated by the European Commission, in fact be exceeded, the arrangement is that in 1980 we will bear only one quarter of the cost of this excess.

4. For 1981 a more complex formula exists under which we would meet the first £12 million of any excess, the next £60 million would be shared between us and our partners equally, and thereafter we would meet only a quarter of the excess cost, as in 1980.

5. For 1982, it was envisaged that by this time the Council would have completed a radical review of the pattern of Community expenditure and the operation of the Budget.

6. However, if that had not by 1982 produced arrangements resolving the United Kingdom's budget problem, the Commission would put forward proposals along the lines of the 1980 and 1981 solutions and the Council would act accordingly.

7. We can therefore be sure that for 1982 as well there will be similar restrictions on the level of the United Kingdom's net contribution.

FINANCIAL MECHANISM : PROPOSED AMENDMENTS

The 1975 Financial Mechnism provides for payments to a Member State which is "forced to bear a disproportionate burden in the financing of the Community Budget" whilst its economy is "in a special situation". It provides that a Member State with:

i) a GNP per capita less than 85% of the Community average; and,

ii) a growth rate of real per capita GNP less than 120% of the Community average,

should, subject to certain further conditions, be entitled to a partial refund of any excess of its share in gross contributions over its share in Community GNP.

2. These further conditions have meant that so far the UK has received no benefit from this Mechanism although it has satisfied the main economic criteria for relief mentioned above. The improvements now proposed are designed to ensure that, provided the UK continues to satisfy the qualifying criteria, the Community will refund in full the excess of its share in gross contributions over its GNP share.

3. This entails a number of amendments to the existing Mechanism:

i) the removal of the balance of payments condition, under which the size of a Member State's refund depends critically on its aggregate balance of payment position over the preceding three years, with the refund being very much larger if this shows a deficit (however marginal) rather than a surplus;

ii) the abolition of the so-called "tranche system" under which any excess contribution less than 30% above a Member State's GNP share is refunded only in part; and,

iii) the removal of the provision limiting any refunds under the Mechanism to 3% of total Budget expenditure.

ANNEX C

TIMING OF PAYMENTS : DETAILED ARRANGEMENTS

The procedure for payment of Financial Mechanism refunds is already well-established. It involves payment of ¾ of the estimated entitlement in the first quarter of the calendar year following that to which the refund relates. Because of the difference in financial years, this is the final quarter of the UK's financial year. The balance of the refund is paid when the final entitlement can be calculated. This occurs when the Commission draws up its accounts in the middle of the year.

2. Following the precedent of the Financial Mechanism, the credits under the new Article 235 regulation will appear in the Community Budget for the following year, but with the possibility of advance payments in the current year. Precise details of the arrangements have yet to be settled.

V N/JS seen.

Treasury Chambers, Parliament Street, SW1P 3AG
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PART 8 ends:-

MODBA to Tsy 3.6.80

PART 9 begins:-

Tsy to PMG's Off 4.6.80