

PART 12

Confidential Filing

The Community Budget
Developments in the European
Community

EUROPEAN
POLICY

Part 1: May 1979

Part 12: Oct 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
19-10-81		19-11-81					
22-10-81		24-11-81					
3-11-81		25-11-81					
11-11-81		26-11-81					
12-11-81		30-11-81					
		1-12-81					
		- Pt-12 Ends -					

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PART 12 ends:-

Franklin Jr PM 1/12
~~8/12/87~~

PART 13. begins:-

RTA Jr PM 2/12/87


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Qz 02391

PRIME MINISTER

30 May Mandate: Follow up to the European Council

PURPOSE OF DISCUSSION

1. The meeting has been arranged in order to consider how the discussion of the 30 May Mandate at the European Council should be followed up.

HANDLING

2. It may be convenient to focus discussion on the issues set out in my minute of 1 December to Mr Alexander. But you may first ask the Foreign Secretary to explain what arrangements he has in mind for the meeting - probably at Lancaster House on 21/22 December.

(i) Purpose of Foreign Ministers' Meeting

3. The Foreign Secretary will probably argue that it is not realistic to expect to get a detailed settlement on the budget in the next few weeks but that guidelines would be a worthwhile step towards full agreement in Spring 1982. The Chancellor of the Exchequer may also consider that the right budget guidelines would be worth having. The Minister of Agriculture on the other hand may argue that it would be better to prevent any agreement at this stage and hold out for a detailed package in the Spring. It is not reasonable to suppose that we can get agreement on figures for the budget if we are only arguing about guidelines for the CAP. The crux of the matter is that we should not enter into agricultural commitments which are more detailed and binding than the commitments we will seek to secure on the budget.

(ii) Minimum requirements on the budget

4. The three texts which were on the table at the European Council (UK Presidency, Commission, and French) are attached at 'A'. You will want to ask the Chancellor whether he considers the minimum requirements set out in paragraph 2(ii) of my minute to Mr Alexander are sufficient. The Foreign Secretary may question whether requirement (b) - a generally applicable corrective - is of crucial importance to us (as distinct from the Germans).

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/The Chancellor

The Chancellor will probably attach importance to the inclusion of "relative prosperity" - point (c) - on the grounds that it combats the principle of degressivity. The point could also be met by insisting that eg "the size of the corrective must be large enough to prevent the recurrence of unacceptable situations in any year"? On duration, it is unlikely that we could achieve an unlimited period and so the terms of any review will be crucial. It might be better to leave open the length of the period until later when it could be negotiated together with amounts. Others will see a connection between duration and degressivity.

(iii) Agricultural Issues

5. On the Mediterranean our concern is the risk of substantially increased expenditure rather than any wish to be unhelpful to Italy and Greece. Your suggestion of "examine with a view to improving" might provide the basis for a compromise. Our concern with the expenditure ceiling is also primarily budgetary. The present texts on the expenditure ceiling are attached at 'B'. We should aim for a compromise between alternatives 'A' and 'B'.

6. On both issues, the Chancellor may suggest that we maintain a common stance with the Germans and hold out so long as they do. In the last resort, our safeguard lies in an adequate budgetary corrective.

7. The major difficulty will be dealing with milk. We together with the Dutch and to some extent the Germans and the Italians do want effective action ("modulation of guarantees ") to penalise overproduction. This could take the form either of a supplementary levy or a reduction in the intervention price. We shall probably have to accept the continuation of the linear co-responsibility levy. But, as the figures at annex 'C' show an exemption from levy on the first x kgs, while it would save our producers some money, would save other countries far more. You will wish to know whether the Minister of Agriculture feels that there is any concession which could be made to what is clearly a major political requirement for President Mitterrand. One suggestion was included in Sir R Armstrong's minute of 20 November to Mr Alexander (see extract at 'D'). The phrase at the end "subject to suitable conditions" covers that possibility

/that member

that member states would be authorised to pay themselves part of the co-responsibility levy which falls on small milk producers whose principal income derives from milk.

(iv) Attendance at the Special Foreign Ministers' Meeting

8. If the Foreign Secretary is not in favour of Agriculture Ministers being invited a remark made by President Mitterrand at his Press Conference suggests that he is not either. You will want to know Mr Walker's views. As there are to be two officials, one of them should be from MAFF.

(v) UK Budget Limits Scheme

FLAGC - 9. In his minute of 24 November the Chancellor suggested that the Treasury's latest budget limits scheme should be made available to other member states. The Foreign Secretary may argue that to do so before the Foreign Ministers' meeting is likely to confuse the handling of the meeting. The Chancellor may be content provided there is agreement that it should go round in the New Year. At the right time officials should meet to consider the text.

CONCLUSIONS

10. You may be able to sum up


- that we should call a meeting of Foreign Ministers before Christmas although the prospects for a successful outcome are poor;
- that we should not settle for a budget text which does not meet the Chancellor's minimum requirements;
- that we should stick with the Germans over Mediterranean agriculture and the share of agriculture in the budget, and not concede on small milk producers beyond what the Minister of Agriculture believes is politically acceptable;
- that our aim should be to keep attendance to Foreign Ministers assisted by agriculture experts;

/ - that

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- 4 -

- that consideration should be given to the Treasury's budget scheme after the Foreign Ministers' meeting.



M D M FRANKLIN

1 December 1981

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CHAPTER III. BUDGETARY PROBLEMS
A. TEXT PROPOSED BY THE PRESIDENCY

ANNEX A

1. The object of the Community budget is to finance agreed Community policies. At the same time the creation or recurrence of an unacceptable situation for any Member State must be avoided and the overall convergence of the economies of Member States must be fostered, without imposing an undue burden on any Member State.

2. In the long term the reconciliation of these objectives will be achieved through the development of Community policies and of the balance between them. The conclusions reached in Chapters I and II above are a first step in that direction.

3. But the process of reconciling the objectives by these means will take a period whose length cannot be predicted with any precision and, in the meantime, a budgetary corrective arrangement will be needed, if unacceptable budgetary situations are to be avoided.

4. The corrective arrangement will need to deal not only with the problem already recognised by the Community when the financial mechanism was agreed, but also with the imbalance in the distribution of expenditure, notably FEOGA guarantee expenditure. The arrangement will be based on objective criteria, so that there will be no need for an annual negotiation. It will take account of relative prosperity as between Member States and progress in achieving balance in Community policies. It will also take account of the volume of net contributions of Member States with undue burdens which must be limited.

5. The financing of the corrective arrangement will be achieved within the agreed VAT ceiling, if necessary by a method which avoids any net budgetary impact: and without putting at risk the financing of other agreed Community policies. The financial effects of the corrective arrangement will have regard to whether the payments come from Member States below or above the Community average GDP per head and whether they already have a problem arising from the Community budget.

6. The corrective arrangement will apply with effect from the Community's 1982 budget year. The Council, acting on a proposal of the Commission, will take the necessary detailed decisions by 31 December 1981.

7. The detailed arrangements so agreed will be reviewed after seven years to consider the progress made towards the Community's long term budgetary objectives and whether any changes are needed.

B. TEXT PROPOSED BY THE COMMISSION

The European Council noted that all the work carried out since the submission of the Commission report complied with the Mandate of 30 May 1980 which aimed to resolve budgetary problems by developing or adapting Community policies without calling into question the principles on which they are based, particularly in the case of the CAP. The effects of the measures being prepared will not, however, be felt to any significant degree for some time.

For this reason, the European Council adopted the principle of financial compensation measures for the United Kingdom to be implemented as from the 1982 financial year. Such measures would be decided upon for a specific period. They should not affect the Community's financing system.

The amount of the compensation would be arrived at annually on the basis of the actual figures for each year using an objective indicator to measure the true extent of the problem and in the light of the agreed rates of compensation. In this way recurrent annual negotiation would be avoided.

The costs arising from the compensation paid to the United Kingdom would be shared according to an ad hoc scale to be decided upon by the Council in accordance with the policy of solidarity which the Community intends to continue to apply towards its less prosperous members and taking into account the specific nature of the German budgetary problem.

C. TEXT PROPOSED BY THE FRENCH DELEGATION

1. The European Council reviewed the Community's budgetary situation on the basis of the report from the Commission.

2. The European Council recognized that a better balance between Community policies was necessary in order to create a sound basis for the further development of the Community.

3. The European Council noted that its conclusions concerning the development of Community policies and the adaptation of the common agricultural policy constituted significant first steps in this direction.

4. The European Council agreed that a temporary, exceptional common action, allowing for an alleviation of the budgetary burden of the UK, should be established, under which funds would be made available to the UK from the budget of the Community for a short period.

5. The European Council invited the Council (General Affairs) to fix, at its next session, the duration and the degressive, arbitrary amounts to be made available.

ALTERNATIVE A

17. It will be the responsibility of the Council, acting on proposals by the Commission, to adopt the necessary decisions on implementation of the above guidelines to ensure that for the time being agricultural expenditure will grow less rapidly than the Community's own resources. It will be the responsibility of the Commission to manage agricultural expenditure within that framework. (1)

ALTERNATIVE B (Proposal by the Danish delegation)

17. It will be the responsibility of the Council, acting on proposals by the Commission, to adopt the necessary decisions on implementation of the above guidelines [which would imply] that for the time being agricultural expenditure will grow less rapidly than the Community's own resources. It will be the responsibility of the Commission to manage agricultural expenditure efficiently.

ALTERNATIVE C (Proposal by the French delegation)

17. The European Council considered that implementation of these guidelines by the Council should ensure that agricultural expenditure grows less rapidly than the Community's own resources, as has been the case over the last two years.

(1) The Commission suggests the following declaration:

"In the opinion of the Commission the implementation of the orientation adopted in paragraph 17 should be evaluated as an average over several years in the case of erratic evolution in the conditions under which the common agricultural policy is executed".

The Greek delegation has a reservation linked to Mediterranean agriculture

The Irish delegation has a reservation linked to the income situation in the farming sector

The Italian delegation has a reservation linked to the feasibility of the guideline in the event of falling world market prices.

MILK CO-RESPONSIBILITY LEVY EXEMPTIONS

1. The Prime Minister asked for some details of the effects of exempting from co-responsibility the first 30,000 Kg of milk (approx 7-8 cows) and the first 120,000 Kg (30 cows) on each holding.
2. If the first 30,000 Kg are exempt, then 90% of UK milk pays the levy, compared with 51% in Germany, 63% in France and 48% in Italy. The UK would pay 22% of the total levy revenue (compared with 16% of the present co-responsibility levy). France would pay 24% and Germany 18%.
3. If the first 30,000 Kg of milk on each holding are exempt from levy, then at present prices and the present rate of levy (2.5%), UK milk producers would pay £52.5m, instead of £58.3m, a saving of £5.8m. The saving to German producers would be £41.7m, and to French producers £33.9m.
4. The saving to the individual producer who produces more than 30,000 Kg would be approximately £116 pa at present prices.
5. If the first 120,000 Kg is exempt, then 61% of UK milk pays the levy, compared with 7% of German milk, 6% of French milk and 10% of Italian milk. The UK would pay 43% of the total revenue collected, compared with 11% for France, 8% for Germany and 6% for Italy.

Milk

Modulation of the guarantee should be achieved by a combination of:-

- (a) a linear co-responsibility levy with the existing exemptions
- (b) a supplementary levy on additional deliveries to dairies or modulation of the intervention price if production exceeds a guarantee threshold
- (c) a possible limited exemption from the co-responsibility levy for a certain quantity of milk from each herd if warranted by price decisions and subject to suitable conditions.

Qz.02390

MR ALEXANDER

30 MAY MANDATE: FOLLOW UP TO THE EUROPEAN COUNCIL

1. The Prime Minister will be discussing with the Foreign Secretary, the Chancellor of the Exchequer and the Minister of Agriculture how best to follow up the decision of the European Council to ask Foreign Ministers to meet urgently to consider the four issues which were identified as creating the greatest difficulty:-

- the milk problem
- guidelines on agricultural expenditure
- Mediterranean agriculture
- the budget problem.

The agreement was that the meeting should, if possible, take place before Christmas, or failing that in January; but it would be difficult for us not to call it before the end of the British Presidency.

2. The issues which Ministers will wish to consider are:-

- (i) is it agreed that the purpose of the meeting should be to attempt to complete the work started by the European Council viz guidelines of equal precision on all three chapters of the Mandate? It could be argued that the idea of guidelines has served its term and that we should now switch to the negotiation of specific agreements, as the French would apparently prefer to do. On the other hand, it would not suit UK interests to be specific on agriculture in advance of the price fixing, and it is not realistic to believe that other member states will be ready for a detailed settlement on the budget during the next few weeks.

/(ii)



- (ii) what would be our minimum requirements for a satisfactory outcome on the budget? In particular, is it agreed that the guidelines must at least include:-
- (a) reference to "unacceptable situations" as the basis for the budgetary corrective;
 - (b) a corrective defined in a way which potentially is of general application (ie not ad hoc, just for the UK);
 - (c) a reference to relative prosperity as an objective criterion for the corrective;
 - (d) a suitable review clause.
- (iii) what position should we adopt on the three agricultural issues? Can we accept (in the context of a package) a reference to "improving" the regimes for Mediterranean products? Can we agree that agriculture expenditure should grow less than own resources, making that as operational as possible? Milk is clearly the most difficult. How far should we press for measures (like the supplementary levy) which would have an effect on containing the surplus? And could we contemplate any special arrangements to favour small milk producers? If so, in what form?
- (iv) attendance at Special Foreign Ministers Meeting. The Prime Minister's summing up referred to Foreign Ministers plus two others. Should Agriculture Ministers be invited?
- (v) should the paper on a budget limits scheme attached to the Chancellor of the Exchequer's minute of 24 November be given to other member states before the meeting of Foreign Ministers?



3. I am copying this minute to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food.

M D M FRANKLIN

1 December 1981



Private Secy
File 15

10 DOWNING STREET

From the Private Secretary

30 November 1981

COMMUNITY BUDGET PROBLEM

The Prime Minister has seen and taken note of the Chancellor of the Exchequer's minute to her of 24 November about the circulation of a paper setting out our scheme for a solution to the Community Budget problem. The Prime Minister has also now seen the paper itself (enclosed with Jill Rutter's letter to me of 17 November).

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

M. O'D. B. ALEXANDER

John Kerr, Esq.,
H.M. Treasury.

A

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Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

25 November 1981

M O'D B Alexander Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

New Rachel,

UK BUDGET REFUNDS FOR 1980 AND 1981

At yesterday's Budget Council the German and French delegations made unhelpful statements about the UK's Budget refunds for 1980 and 1981.

We doubt whether we shall want to advise the Prime Minister to raise this matter with either Schmidt or Mitterrand tomorrow. We know from discussions our Bonn Embassy have had with the Federal Chancellor's office that Schmidt will wish to avoid any discussion of the issue. Our Embassy in Paris are still trying to clarify the French position.

Further advice will be submitted if necessary in the light of the outcome of those enquiries.

In the meantime, I thought it might be helpful to let you have tonight a background note which explains what the point at issue is.

Copies go to Brian Fall, Tom Bridges and David Hannay (FCO) and Sir Robert Armstrong and Michael Franklin (Cabinet Office).

Yours ever,
John Kerr

J O KERR
Principal Private Secretary

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Hooda
Bl.
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Pmt

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UK BUDGET REFUNDS FOR 1980 AND 1981

1. The German and French delegations made unhelpful statements at yesterday's Budget Council about the UK's budget refunds for 1980 and 1981. They gave no advance warning.
2. The German representative (Dr Schulmann) said that the UK "stood to receive 900 million ecus too much" and warned the Commission that "extreme care was needed.....both in framing and using estimates of net contributions in future."
3. The French representative (M. Vidal) said, more categorically, that France would oppose further supplementary measures payments in 1981 (including advances on refunds for 1981 as well as payments in respect of 1980) until there was agreement in the mandate negotiations on a settlement which was lump-sum, temporary and degressive.
4. The background to the German and French statements is as follows:-

- (i) Figures (million ecus). The 30 May agreement was based on Commission projections for the UK's uncorrected net contribution of 1784 in 1980 and 2140 in 1981. The basic figures were:-

	<u>1980</u>	<u>1981</u>
Estimate of unadjusted net contribution	1784	2140
Refund	1175	1410
Net contribution	609	730

The Commission's latest estimates, published earlier this month, put our unadjusted net contribution at 1521 in 1980 and 1505 in 1981 - a reduction of some 900 over the two years. This 900 is the figure mentioned by the German and French representatives at the Budget Council. The implication is that the refunds in the above table should be reduced by 263 in respect of 1980 and 635 in respect of 1981.

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- (ii) UK position. In our view, the 30 May agreement clearly provides for a minimum net refund to the UK, which is due to us whatever the actual level of our uncorrected net contribution turns out to be. In the negotiations before the 30 May agreement, we in fact argued for a fixed net contribution, but others insisted on a fixed net refund. We finally accepted this subject to the proviso that if our unadjusted net contribution exceeded the Commission's projections we would split the difference with other Member States.
- (iii) Commission position. The Commission stated in the autumn of last year that they ^{accept the} ~~share~~ out interpretation of the 30 May agreement but recognised that other Member States might dispute this and wish to discuss the matter.
- (iv) Council position. An agreed Council Minutes entry in October 1980 stated that the supplementary measures regulation was "without prejudice to the positions of the Member States at [the Council's] discussions in the event of the actual net balance of the United Kingdom in 1980 and 1981 falling short of the forecasts adopted by the Council in its conclusions of 30 May 1980". We cannot therefore avoid a discussion of this issue in the Council if other Member States insist on one.
- (v) German position. In last week's Summit talks in Bonn, Matthöfer made threatening noises about our refunds to the Chancellor of the Exchequer. But Schmidt appeared to go some way, at least, to over-ruling him at the press conference, when he said:-
- "Let me make it quite clear that any request on the part of the German Government for a payment back is absolutely out of the question. This is a rumour and I categorically reject that."

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As German officials have since pointed out, however, Schmidt's words do not rule out the possibility that the Germans will try to prevent us from receiving in full the amounts which we believe are due to us but not yet paid.

- (vi) French position. The French earlier appeared intent on reducing our refunds for 1980 and 1981. More recently, the line seemed to have changed. The French argued instead that we are doing "much too well" on our refunds for 1980 and 1981 and that the Community will need to exact a terrible revenge in 1982 and subsequent years. As recently as Monday of this week, Beregovoy told Sir Robert Armstrong and Mr Franklin that "although French would not ask repayment for the 'famous 900 million ecus', it had to be taken into account in the compensation paid during 1982, 1983 and 1984". The hard French line in the Budget Council came therefore as a surprise.

5. The Commission have told us that they intend to implement the regulation, as we interpret it, and to make arrangements for paying to us the provision for refunds in the 1981 Budget - unless Member States agree to a different interpretation of the 30 May agreement or decline to approve the necessary budgetary provision. Member States do however have the power to frustrate the Commission's intentions over the next two or three weeks by the following means:-

- (a) Since we have again failed to qualify for the financial mechanism, a transfer is needed from the financial mechanism to supplementary measures. The Council could block this.
- (b) A transfer is also needed from the "reserve" chapter of the Budget to the supplementary measures chapter in order to cover advances in respect of 1981. The Council could block this, too.
- (c) No further refunds can be paid to us until the ad hoc committee of Member States on supplementary measures has considered draft decisions by the

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Commission. The committee is due to meet on 10 December. If a qualified majority of Member States should vote against the draft decisions, the Commission would not be able to proceed with making the payments until the Council had resolved the matter.

The immediate concern for the UK will be to avoid blocking votes either in the Council or in the ad hoc committee.

Ref. A06094

PRIME MINISTER

Cabinet: Community Affairs

You might like, without going into substance, to bring the Cabinet up to date on the preparations for the discussion of the 30th May 1980 Mandate at the meeting of the European Council in London beginning on Thursday afternoon. You received Monsieur Thorn on 24th November; and held a briefing meeting with the Ministers concerned later that day, at which it was agreed that the United Kingdom Presidency should circulate immediately to its partners draft guidelines on the budget chapter which the European Council might approve as a mark of progress and a basis for future work towards a final solution. If this is not successful, we shall propose that the work is remitted to the various Councils with a view to a package settlement by the time of the next European Council in spring 1982.

2. The Chancellor of the Exchequer could report on the meeting of the Budget Council on 24th November, which was chaired by the Financial Secretary, Treasury. The Council took decisions on the Parliament's amendments to the 1981 Amending Budget and the 1982 Draft Budget involving a number of cuts in agricultural expenditure, a minimal increase in food aid, and small increases in non-obligatory expenditure (e. g. the Regional and Social Fund). Decisions on the financing of two issues of importance to the United Kingdom - steel social measures and Northern Ireland housing - were deferred to the meeting of the Foreign Affairs Council in December. The Draft Budget now returns to the Parliament for adoption.

3. The Chancellor of the Exchequer will also want to report on a German statement in the Budget Council criticising the Commission for having over-estimated the United Kingdom's net contribution for 1981 and noting that the United Kingdom stood to receive 900 MECUs too much in refunds as a result. The French then stated that they would oppose further refund payments to the

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United Kingdom until there was agreement in the Mandate negotiations on a lump sum, temporary and degressive settlement. These statements were rebutted on the spot by the Economic Secretary, Treasury. The French statement was in contradiction to the assurance given to me by the Secretary General at the Elysee; and is being pursued in Paris.

4. As foreshadowed in last week's Cabinet, the meeting of the Fisheries Council scheduled for 30th November-1st December has been postponed because of the Danish General Election and will now take place on 14th December. Next week the Environment Council meets on 3rd December.

RA

ROBERT ARMSTRONG

25th November, 1981

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

PRIME MINISTER

COMMUNITY BUDGET PROBLEM

Prime Minister
To note at this stage.

Paul

MS

*Papers
a case
Council
file*

In Bonn on 18 November I agreed with the Foreign Secretary that we should not, in advance of the European Council, circulate to the other Member States and the Commission a paper setting out our scheme for a solution to the Community Budget problem. But at our meeting on 19 November to discuss preparations for the European Council we agreed to keep open the possibility of doing so in due course.

2. The arguments in favour of doing so were set out in my minute of 11 November, the Minutes of the OD Meeting on 12 November and my Private Secretary's letter to you of 17 November. In brief, it would provide public evidence of our efforts to find a truly communautaire solution during our Presidency; it would make clear our requirements from the negotiation; and it would get away from the situation in which there was only one scheme - the Commission's - on the table.

3. I believe that we should make a paper available to the other Member States and the Commission reasonably soon after the European Council and certainly before the end of the year. The drafting of the present paper can readily be adapted to present the scheme as the outcome of our reflections on the range of opinions expressed at this week's European Council. I would favour an undramatic approach: we might stress that our aim is to make a constructive contribution to the debate inside

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the Community; and rather than tabling the paper at a Community meeting, we might send it round via our Embassies in Community capitals.

4. Perhaps we could discuss this soon after the European Council meeting? And in the meantime, I think it most important that nothing be said or implied which might be taken as indicating that we are prepared to negotiate on the basis of the Commission scheme.

5. I am sending copies of this minute to the Foreign Secretary and Sir Robert Armstrong.

(G.H.)

24 November 1981

PRIME MINISTER'S

PERSONAL MESSAGE

200 RUE DE LA LOI

SERIAL No. T.162 A

1049 BRUSSELS
TEL: (02) 735 80 40

24 November 1981
ref. 1272

Subject
COMMISSION
OF THE
EUROPEAN COMMUNITIES

His President

PM has seen

*H.
Aunt*

Dear Prime Minister,

- I. Now that I have finished my tour of capitals and after our meeting in London this morning, I think it might be useful for me to set out how the Commission and I view prospects for this week's European Council.

Whilst sharing some of your fears concerning the uncertainties that surround the outcome of our discussions and the diverging views held by our governments on a large number of issues, we are convinced that the London meeting really can produce meaningful results.

At this time of political tensions and deep-seated economic and social difficulties, it is absolutely essential that the European Council should have a significant and successful outcome. Failure would discredit the European idea and diminish the authority of Heads of State and Government. Success would prove that Europe is indeed capable of providing at least part of the answer that our countries and citizens are awaiting with growing impatience. This would then create the conditions for a new dynamic progress.

It is clear from the preparatory discussions within the Council and the Mandate Group that our ten governments, like the Commission, accept that the decisions to be taken must be comprehensive and that broadly equal progress must be made on three points: revitalizing the Community, reforming the common agricultural policy and solving the budget problem. This, aside from the political will to succeed which we take as read, is the first condition for success.

H.E. Mrs Margaret THATCHER
Prime Minister

10, Downing Street
L o n d o n

-- / --

The second condition relates to the possibility, in the limited time available in London, of formulating a set of political guidelines which are clear enough to do more than simply camouflage disagreements by woolly drafting and which will stimulate continued discussion and an early conclusion. We feel that this second condition could be fulfilled as long as one respects the role of the European Council which is not to settle the detail but to adopt the line which will guide later work.

Discussions within the Council give the Commission reason to believe that a consensus could be found along the general lines indicated in the second part of this letter. To our way of thinking these provide the skeleton of a balanced political agreement which would rule out ambiguity and help to keep subsequent discussions moving.

But this presupposes that the European Council will also adopt a binding timetable, with a short deadline, for winding up discussions and taking decisions (end of February) and a working procedure under which the General Affairs Council would meet as frequently as is necessary and at political level to ensure that we maintain a global approach. In doing so the European Council would only be opting for a procedure that has been used before to good effect. The next European Council could then consider how far its instructions had been complied with.

II. This is how we see the general balance of an overall agreement :

1. Let us begin with the common agricultural policy, the central issue in the Commission's view. It is here that opinions differ most and suspicions abound.

Political agreement should be sought on the following lines :

The European Council would stress that the common agricultural policy has been a success and confirm its willingness, twenty years on, to adapt it without interfering with its three basic principles.

The European Council would adopt general guidelines to shape the future development of the common agricultural policy :

- . Development would be based on a prudent pricing policy where justified by market conditions, and on a hierarchy of prices designed to improve the balance of production.
- . Guarantees would be modulated, in a manner that might vary from product to product, in sectors where better control of production is the goal; allowances would be made for the position of poorer farmers and the less-prosperous regions.
- . The Community would pursue a more active commercial policy in relation to exports and a more careful policy in relation to Community preference for imports of agricultural products, processed products, and Mediterranean products. This would be done while honouring our international commitments and within the context of our aim to narrow the gap between Community prices and prices applied by other leading exporters.
- . An integrated policy for the less-favoured areas of the Mediterranean region would be introduced gradually to deal with their specific commercial and structural problems.
- . Stricter discipline would be applied to state aids.

The application of these guidelines should help to hold the increase in agricultural spending below the increase in the Community's own resources, as has been the case in the last two years.

2. The prospects of an agreement on Community policies other than the common agricultural policy seem much brighter. It is clear from the draft conclusions of the British presidency that views converge on many important issues. This being so, it should be relatively easy to identify the main lines of a Community strategy to be pursued simultaneously in a number of areas in tandem with national policies. These areas are monetary affairs; industrial adjustment and renewal; energy; research and development and technological innovation; social and regional affairs; and the Community's borrowing and lending capacity, which should be increased so as to help promote economic convergence.

It would then be possible to adopt a timetable for further progress in the form of decisions to be taken on the basis of Commission proposals.

3. Once the key role of a reformed common agricultural policy is confirmed and the need for a qualitative leap forward on other policies is recognized, we are convinced that a solution to specific budget problems could be formed.

All the work accomplished since presentation of the Commission's report is in line with the Mandate of 30 May 1980, which set out to solve the budget problem by developing or adapting Community policies, and the common agricultural policy in particular, while leaving the underlying principles intact.

The measures now being devised cannot be expected to produce results overnight. For this reason, the European Council could agree in principle to financial measures to compensate the United Kingdom. These would have to be taken for a number of years without affecting the Community's financial system.

The level of compensation would be fixed each year on the basis of actual data, using a method which incorporated an objective indicator.

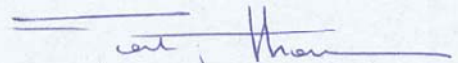
The cost would be shared on the basis of an ad hoc scale to be adopted by the Council. This would reflect the Community's policy of solidarity with the less prosperous Member States and take account of the largely political arguments advanced by the Federal Republic of Germany.

A solution along these lines could be abandoned in due course without any aftermath.

These, then, are the ideas I was anxious to share with you on the eve of the European Council which will be of exceptional importance. It is this factor which has led me to let you know exactly where the Commission stands.

Yours sincerely,

Your sincerely,



Gaston E. THORN

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FM UKREP BRUSSELS 241815Z NOV 81
TO FLASH F C O
TELEGRAM NUMBER 4463 OF 24 NOVEMBER 1981

30 MAY MANDATE

1. FOLLOWING IS TEXT OF LETTER TO PRIME MINISTER FROM THORN, WRITTEN IN LIGHT OF HIS TOUR OF CAPITALS, ENDING WITH LONDON. ACCORDING TO THORN'S CHEF DE CABINET IT HAS NOT (NOT) BEEN COPIED TO OTHER HEADS OF GOVERNMENT.

BEGINS

1. NOW THAT I HAVE FINISHED MY TOUR OF CAPITALS AND AFTER OUR MEETING IN LONDON THIS MORNING, I THINK IT MIGHT BE USEFUL FOR ME TO SET OUT HOW THE COMMISSION AND I VIEW PROSPECTS FOR THIS WEEK'S EUROPEAN COUNCIL.

WHILST SHARING SOME OF YOUR FEARS CONCERNING THE UNCERTAINTIES THAT SURROUND THE OUTCOME OF OUR DISCUSSIONS AND THE DIVERGING VIEWS HELD BY OUR GOVERNMENTS ON A LARGE NUMBER OF ISSUES, WE ARE CONVINCED THAT THE LONDON MEETING REALLY CAN PRODUCE MEANINGFUL RESULTS.

AT THIS TIME OF POLITICAL TENSIONS AND DEEP-SEATED ECONOMIC AND SOCIAL DIFFICULTIES, IT IS ABSOLUTELY ESSENTIAL THAT THE EUROPEAN COUNCIL SHOULD HAVE A SIGNIFICANT AND SUCCESSFUL OUTCOME. FAILURE WOULD DISCREDIT THE EUROPEAN IDEA AND DIMINISH THE AUTHORITY OF HEADS OF STATE AND GOVERNMENT. SUCCESS WOULD PROVE THAT EUROPE IS INDEED CAPABLE OF PROVIDING AT LEAST PART OF THE ANSWER THAT OUR COUNTRIES AND CITIZENS ARE AWAITING WITH GROWING IMPATIENCE. THIS WOULD THEN CREATE THE CONDITIONS FOR A NEW DYNAMIC PROGRESS.

IT IS CLEAR FROM THE PREPARATORY DISCUSSIONS WITHIN THE COUNCIL AND THE MANDATE GROUP THAT OUR TEN GOVERNMENTS, LIKE THE COMMISSION, ACCEPT THAT THE DECISIONS TO BE TAKEN MUST BE COMPREHENSIVE AND THAT BROADLY EQUAL PROGRESS MUST BE MADE ON THREE POINTS: REVITALIZING THE COMMUNITY, REFORMING THE COMMON AGRICULTURAL POLICY AND SOLVING THE BUDGET PROBLEM. THIS, ASIDE FROM THE POLITICAL WILL TO SUCCEED WHICH WE TAKE AS READ, IS THE FIRST CONDITION FOR SUCCESS.

THE SECOND CONDITION RELATES TO THE POSSIBILITY, IN THE LIMITED TIME AVAILABLE IN LONDON, OF FORMULATING A SET OF POLITICAL GUIDELINES WHICH ARE CLEAR ENOUGH TO DO MORE THAN SIMPLY CAMOUFLAGE DISAGREEMENTS BY WOOLLY DRAFTING AND WHICH WILL STIMULATE CONTINUED DISCUSSION AND AN EARLY CONCLUSION. WE

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FEEL THAT THIS SECOND CONDITION COULD BE FULFILLED AS LONG AS ONE RESPECTS THE ROLE OF THE EUROPEAN COUNCIL WHICH IS NOT TO SETTLE THE DETAIL BUT TO ADOPT THE LINE WHICH WILL GUIDE LATER WORK.

DISCUSSIONS WITHIN THE COUNCIL GIVE THE COMMISSION REASON TO BELIEVE THAT A CONSENSUS COULD BE FOUND ALONG THE GENERAL LINES INDICATED IN THE SECOND PART OF THIS LETTER. TO OUR WAY OF THINKING THESE PROVIDE THE SKELETON OF A BALANCED POLITICAL AGREEMENT WHICH WOULD RULE OUT AMBIGUITY AND HELP TO KEEP SUBSEQUENT DISCUSSIONS MOVING.

BUT THIS PRESUPPOSES THAT THE EUROPEAN COUNCIL WILL ALSO ADOPT A BINDING TIMETABLE, WITH A SHORT DEADLINE, FOR WINDING UP DISCUSSIONS AND TAKING DECISIONS (END OF FEBRUARY) AND A WORKING PROCEDURE UNDER WHICH THE GENERAL AFFAIRS COUNCIL WOULD MEET AS FREQUENTLY AS IS NECESSARY AND AT POLITICAL LEVEL TO ENSURE THAT WE MAINTAIN A GLOBAL APPROACH. IN DOING SO THE EUROPEAN COUNCIL WOULD ONLY BE OPTING FOR A PROCEDURE THAT HAS BEEN USED BEFORE TO GOOD EFFECT. THE NEXT EUROPEAN COUNCIL COULD THEN CONSIDER HOW FAR ITS INSTRUCTIONS HAD BEEN COMPLIED WITH.

II. THIS IS HOW WE SEE THE GENERAL BALANCE OF AN OVERALL AGREEMENT :

1. LET US BEGIN WITH THE COMMON AGRICULTURAL POLICY, THE CENTRAL ISSUE IN THE COMMISSION'S VIEW. IT IS HERE THAT OPINIONS DIFFER MOST AND SUSPICIONS ABOUND.

POLITICAL AGREEMENT SHOULD BE SOUGHT ON THE FOLLOWING LINES :

THE EUROPEAN COUNCIL WOULD STRESS THAT THE COMMON AGRICULTURAL POLICY HAS BEEN A SUCCESS AND CONFIRM ITS WILLINGNESS, TWENTY YEARS ON, TO ADAPT IT WITHOUT INTERFERING WITH ITS THREE BASIC PRINCIPLES.

THE EUROPEAN COUNCIL WOULD ADOPT GENERAL GUIDELINES TO SHAPE THE FUTURE DEVELOPMENT OF THE COMMON AGRICULTURAL POLICY :

- . DEVELOPMENT WOULD BE BASED ON A PRUDENT PRICING POLICY WHERE JUSTIFIED BY MARKET CONDITIONS, AND ON A HIERARCHY OF PRICES DESIGNED TO IMPROVE THE BALANCE OF PRODUCTION.
- . GUARANTEES WOULD BE MODULATED, IN A MANNER THAT MIGHT VARY FROM PRODUCT TO PRODUCT, IN SECTORS WHERE BETTER CONTROL OF PRODUCTION IS THE GOAL: ALLOWANCES WOULD BE MADE FOR THE POSITION OF POORER FARMERS AND THE LESS-PROSPEROUS REGIONS.

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- . THE COMMUNITY WOULD PURSUE A MORE ACTIVE COMMERCIAL POLICY IN RELATION TO EXPORTS AND A MORE CAREFUL POLICY IN RELATION TO COMMUNITY PREFERENCE FOR IMPORTS OF AGRICULTURAL PRODUCTS, PROCESSED PRODUCTS, AND MEDITERRANEAN PRODUCTS. THIS WOULD BE DONE WHILE HONOURING OUR INTERNATIONAL COMMITMENTS AND WITHIN THE CONTEXT OF OUR AIM TO NARROW THE GAP BETWEEN COMMUNITY PRICES AND PRICES APPLIED BY OTHER LEADING EXPORTERS.
- . AN INTEGRATED POLICY FOR THE LESS-FAVoured AREAS OF THE MEDITERRANEAN REGION WOULD BE INTRODUCED GRADUALLY TO DEAL WITH THEIR SPECIFIC COMMERCIAL AND STRUCTURAL PROBLEMS.
- . STRICTER DISCIPLINE WOULD BE APPLIED TO STATE AIDS.

THE APPLICATION OF THESE GUIDELINES SHOULD HELP TO HOLD THE INCREASE IN AGRICULTURAL SPENDING BELOW THE INCREASE IN THE COMMUNITY'S OWN RESOURCES, AS HAS BEEN THE CASE IN THE LAST TWO YEARS.

2. THE PROSPECTS OF AN AGREEMENT ON COMMUNITY POLICIES OTHER THAN THE COMMON AGRICULTURAL POLICY SEEM MUCH BRIGHTER. IT IS CLEAR FROM THE DRAFT CONCLUSIONS OF THE BRITISH PRESIDENCY THAT VIEWS CONVERGE ON MANY IMPORTANT ISSUES. THIS BEING SO, IT SHOULD BE RELATIVELY EASY TO IDENTIFY THE MAIN LINES OF A COMMUNITY STRATEGY TO BE PURSUED SIMULTANEOUSLY IN A NUMBER OF AREAS IN TANDEM WITH NATIONAL POLICIES. THESE AREAS ARE MONETARY AFFAIRS; INDUSTRIAL ADJUSTMENT AND RENEWAL; ENERGY; RESEARCH AND DEVELOPMENT AND TECHNOLOGICAL INNOVATION; SOCIAL AND REGIONAL AFFAIRS; AND THE COMMUNITY'S BORROWING AND LENDING CAPACITY, WHICH SHOULD BE INCREASED SO AS TO HELP PROMOTE ECONOMIC CONVERGENCE.

IT WOULD THEN BE POSSIBLE TO ADOPT A TIMETABLE FOR FURTHER PROGRESS IN THE FORM OF DECISIONS TO BE TAKEN ON THE BASIS OF COMMISSION PROPOSALS.

3. ONCE THE KEY ROLE OF A REFORMED COMMON AGRICULTURAL POLICY IS CONFIRMED AND THE NEED FOR A QUALITATIVE LEAP FORWARD ON OTHER POLICIES IS RECOGNIZED, WE ARE CONVINCED THAT A SOLUTION TO SPECIFIC BUDGET PROBLEMS COULD BE FORMED.

ALL THE WORK ACCOMPLISHED SINCE PRESENTATION OF THE COMMISSION'S REPORT IS IN LINE WITH THE MANDATE OF 30 MAY 1980, WHICH SET OUT TO SOLVE THE BUDGET PROBLEM BY DEVELOPING OR ADAPTING COMMUNITY POLICIES, AND THE COMMON AGRICULTURAL POLICY IN PARTICULAR, WHILE LEAVING THE UNDERLYING PRINCIPLES INTACT.

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THE MEASURES NOW BEING DEVISED CANNOT BE EXPECTED TO PRODUCE RESULTS OVERNIGHT. FOR THIS REASON, THE EUROPEAN COUNCIL COULD AGREE IN PRINCIPLE TO FINANCIAL MEASURES TO COMPENSATE THE UNITED KINGDOM. THESE WOULD HAVE TO BE TAKEN FOR A NUMBER OF YEARS WITHOUT AFFECTING THE COMMUNITY'S FINANCIAL SYSTEM.

THE LEVEL OF COMPENSATION WOULD BE FIXED EACH YEAR ON THE BASIS OF ACTUAL DATA, USING A METHOD WHICH INCORPORATED AN OBJECTIVE INDICATOR.

THE COST WOULD BE SHARED ON THE BASIS OF AN AD HOC SCALE TO BE ADOPTED BY THE COUNCIL. THIS WOULD REFLECT THE THE COMMUNITY'S POLICY OF SOLIDARITY WITH THE LESS PROSPEROUS MEMBER STATES AND TAKE ACCOUNT OF THE LARGELY POLITICAL ARGUMENTS ADVANCED BY THE FEDERAL REPUBLIC OF GERMANY.

A SOLUTION ALONG THESE LINES COULD ABANDONED IN DUE COURSE WITHOUT ANY AFTERMATH.

THESE, THEN, ARE THE IDEAS I WAS ANXIOUS TO SHARE WITH YOU ON THE EVE OF THE EUROPEAN COUNCIL WHICH WILL BE OF EXCEPTIONAL IMPORTANCE. IT IS THIS FACTOR WHICH HAS LED ME TO LET YOU KNOW EXACTLY WHERE THE COMMISSION STANDS.

YOURS SINCERELY,

GASTON E. THORN

ENDS

FCO ADVANCE TO:-
FCO - PS, BRIDGES, HANNAY
CAB - FRANKLIN
NO. 10 - ALEXANDER

ADVANCED AS REQUESTED

BUTLER
FRAME ECONOMIC
EC) (1)

COPIES TO:
PS/NO 10 DOWNING STREET
MR ALEXANDER,
NO 10 DOWNING STREET

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(1)

10 DOWNING STREET

Prime Minister.

If you agree, A. N. Ambassador
would speak along these
lines in Paris when handing
over the guidelines to-morrow.
Correct?

Amst

24/11

Yes
not

Qz 02375

Text approved. FCO +
Cab Office informed. *Phd*
- 29/11

Draft Telegram to Paris

1. In handling over the budget guidelines text, you should make the following additional points which you may leave as an informal piece of paper.
2. UK Ministers have considered carefully the points made by Mr Beregovoy and his colleagues to Sir Robert Armstrong and Mr Franklin at their meeting on 23 November.
3. So far as the temporary nature of the new corrective arrangement is concerned, we have proposed in the guidelines that the solution to the Budget problem should be reviewed after 7 years to consider the progress made towards the Community's long-term budgetary objectives and whether any changes are needed. We would be ready to discuss the date for the review. But the principle underlying the review must be that the agreed solution to the problem should remain in operation if the problem continues to exist.
4. Whatever the duration of the corrective arrangement, there will need to be objective criteria to measure what should be corrected. Like the figures in the 30 May Agreement, any pre-determined lump sum would probably prove in the eyes of one side or the other to be too much or too little. Moreover, the UK did not want before 30 May to work on the basis of forecasts. Surely the French Government ought now to see some force in our argument. The agreed method of measuring the extent of the correction needed to meet the UK problem should apply ex post facto to the actual outturn of the budget.



5. Your argument that the corrective should be automatically degressive is not acceptable to us. We hope ^{that} the budget problem will be gradually relieved by the development of new policies and the control of agricultural expenditure so that less reliance will be placed on the corrective arrangement. The Commission's report made it quite clear that the problem facing the UK was not one of adaptation or adjustment by the UK but of the structure of the Community budget, in particular the preponderance of agriculture in it, and the relative size of British agriculture in the economy.

6. As regards the size of the correction, we understand that it is the view of the French authorities that the 30 May agreement indicated the right order of magnitude for a solution to the budgetary problem. Our view is different. We did not devise the 30 May agreement and accepted it only with reluctance. Having accepted it along with all the other Member States, we all must now abide by its terms. One of these was the pledge to replace this temporary ad hoc solution by structural changes to come into force in 1982. Given that the problem cannot be solved in the near future by changes in other Community policies, the structural changes proposed must include a corrective arrangement based on defensible criteria. It would follow that we see no grounds that would justify a net transfer by the taxpayers and consumers of the United Kingdom to the taxpayers and producers of the rest of the Community, so long as the GNP per head of the United Kingdom remained below the Community average. But we would not rule out being left with a modest net contribution which would represent a share of the administrative expenditure of the Community which the Commission included in their allocated Budget. We, of course, already make a substantial contribution to the unallocated Budget.

*These in our view
should include
relative prosperity.*



7. We thought it necessary to set out our reactions to the points you made to Armstrong and Franklin. We would of course be prepared to discuss figures but this is not now practicable before or at this European Council. We hope you will be willing to look seriously at these guidelines which will, we believe, help to carry the negotiation forward without prejudicing the position of either side on the method of dealing with the problem or the amount involved. ~~In particular we would draw your attention to the substantial modification we have made to paragraph 4, where we have included a reference to degressivity.~~

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EUROPEAN COUNCIL: MANDATE

NOTE FOR THE RECORD

Sir R Armstrong and I saw M. Beregovoy at the Elysee this morning. He was accompanied by M. Attali and M. Morel.

2. We explained that the Prime Minister had concluded that it would not be possible to settle figures at the European Council this week but that we should work for parallel progress on all three chapters. With this in mind, we had prepared the attached draft guidelines on the budget to which we should welcome their reactions. We had also shown the text to the Germans who had been generally favourable, although they wanted a more specific reference to the German problem.
3. M. Beregovoy said there still appeared to be a large gap. The French President was prepared to do something for the United Kingdom but it could not involve a new system which called into question Community rules, including the CAP. He was willing to discuss figures but only on the basis of another temporary arrangement for the United Kingdom which should be degressive in character, giving more time for the United Kingdom to adapt, and last until 1984 (he appeared to believe this date had some significance for the United Kingdom but when we denied this, Morel explained that the date was linked to enlargement). Guidelines which could be differently interpreted after the European Council were not acceptable. If no agreement could be reached in London, then it would be a long time before the issue could be reconsidered ("not in April, nor in June"). As to figures, the present French Government had criticised the 30 May agreement as being too favourable to the United Kingdom. Now the German Government wanted a limit on their net contribution. President Mitterrand was prepared to make limited compensation for the United Kingdom but not to pay more than under 30 May agreement. And although France would not ask repayment for the "famous 900 mecu", it had to be taken into account in the compensation paid during 1982, 83 and 84.
4. Attali took an even tougher line. Compensation for the UK had to be for

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three years, degressing to zero. Otherwise, we should have no incentive to adjust. We appeared to be asking for a better outcome than 30 May which the British Government had accepted.

5. We explained once again, for the benefit of M. Beregovoy, that we were not suggesting a system of juste retour; that we believed a system applicable to all members was desirable but not implied by our draft guidelines; that we could accept the notion of degressivity but only in the sense that the development of Community policies would reduce the need for a corrective; that we were surprised the French should be going for a forfaitaire solution after the experience of 30 May; that of what had happened in 1980 and 1981 was past and should not be taken into account for the future; and that, in a structural solution, it was unreasonable to expect the United Kingdom to be a net contributor of any significance so long as we were below the Community average in terms of GDP per head.

6. During the subsequent exchanges, Beregovoy made it clear that he did not insist on degressivity to zero. He also said that he could agree to any arrangement being reviewed and did not insist that three years was the last word.

7. On the other chapters, Beregovoy said that some progress/^{must be} made on reliance especially on Social and Economic policies and the new Community instrument (NIC). But a commitment to further study might be enough. On the CAP, France was ready to agree that expenditure should not grow faster than own resources. However they wanted a system of co-responsibility from which small producers would benefit and not only in the milk sector; contracts for exports; and controls over/manioc, maize derivatives and soya. We said that chapter one already went in the direction sought by the French. We were willing to look at arrangements for long term contracts and ways of stabilizing imports and certain cereal substitutes but measures to favour small producers would be extremely difficult for us.

8. In response to questions, Beregovoy said that the French felt they had already responded to German political needs by showing a readiness to move on the CAP. The budgetary problem for Germany only arose as a consequence of British budgetary demands. If Germany insisted on some budgetary limit and France was unwilling to

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pay any more, the case for asking more of the more prosperous member states like Denmark which benefited heavily from the CAP could be examined.

9. Summing up the French position, Beregovoy said President Mitterrand wanted an agreement, if possible during the European Council in London. There could not be a new mechanism in the Community and whatever was done for the United Kingdom should be based on a fixed amount with a degressive character. The decisions needed to be "as precise as possible" so that there would be no subsequent dispute over the figures. The period could be discussed. But the package would have to include the other chapters as well. Sir Robert Armstrong said he would report back to the Prime Minister on the President's position. She would have liked to reach a final agreement in London but reluctantly came ^{to the conclusion} ~~also the Danes.~~ that this was not possible given the attitude noticeably of Chancellor Schmidt, but Our draft guidelines for the budget were an attempt to register progress leading to a final solution in the Council as soon as possible thereafter. It would not be in the interests of the Community given the wider political background, to have a crisis at this juncture. We hope the French would consider carefully whether the draft guidelines could form the basis for conclusions later this week and let us know whether they had any further comments. We for our part would inform them when decisions had been taken whether or not to table a text of this kind. What he had said about a package was equally true for us.

W. J.
M D M FRANKLIN

23rd November 1981

cc ✓ Mr Alexander No 10
PS/Foreign Secretary
PS/Chancellor of the Exchequer
PS/Minister of Agriculture
Sir Robert Armstrong
Lord Bridges
Mr Hancock
Mr Andrews
Sir R Hibbert (Paris)
Sir M Butler (UKREP)

ORIENTATIONS POUR LE CHAPITRE 'BUDGET'

TEXTE

1. L'objet du budget communautaire est de financer les politiques communautaires convenues. En même temps il est nécessaire d'éviter la création ou la réapparition d'une situation inacceptable pour tout état membre et de favoriser la convergence global des économies des états membres, sans imposer à aucun état membre un fardeau excessif.
2. A long terme, la conciliation de ces objectifs sera atteinte par le moyen du développement des politiques communautaires et de l'équilibre entre ces politiques. Les conclusions des chapitres I et II ci-dessus représentent un premier pas dans cette direction.
3. Mais le processus de la conciliation de ces objectifs nécessitera un laps de temps dont la longueur ne saurait être déterminé avec exactitude. Entretemps, il y aura besoin d'un arrangement budgétaire correcteur si l'on veut éviter des situations budgétaires inacceptables.
4. L'arrangement correcteur devra répondre non seulement au problème déjà reconnu par la Communauté lorsque le mécanisme financier a été arrêté, mais également au déséquilibre qui existe dans la répartition des dépenses, notamment en ce qui concerne les dépenses FEOGA 'garantie'.
5. L'arrangement correcteur sera fondé sur des critères objectifs ayant pour but d'éviter la nécessité d'une négociation annuelle. Ces critères devraient couvrir non seulement les progrès réalisés en ce qui concerne la réduction des situations inacceptables par le biais de l'évolution des politiques communautaires, mais également la population respective du/des état(s) membre(s) concerné(s) ainsi que le rapport entre leur PIB par habitant et la moyenne communautaire.

6. Le financement de l'arrangement correctif sera réalisé dans les limites du plafond de 1% et sans mettre en danger le financement d'autres politiques communautaires convenues, et cela le cas échéant, par une méthode qui n'aura aucun impact budgétaire net. Les effets financiers de l'arrangement correcteur sur les différents états membres tiendront compte dans leur calcul, de la source des versements, à savoir s'ils proviennent d'états membres dont le PIB par habitant est inférieur ou supérieur à la moyenne communautaire et s'ils sont ou non contributeurs nets au budget communautaire.

7. L'arrangement correcteur prendra effet à partir du budget communautaire de 1982. Le Conseil, agissant sur une proposition de la Commission, prendra les décisions détaillées nécessaires d'ici le 31 décembre 1981.

8. Les arrangements détaillés ainsi convenus seront réexaminés après une période de sept ans afin d'étudier les progrès réalisés en ce qui concerne les objectifs budgétaires à longue échéance de la Communauté et de considérer s'il est nécessaire d'y apporter des modifications.

A06056

MR ALEXANDERPreparations for the European Council

1. At the informal meeting which the Prime Minister held on 19 November with the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer it was agreed that we should be prepared to shew a willingness to consider ways in which we could offer the French some limited help on the CAP if they were clearly prepared to reciprocate on the budget guidelines, and that officials should consider urgently the precise content of the offer which might be made. (Your letter to Mr Richards of today's date refers.)
2. Officials from the Treasury, the Foreign and Commonwealth Office, the Ministry of Agriculture and the Cabinet Office have accordingly considered possible fallback positions on six issues of importance to the French - five on the CAP and one on the new Community instrument (Ortoli facility). The resulting texts of possible alternative conclusions ... for the European Council are attached.
3. It is not intended to shew the texts themselves to the French in advance of the European Council. But they would provide the basis on which Mr Franklin and I would explain orally to President Mitterand's representatives on 23 November the ways in which we might be prepared to accommodate French interests if they in turn were willing to accept our budget guidelines.
4. Mr Franklin and I will be leaving for Paris on the morning of Monday, 23 November. I should be most grateful for the Prime Minister's approval to our proceeding on this basis.
5. I am copying this minute to the Private Secretaries of the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food.

ROBERT ARMSTRONG

ROBERT ARMSTRONG

20 November 1981

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DRAFT EUROPEAN COUNCIL CONCLUSIONS ON 30 MAY MANDATE

DRAFT FALL-BACK TEXTS

CHAPTER I

New Community Instrument (alternative to paragraph 9)

The European Council decided to transform the new Community instrument for loans into a European Fund to increase investment in infrastructure, industrial renewal and self-sufficiency in energy in the Community and agreed that consideration should be given to the conditions for a further increase in the Fund's loan capacity.

CHAPTER II

Price Policy (alternative to paragraph 3)

The European Council considers a prudent price policy to be necessary, at the same time taking account of the objectives of Article 39 of the Treaty, the need to achieve in some sectors a greater market equilibrium, and the relationship between Community support prices and the level of comparable support prices for similar products in the main competitor countries.

Cereals substitutes (alternative to second bracketted passage in paragraph 7(a))

The Council will

- (a) complete negotiations rapidly for the stabilisation of imports of manioc;

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(b) authorise exploratory discussions with third country suppliers of individual products competing directly with cereals with a view to securing agreement on stabilising imports of other individual substitutes on the basis that the gap between Community support prices and comparable support price levels in competitor countries will be reduced.

Note: The text of (b) would not commit the United Kingdom at this stage to substantive decisions. The reference to "products competing directly with cereals" would enable the United Kingdom to argue that soya is not included.

Milk (alternative to paragraph 7(b))

Modulation of the guarantee should be achieved by a combination of

- (a) a linear co-responsibility levy with the existing exemptions
- (b) a supplementary levy on additional deliveries to dairies or modulation of the intervention price if production exceeds a guarantee threshold
- (c) a possible limited exemption from the co-responsibility levy for a certain quantity of milk from each herd if warranted by price decisions and subject to suitable conditions.

Note: We would interpret "subject to suitable conditions" as entailing that at least part of the cost was borne nationally, and would make this intention clear to the French.

Export Contracts (alternative to paragraph 12(b))

The Council should be ready to examine specific proposals for the

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negotiation of framework agreements for the multi-annual supply of products to importing countries, specifying in each case the products and the provisions to be included.

Note: This text would not commit the United Kingdom at this stage to substantive decisions.

Financial limit (alternative to paragraph 18)

The Heads of State and Government invite the Council and Commission to implement these guidelines so that agricultural expenditure in the years ahead grows markedly less rapidly than the growth of own resources.

Note: The United Kingdom would agree to drop the word "markedly" only if the Germans had abandoned it first.


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PRIME MINISTER

c Sir R Armstrong o/r

Cabinet: 19 November


Brief for Community Affairs Item

1. In the absence of both the Foreign and Commonwealth Secretary and the Lord Privy Seal, you might wish to inform the Cabinet of the main developments on the restructuring mandate in the past week.

2. Following detailed discussion of chapter II in the 16 November Agriculture Council, on which the Minister of Agriculture could comment later if necessary, the 16/17 November Foreign Affairs Council went through the draft European Council conclusions on all three chapters. The discussion added little to the previous work of the Mandate Group and shewed no movement on the key budget chapter. The Foreign and Commonwealth Secretary accordingly conducted bilateral meetings with each of his colleagues in turn, in the presence of M Thorn. From these interviews he concluded from the chair that chapter I was soluble; that on chapter II there were major differences of opinion, the three main issues being a limit on agricultural expenditure, milk, and Mediterranean products; and that on chapter III most member states recognised that there was a British budget problem but there was still no clear idea how it could be resolved. He invited all delegations to consider their positions urgently with their Governments on 18 November and to resume the task of preparing for the European Council in a highly restricted Council session on 19 November. The Presidency would meanwhile revise the draft conclusions again in order to produce as clean a text as possible for the European Council.

3. You will then wish to inform the Cabinet of Federal Chancellor Schmidt's approach to the mandate, as it emerged in the 18 November Anglo-German summit meeting in Bonn.

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4. Bearing in mind your meeting later on Thursday with the Chancellor and the Foreign Secretary to review tactics for the European Council you may not want to take discussion on the mandate far in the Cabinet. You might nevertheless conclude, in line with the OD discussion on 12 November, that our main aim for the Council must be to get guidelines agreed that will put the United Kingdom in the best possible position for the next round of negotiations.
5. On other matters, the Foreign Affairs Council agreed to submit a draft declaration on enlargement to the European Council, although the French insisted that the decision on whether or not to issue it would depend on progress in the European Council on Mediterranean agriculture. The Council also heard presentations by Herr Genscher and Signor Colombo of their new ideas on European union and agreed that the follow-up procedure should be decided at the European Council.
6. You might wish the Chancellor of the Exchequer to report briefly on the 17 November Finance Council, which made some progress towards a compromise agreement on the non-life insurance services Directive.
7. The Secretary of State for Trade might report on the discussion on textiles at the Foreign Affairs Council. Only a partial mandate for the 18 November negotiations on the renewal of the Multi-Fibre Arrangement in Geneva could be agreed. The UK was isolated on the anti-surge mechanism and undertook to review its position urgently.
8. Next week the Budget Council meets on 24 November, and the European Council on 26/27 November.

D. M. Elliott

D M ELLIOTT

18 November 1981

PRIME MINISTER

I attach a copy of today's statement by the Lord Privy Seal on the Foreign Affairs Council.

Denis Healey claimed that the statement said nothing, despite Mr. Atkins' frequent reference to it at Question Time beforehand. Mr. Healey characterised the UK Presidency as "a fiasco" so far.

Thereafter, two critical themes emerged from the Opposition benches. The anti-Europeans were angry about what Mr. Stoddart described as the "Rome-Bonn axis" proposals for further European integration. Mr. Stoddart spoke of "treachery" in selling the country down the road. He was pulled up by the Speaker. Mr. Atkins made it clear that he had welcomed the proposals in his Presidency capacity. But a number of other Opposition Members were highly critical over the proposals.

Secondly, a number of Members were very dissatisfied with the Lord Privy Seal's report on the MFA Negotiating Mandate. Jack Straw suggested that the Lord Privy Seal had said so little because he did not actually understand the Mandate. Mr. Atkins retorted that anybody who had chaired a meeting on it from 2.30 p.m. to 1.30 a.m. was bound to understand a little, but that he had no intention of revealing our negotiating ^{positions} in any detail. The point was nevertheless pursued by Messrs. Cryer, Skinner and Healey. There was some criticism that it was covered in a Foreign Office Minister's statement, and not in a separate statement from Mr. Rees. This could be raised with you.

(SIGNED) M.A.P.

18 November 1981

STATEMENT ON THE FOREIGN AFFAIRS COUNCIL TO BE MADE BY
MR HUMPHREY ATKINS MP, THE LORD PRIVY SEAL, IN THE HOUSE OF
COMMONS ON WEDNESDAY 18 NOVEMBER 1981

TO BE CHECKED
AGAINST DELIVERY

With permission Mr Speaker, I will make a statement on the Foreign Affairs Council which has just taken place.

The Foreign Affairs Council yesterday discussed all aspects of the 30 May Mandate, in preparation for the European Council in London on the 26th and 27th of November. In addition, to the formal Council sessions, my right honourable and noble Friend and the President of the Commission held bilateral contacts with each Foreign Minister. Discussion was wide-ranging, but progress was only limited. There was general agreement that we should aim for progress on all three chapters of the negotiations (development of Community policies, the CAP and the budget) and that the European Council should be asked to decide operational guidelines on all three. But considerable differences of view remain and there will be a further meeting of the Council tomorrow.

The Foreign Ministers of the Ten meeting in Political Cooperation discussed the German/Italian proposals on European Union, the Middle East, and Chad. As Presidency, we have welcomed efforts by the Federal Republic of Germany and Italy to give greater impetus to the Community. The Ministers agreed that the proposals would be presented to the European Council, which meets in London on the 26th and 27th of November. The Council would decide on the follow up procedure. On the

/Middle East, they

Middle East, they discussed the question of participation in the Sinai Force. As the House will know, Governments of the Ten have been engaged for some weeks in consultations on participation in the Multinational Force and Observers to be established in Sinai under the terms of the Agreement between Israel and Egypt. We are seeking a basis which will be in accordance with the requirements of those Governments and of the United States, and which is in conformity with the well-known and fundamental position which the Ten have taken on the Middle East question, notably in the Venice Declaration. Consultations are still continuing.

The Ministers welcomed the Libyan withdrawal from Chad, and the moves to establish an OAU peacekeeping force. I have arranged for copies of the text of their statement to be placed in the Library of the House.

I chaired a parallel session of the Council which discussed the future arrangements to apply to the Community's imports of low-cost textiles. My honourable and learned Friend the Minister for Trade represented the United Kingdom. Early this morning the Council reached agreement that, in the negotiations on the extension of the multi-fibre arrangement which resume today in Geneva, the Community would seek a number of improvements including arrangements to deal with the problems both of recession and of sudden surges in actual trade. The Commission undertook to report back to the next meeting of the Council on the 7th and 8th of December, which will consider the further decisions which will be required.

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CAW



This has not yet been seen
by P.M. : the possibility of circulating
will be reviewed after the European
Council meeting

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

h.

Amul 20/11

17 November 1981

M O D B Alexander Esq
Private Secretary
No 10 Downing Street
SW1

Dear Michael,

COMMUNITY BUDGET PROBLEM

DRAFT PAPER FOR CIRCULATION IN THE COMMUNITY

Following the discussion at last week's OD meeting, the Chancellor has asked me to circulate the attached draft of a paper outlining our new corrective scheme which we might put forward for consideration in the Community later this week (if possible at Thursday's Foreign Affairs Council).

2. The record of the OD discussion last week has reinforced the Chancellor in the view that we ought to give a paper on these lines to the Commission and other member states as soon as practicable. The Germans may well express reservations about our scheme on Wednesday. The Chancellor believes that, for the reasons given in his minute of 11 November, we should plan to put forward the scheme even so. One criticism which the Germans are particularly likely to make is that the scheme is too generous to the UK. Ministers have agreed, however, that we need to go for a net contribution close to zero. We do not want to give the Germans the impression that we are going to give way on this point.

3. The Chancellor also sees great merit in being able to demonstrate how hard we have tried to promote a constructive solution, and he does not foresee any further convenient opportunities for putting forward our scheme after the November European Council. As the Prime Minister will see, the draft paper attempts to put the scheme across as a constructive contribution to the debate inside the Community, offered in a spirit of reconciliation.

4. It is for consideration whether the table of figures attached to the paper should be included or omitted, along with paragraph 16, or made available separately. The Chancellor

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is inclined to include the table on the grounds that it would help us to transmit a suitably robust signal about our requirements from the negotiation. The table will also indicate that, with an approach on these lines, the less prosperous countries would be better off than under the 30 May arrangements, while the small rich countries would still have significant net receipts, albeit less than now.

5. It might be argued that dropping the table - or including in it figures less favourable to the UK - would make it harder for other member states to accuse us of seeking a 'juste retour'. The Chancellor does not accept this argument. An important part of our objective is to transmit a clear signal about what we are prepared to pay, and it would be a tactical error to create the impression that we were prepared to make a significant net contribution.

6. The Chancellor hopes that, immediately after the summit talks in Bonn, it will be possible to reach agreement that the paper should be released to our partners. In practice, that would also mean that we would have to make our ideas available to Parliament also, but in as low-key a way as possible.

7. I am copying this letter to the Private Secretaries to the Foreign Secretary and Sir Robert Armstrong.

Yours sincerely,

Jill Rutter

JILL RUTTER

THE COMMUNITY BUDGET PROBLEM : A POSSIBLE APPROACH

Note by the UK Government

This paper outlines a possible approach to solving the Community budget problem which differs somewhat from the ideas already discussed in the negotiations in Brussels about the 30 May mandate but includes important features from each of them.

The problem

2. In the UK Government's view, the problems over the Community budget which have given rise to the current negotiations result from the fact that the financial impact of the Community's policies as a whole on individual member states bears no relationship to the relative needs of individual states or their ability to pay. There is nothing in the Community's financial arrangements to prevent a less prosperous member state from being a large net contributor to the budget, or a more prosperous member state from being a large net recipient. The differences in net budgetary positions resulting from patterns of agricultural production are accompanied by gains and losses on trade in agriculture, not reflected within the budget figures, which tend to work in the same direction and thus exacerbate the problem.

Existing ideas

3. Recent discussions in the Community have pointed to a number of possible solutions to the problem. The main approaches which have been suggested are as follows:

- i. The non-agricultural policies approach. This calls for the development of Community policies other than agriculture to the point where the problem will disappear.

- ii. The Commission approach. This calls for reimbursement to the UK a fairly high percentage of the difference between the UK's actual and GDP shares of CAP receipts and possibly the difference between actual and GDP shares of own resources.
- iii. The UK approach. Under this approach, the Community would take conscious decisions, based on the objective criteria of relative prosperity and population size, on what the effects of the budget as a whole on individual member states should be, and make corrective payments accordingly.
- iv. Limits for Germany as well as the UK. This approach would set some kind of upper limit on the amount which Germany, as the largest net contributor, should be expected to pay as well as the UK.
- v. The lump-sum approach. This would fix by political decision a lump-sum refund to the UK, based on a forecast by the Commission of the UK's net contribution before correction.

4. In the UK Government's view, these approaches all have their advantages and disadvantages. There is general agreement that approach i. would be highly desirable, but that it cannot by itself solve the problem in the near future: the scale of the problem is too great, and development of new and existing policies is bound to take time. A further consideration is that to put on the Community's policies the whole burden of correcting the distributional impact of the CAP and own resources could involve considerable distortions in the policies themselves.

5. Approach ii., which the Commission put forward in their June report on the mandate, has the considerable merit of identifying the two main areas of the budget which cause the imbalances - CAP expenditure and own resources. As several member states have pointed out, however, the Commission's CAP receipts

mechanism on its own would be illogical: the higher a beneficiary country's share of Community GDP, the greater its receipts under the mechanism would be. Another problem is that a beneficiary country's receipts under the mechanism would be uncertain and volatile. Still another problem is that, having defined how the deficiency of CAP receipts should be measured, the Commission appear to envisage correcting it only in part. These potential illogicalities could be removed, or largely removed, by combining a 100 per cent rate of correction under the CAP receipts mechanism with a new financial mechanism. The latter would need to guarantee beneficiary countries full reimbursement of the difference between their actual and GDP shares of own resources contributions, without any accompanying qualifications such as those in the existing financial mechanism regulations.

6. Unfortunately the Commission scheme raises other problems. It would refer only to the United Kingdom, whereas the problem of budgetary imbalances is a Community problem to which a Community solution is needed. The aim therefore should be to find an approach which would protect any member state in a particular situation and also provide the basis for solving the budgetary problems of an enlarged Community.

7. Approach iii., which the United Kingdom Government has put forward, would tackle the problem directly and solve it on a lasting basis, while preserving the fundamental principle that the Community's own resources belong to the Community. It should also remove from Community decision making the bias created by the need to try to redress the net budgetary positions of individual member states through the direction of policy. It would represent in itself a major step forward for the Community, in that it would introduce into the operation of the budget a principle for determining its impact which already applies within member states, and it would remove many of the existing obstacles to progress. The discussions thus far suggest, however, that most member states would see this approach as moving too far too fast. The changes in the budgetary positions of individual member states, compared with existing arrangements, would be very substantial.

8. Approach iv. attempts to deal with the immediate and potential problems of the two present net contributor countries in as simple and direct a way as possible and with minimum disturbance to the Community's existing arrangements. At this stage, however, no specific proposal has been put forward in connection with this approach. Approach v., similarly, attempts to deal simply and directly with the problems of one member state - the United Kingdom. Both these approaches, however, have the drawback that they apply to an individual member state, or individual member states, by name. There is also no provision whereby corrective payments under the two approaches would be directly related to relevant objective criteria, such as relative prosperity and population size. The amount of the payments would be left to be settled by arbitrary means; and in practice renegotiated every few years.

A general scheme for correcting net contributions

9. The UK Government continues to believe that approach iii. offers the best way ahead for the Community. However, in the light of the arguments put forward by other member states, we have devised a less radical approach, incorporating important features from all the other approaches discussed above. This approach would address directly the most pressing aspect of the budget problem - the uncertain and open-ended nature of the liabilities of the net contributor countries.

10. The main features of the approach would be:

- (1) The Community would place upper limits on any member state's net contribution (not just the UK's and Germany's) There would be no corresponding limits on net receipts.
- (2) The limits would be calculated in accordance with a formula based on relative prosperity and population size (see next paragraph). Member states with less than average prosperity would not be expected to make any net contribution to that part of the budget which can be allocated between member states. The limits for the more prosperous member states would vary directly with their size and relative prosperity.

(3) The Community would decide on the overall scale of the limits in the light of the Community's needs and what the main net contributor countries could afford.

(4) The financing of any corrective payments made necessary by the limits would be shared between the more prosperous member states in proportion to the difference between (a) their uncorrected net positions and (b) the limits on their net contributions given by the formula in (2) above.

11. Further to paragraph 10(2) and (3) above, the limits might be set at some small percentage - say $1\frac{1}{2}$ or 2 per cent - of the amount by which a member state is better off in aggregate than the Community average: ie $1\frac{1}{2}$ or 2 per cent of the difference between a member state's actual GDP and what its GDP would be if it had Community average GDP per head. (This difference can be calculated as the difference between a member state's GDP per head and Community average GDP per head, multiplied by its population size.)

12. The precise effects on individual member states would depend on the chosen percentage. If it were $1\frac{1}{2}$ -2 per cent, the limit on Germany's net contribution would be likely to lie in practice some way above the estimate for the uncorrected German net contribution. Hence in present circumstances only the United Kingdom would qualify for corrective payments. Because of the financing arrangements at paragraph 10(4), however, Germany would contribute more modestly than under the 30 May 1980 system to the corrective payments to the United Kingdom.

13. The corrective payments would preferably be made during the year to which they relate, on the basis of estimates. In the event of errors in these estimates, adjustments could be made in the following year. Alternatively, the corrective payments could be made as early as possible in the year following the year to which they relate.

14. The corrective payments could in principle be financed from own resources. But it would be simpler to handle them through some kind of clearing account within the budget, supervised by the Commission.

15. As noted earlier, the approach suggested here would incorporate important features from the other approaches recently discussed in the Community. Thus:

- It would be entirely consistent with approach i. in the previous section: as the development of Community policies reduces the size of the imbalances problem, so the scale of corrective payments would be reduced.
- It would resemble approach iv. in setting upper limits on the liability of the net contributor countries, without seeking to fix the net budgetary positions of all member states. The existing incentives to the net contributor countries to oppose any increase in the scale of Community activities would thus be reduced.
- As with approach iii., however, the suggested scheme would in principle be of general application, and both the upper limits and their financing would be based on objective criteria.
- The approach would resemble approaches ii. and v. in that in practice only the United Kingdom would in present circumstances actually qualify for refunds. It would also resemble approach ii. in that the financing of the corrective payments would be sensitive to relative ability to pay.

16. The attached illustrative table, based on the Commission's latest estimates for 1981, shows possible corrected patterns of net contributions and receipts under the proposed approach on two hypotheses as to the level of the sterling/ecu exchange rate. Hypothesis A is based on UK estimates of the average exchange rate during 1981. Hypothesis B illustrates how the outcome would

change if the UK exchange rate or UK GDP per head were 5 per cent higher. Also shown, for comparison, are the Commission's estimates for uncorrected net positions in 1981 and UK government calculations of the pattern of net positions as corrected by the 30 May 1980 arrangements.⁷

Conclusion

17. The United Kingdom Government offers these thoughts as a contribution to the discussions in the Community on the budget chapter of the mandate.

NET CONTRIBUTIONS (-) AND RECEIPTS BEFORE AND AFTER CORRECTION

Million ecus estimates for 1981

	'Uncorrected' pattern (1)	Post 30 May pattern (2)	Possible 'corrected' patterns under proposed scheme (3)				'Unallocated' budget (4)
			At current exchange rates	At higher exchange rate	At higher exchange rate	At higher exchange rate	
	1	2	3a 1½% scaling	3b 2% scaling	4a 1½% scaling	4b 2% scaling	5
Germany	-1620	-2125	-1715	-1865	-1685	-1865	-120
France	680	235	-140	-75	-130	-60	-30
Netherlands	195	100	80	100	80	105	-55
Belgium	370	300	170	205	170	210	5
Denmark	305	270	105	110	105	140	5
Luxembourg	280	280	160	185	160	185	-
UK	-1550	-140	-	-	-40	55	-185
Italy	625	380	625	625	625	625	-105
Ireland	590	575	590	590	590	590	-
Greece	125	125	125	125	125	125	15

Notes

- Column 1 is taken from the Commission's estimates of 30 October 1981 (SG(81)D/14060), Table 4.
- Column 2 assumes that Greece does not contribute to the UK refunds
- Columns 3a and 3b are based on forecast average exchange rates for 1981. Columns 4a and 4b show how the pattern might look if the £/ecu exchange rate were 5 per cent higher.
- The figures in columns 1, 2, 3 and 4 relate to the 'allocated' budget only. UK estimates for net contributions to, and receipts from, the 'unallocated' budget are shown in column 5. The unallocated budget includes aid, unallocated administration, ERDF non-quota section, transport infrastructure, various items of fisheries expenditure, disaster relief, Greek refunds etc.

Ref: A05992

MR. ALEXANDER

Meeting took place
last night.

to. *Print* 2/41

EC Budget Restructuring
Follow up to OD(81) 17th Meeting

It was agreed at OD on 12th November that a meeting should be arranged to consider further our line on budget restructuring for the European Council. In particular, a decision will be needed in the light of the Anglo-German Summit on how we handle the budget issue and whether the United Kingdom should be tabling proposals in advance of the European Council.

2. The Prime Minister may prefer to have this time an ad hoc meeting with the Foreign Secretary and the Chancellor of the Exchequer. Mr. Franklin and I might also attend. The meeting needs to take place before Friday evening 20th November since decisions on subsequent action will be needed. These may include the Foreign Secretary going to Paris on 23rd November. The meeting could not take place before Thursday afternoon, 19th November, since the Foreign Secretary is likely to be in Brussels that morning. If the Prime Minister agrees, could you put in hand the necessary arrangements?

RA

Robert Armstrong

13th November 1981

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TO IMMEDIATE FCO

TELEGRAM NUMBER 897 OF 12 NOVEMBER

INFO IMMEDIATE UKREP BRUSSELS

MANDATE: GERMAN ATTITUDES

1. AFTER CARRYING OUT THE INSTRUCTIONS IN FCO TELNO 241 TO ATHENS (SEE MY TELNO 893) BEAMISH HAD A LENGTHY CONVERSATION WITH MUELLER-THUNS ABOUT THE MANDATE.
2. MUELLER-THUNS APOLOGISED FOR THE FACT THAT THE GERMANS HAD NOT GIVEN US A CONSIDERED REPLY TO OUR NEW LIMITS SCHEME. IT WAS ON THE AGENDA FOR TOMORROW'S EUROPEAN STATE SECRETARIES' MEETING: HE HOPED THEY MIGHT BE ABLE TO COME TO AGREED CONCLUSIONS ON IT BUT HE WAS NOT CONFIDENT THAT THEY WOULD. HE ADDED THAT THE GERMANS HAD APPRECIATED THE EFFORT WE HAD MADE TO ALIGN GERMAN AND BRITISH POSITIONS MORE CLOSELY. HE RECOGNISED THAT THE GAP BETWEEN THE GERMAN AND BRITISH POSITIONS THAT HAD EMERGED DURING THE DISCUSSIONS LAST WEEK WITH FRANKLIN MIGHT HAVE HAD A NEGATIVE IMPACT ON MUTUAL CONFIDENCE AND THAT IT WOULD HAVE BEEN BETTER IF THE GERMANS HAD BEEN ABLE TO SHOW MORE OF THEIR HAND EARLIER BUT HE SAID THAT THEIR DIFFICULTY WAS THAT THE GERMAN POSITION WAS STILL NOT SETTLED AND THAT THEY WERE VERY DEPENDENT ON PROGRESS BEING MADE IN BRUSSELS.
3. THE BASIC GERMAN POSITION WAS THAT IF THE UK GOT RELIEF THEN GERMANY SHOULD GET RELIEF TOO.
4. THE CABINET ON 18 SEPTEMBER HAD INSTRUCTED THE DELEGATION IN BRUSSELS TO PRESS FOR THE RECOGNITION OF THE GERMAN PROBLEM. SO FAR THIS HAD PROVED VERY DIFFICULT: ONLY BRITAIN AND THORN HAD ACKNOWLEDGED IT. THREE SORTS OF OBJECTION, VERY DIFFICULT TO DISENTANGLE, HAD EMERGED:
 - (I) THE QUOTE BURDEN OF HISTORY UNQUOTE:
 - (II) THE NOTION THAT WHILE THE GERMANS MIGHT HAVE FINANCIAL PROBLEMS IN THE COMMUNITY THE POLITICAL AND ECONOMIC BENEFITS THEY DREW WERE SO OVERWHELMING THAT THERE

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/ WAS NO

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WAS NO REAL CASE FOR RELIEF: AND

(III) THAT RELIEF FOR GERMANY WOULD MEAN THAT SOMEONE ELSE HAD TO PICK UP THE TAB.

THE FRENCH HAD MADE SOME HELPFUL NOISES BUT THE GERMANS HAD NO IDEA WHAT THEY MEANT.

5. AS REGARDS THE LIMITS SCHEME, WHILE THE GERMANS RECOGNISED THAT IN LOGIC THE POORER COUNTRIES HAD TO BE LET OFF THEY SAW TACTICAL OBJECTIONS TO ATTEMPTING THAT FROM THE START. THEY ALSO THOUGHT THAT THE OUTCOME FOR BRITAIN - A NIL OR SMALL NET CONTRIBUTION - WAS NOT NEGOTIABLE AND, IN ADDITION, THEY FEARED (HE SAID THEY HAD NOT SHARED THIS FEAR WITH OTHERS) THAT IF BRITAIN ACHIEVED A NIL POSITION THEN HER INTEREST IN CONTROLLING POLICIES WITH BUDGETARY CONSEQUENCES COULD DISAPPEAR. ASKED WHAT EVIDENCE HE HAD OF BRITISH LACK OF COMMITMENT OR WHAT FURTHER PROOF BRITAIN NEEDED TO GIVE OF HER COMMITMENT TO THE COMMUNITY, MUELLER-THUNS HAD NO ANSWER BUT REPEATED THAT THE ANXIETY HE REFERRED TO EXISTED.

6. AS TO THE POSSIBLE SHAPE OF A SOLUTION, MUELLER-THUNS SAID THAT THE HEADS OF GOVERNMENT WOULD WANT TO RETURN FROM THE COUNCIL WITH SOMETHING TO SAY. IF MITTERRAND WAS TO ACCEPT RELIEF FOR GERMANY AND BRITAIN HE WOULD NEED SOMETHING TO BALANCE IT, AND THAT MEANT SOMETHING UNDER AGRICULTURE AND RELANCE. MUELLER-THUNS FEARED THAT UNLESS THE PRESENT OPPORTUNITY FOR CONTROLLING AGRICULTURAL EXPENDITURE WAS SIEZED, THE CHANCE OF CURBING THE CAP MIGHT BE GONE FOR GOOD. HIS PERSONAL VIEW WAS THAT A NIL RESULT AT THE LONDON SUMMIT WOULD BE PREFERABLE TO A QUOTE SURRENDER UNQUOTE ON THE AGRICULTURAL CHAPTER. IN VIEW OF THE TOUGH FRENCH HE WAS THEREFORE SCEPTICAL ABOUT THE PROSPECTS FOR PROGRESS IN LONDON.

7. ON THE QUESTION OF THE FINANCING OF NET TRANSFERS, THE GERMANS HAD CONSIDERED MODELS BASED ON GDP CRITERIA BUT DOUBTED THEY

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WERE NEGOTIABLE IN PRESENT CIRCUMSTANCES. THEY HAD THEREFORE BEEN
LOOKING AT WHAT HE DESCRIBED AS A POLITICAL RANKING FOR NET
CONTRIBUTORS. THE FOLLOWING SEEMED TO THEM NOT UNREASONABLE
IN DESCENDING ORDER OF MAGNITUDE:

AMOUNTS	PERCENTAGES
D	D
F	F
UK	NL
NL	B
B	UK

MUELLER-THUNS DID NOT EXPLAIN THE KEY FROM WHICH THE PERCENTAGES
WERE DERIVED. HE SAID THAT, AS WE KNEW, THE FRENCH WERE TAKING THE
LINE THAT THE COMPENSATION FOR THE BRITISH SHOULD BE TEMPORARY,
DEGRESSIVE AND QUOTE FORFAITAIRE UNQUOTE. IN PRIVATE, THE FRENCH
HAD MADE CLEAR THEIR VIEW TO THE GERMANS THAT THE BRITISH NET
CONTRIBUTION SHOULD IN ANY CASE RISE.

8. ON THE QUESTION OF DURATION, MUELLER-THUNS SAID THAT THE
GERMANS WANTED SOMETHING THAT WOULD LAST AS LONG AS POSSIBLE
BUT DOUBTED IF IN PRACTICE ARRANGEMENTS LASTING BEYOND ENLARGEMENT
WOULD BE POSSIBLE TO SECURE.

9. MUELLER-THUNS WAS TALKING PERSONALLY AND IN STRICT CONFIDENCE
WHICH SHOULD BE RESPECTED.

FCO PSE ADVANCE COPIES TO:

CAB OFFICE - FRANKLIN, WENTWORTH

FCO - BRIDGES, HANNAY, SPRECKLEY

TREASURY - HANCOCK, EDWARDS, CULPIN

MAFF - ANDREWS, HADDON

GOODALL

[ADVANCED AS REQUESTED]

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PRIME MINISTER

Community Affairs

You will wish to inform the Cabinet about the Anglo-Irish and Anglo-Italian Summit meetings on 6th and 9th November respectively, including the outcome (such as it was) of your discussions with Signor Spadolini on the Mandate and other Community questions.

2. The Secretary of State for Industry might report on the successful outcome of the 9th November Research Council, which was chaired by the Minister for Information Technology. The Council reached agreement on research programmes for micro-electronics and biomolecular engineering, and discussed a Commission communication on the future of Community R and D.

3. You could ask the Secretary of State for Trade to report on the 10th November Foreign Affairs Council, which was specially convened to discuss the Community's position on textiles in advance of negotiations in the GATT later this month on the renewal of the Multifibre Arrangement. No common position could be achieved because of the continuing gap between the liberal and the hard line member states, but the Commission agreed to prepare a compromise mandate for discussion at a further special session of the Council on 17th November.

4. The Minister of Agriculture might report on his bilateral talks on fisheries matters with his French counterpart on 10th November.

5. OD(E) will have met on 11th November to consider the United Kingdom's response to Commission proposals for the harmonisation of summertime dates. OD will meet later on 12th November to discuss the approach to the Mandate at the November European Council. Next week the Agriculture, Finance and Foreign Affairs Councils will all take place during the period 16th-17th November.



Robert Armstrong

11th November 1981

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Ref: A05956

MR ALEXANDER

OD, 12 November: Budget Restructuring

Most of the points in the Chancellor's minute of 11 November are covered in the brief. But the Prime Minister may like to have this note on the table which is attached to it. The table illustrates on the basis of the latest Commission figures, how the Commission's scheme might reduce the United Kingdom's net contribution. The salient points to note are -

i. a FEOGA mechanism by itself could not give us adequate relief; but complemented by a fully effective Financial Mechanism it could bring us to a low level of net contribution, or even on extreme assumptions to a position of net benefit;

ii. our refund in any given year would not be dependent on the size of our unadjusted net contribution in that year. It would be based on what had happened to our GDP in previous years (either real changes or those resulting from exchange rates) and our share of CAP expenditure in those years. The FEOGA compensation would go up if our GDP had gone up or our CAP receipts had gone down; it would go down if our GDP had gone down or our CAP receipts had gone up. The Financial Mechanism (which compensates for any excess in our gross contribution over our GDP share) would operate in the opposite direction, ie we would get a higher refund if our GDP share fell. So the combined result would tend to even out otherwise arbitrary results.

Commission scheme

iii. The Treasury figures apply the scheme to 1981 and 1982. They produce (with the Financial Mechanism) an average net contribution over the two years of 450 mecu if the FEOGA correction was only 60 per cent and 200 mecu if it was 80 per cent. If the correction had been 100 per cent we would actually make a tiny net benefit taking the two years together. The Commission's document speaks of "a fairly high level of compensation".



Robert Armstrong

*(approved by Sir R Armstrong)**Reminders**Export Controls in some form.*

11 November 1981

TABLE 1

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UK NET CONTRIBUTION TO EC BUDGET

Million ecus

	<u>1981</u>	<u>1982</u>
1. Before refunds	1505	2020
2. After 30 May agreement	95-730	na
After present financial mechanism and agricultural correction at:		
3. 100 per cent	645	685
4. 80 per cent	820	955
5. 60 per cent	990	1220
After ideal financial mechanism as well as agricultural correction at:		
6. 100 per cent	245	0 (net receipts of 270)
7. 80 per cent	415	0
8. 60 per cent	585	265
<u>Memorandum items: refunds</u>		
Refunds from agricultural correction at:		
9. 100 per cent	860	1335
10. 80 per cent	685	1065
11. 60 per cent	515	800
12. Refunds from present financial mechanism	0	0
13. Refunds from ideal financial mechanism	405	955

Ref: A05949

PRIME MINISTER

EC Budget Restructuring: Preparation for the European Council

PURPOSE OF DISCUSSION

1. To agree the approach the United Kingdom should adopt in the run up to the European Council on 26-27 November.

BACKGROUND

2. OD approved a plan of campaign on the mandate in September (OD(81) 15th Meeting). You have since been kept abreast of developments and at your meeting with the Chancellor of the Exchequer and the Foreign Secretary on 2 November (Mr Alexander's letter to Mr Fall of the same date) you agreed to try out on the Germans a new approach to the budget problem. The Committee will have before it a memorandum by the Foreign and Commonwealth Secretary covering a note by officials (OD(81) 54), and a memorandum by the Minister of Agriculture, Fisheries and Food (OD(81) 53).
3. The Foreign Secretary's note summarises the present state of progress and recommends option (iii) in the Note by Officials viz that our aim should be agreement on the basic features of a budget solution; guidelines for the CAP; and fresh impetus on certain other Community policies, leaving both the details of the budget settlement and the implementation of the CAP guidelines to be decided in the spring of 1982. Even that objective may appear optimistic in the face of evidence that the Italians and the smaller countries may be trying to postpone any decisions until next year. Although not definitive so far, the German response to our new budget scheme is not encouraging. The signs are that they regard a small

net contribution as an unrealistic objective for the United Kingdom,
and that they have in mind an outcome more in line with the 30 May
agreement leading to a United Kingdom net contribution reduced to about
one third of the uncorrected amount. On the other hand there are signs
that the French are at last beginning to take up a position, though not
a very forthcoming one.

4. The memorandum by the Minister of Agriculture (OD(81) 53) brings
out some of the difficulties in handling the CAP in the budget negotiations.
For domestic public opinion we need clear statements on price policy;
limiting the open-endedness of guarantees, particularly for surplus
commodities; state aids; and containing the growth of expenditure. But
there will be pressure for concessions which would be biased against our
industry and to some extent against these objectives. Mr Walker proposes
concessions only on multi-annual export agreements and on the stabilisation
of imports of cereals substitutes: these would be made in the context of
a good deal on the budget. He argues that we should not be prepared to make
concessions, even of a generalised kind, to favour smaller enterprises as
the French wish. Attached to his memorandum is an Annex giving in more
detail the line which he proposes: it has not been discussed interdepartmentally
and OD will probably not wish to endorse it at this stage.

HANDLING

5. You may wish to invite the Foreign and Commonwealth Secretary to open
by introducing his paper and explaining the approach he recommends. Since
the Minister of Agriculture's memorandum is also fundamental to the overall
strategy it may be helpful to invite him to introduce it early on in
discussion.

6. To focus subsequent discussion it may be helpful to consider in turn
the progress on the three chapters of the mandate and then to consider the
prospects and tactics for the European Council.

(i) Non-Agricultural Policies

7. The Foreign and Commonwealth Secretary may say that for several member states this part of the work represents the only positive element of the mandate and that agreement on it could offer some worthwhile advantages for the United Kingdom without committing us to unwelcome elements of significance. But the Secretaries of State for Industry and Energy may be more cautious.

(ii) CAP

8. The Minister of Agriculture is likely to stress the difficulty of making worthwhile progress on this chapter. While agreeing to the United Kingdom adopting a firm tactical position on prices and agricultural expenditure, he is concerned that some member states, especially France, will press for discriminatory measures to protect their small farmers and that other member states (including Germany) may be more ready to go along with this than we are. If concessions on the CAP have to be given in order to secure our budget objectives, he would want them limited to measures which would impinge relatively indirectly on United Kingdom farmers eg long term export contracts and arrangements to limit Community imports of cereals substitutes from third countries; but this may cause difficulties for the Secretary of State for Trade.

9. The Treasury representatives are likely to argue that reform of the CAP is important in its own right and that we must maintain a strong line. But some concessions will be necessary to secure the agreement of France and others to a budget mechanism.

10. The Committee should be able to agree that any concessions on the CAP should be made only when it is clear that they are buying real and worthwhile benefits in the mandate package as a whole. If the Foreign Secretary's approach to the November European Council is agreed, this would imply that specific concessions should be held back, probably until the 1982 agricultural price fixing. But to get what we want on the budget in November it may be

necessary to accept certain concessions at the European Council: eg the principle of certain measures directed towards protecting small farmers and limited action on imports of cereal substitutes to get what we want on the budget at that stage. The Minister of Agriculture might be invited to propose for agreement by OD(E) a formulation which would be acceptable for use in November. You will not wish to be committed to the Annex in Mr Walker's paper.

(iii) Budget

11. Given the current state of the negotiations, the choices facing Ministers appear to be the following. All are consistent with the idea of parallel progress on all three chapters recommended by the Foreign Secretary (option (iii) in the Note by Officials):

- i. to stick with the ambitious approach which the Chancellor put forward in his 'Hague' speech by which every member state's net contribution or net benefit would be decided in advance according to their relative prosperity. This may be the Treasury's preferred course if the German response has been unhelpful. It might be the right one if it is apparent that no progress at all is possible in November, but not if we wish to get some measure of agreement;
- ii. to put forward the revised Treasury scheme which is limited to net contributors and puts the United Kingdom at zero, or making only a token net contribution to the allocated budget. This would only make sense if the Germans were willing to support it in terms acceptable to us;
- iii. to be ready to negotiate on the basis of the Commission's scheme. There is no guarantee that this would be successful; the scheme has been strongly criticised by some of the smaller member states. Moreover to give the United Kingdom an acceptable outcome the details would have to be right and the scheme would have

to be accompanied by an extension of the Financial Mechanism and the removal of the present constraints on its effectiveness. The Treasury representatives may argue that it is too risky. On the other hand, our own approach is even less acceptable to the other member states and, if the Commission shew some readiness to modify their scheme in favour of Germany, the Germans may join the Italians and the Belgians in supporting it. It can be made to produce an acceptable result for the United Kingdom, though with less certainty than a scheme of budget limits. It would deal with one of the basic criticisms of opponents of the Community at home, namely that Britain is paying for the excesses of the CAP; and negotiating on the basis of a Commission proposal is always an advantage;

iv. not to aim for agreement on a method of dealing with the budget problem, as in the three preceding options, but to go for general guidelines. A draft of what these guidelines might look like is attached. The Foreign Secretary may favour going straight for this approach; or it could serve as the fallback from any of the others mentioned above. It will leave more to be negotiated in 1982 but may be the most that can be achieved this time. Would it be sufficient to justify any movement on other parts of the negotiations, eg the CAP?

1982 Refunds

12. The Foreign and Commonwealth Secretary will probably argue that we should not allow the question of a third year of refunds to distract from the main mandate negotiations. We should aim to get agreement in November that 1982 should be the first year of the new system whatever it is. The Treasury representatives will probably argue that we should revert to the 30 May agreement for the 1982 refunds only if it later becomes clear that the mandate negotiations are irremediably stuck.

Operational Steps

13. The Foreign and Commonwealth Secretary may wish to set out the practical arrangements he envisages for the period up to the European Council. He has in mind using the Foreign Affairs Council on 16-17 November to take the views of other member states bilaterally on the mandate. The Anglo-German summit on 18 November will provide a further opportunity to try to concert with the Germans. Another meeting of the Foreign Affairs Council (or the Mandate Group) may be held on 19 November. In the few remaining days before the European Council, it may well be desirable for the Foreign Secretary or another emissary to have further bilateral contacts, especially with the French. This would be the moment, if any, for you to send a message to the other Heads of Government.

CONCLUSIONS

14. You may wish to cover the following in your summing up -
- i. agreement that we must aim for some decisive progress at the November European Council as recommended by the Foreign Secretary;
 - ii. agreement that we should not allow the question of our 1982 refunds to become a major issue in November;
 - iii. conclusions on how far we can modify our current stance on the CAP in order to secure a satisfactory outcome on the budget (Mr Walker to consult OD(E) if necessary);
 - iv. which of the options on the budget we should go for (paragraph 11 above);
 - v. operational decisions eg about messages to other Heads of Government or additional bilateral contacts before the European Council.

11 November 1981



ROBERT ARMSTRONG

GUIDELINES FOR BUDGET CHAPTER

1. The objectives of the Community budget are to finance agreed Community policies while avoiding the creation or recurrence of an unacceptable budgetary situation for any member state and while contributing to the overall convergence of the economies of member states.

2. In the long term the reconciliation of these objectives will be achieved through the development of Community policies and the balance between them. The conclusions reached in Chapters I and II above are a first step in that direction.

3. But the process of reconciling the objectives by these means will take a period whose length cannot be predicted with any precision and, in the meantime, a budgetary corrective arrangement will be needed, if unacceptable budgetary situations are to be avoided.

4. The corrective arrangement will need to deal not only with the problem already recognised by the Financial Mechanism but also with the imbalance in the distribution of expenditure, notably FEOGA guarantee expenditure. The arrangement will be based on an objective criteria so that there is no need for annual negotiations. These criteria should include not only the progress made in reducing the problem of unacceptable situations through the development of Community policies, but also the relative size of the member state(s) in question and the relationship of their GDP per head to the Community average.

5. So long as the financing of the corrective arrangement can be achieved within the 1 per cent ceiling it will be financed under normal budgetary rules. Otherwise, an alternative method will be used which avoids any net budgetary impact. The financial effects of the corrective arrangement will have regard to whether the payments come from member states below or above the Community average GDP per head and whether or not they are net contributors.

6. The corrective arrangement will apply with effect from the Community's 1982 budget year. The Council, acting on a proposal of the Commission, will take the necessary detailed decisions by 31 December 1981.

7. The detailed arrangements so agreed will be reviewed after five years to consider the progress made towards the Community's long term budgetary objectives and whether any changes are needed.

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

PRIME MINISTER

COMMUNITY BUDGET MANDATE : THE NOVEMBER EUROPEAN COUNCIL

As you know, I unfortunately cannot be present at OD tomorrow. I am therefore sending you in this minute my views on the important matters which OD will be discussing.

State of Play

2. It seems clear that the starting point for most of our partners in the Community, and possibly the Commission too, will be to look for a solution to the UK budget problem which leaves us worse off than foreseen last year under the 30 May system: i.e. a UK net contribution of more than 730 million ecus. That, at any rate, is the signal which the French and others seem at present to be transmitting; and the French want the new solution, like the old, to be temporary.

3. The scheme which the Commission has placed on the table is compatible with a wide variety of outcomes. Indeed, the main point about the scheme is that its effects are unpredictable. The effects on the UK would depend crucially on what we could negotiate for the critical parameters - in particular, the rate of compensation under the FEOGA mechanism and the nature of the financial mechanism on the contributions side. To obtain a reasonably secure presumption of a net contribution which was on average either modest or zero we should need a combination of a very high compensation rate (100 per cent or very close to it) under the FEOGA mechanism; and an "ideal" financial mechanism which went well beyond the present one and gave us full and unconditional reimbursement of the difference between our Community GDP share and our uncorrected share of own resources.

/The effects

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The effects would also be likely to vary substantially from year to year (see the illustrative figures at the Annex, based on estimates for 1981 and 1982). Unless we are very successful in the negotiation, it would thus be difficult to establish publicly that a settlement based on the Commission's scheme was better than (or even as good as) the 30 May settlement.

4. We, for our part, have put forward publicly - both in my Hague speech and in the Community itself - an approach to the Community budget which we genuinely believe would be in the Community's best interests and would solve the German problem (and the budgetary problems of enlargement) as well as our own. We have also outlined to the Germans - but not at this stage put forward publicly - a less radical corrective scheme which (a) is closer to one strand in the German Government's own thinking, (b) is consistent with a zero or small net contribution, on a predictable basis, for the UK and (c) would not involve excessive changes in the positions of individual member states compared with the existing, post-30 May position. We await considered German reactions. There are probably differences of opinion in Bonn. Chancellor Schmidt seems still to want a limit for Germany (as do the German Finance Ministry). They could not in fact get this under the Commission's scheme. But some in the German Foreign Ministry would be willing to settle for the Commission's scheme and for a modest gesture from the Commission in the form of a reduction in the cost to Germany of relief to the UK under that scheme. And although Chancellor Schmidt is reported to have said privately that there was really no reason why the UK should be a net contributor, there is naturally much resistance in Bonn to a low or zero net contribution for the UK, especially from those who are ready to accept the minimalist solution for Germany.

Next Moves

5. Looking ahead, there are 5 points which I particularly want to make. The last 2 are closely in line with what Peter Carrington and Peter Walker have already suggested. The first 3 are other points to which I attach special importance.



6. First, we must continue to signal to our partners that there is no justification for a less prosperous country like the UK being a net contributor at all. We must counter the signals from other member states that they are looking for an outcome for the UK worse than that envisaged on 30 May 1980. If we dilute or weaken our own signal prematurely, we shall simply redefine the target area for the negotiations to our own disadvantage. All this is compatible with hinting to the Germans that we are reasonable people and do not necessarily rule out making some small contribution to the allocated budget as at present defined at the end of the day - in addition to the substantial contribution we anyway make to the unallocated budget. But we must not give the impression that we can be driven back to the 30 May level or beyond.

7. Second, I think it would be a mistake to fall back on the Commission scheme at this stage in the interests of promoting a more orderly negotiation. I hope that Peter Carrington is not suggesting this in paragraph 4 of his minute of 6 November. It would, I believe, be wrong to retreat abruptly from our existing position. To do so would convey the wrong signal about our requirements from the negotiation. Neither could we possibly rely on negotiating a version of the Commission scheme which represented a good deal for the UK - least of all if we agreed to the method now. As the annexed estimates illustrate, the only version of the scheme which might give us a reasonably secure presumption of getting rid of our net contribution, or reducing it to something small, would be one in which all the critical parameters were settled in a manner exceptionally favourable to the UK.

8. Third, I think we need to consider whether, subject to Chancellor Schmidt's reaction at the talks on 18 November, we ourselves should table the corrective scheme which we have shown to the Germans. Although Peter Carrington's minute does not discuss the point, there is in my view a considerable prima facie case for doing this. I believe it could be put forward without pinning our colours irrevocably

/to it,



to it, as an alternative which was more firmly based on principle than the Commission scheme and more likely to be a lasting solution for the Community. And it would be evidence of our efforts to make progress on the Budget during our Presidency: evidence which is lacking in public at present. It would make clear our requirements from the negotiation and remove the situation in which there is only one scheme - the Commission's - on the table. In doing so I believe it would increase our leverage in the negotiation.

9. A further consideration is that we must expect the substance of our exchanges with the Germans to reach others, especially the French and the Commission: this may already be happening! So our scheme is quite likely to become public anyway.

10. You will anyway wish to discuss our new scheme with Chancellor Schmidt and a final decision on making it public will have to take account of Schmidt's reactions. If however there should be any degree of support from Schmidt - even on the lines that the framework if not the figures provide one possible basis for the negotiation - then the case for outlining our new scheme publicly would be particularly strong. Even if Schmidt is non-committal, there would still, I suggest, be a case for outlining it publicly, along with the Hague speech approach, while referring at the same time to the Commission scheme as another possible route.

11. My fourth point is concerned with the question, already discussed in the papers by Peter Carrington and Peter Walker, of the possible need at some stage for concessions on the agricultural chapter. I am sure that Peter Carrington and Peter Walker are right when they suggest that a link is likely to develop between the French demands on the CAP and our own demands for satisfactory budget refunds. I entirely agree with Peter Walker that we should withhold any specific concessions to the French until we have an equally specific settlement on the budget refund. I also agree in general with his conclusions as to the points on which we might in due course offer the French some limited concessions (export /contracts and



contracts and cereal substitutes) and those on which we cannot (vegetable oils and oil seeds). I am concerned at the signs that the French may continue to demand that small producers in the milk sector should get some special treatment, as their price for a satisfactory budget settlement. We should clearly resist this at present. But I believe we should now start to consider whether there are any ways in which some concession to the French might be made at a tolerable cost to our budgetary and agricultural interests: for example, by offering some degree of exemption from the basic coresponsibility levy to small producers, provided this was clearly identified as an income aid and nationally financed.

12. Also on agriculture, the likely linkage between the budget refund negotiations and next year's price fixing requires in my view that we must continue to press for the European Council guidelines on CAP prices and the rate of growth of expenditure to be as toughly worded as possible. Our aim should therefore be to stick as closely as we can to the text - the full version of alternative A on prices and alternative D on the rate of growth of expenditure in the draft guidelines of 6 November - which we have hitherto been supporting in the Mandate Group discussions.

13. Finally, there is the question of what we should seek to obtain from the November European Council. I agree with Peter Carrington that an all or nothing approach would be wrong and that a 'half-success' could suit us pretty well. I suggest that our aim at the November Council should be:

- (i) to avoid discussing possible solutions in too much detail;
- (ii) to extol the virtues of a 'Community approach' to the budget problem and to avoid outright rejection of our scheme (assuming that we have tabled it); and
- (iii) to secure agreement on a set of guidelines for reform of the budget which would be compatible with either the Commission approach or our own. I believe that

*Fr. Gervais
Commission
Ap. reduce cost
to response. levy
charges -
budgetary
arrangements*



officials have already prepared draft guidelines on this basis.

Conclusions

14. To sum up, I hope that OD will be able to agree on:

- (i) the importance of continuing to send suitably robust signals to the Germans and other member states about our requirements from the negotiation;
- (ii) the importance of not abandoning our own approach or indicating willingness to negotiate on the Commission scheme alone;
- (iii) a provisional conclusion, subject to German reactions at the 18 November talks, in favour of tabling our new corrective scheme publicly - ahead of the European Council if possible;
- (iv) the need to avoid making concessions to the French or others on the CAP until we are in a position to trade any such concessions against concessions by others on the budget settlement; and
- (v) the aim of getting agreement at the November Council to guidelines for budgetary reform compatible with either the Commission or our own approaches.

15. I am copying this minute to other members of OD and Sir Robert Armstrong.

Peter Jenkins
for (G.H.)

11 November 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).

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UK NET CONTRIBUTION TO EC BUDGET

This table illustrates what corrected net contribution we might have expected to make for 1981 and 1982 if the Commission's scheme were in force. The outcome would depend critically on what parameters were agreed for the financial mechanism (if any) and the FEOGA mechanism. In other years, the outcome could look very different, even with the same parameters.

	Million ecus	
	<u>1981</u>	<u>1982</u>
Present expectations for our net contribution, based on the latest Commission figures, are:		
1. Before refunds	1505	2020
2. After 30 May agreement	95-730	na

If the present financial mechanism were extended (or there were no financial mechanism) the outcome would depend on the FEOGA compensation percentage. For example:

3. 60 per cent	990	1220
4. 80 per cent	820	955
5. 100 per cent	645	685

If we could negotiate an 'ideal' financial mechanism (see paragraph 3 of minute) as well as the FEOGA mechanism, the corresponding figures would be:

6. 60 per cent	585	265
7. 80 per cent	415	0
8. 100 per cent	245	0 (net receipts of 270)

All the net contribution figures relate to the allocated budget only. Our net contribution to the unallocated budget is of the order of 150 million ecus a year.

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1978-80 instead of 1979-81. This interpretation follows the precedent of the financial mechanism. Sticking to the earlier interpretation in OD(81)40 would raise the value of a 100 per cent FEOGA mechanism by 250 million ecus in 1981 and 40 million ecus in 1982 - though the effect could go the other way in later years.

MB. ||| 5. The calculations also confirm that the results of the Commission's scheme would be likely in practice to vary substantially from year to year, even if all the details were completely specified. This is partly because the factors which would determine refunds each year would be only loosely related to our unadjusted net contribution for that year, since the FEOGA refunds would be based on past averages. It is also because the lags involved in averaging would interact with other lags in the system such as the procedure for making VAT adjustments in arrears.

6. Franklin pointed out, in particular, that in our earlier table the UK's net contribution was shown as falling between 1981 and 1982, while our unadjusted net contribution was shown as rising. On the illustrative figures in Table 1, this is still so if - but only if - we could negotiate an ideal financial mechanism. The main reason is that the gap in 1982 between our GDP and our contribution shares is expected to be exceptionally large. The lag in adjusting the 'budget exchange rate' means that our contribution share will not rise until 1982 to take account of the surge in the £/ecu exchange rate earlier this year. But by 1982, the market exchange rate may well be lower, on average, than in 1981. So a higher contribution share is likely to coincide with a lower GDP share. As a result, an ideal financial mechanism which compensated for the gap between the two could be more than usually valuable.

7. I am sending copies of this letter to Graham Fry (FCO) and Martin Haddon (MAFF). You kindly said that you would consider how best to transmit the material to Franklin in Brussels. To be on the safe side, I am also sending 4 copies in the bag to Richard Butt (UKREP) with the request that he pass them on to Sir Michael Butler, Mr Franklin and Mr Hannay.

R P CULPIN

UK NET CONTRIBUTION TO EC BUDGET

Million ecus

	<u>1981</u>	<u>1982</u>
1. Before refunds	1505	2020
2. After 30 May agreement	95-730	na

After present financial mechanism
and agricultural correction at:

3. 100 per cent	645	685
4. 80 per cent	820	955
5. 60 per cent	990	1220

After ideal financial mechanism
as well as agricultural correction at:

6. 100 per cent	245	0 (net receipts of 270)
7. 80 per cent	415	0
8. 60 per cent	585	265

Memorandum items: refunds

Refunds from agricultural correction at:

9. 100 per cent	860	1335
10. 80 per cent	685	1065
11. 60 per cent	515	800
12. Refunds from present financial mechanism	0	0
13. Refunds from ideal financial mechanism	405	955

(Assumptions attached)

ASSUMPTIONS

- a. The UK does not contribute to its own refunds.
- b. Agricultural correction payments in respect of year 0 are determined by:
 - i. the average difference between the UK's share of Community GDP and its share of agricultural receipts in years -3, -2 and -1, multiplied by
 - ii. total agricultural spending in year 0.
- c. The UK's average share of Community GDP is 17.11 per cent in 1978-80 (determining the correction in respect of 1981) and 18.29 per cent in 1979-81 (determining the correction in respect of 1982). The UK's share in 1981 is 19.32 per cent - not the 20.63 per cent suggested by the Commission.
- d. The UK's average share of agricultural receipts is 9.7 per cent in 1978-80 and 8.7 per cent in 1979-81.
- e. Total agricultural spending by the Community is 11,580 million ecus in 1981 and 13,919 million ecus in 1982.
- f. An "ideal" financial mechanism is one which would reimburse to the UK, in net terms and without qualification, the excess of its share in budget financing over its share in Community GDP in any year, multiplied by the total size of the budget. (The present financial mechanism would yield nothing in either 1981 or 1982.)
- g. The UK's share of Community financing is 21.51 per cent in 1981 and 22.37 per cent in 1982.
- h. The Community budget is 18,435 million ecus in 1981 and 22,460 million ecus in 1982.

TABLE 2 : NET CONTRIBUTIONS (-) AND RECEIPTS ON DIFFERENT FINANCING KEYS FOR FEOGA MECHANISM

1981

million ecus

	Unadjusted positions	HIGH UK REFUNDS*			LOW UK REFUNDS †		
		Own resources key 2	CAP key 3	Modulated C/P key 4	Own resources key 5	CAP key 6	Modulated CAP key 7
Germany	-1647	-2102	-2009	-2035	-1833	-1777	-1792
France	624	256	310	287	474	507	492
Netherlands	223	141	75	60	190	150	141
Belgium	388	326	311	304	363	354	349
Denmark	302	267	235	228	287	269	265
Luxembourg	282	279	279	279	281	281	280
UK	-1505	-243	-243	-243	-990	-990	-990
Italy	619	399	389	431	529	523	549
Ireland	591	579	546	582	586	565	588
Greece	123	98	107	107	113	118	118

* FEOGA mechanism at 100 per cent; ideal financial mechanism. Line 6 of Table 1.

† FEOGA mechanism at 60 per cent; present financial mechanism. Line 5 of Table 1.

‡ FEOGA mechanism financed in proportion to shares of CAP receipts averaged over previous 3 years. (Financial mechanism financed from own resources.)

+ As a percentage, but contributions of Italy, Ireland and Greece limited to GDP shares averaged over previous 3 years.

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TABLE 3 : NET CONTRIBUTIONS (-) AND RECEIPTS ON DIFFERENT FINANCING KEYS FOR FEOGA MECHANISM

1982

million ecus

	Unadjusted positions	HIGH UK REFUNDS*			LOW UK REFUNDS †		
		Own resources key 2	CAP key † 3	Modulated CAP key † 4	Own resources key 5	CAP key † 6	Modulated CAP key † 7
Germany	-1796	-2596	-2438	-2472	-2076	-1981	-2002
France	104	-593	-546	-587	-140	-112	-136
Netherlands	312	154	62	43	257	201	190
Belgium	477	363	346	338	437	427	422
Denmark	358	299	255	247	337	311	306
Luxembourg	315	309	311	311	313	314	314
UK	-2021	267	267	267	-1220	-1220	-1220
Italy	956	572	558	609	822	813	844
Ireland	697	674	621	679	689	658	692
Greece	598	551	564	565	581	589	590

* FEOGA mechanism at 100 per cent; ideal financial mechanism. Line 6 of Table 1.

† FEOGA mechanism at 60 per cent; present financial mechanism. Line 5 of Table 1.

‡ FEOGA mechanism financed in proportion to shares of CAP receipts averaged over previous 3 years. (Financial mechanism financed from own resources.)

+ As a percentage, but contributions of Italy, Ireland and Greece limited to GDP shares averaged over previous 3 years.

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TABLE 4 : MEMORANDUM ITEMS: DETERMINATION OF FINANCING KEYS

Percentages

	KEYS FOR 1981			KEYS FOR 1982		
	Marginal share of own resources, 1981	Average share of CAP receipts, 1978-80	Average GDP share, 1978-80 where binding	Marginal share of own resources, 1982	Average share of CAP receipts, 1979-81	Average GDP share, 1979-81 where binding
	1	2	3	4	5	6
Germany	29.5	23.0		27.3	21.1	
France	23.9	20.8		23.8	24.6	
Netherlands	5.3	13.0		5.4	12.6	
Belgium	4.0	6.1		3.9	5.7	
Denmark	2.3	5.9		2.0	5.4	
Luxembourg	0.2	0.1		0.2	0.1	
UK	18.1	9.7		21.9	8.7	
Italy	14.3	17.0	13.7	13.1	16.3	14.0
Ireland	0.8	4.4	0.6	0.8	4.5	0.6
Greece	1.6	na	[1.0 in 1981]	1.6	1.0	[1.0 in 1981]

Bonnie Hunter

(2)

NOTE FOR THE RECORD

Amh

30 MAY MANDATE: GERMAN VIEWS

1. I lunched in Brussels on 10 November with Herr Ungerer, my German opposite number.
2. Ungerer gave me a very frank account of how opinion had evolved in Bonn on the budget issue. There had been a major battle in September between the Finance Ministry and the Foreign Ministry. The former had put to the Federal Government a limits scheme rather similar to the one we had put to them now, but with a lower limit for Germany and a higher one for the UK than we were proposing. The Finance Ministry had been beaten in cabinet by the Foreign Ministry, basically because their scheme involved a loss to France of 600 mecu, and this was judged politically unsaleable ("So what hops have you now of persuading us with your scheme which would cost France 800 mecu?", said Ungerer). It was agreed that the German line should be to press the Commission to make proposals to meet the German problem.
3. Since then, according to Ungerer, an uneasy truce had reigned in Bonn. This truce precluded their responding definitively to our approach. They were still waiting for the Commission and believed M Thorn might produce something next weekend. Of course the differences in Bonn still remained. The Foreign Ministry would probably wish to settle for no more than alleviating the burden of UK refunds (paragraph 44 of the Commission paper), while the Finance Ministry would want refunds for Germany (paragraph 42 of the Commission paper); a further complication was that the Agriculture Ministry was opposed to the idea of any abatements being linked to FEOGA payments, but that point would be met if the Commission went over to a new "political" key for financing the refunds. It was Ungerer's view that the chances were much greater now than earlier that the Germans would agree to base any solution for themselves on some variant of the Commission's ideas and not go for a scheme of their own devising or ours.
4. I asked Ungerer about the possible expansion of the NCI for Community loans, now being sponsored by the French and Italians (the French have proposed 3 billion ecu). Ungerer recalled the basic German dislike of any expansion of the NCI; they regarded the EIB as the right instrument for loans. But, that said, they might well not die in the last ditch to resist some further expansion of the NCI.
5. Ungerer then told me there was great nervousness in Bonn at every level that the London European Council might turn into a confrontation like the Dublin meeting, with the Prime Minister in an embattled position vis-a-vis her colleagues.

/I said

I said there were two keys to avoiding anything like that. The first was for the UK and Germany to establish sufficient common ground to avoid any polarisation such as we had had in 1979-80. The 18 November bilateral summit was obviously of crucial importance there. We had been encouraged by the amount of common ground we had so far established on GAP reform; less so on the budget. The second was to ensure that solid progress was made in all three chapters of the mandate at the London meeting. Many would try to avoid that, while proclaiming endlessly that they wanted it. We should need help. But it was no good expecting the Prime Minister to say the meeting had been a success, if it had in fact achieved nothing. That was not her style, any more than it was Chancellor Schmidt's.

D H A Hannay

10 November 1981

cc: PS/PUS/Lord Bridges
ECD (I)
M Franklin, Cabinet Office
D Hancock, Treasury
D Andrews, MAFF
Sir M Butler, UKRep
Sir J Taylor, BONN

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DESKBY 110900Z

FM UKREP BRUSSELS 101800Z NOV 81

TO IMMEDIATE FCO

TELEGRAM NUMBER 4165 OF 10 NOVEMBER

INFO ROUTINE EC POSTS

1. AT LUNCH FOR THE MANDATE GROUP MR HURD AND I EXPLAINED THE PRESIDENCY'S PLAN FOR THE MANDATE GROUP AND FOR THE FOREIGN AFFAIRS COUNCIL AS SET OUT IN FCO TEL NO 241 TO ATHENS.

2. LED BY CHANDERNAGOR, SEVERAL REPRESENTATIVES SAID THAT FURTHER ROUND-TABLE DISCUSSIONS AT THE FOREIGN AFFAIRS COUNCIL BASED ON A QUESTIONNAIRE WOULD GET NOWHERE. IT WOULD BE AT BEST REPETITIVE AND AT WORST HARDEN POSITIONS. IT WOULD NOT ENABLE THE QUILIBRIUM BETWEEN THE THREE CHAPTERS TO BE MAINTAINED. THE FOREIGN AFFAIRS COUNCIL SHOULD DISCUSS A NEW TEXT. EVERYONE AGREED THAT IT MUST BE MUCH SHORTER THAN THE PRESENT TEXT. CORTERIER SAID THE TEXT SHOULD RECORD AGREEMENT WHERE IT EXISTED AND BRING OUT THE OPTIONS ON THOSE ISSUES WHERE DISAGREEMENTS PERSISTED. I STRESSED THAT IF WE WERE TO PRODUCE SUCH A TEXT, IN COOPERATION WITH THE COMMISSION, WE COULD NOT POSSIBLY INCLUDE ALL THE IDEAS DEAR TO EVERY DELEGATION. RUGGIERO SAID THAT THE PRESIDENCY WOULD HAVE TO DO VIOLENCE TO ALL DELEGATIONS EQUALLY. THORN SAID THE COMMISSION WOULD COOPERATE WITH THE PRESIDENCY IN PRODUCING A NEW DRAFT WHICH WAS NEITHER TOO LONG TO BE USABLE NOR TOO SHORT TO SAY ANYTHING, BUT THEY WOULD HAVE TO BE FREE LIKE OTHER DELEGATIONS TO EXPRESS THEIR OWN POSITION. MR HURD CONCLUDED THAT THE PRESIDENCY WOULD RESPOND TO THE GENERAL WISH TO HAVE A TEXT FOR THE FOREIGN AFFAIRS COUNCIL ALONG THE LINES PROPOSED BY CORTERIER AND DO ITS BEST TO PRODUCE IT FOR FRIDAY.

3. DOUBTS WERE ALSO EXPRESSED ABOUT THE IDEA OF "CONFESSIONALS", ALTHOUGH THORN HAD PREVIOUSLY TOLD US PRIVATELY THAT HE WAS READY TO JOIN YOU IN SUCH AN EXERCISE. POENSGEN SAID GENSCHER WOULD NOT COME IF THIS WAS THE PROSPECT. OTHERS THOUGHT IT WAS PREMATURE. FRANKLIN SAID IT COULD HELP THE PRESIDENCY AND THE COMMISSION IN PREPARING FOR THE EUROPEAN COUNCIL AND ANY FURTHER MEETING ON 19 NOVEMBER TO WHERE THE POLITICAL PRIORITIES LAY. MR HURD SAID HE WOULD CONSULT YOU IN THE LIGHT OF THE DISCUSSION.

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4. ECONOMIDES SAID THE GREEK MINISTER OF AGRICULTURE WOULD WISH TO ATTEND THE DISCUSSION ON THE CAP. BUT CHANDERNAGOR DISLIKED THE IDEA OF TAKING AGRICULTURE OUT OF TURN ON 17 NOVEMBER. HE WANTED THE PACKAGE DISCUSSED AS A WHOLE THOUGH WAS UNABLE TO EXPLAIN HOW THIS COULD BE RECONCILED WITH DISCUSSING A DRAFT TEXT WITH OPTIONS.

5. IT SEEMED TO BE THE GENERAL ASSUMPTION THAT IF THE EUROPEAN COUNCIL IS TO BE PROPERLY PREPARED THERE WILL HAVE TO BE A FURTHER COUNCIL ON 19 NOVEMBER.

FCO ADVANCE TO:-

FCO - PS, PS/LPS, PS/MR HURD, BRIDGES, SPRECKLEY, DE FONBLANQUE

ECD(1)

CAB - FRANKLIN ELLIOTT GOODENOUGH WENTWORTH

MAFF - ANDREWS HADDON

TSY - HANCOCK EDWARDS

BUTLER

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[ADVANCED AS REQUESTED]

GPS 340
[FRAME ECONOMIC]
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DESKBY 101800Z

FM BONN 101635Z NOV 81

TO IMMEDIATE FCO

TELEGRAM NUMBER 883 OF 10 NOVEMBER

INFO ROUTINE UKREP BRUSSELS

MIPT: 30 MAY MANDATE

1. IT IS NOT EASY TO BE SURE HOW AUTHORITATIVE ALL THIS IS. THERE IS NO DOUBT A TACTICAL ELEMENT IN IT. THE SUGGESTION THAT SCHMIDT IS NOT PREPARED TO FIGHT FOR RADICAL REFORM SOUNDS OMINOUS THOUGH NOT SURPRISING. NEVERTHELESS ALTHOUGH IT IS DISAPPOINTING THAT THE GERMANS HAVE NOT SO FAR BEEN ABLE TO GIVE US A FORMAL REPLY, THERE ARE AT LEAST SOME ENCOURAGING ELEMENTS IN THE LINE THIELE AND OTHERS HAVE BEEN TAKING WITH US INFORMALLY. MOST OF THOSE CONCERNED IN BONN SEE THE ELEGANCE AND RATIONALITY OF THE KINDS OF SCHEMES WE HAVE PROPOSED AND ACCEPT THAT SUCH SCHEMES WOULD BE ULTIMATELY OF GREAT VALUE TO THE COMMUNITY. IT IS ALSO ENCOURAGING THAT THEY SEE ATTRACTIONS IN THE LIMITS SCHEME. BUT THEY CONTINUE TO HAVE DIFFICULTY OVER THE NEGOTIABILITY OF THE FIGURES WHICH OUR PROPOSALS PRODUCE. AND THEY CONTINUE TO FEEL THAT OUR SEARCH FOR ROUGH BALANCE, HOWEVER JUSTIFIED BY THE LOGIC OF OUR APPROACH, WILL, IF PURSUED, INEVITABLY LEAD TO A MONUMENTAL ROW IN THE COMMUNITY.

2. MOST OF THE GERMAN RESERVATIONS WE HAVE SO FAR IDENTIFIED HAVE TO DO WITH THE FIGURING, NOT WITH THE PRINCIPLES WE ADVOCATE. IN THE INTERESTS BOTH OF KEEPING THE GERMANS WITH US IN THE RUN UP TO THE EUROPEAN COUNCIL AND OF GOOD ANGLO-GERMAN RELATIONS IN OTHER CONTEXTS, I HOPE WE CAN CONTINUE TO STRESS TO THE GERMANS THE IMPORTANCE WE ATTACH TO THE FUTURE DEVELOPMENT OF THE COMMUNITY, AS A REASON FOR PUSHING THOSE PRINCIPLES THROUGH TO GENERAL ACCEPTANCE. IN THEIR PREOCCUPATION WITH NEGOTIABILITY, THE GERMANS DO NOT ACCEPT, OR REALLY FOCUS ON, OUR VIEW THAT AN APPROACH BASED ON OUR PRINCIPLES IS THE ONLY WAY TO OPEN UP THE POSSIBILITY OF A FURTHER AND LOGICAL DEVELOPMENT OF THE COMMUNITY. THE PROBLEM REMAINS TO GET THEM TO LOOK AT THE CURRENT MANDATE DEBATE AS AN OPPORTUNITY TO PUT THE COMMUNITY ON A LOGICAL AND DEVELOPING FOOTING RATHER THAN AS A BRITISH OR GERMAN PROBLEM TO BE SOLVED BY A SHORT TERM FIX. THE WAY TO DO THIS IS TO GO ON STRESSING PRINCIPLES, NOT FIGURES.

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DESKBY 101745Z

FM BONN 101635Z NOV 81

TO IMMEDIATE FCO

TELEGRAM NUMBER 862 OF 10 NOVEMBER

INFO ROUTINE UKREP BRUSSELS

30 MAY MANDATE

1. WE HAVE NOT BEEN GIVEN ANY FORMAL REPLY TO THE PROPOSALS FRANKLIN OUTLINED TO THIELE AND OTHERS ON 5 NOVEMBER (BONN TEL NO 670). THEY HAVE HAD THE EFFECT HOWEVER, OF PROVOKING THE MOST SPECIFIC REACTIONS WE HAVE YET HAD FROM THE GERMANS, WHICH OFFER CLUES TO THE LINE THEY MAY TRY TO TAKE IN NEGOTIATIONS. WE HAVE HAD A NUMBER OF CONVERSATIONS BUT MOST OF THE FOLLOWING COMES FROM THIELE.
2. THE FIRST REACTION IS ALARM AT THE NOTION THAT THE BARGAINING SHOULD START WITH A CLAIM FOR A NIL NET CONTRIBUTION OR BROAD BALANCE FOR BRITAIN. THIELE MAINTAINS THAT THERE WILL BE NO SUPPORT FROM THE GERMANS OR ANYONE ELSE FOR SUCH A POSITION AND THAT PROMOTING IT WILL HAVE THE EFFECT OF SOURING THE NEGOTIATIONS AT THE OUTSET. NO ONE, HE MAINTAINS, IS PREPARED FOR THAT KIND OF NEGOTIATION, CERTAINLY NOT CHANCELLOR SCHMIDT. HE SAYS THAT THE FEDERAL CHANCELLOR IS PERSUADED THE BRITISH HAVE A CASE AND AT LACHE URGED MITTERRAND TO RECOGNISE THAT FACT AND, IN THE COMMUNITY'S INTEREST, TO TRY TO SOLVE IT ON A LONG TERM BASIS. MITTERRAND APPEARED TO ACKNOWLEDGE THAT BRITAIN WAS AT A DISADVANTAGE. NO FIGURES, WE ARE TOLD, WERE MENTIONED, BUT THIELE IMPLIED THAT SCHMIDT AND MITTERRAND WERE THINKING OF A PATTERN SIMILAR TO THE 30 MAY AGREEMENT, RELEASING BRITAIN FROM 2/3 OF HER NET CONTRIBUTIONS. IF CHANCELLOR SCHMIDT WAS ASKED TO SUPPORT A BIGGER CLAIM FROM BRITAIN HE WOULD BE LIKELY TO DECLINE HE EFFORT AND INVITE US TO FIGHT OUR OWN CORNER.
3. IN FURTHER DISCUSSION, THIELE MENTIONED TO US THE FOLLOWING SEQUENCE OF FIGURES FOR THE UK'S NET CONTRIBUTION:
 - 1980 - 609 MECU
 - 1981 - 730 MECU
 - 1982 - 660 MECU

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AND THEREAFTER THE FIGURE WOULD RISE IN LINE WITH THE RATE OF GROWTH OF THE BUDGET. THIELE SAID THAT THE GERMANS COULD ENVISAGE A HIGHER OR LOWER TREND LINE BUT ARE QUITE CLEAR THAT THE STARTING POINT HAS TO BE THE 30 MAY FIGURES AND THAT A NIL POSITION FOR BRITAIN COULD BE NO BASIS FOR A NEGOTIATION. THE GERMANS WOULD WANT A LIMIT FOR THEMSELVES AND EXPECT THE BALANCE OF THE NET TRANSFERS NO LONGER COVERED (IE. BY THE FRG AND THE UK) TO BE CARRIED BY THE OTHERS. IN SHORT, WHAT THEY SEEM TO HAVE IN MIND IS AN INSTITUTIONALISATION/PROLONGATION OF THE 30 MAY AGREEMENT FOR THE UK, PLUS A LIMIT FOR THE FRG AND CONTRIBUTIONS FROM THE OTHERS. THEY CLAIM TO HAVE NO INTEREST IN SEEING ANY DETERIORATION IN OUR POSITION. THIELE RECOGNISED THAT THIS SORT OF ARRANGEMENT MIGHT NOT BE VERY ATTRACTIVE TO THE UK AND ADDED THAT IT WAS VERY IMPORTANT TO DEVELOP EXISTING (ESPECIALLY THE CAP), AND NEW POLICIES IN WAYS THAT AIDED CONVERGENCE. BUT HE ADMITTED THAT THAT WAS A LONG HAUL. ALTHOUGH HE QUOTED THE CHANCELLOR AS WANTING A LONG TERM SOLUTION, OTHER INDICATIONS WE HAVE HAD SUGGEST THAT THE GERMANS ARE ONLY AIMING AT SOMETHING THAT WILL LAST UNTIL ENLARGEMENT.

4. WITH REGARD TO OUR LIMITS SCHEME, THIELE SAID THAT THE GERMANS HAD NOT YET COMPLETED THEIR TECHNICAL EVALUATION BUT CONSIDERED THAT THE SCHEME, OR VARIANTS OF IT, COULD MAKE A USEFUL CONTRIBUTION TO THE SEARCH FOR A SOLUTION. THEY MAY BE ABLE TO GIVE US A FORMAL RESPONSE LATER THIS WEEK. ON THE QUESTION OF THE ITALIAN, IRISH AND GREEK POSITIONS, THEY SAW NO POINT IN LETTING THEM OFF THE HOOK, AT LEAST TO START WITH, THOUGH THEY RECOGNISED THAT AT THE END OF THE DAY IT MIGHT BE APPROPRIATE TO DO SO.

5. WITH REGARD TO THORN'S RECENT VISIT, THIELE COULD TELL US NO MORE THAN THAT SCHMIDT HAD REPEATED THAT THE FRG WAS PREPARED TO REMAIN THE SINGLE LARGEST NET CONTRIBUTOR, IF NEED BE, BUT NOT THE ONLY ONE, AND THAT THE GERMANS NEEDED A LIMIT. THORN HAD SEEMED TO UNDERSTAND. SEE WIFT.

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Treasury Chambers, Parliament Street, SW1P 3AG

David Wright Esq
Private Secretary to the
Secretary of the Cabinet
Cabinet Office
Whitehall
London SW1

Handwritten signature

10 November 1981

Dear David,

OD: 12 NOVEMBER

As the Chancellor will be away from London on 12 November, he has asked the Chief Secretary to attend this meeting of OD in his stead. I should be grateful, therefore, if the Chief Secretary could take up his standing invitation to attend on this occasion. I understand that the Financial Secretary and Sir Kenneth Couzens are also to be invited to attend.

I am sending a copy of this letter to Michael Alexander at No. 10.

*Yours ever,
Terry Matthews*

T F MATHEWS
Private Secretary



10 DOWNING STREET

From the Private Secretary

9 November 1981

COMMUNITY AID FOR HOUSING IN NORTHERN
IRELAND

The Prime Minister has seen and taken note of your letter to me of 31 October on this subject.

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

M. O'D. B. ALEXANDER

Richard Riley, Esq.,
Department of Industry.



File
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10 DOWNING STREET

From the Private Secretary

9 November 1981

EC BUDGET: NEW ESTIMATES OF NET
CONTRIBUTIONS AND RECEIPTS

The Prime Minister has seen and taken note of your letter of 5 November to Michael Scholar on this subject.

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office), Kate Timms (Ministry of Agriculture, Fisheries and Food) and to David Wright (Cabinet Office).

M. O'D. B. ALEXANDER

John Kerr, Esq.,
H.M. Treasury.



PM/81/50

PRIME MINISTER

*I think I shall
need a touch-up
for the Foreign
Prime Minister*

*for O.S. (unless we
succeed in arranging prior
meeting with Mr Brandin)*

*This is, of course, for discussion at
O.S. But you may like to have a first
read over the weekend. (also attach Mr
Walker's paper.*

EC Budget Restructuring: The November European Council

*Paul
6/11*

1. The attached paper by officials sets out the present situation of the negotiations and the main tactical options for us in the remaining two weeks run-up to the November European Council.

2. As was predictable, the prospect is not an encouraging one. The traditional reluctance to concede a shift from opening negotiating positions until the last possible moment is in full operation. Other Governments are nervous about the very large financial transfer needed if we (and the Germans) are to get satisfaction. And there have been a number of recent changes in government (France, Greece, Ireland) or government crises (Belgium, Netherlands) which have caused delay. As the country holding the Presidency and as the Member State with the biggest interest in change, our task is to bring about some movement and flexibility.

3. Over the next few weeks we shall be seeking to achieve this. At the Foreign Affairs Council on 16/17 November I intend to invite President Thorn to join me in a series of bilateral consultations designed to probe the position of each of the Member States. But to have any chance of success I need to know more clearly what our own objectives for the European Council are. The Anglo-German Summit on 18 November will be a further opportunity to concert with Chancellor Schmidt. Thereafter I think we must be ready to use the few remaining days in key bilateral contacts probably backed up by a message from you to your colleagues on the European Council. The President of the Commission will visit London on 13-24 November. We need to ensure that his efforts complement rather than cut across our own.

4. So far as the substance of the negotiation is concerned, I think the main issues and our interest are as follows. The chapter dealing with non-agricultural policies is the least contentious.

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We need to ensure that it does not result in an expansion putting the 1% ceiling at risk (on which we see eye to eye with the Germans, and where the financial trends away from early exhaustion of the existing resources makes this less and less a live issue). Subject to that caveat we need to do as well as we can on such policies as the Regional and Social Funds, where we have hitherto achieved a net gain and which could again in the future affect our net contribution if, as is possible, the Commission scheme forms the basis of the final solution on the budget. And we must at all stages remember that a presentational success on this chapter is a crucial political need for a number of the Member States who will be taking losses, often substantial losses, on the other two. So far as the reform of the Common Agricultural Policy is concerned, we have our own national objectives to pursue. But we shall not achieve them all. There are too many vital, entrenched interests among the other Member States to permit that. The French in particular are shaping up clearly to insist on some of their main agricultural objectives in return for a settlement on the budget. We shall need to consider very carefully how much we can afford to concede in such a trade-off. We may need to distinguish between concessions that would seriously affect our own farming or our overseas interests, which we must resist, and those with mainly financial consequences which could be recovered or largely offset by a satisfactory budget deal. The Minister of Agriculture's paper deals in more detail with this aspect of the negotiations. Finally there is the budget, where the prospects for achieving the kind of overall reform of the Community's financial arrangements, which we have so far advocated, look pretty bleak. We shall first have to see whether the Germans will support the modified limits scheme which we have put to them. If not, or if the reaction from other Member States is hostile, we shall have to consider how we can achieve our budgetary aims within the framework of the Commission's ideas. It is always a great deal easier in the Community to be negotiating on the basis of something the Commission has proposed.

5. We need to face the possibility that the November European Council will not be a full success, with detailed decisions,

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acceptable to us, taken on all three chapters. While we should, I am convinced, keep up as much pressure as we can for making decisive progress, both in advance of the meeting and at it, we need to avoid an all-or-nothing approach which would result in failure on this occasion almost certainly polarising the subsequent negotiation on a familiar 9 : 1 pattern, and leading to the sort of parliamentary and public reaction in this country which will be damaging to any party committed to continued membership of the Community.

6. In fact a half-success, with some progress on all three chapters, could suit us pretty well, given that the subsequent detailed negotiation would come to a head when we were no longer inhibited by being in the Chair, and when the 1982/3 agricultural prices are up for discussion, giving us the leverage we lack at the moment. A half-success, with credit to the British Presidency for having achieved it, would certainly be a better springboard for achieving our objectives in the next stage of the negotiations than would be a clear confrontation. For these reasons, I favour an approach based on option (iii) in the note by officials. The main problem we shall face in working for such an outcome is that, in order to get something useful on the budget (and without precision on figures I believe we can make some progress there) we shall come under pressure, particularly from the French, to concede something on agriculture. But anything we do concede on agriculture will require much detailed working out in the Agriculture Council and that leads back to the leverage we shall have at the time of the next price-fixing, particularly if we are prepared to be really tough in the opening stages on the prices themselves.

7. As to our third year of refunds under the 30 May agreement, I am sure it is right to play this cool and long. If we can get a clear indication from the European Council that the target remains to apply a longer term solution to our unacceptable situation with effect from 1982, then the domestic situation should be reasonably easy to handle, given that our 1981 refunds will be coming in during the first quarter of next year. The last thing we want is

/to



to shift the main focus of negotiation away from the Mandate; and to get into a squabble over the figures which will split us from the Germans and which will inevitably be centred on a system and numbers heavily prejudicial to what we are trying to achieve in the wider negotiation.

8. I invite my colleagues to agree that in the run-up to the European Council we should follow the tactics I have suggested.

9. I am copying this minute to other members of OD and to Sir Robert Armstrong.


(CARRINGTON)

Foreign and Commonwealth Office, SW1

6 November 1981

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BUDGET RESTRUCTURING: PREPARATION FOR NOVEMBER EUROPEAN COUNCIL

Note by Officials

Introduction

1. When the Committee last considered this subject in September, it agreed (OD(81)15th Meeting) that while the UK might not be able to carry the budget restructuring negotiations as far forward as we would like during our Presidency, we should push hard for decisions at the November European Council for a fair and lasting solution to our net contribution problem. We should work for clear guidelines on CAP reform, take a constructive attitude on the development of other policies within the 1% ceiling and, while not ruling out the Commission's ideas for a budgetary mechanism, we should maintain the Chancellor of the Exchequer's 'Hague' approach that the effects of the budget on member states should be based on deliberate decisions reflecting relative prosperity. Although this approach implied that the UK should end up as a net beneficiary, our private fall back position would be to aim for a nil net contribution.

2. This note reviews progress in the negotiations and analyses the tactical choices for the European Council on 26/27 November.

Progress in the Council and Mandate Group

3. The Mandate Group has met weekly since early September, dealing successively with each of the three chapters of the Mandate, namely non-agricultural policies, CAP reform, and budget problems. The Agriculture and Finance Councils held debates on 19 October and the Foreign Affairs Council discussed the Mandate on 26 October.

4. It is generally accepted that the European Council will be asked to consider three interrelated issues: the development of other Community policies, CAP reform and the budget.

Chapter I: Other Policies

5. Apart from the substance, this Chapter is of considerable political importance. Most member states wish to give renewed impetus to the development of Community policies on a broad front. And for Denmark and the Benelux countries it is only in Chapter I that they can look for positive progress to offset the painful concessions they will have to make on

/Chapters II

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Chapters II and III. The Italians will also expect to benefit substantially from the new guidelines on the Regional and Social Funds. Several of the ideas put forward by the French in the recent 'relance' memorandum can also be subsumed under this chapter. There is also quite a lot for the UK to play for: there is scope for some modest budgetary improvements from the Regional and Social Funds, and completion of the internal market including services such as insurance will also be to our advantage. While there will also be new efforts to coordinate monetary, economic, social, employment and energy policies, this is unlikely to involve very precise commitments which would tie our freedom of action. No one is arguing that the 1% VAT ceiling should be raised now, and support even for mentioning the possibility in the future is weak.

Chapter II: CAP Reform

6. Discussion on changes in the CAP have brought to the fore highly divergent points of view about how the CAP should be developed. There is no prospect of presenting the European Council with agreed conclusions. While no one disputes the need for price restraint, we are unlikely to get any precise guidelines except in the case of cereals where the Commission have proposed that the Community needs to progress towards the US cereals price by 1988. The Commission have now given up the idea that prices for other commodities should be linked to external benchmarks. There is support for the concept of limiting guarantees to producers once specified production levels are reached. But for cereals and milk products at least, the French and some others want such measures applied so that they hit large scale rather than smaller producers, although this concept is resisted by the Netherlands and Denmark as well as by the UK. The latest Commission proposals for exemptions from coresponsibility levies for milk which go some way to meet French demands contain features which would be unacceptable to us. The concept of income aids as a counterpart to a rigorous price policy has not found much favour, and the Commission's latest proposals include instead the differentiated application of co-responsibility measures as an alternative approach. The French are pressing for the Community to develop an active export policy and to apply stronger import protection particularly for cereals substitutes and they would like to see some commitment to a tax on oils and fats after Spanish accession. All these ideas are being resisted by ourselves and the Germans, with some Dutch support, but it may be difficult to avoid giving some ground if we are to get what we want on the Budget. Similarly we may have to go some way to meet the Italians on Mediterranean agriculture though our aim is to leave any commitment as vague as possible. All member states are likely to pay lip-service at least to stronger discipline on

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national aids. We have had some useful support from the Germans, and to a lesser extent the Dutch on setting a financial ceiling on the growth of agricultural guarantee expenditure. But the idea is strongly resisted by the other member states.

Chapter III: Budgetary Problems

7. No concrete progress towards an agreed solution has been made. We have demonstrated that even on the most optimistic assumptions about CAP reform and the development of other policies the UK would remain a substantial net contributor in the absence of some form of budget corrective mechanism. But there has been no support for our Hague speech approach. The French and Danes still argue strongly that if there is a budget problem it should be treated as a residual to be dealt with only after the financial effects of CAP reform and the development of other policies have become clear. Together with the Netherlands and Belgium they contend that any eventual compensation must be ad hoc, temporary and degressive. The Commission scheme, which would compensate the UK for a proportion of the difference between its share of Community GDP and the share of CAP guarantee section receipts, has found support only from the Belgians and the Italians. The Germans have argued that their own net contribution should be limited and have invited the Commission to make appropriate proposals but have not put forward any specific proposals of their own. The Commission are confident that their own scheme provides the only basis on which agreement will prove possible. We have not ruled out the possibility, but have said that we could only consider it if it were accompanied by the continuation of an appropriately amended Financial Mechanism. We have put to the Germans a scheme based on the Hague speech approach, but limited to net contributors and any possibility of reaching agreement on a method of this kind will depend on their reaction.

The Objectives of Other Member States

8. The German Government have not made up their minds as to what they want. Some are arguing for a direct limit on the German net contribution to the budget while at the other extreme, some would be content with some modest alleviation of the German contribution to the UK refunds. The former arrangement would be anathema to several member states involving as it would payments by them to the Germans, but the latter arrangement might be acceptable. The Germans are prepared to contemplate additional expenditure on other policies only to the extent that savings on the CAP are achieved though their ideas for the CAP are different from ours. As far as we

/know,

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know, the French have not considered what final outcome they want to achieve. But what seems to be emerging more clearly is a determination to win substantial concessions from us over the CAP for whatever they are forced to concede on budget mechanisms. They may also seek to make a link with the outstanding issues on the common fisheries policy. While the key to the negotiations will lie with what we can bring the French and Germans to accept, in contrast to the negotiations leading to the 30 May Agreement their positions are still wide apart on all three chapters. The Italians will hope that, as a less prosperous member state, they will not have to contribute to our refunds, and will concentrate mainly on maximising their financial gain from the CAP and other policies. So far the Greeks have followed a similar line but no one yet knows the attitude of the new government. The Benelux countries have shown some flexibility as regards the UK budget problem but will be concerned to minimise the cost to them. The Danes have taken the most extreme position in resisting our claims and criticising the Commission's proposals. The statements made in public will make it difficult for them to accept a settlement which will satisfy us. The Irish are concentrating on defending the benefits they have secured from the CAP and avoiding any restraints on the future expansion of Irish agriculture.

Some tactical issues

9. There are important links between the three Chapters. Our essential objective is to achieve a satisfactory conclusion on Chapter III. But to achieve this, we shall have to be prepared to make concessions to the French, in particular on Chapter II on which we have our own objectives of getting clear guidelines for the reduction of CAP surpluses and the cost of their disposal. The French objectives of increasing agricultural protection and discriminating in favour of small producers are contrary to UK interests and do not deal with the underlying problems of the CAP. Other member states will not be prepared to agree to anything on Chapter III unless equivalent progress is made on Chapter I.

10. Our objective remains to avoid linking fisheries with restructuring. Otherwise our fisheries objectives might be achieved only at an excessively high cost in terms of restructuring yet might still be criticised by the fishing industry in the belief that their interests had been sacrificed. Our aim is to reach agreement on a CFP at the Fisheries Council on 30 November/1 December or shortly thereafter. If we do not succeed, however, and if we have not reached agreement on restructuring at the November European Council it will become increasingly difficult to keep the two issues disentangled.

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11. There is also the problem of our 1982 refunds. Under the 30 May Agreement "For 1982 the Community is pledged to resolve the [budget] problem by means of ^{structural} changes... If this is not achieved the Commission will make proposals along the lines of the 1980-1981 solution and the Council will act accordingly". If no agreement is reached on a more lasting solution, therefore, we are entitled to 1982 refunds on the basis of the 30 May agreement. These refunds for 1982 would mainly be provided for in the 1983 budget, which does not come forward in draft until June 1982. So technically there is no need to settle this matter as soon as this November (although there is a minor problem about advances in the 1982 budget itself which will be adopted in December of this year). There are several reasons for not pressing the issue at this stage:

- our whole posture is that we want a lasting solution, taking effect from 1982
- pressure from us for a third year of 30 May refunds would bring us into conflict with the Germans, who believe that their share in the financing of our refunds is excessive
- given the way the current drop in the Community's agricultural spending is affecting the UK's unadjusted net contribution some member states will seize the opportunity to urge that the 30 May arrangements provided for a minimum net contribution by the UK, not a minimum net refund
- the whole negotiation for a third year of refunds under the 30 May agreement will be on a basis and about figures which will prejudice what we are trying to negotiate for a long term settlement
- finally, if 1982 becomes the first year of the new system it could well be financially preferable for us to having a third year of the old.

For all these reasons we should go for a decision at the November European Council that the new system, whatever it is, will apply from 1982. A third year under the 30 May system should be a fall-back, only to be used if the Mandate negotiations get irremediably stuck.

Options for European Council

12. We have always recognised that however successful we were on 26/27 November, a lot of work would be needed after November, at least on Chapters I and II, to turn
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the European Council's conclusions into operative legal measures. It is increasingly difficult to be optimistic that we shall reach complete agreement on the main points of substance in November. In particular the French seem bent upon a long negotiation, and their Government is not so organised as to be able to reach decisions quickly. The Germans have not yet brought themselves to the point of decision so, although we may still hope to influence them they are for the moment another obstacle to progress. But there will be some intensive negotiations over the next few weeks in which we might improve the position. There will be meetings of the Foreign Affairs Council on 16/17 and 19 November, while the Anglo-Italian and Anglo-German summits on 9/10 and 18 November will provide further opportunities to bring pressure to bear. The question therefore is how far we should try to go towards our objectives at the European Council in November. The options seems to be as follows:-

- i. We could go all out for a full settlement on the substance in November, including agreement on the detailed arrangements for solving our budget problem, recognising that we would in all probability fail. (Obviously it would not be in our interests to reduce our objectives to what others are prepared to agree to, merely in order to achieve a quick settlement in November). Since there is no agreement in sight even on the basis for negotiation on the budget, we could not realistically expect to get decisions in November. The 1% VAT ceiling is not an imminent constraint and so we cannot use it as a lever to force others into a quick settlement. To go all out for a full settlement and fail would polarise positions, probably on a 9:1 basis and thus make more difficult the achievement of our objectives in subsequent negotiations. Moreover to pursue such a course while we hold the Presidency would not be easy; and failure would make it more difficult to avoid an early negotiation on our 1982 refunds.
- ii. We could acknowledge that a budgetary settlement needs more time, and concentrate our negotiating efforts on CAP reform and the development of other policies. This would undoubtedly be the easiest course for us to pursue as Presidency. But we should lose the leverage the other two chapters give us to secure what we need on the budget and it would be seen as a loss of resolve on the part of the UK. Moreover, our 1982 refunds might then need to be negotiated on the basis of 30 May Agreement. This course cannot therefore be recommended.

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- iii. We could aim to make roughly parallel progress on all three chapters, which would imply at best settling only on the basic features of a budget solution in November leaving the negotiation of the figures until later. We should have to insist that we could only adopt conclusions at the European Council on Chapters I and II if we got parallel satisfaction on Chapter III. We should under this option be able to use a link with the 1982 agricultural price fixing to enable us to achieve satisfaction when the budget figures were negotiated and possibly also to ensure that further work on Chapters I and II was acceptable to us. Under this option it should be possible to get agreement that the new budget system should come into effect in 1982.
- iv. We could decide now to defer the crunch on all three chapters until next spring when it would inevitably coincide with the agriculture price fixing. This option would fail to meet the timetable laid down in the 30 May Mandate and would imply a lack of resolve on our part. It would not allow us to claim any credit for the UK Presidency in achieving progress on the Mandate and we would have lost such opportunity as holding the Presidency gives us to influence the outcome in our favour. It would, however, maintain the Mandate work as a coherent whole and would not in practice impede work on specific measures where work was sufficiently advanced and we could pursue selectively whatever was appropriate in the national interest. But this is not an option to be recommended.

Anglo-German Summit

13. We shall want to use the Anglo-German summit to try to maintain our joint approach and if possible to agree on a method for dealing with the budget problem. We shall also want to try to maximise our common ground and minimise our differences on agriculture. If Ministers decide that we should try to make parallel progress on all three chapters at the November European Council (Option iii) it will be necessary to take a final view on precisely what we could realistically aim to achieve in the light of the Anglo-German summit.

/CONCLUSION

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CONCLUSION

14. However successful we are on CAP reform and the development of other policies, a budget corrective mechanism will be essential to deal with the United Kingdom's net contribution problem. Our arguments that the Community should have a policy for distributing the budget according to objective criteria such as relative wealth and population size have made no headway and show no signs of doing so. We are therefore faced with the options set out in paragraph 12 above. Ministers are invited to consider what general approach they want to adopt in the remaining weeks before the European Council.

Cabinet Office
3 November 1981

CONFIDENTIAL



Mr Alexander

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

5 November 1981

(4)

Michael Scholar, Esq.,
Private Secretary,
10, Downing Street

MS

Prime Minister

Paul

Dear Michael,

EC BUDGET: NEW ESTIMATES OF NET CONTRIBUTIONS AND RECEIPTS

The Chancellor has asked me to let you know that, as he foreshadowed when he spoke to the Prime Minister and the Foreign and Commonwealth Secretary on Monday, the Commission have now released to the press new estimates for Member States' net contributions and receipts in respect of the EC Budgets for 1980 and 1981. These show lower net contributions by the UK than previously expected. They also show higher net receipts by France and lower net receipts by Italy. The attached table sets out the figures, which are before refunds to the UK.

....

The Chancellor has asked our Press Office to take the following line:-

We shall need to examine these new Commission estimates with care. If it is true that our adjusted net contribution in respect of 1980 and 1982 will turn out to be lower than expected, that is very satisfactory, because the 30 May Agreement left us paying a large net contribution even though we are one of the poorer Member States. But the problem of 1982 and later years remains to be solved.

If it is argued that our refunds should be reduced because of the shortfall in our unadjusted net contribution, we shall reply that the 30 May Agreement gives us refunds of 1175 million ecus in respect of 1980 and 1410 million ecus in respect of 1982. There is no provision for these refunds to be reduced.

If it is argued that the latest figures show our budget problem to be disappearing, we shall reply that the figures relate to the past, but the current negotiations are about the future. A number of factors are tending to reduce our net contribution at present. Some may be reversed, some certainly will be. On the expenditure side of the Community Budget, high world food prices are tending to curb the costs of the CAP. On the financing side, the behaviour of the sterling/ecu exchange rate has

/switched some



switched some of the UK's contributions from 1981 into 1982. Our net contribution in respect of 1982 may well be of the order of 2 billion ecus (before refunds).

Finally, I should mention that we have one or two technical doubts about the Commission's figuring. In particular, we believe our net contribution in respect of 1980 to have been of the order of 1700 million ecus, rather than the 1512 million ecus suggested by the Commission. We are pursuing detailed methodological points with the Commission.

I am sending copies of this letter to Brian Fall (FCO), Kate Timms (MAFF) and David Wright (Cabinet Office).

Yours ever

J.O. Kerr.

J.O. KERR

COMMISSION ESTIMATES OF NET CONTRIBUTIONS (-) AND
RECEIPTS (+) BEFORE UK REFUNDS⁺

Million ecus

	<u>1980</u>	<u>1981</u>
Germany	- 1540	- 1647
France	+ 423	+ 624
Netherlands	+ 441	+ 223
Belgium	+ 225	+ 388
Denmark	+ 331	+ 302
Luxembourg	+ 232	+ 262
UK	- 1521*	- 1505*
Italy	+ 735	+ 619
Ireland	+ 644	+ 591
Greece	n.a.	+ 123

⁺ On our interpretation, the 30 May agreement gives the UK refunds of 1125 million ecus in respect of 1980 and 1410 million ecus in respect of 1981.

^{*} The forecasts in the 30 May agreement were -1784 million ecus in respect of 1980 and -2140 million ecus in respect of 1981.

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TO IMMEDIATE FCO

TELEGRAM NUMBER 870 OF 5 NOVEMBER

INFO UKREP BRUSSELS

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MANDATE: LIMITS SCHEME: THIELE/FRANKLIN MEETING

1. THIELE WAS SUPPORTED BY FISCHER, MUELLER-THUENS, HECK AND BROCKDORFF.

2. AFTER APOLOGISING FOR THE HASTE WITH WHICH THE MEETING HAD BEEN SET UP, THE VERY SHORT TIME THE GERMANS HAD HAD TO STUDY OUR PROPOSALS AND THE NEED THAT WAS LEADING US TO PRESS THEM FOR AN EARLY RESPONSE, FRANKLIN INTRODUCED THE MAIN FEATURES OF THE SCHEME OUTLINED IN FCO TELS NOS 468 TO 470 AND 473 TO BONN. HE POINTED OUT THAT WHEREAS THE LOGIC OF THE SCHEME THAT WE HAD EARLIER BEEN DISCUSSING, BASED ON THE PRINCIPLE OF FLOWS FROM THE RICHER TO THE POORER, MEANT THAT THE UK SHOULD BE A NET BENEFICIARY, WE WERE, WITH A VIEW TO ADVANCING DISCUSSION, NOW READY TO DILUTE THAT PRINCIPLE AND ACCEPT A POSITION OF MAKING A SMALL CONTRIBUTION TO THE ALLOCATED BUDGET. WE HAD NOT DISCUSSED THESE IDEAS WITH ANYONE ELSE, HAD NO GAME PLAN FOR PURSUING THEM AT THE MOMENT. THEIR FUTURE WOULD DEPEND UPON THE GERMAN REACTION. IN ANSWER TO A QUESTION, HE SAID THE NEW PROPOSALS, AS THE PAPERS SHOWED, DID NOT MEAN QUOTE BROAD BALANCE UNQUOTE FOR THE UK.

3. IN RESPONSE TO THE REQUEST FOR A GERMAN REACTION, FISCHER SAID THAT THE GERMANS COULD NOT SAY WHAT IT WAS NOR WHEN THEY MIGHT BE IN A POSITION TO RESPOND. MUELLER-THUENS, HOWEVER, OBSERVING THAT TIME WAS SHORT SAID THAT HE SAW A CONSIDERABLE POLITICAL DIFFICULTY IN OUR LATEST PROPOSALS IN THAT THE BRITISH POSITION WOULD BE NEARER TO A NIL CONTRIBUTION THAN TO THE LEVEL OF CONTRIBUTION AGREED UNDER THE 30 MAY AGREEMENT. IT SEEMED TO HIM INCONCEIVABLE THAT NEGOTIATIONS IN THE COUNCIL WOULD START ANYWHERE ELSE THAN AT THE

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POINT THAT IN 1960 AND 1961 BRITAIN'S CONTRIBUTION WAS RESPECTIVELY 609 AND 750 MECU AND WENT ON TO RECALL THAT THE 30 MAY AGREEMENT ALSO PROVIDED FOR A SOLUTION IN RESPECT OF 1962 QUOTE ON THE LINES UNQUOTE OF THOSE AGREED FOR 1960-81. SOME MEMBER STATES WERE ARGUING THAT THE BRITISH CONTRIBUTION SHOULD RISE. FRANKLIN OBSERVED THAT THE 30 MAY MANDATE ALSO SPOKE OF THE NEED TO FIND A LONGTERM SOLUTION TO THE STRUCTURAL PROBLEM AND THAT THE BRITISH HAD THOUGHT THE GERMANS WOULD FIND ATTRACTIVE IN A LIMITS SCHEME. THE GERMANS ACKNOWLEDGED THAT, BUT QUESTIONED WHETHER THE LIMITS SCHEME WOULD HELP NEGOTIATIONS AT THIS STAGE. FRANKLIN POINTED OUT THAT THERE HAD TO BE SOME BASIS FOR THE NEGOTIATION AND WANTED TO KNOW IF THE GERMANS HAD ANYTHING IN MIND. AFTER A NOTICEABLE PAUSE THE GERMANS SAID THEY WERE WAITING FOR THE COMMISSION AND THAT CHANCELLOR SCHMIDT HAD PRESSED THORN YESTERDAY TO MAKE PROPOSALS THAT TOOK ACCOUNT OF THE GERMAN POSITION AS SOON AS POSSIBLE.

4. THIELE OBSERVED THAT THE NEW PROPOSALS EXONERATED THE IRISH AND THE ITALIANS FROM ANY CONTRIBUTION AT ALL. DID THAT MAKE SENSE QUESTION MARK.

5. FRANKLIN SAID THAT IN CONSIDERING THIS OR ANY OTHER SCHEME IT WOULD BE A MISTAKE TO ASSUME THAT BRITAIN WOULD BE READY TO BE A NET CONTRIBUTOR ON ANY SIGNIFICANT SCALE.

6. THE ILE UNDERTOOK TO TRY TO CONVEY A REACTION TO US BY MONDAY OR TUESDAY 9/10 NOVEMBER.

FCO PLEASE ADVANCE TO:-
CAB OFFICE FRANKLIN WENTWORTH
FCO BRIDGES HANNAY SPECKLEY
TREASURY HANCOCK EDWARDS CULPIN

TAYLOR
FRANKLIN ECONOMIC
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#12
Ref: A05891PRIME MINISTERCommunity Affairs

The Chancellor of the Exchequer could report on the discussions at the Informal Meeting of Finance Ministers on 30/31 October, with particular reference to the mandate negotiations. The Chancellor also had a private talk with M Delors, the French Finance Minister, in the margins of the meeting.

2. The Foreign and Commonwealth Secretary could report on the meeting of the Development Council on 3 November, which agreed useful conclusions on a number of relatively minor aid questions. Despite pressure from the Commission and the Dutch for substantive discussion of the Community's position on the global negotiations, the Council reserved decisions on this issue to the Foreign Affairs Council.

3. The Secretary of State for Employment might report on the meeting of the Standing Committee on Employment on 3 November, which he chaired. The main item on the agenda was a Commission communication on the social aspects of new technologies.

4. OD(E) will have met before Cabinet to settle the United Kingdom's approach to the next stage of the negotiations for a renewed Multifibre Arrangement. Next week the Research Council meets on 9 November, and the Foreign Affairs Council on 10 November (to deal with textiles). The Anglo-Italian Summit will take place in London on 9 November.

RA
ROBERT ARMSTRONG

4 November 1981



JS
cc HM/T
CW

Suro pd.

10 DOWNING STREET

From the Private Secretary

3 November 1981

EC BUDGET MANDATE

I should be grateful if you could make a small amendment to my letter to you of 2 November on this subject. The final sentence of the first paragraph on page 2 should be deleted and the penultimate sentence should read:- "In any case it would be more effective if the new scheme was presented direct to the Chancellor's staff rather than to the Finance Ministry in Bonn.

original letter amended.

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

M. O'D. B. ALEXANDER

Brian Fall, Esq.,
Foreign and Commonwealth Office.

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JS
cc HMT
CO

SUBJECT.

10 DOWNING STREET

cc. Minister etc.

From the Private Secretary

2 November 1981

BF (see page 2)

Dear Brian,

EC BUDGET MANDATE

The Prime Minister held a meeting here this morning to discuss our approach to the discussion of the EC Budget Mandate at the European Council meeting later this month. The Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Lord Privy Seal took part. Mr. Franklin was also present.

1981 Figures

There was a brief preliminary discussion of the size of the UK contribution to the 1981 Budget. The Foreign and Commonwealth Secretary said that the UK contribution was likely to be small. It might not be as low as the Sunday Times had suggested the previous day, i.e. £55 million. But the latest Commission figures suggested that it would be about £70 million. The Chancellor of the Exchequer agreed that the figures were likely to be very good but said that this was the result of a number of chance factors, e.g. favourable agricultural prices. It would be essential to be cautious until the final figures were produced. In any case they provided no basis for optimism in the longer term. The Foreign and Commonwealth Secretary agreed.

New Budget Limits Scheme

The Foreign and Commonwealth Secretary said that he thought it unlikely that the Germans would be attracted to the new scheme which the Chancellor of the Exchequer had circulated under cover of his minute of 19 October (and which had been amended in Mr. Kerr's letter of 29 October to Mr. Scholar). He had no objection to the presentation of the scheme to the German Government but he was concerned about the impact on the Germans of the illustrative tables which had been prepared. He himself would prefer that no tables should be handed over. If there had to be tables, he hoped that they would not show a zero contribution by Britain. To do this would leave us open to the accusation that we were seeking a "juste retour". Moreover, if the Germans were going to have to pay as much as the tables proposed, they would certainly expect us to pay something. We would need German support if we were to get anywhere with the rest of the Community. As regards our overall objective, we had never said publicly that our aim was to contribute nothing.

/ The Chancellor

JS

The Chancellor of the Exchequer said that he was less worried than the Foreign and Commonwealth Secretary about presenting tables along the lines proposed to the Germans. It would be wrong to circulate anything which suggested that the United Kingdom was prepared to be a net contributor. OD had established our objective as being a zero contribution. The figures proposed for a German contribution might be high. But they were lower than the Federal Republic would otherwise pay and they did set a ceiling. Moreover, the effect on the anticipated receipts of the "small rich" members of the Community would be severe. If the figures in columns 3a and 3b of the enclosure to Mr. Kerr's letter under reference were unacceptable, perhaps they could be replaced with a table in which one column would show Britain as a net contributor and the other as a net recipient. In any case it would be *more effective if* the new scheme ~~should be~~ presented direct to the Chancellor's staff rather than to the Finance Ministry in Bonn. The latter could be expected to react negatively.

The Prime Minister agreed that illustrative tables would have to be provided but said that she was unhappy about handing over a table showing a zero contribution for the United Kingdom. 'It would be easier if the figures suggested a contribution of, say, 70 million ecus. The German contribution seemed in any case very high. The Prime Minister said that she sympathised with the Chancellor of the Exchequer's objectives. But the question was what it was realistic to expect to achieve and what tactics were most likely to succeed. Would it be possible, for instance, to include in the figures the unallocated budget? Everyone had to contribute to administrative costs.

It was agreed that a table with amended figures showing a UK contribution should be prepared and handed to the Germans as soon as possible. The best means might be for Sir J. Taylor to take action with Dr. Heick. The Germans should be asked to reply in the course of this week in order that their reaction would be available before the Italian bilateral or, at the latest, before OD on 12 November.

General

The Foreign and Commonwealth Secretary said it was not realistic to envisage a settlement of the Budget problem at the European Council later this month. But some progress had to be seen to be made. We should be attempting to get the method of Budget reform, rather than the figures, settled. It would be right also to try to ensure that our 1982 Budget contribution was determined on the basis of whatever new approach was agreed rather than by rolling forward the May 1980 arrangement. It would be essential to decide before the European Council whether we were going for a solution along the lines favoured by the Treasury, i.e. a ceiling on contributions adjusted by reference to GDP, or along the lines favoured by the Commission, i.e. a combination of Chapter 1, FEOGA reform and a balancing mechanism. The Treasury approach would, of course, be excellent if we could secure its adoption. But we might be forced back to the approach advocated by the Commission.

/ The Chancellor

The Chancellor of the Exchequer said that it would be sensible to await the German reaction to the latest version of the Treasury approach before deciding how to proceed. The Prime Minister agreed. She said that she was much concerned by the absence of progress so far. She thought it would be essential to have something to show as a result of the UK Presidency. (The Foreign and Commonwealth Secretary noted that it was in some ways a handicap for us to hold the Presidency.) It was difficult to see how a satisfactory outcome could be achieved which did not include a corrective based on Member States' ability to pay.

Bilateral Contacts

The Chancellor of the Exchequer said that a conversation in the margin of the ECOFIN meeting before the weekend had led him to the conclusion that M. Delors was the French Minister most likely to be helpful to our cause. M. Delors was looking for a solution before next summer. He was thinking of an arrangement which would last some years and would be degressive. M. Mitterrand, according to M. Delors, was anxious to keep in close touch with the Prime Minister in the run-up to the European Council. He would like to arrange a contact with the Secretary of the Cabinet. The Prime Minister said she saw no difficulty in this.

It was agreed that there would be little point, given the shortage of time, in trying to expand the Italian bilateral to include Finance Ministers.

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

Yours ever

Michael Alexander

Brian Fall, Esq.,
Foreign and Commonwealth Office.

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MY TWO I.P.T.S FOLLOWING ARE FIGURES:

NET CONTRIBUTIONS AND RECEIPTS BEFORE AND AFTER CORRECTION
 MILLION ECUS ESTIMATES FOR 1981

	'UNCORRECTED' PATTERN (1)	POST 30 MAY PATTERN(2)	POSSIBLE PATTERNS UNDER PROPOSED SCHEME(3)	'CORRECTED' UNDER SCHEME(3)	'UNALLO- CATED' BUDGET(6)
	1	2	3A AT CURRENT EXCHANGE RATES	3B HIGHER £ EXCHANGE RATE VARIANT	4
GERMANY	-1650	-2155	-1810	-1695(4)	-120
FRANCE	135	- 305	- 445	- 370	- 30
NETHERLANDS	370	275	80	80	-55
BELGIUM	450	380	105	105	5
DENMARK	405	370	70	70	- 5
LUXEMBOURG	285	280	130	130	-
UK	-1865	- 455	- 5	-190	-185
ITALY	1020	775	1020	1020	-105
IRELAND	710	695	710	710	-
GREECE	140	140	140	140	- 15

NOTES

1. COLUMN 1 IS THE AVERAGE OF THE TWO CASES ILLUSTRATED IN THE COMMISSION'S PAPER SEC(81)1.281 DATED 30 JULY 1981.
2. COLUMN 2 ASSUMES THAT GREECE DOES NOT CONTRIBUTE TO THE UK REFUNDS.
3. COLUMN 3A IS BASED ON FORECAST AVERAGE EXCHANGE RATES FOR 1981 AND ASSUMES THAT UK GDP PER HEAD, IN ECUS, IS 93.4 PER CENT OF THE COMMUNITY AVERAGE. COLUMN 3B ILLUSTRATES HOW THE PATTERN MIGHT LOOK IF THE POUND/ECU EXCHANGE RATE WERE 10 PER CENT HIGHER AND UK GDP PER HEAD, IN ECUS, ROSE IN CONSEQUENCE TO 102.8 PER CENT OF THE COMMUNITY AVERAGE (SEE PARAGRAPH 5 OF THE NOTE).

/4. THE

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4. THE UPPER LIMITS ON THE GERMAN NET CONTRIBUTIONS IN COLUMNS 3A AND 3B WOULD BE SOME 1950 MILLION ECUS AND SOME 1725 MILLION ECUS RESPECTIVELY. ON THE FIGURES USED HERE, THESE LIMITS WOULD NOT BE 'BINDING' IN EITHER CASE - SEE PARAGRAPH 7 - BUT THE PROXIMITY OF GERMANY'S UNCORRECTED NET CONTRIBUTION TO ITS UPPER LIMIT WOULD BE REFLECTED IN MORE MODEST GERMAN CONTRIBUTIONS TO THE UK REFUNDS THAN UNDER THE 30 MAY SYSTEM.
5. SEE FURTHER PARA 2(2) OF THE NOTE.
6. THE FIGURES IN COLUMNS 1, 2 3A AND 3B RELATE TO THE 'ALLOCATED' BUDGET ONLY. UK ESTIMATES FOR NET CONTRIBUTIONS TO, AND RECEIPTS FROM, THE 'UNALLOCATED' BUDGET ARE SHOWN IN COLUMN 4. THE UNALLOCATED BUDGET INCLUDES AID, UNALLOCATED ADMINISTRATION, ERDF NON-QUOTA SECTION, TRANSPORT INFRASTRUCTURE, VARIOUS ITEMS OF FISHERIES EXPENDITURE, DISASTER RELIEF, GREEK REFUNDS ETC.

CARRINGTON

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MIPT:
FOLLOWING IS EXPLANATORY NOTE:

A GENERAL SCHEME FOR CORRECTING NET CONTRIBUTIONS.

1. THIS NOTE OUTLINES A POSSIBLE SCHEME FOR CORRECTING MEMBER STATES' NET CONTRIBUTIONS TO THE COMMUNITY BUDGET.

2. THE MAIN FEATURES OF THE SCHEME WOULD BE:

(1) THE COMMUNITY WOULD PLACE UPPER LIMITS ON ANY MEMBER STATES CONTRIBUTION (NOT JUST THE UK'S AND GERMANY'S).

(2) THE LIMITS WOULD BE CALCULATED IN ACCORDANCE WITH A FORMULA BASED ON RELATIVE PROSPERITY AND POPULATION SIZE. (SEE FURTHER PARA 3 BELOW) MEMBER STATES WITH LESS THAN AVERAGE PROSPERITY WOULD NOT MAKE ANY NET CONTRIBUTION TO THE ALLOCATED BUDGET EXCEPT POSSIBLY TO SOME PART OF ALLOCATED ADMINISTRATION EXPENDITURE. THE LIMITS FOR THE MORE PROSPEROUS MEMBER STATES WOULD VARY DIRECTLY WITH THEIR SIZE AND RELATIVE PROSPERITY.

(3) THE COMMUNITY WOULD DECIDE ON THE OVERALL SCALE OF THE LIMITS IN THE LIGHT OF THE COMMUNITY'S NEEDS AND WHAT THE MAIN NET CONTRIBUTOR COUNTRIES COULD AFFORD.

(4) THE FINANCING OF ANY BUDGET REFUNDS MADE NECESSARY BY THE LIMITS WOULD BE SHARED BETWEEN THE MORE PROSPEROUS MEMBER STATES IN PROPORTION TO THE DIFFERENCE BETWEEN (A) THEIR UNCORRECTED NET POSITIONS AND (B) THE LIMITS ON THEIR NET CONTRIBUTIONS GIVEN BY THE FORMULA IN (2) ABOVE. THE LESS PROSPEROUS MEMBER STATES WOULD NOT BE EXPECTED TO CONTRIBUTE TO THE REFUNDS AND WOULD THUS BE BETTER OFF THAN UNDER THE 30 MAY ARRANGEMENTS.

3. FURTHER TO PARAS, 2 (2) AND (3) ABOVE, THIS LIMITS MIGHT BE SET AT SOME SMALL PERCENTAGE - SAY 1 AND 1 HALF PERCENT - OF THE AMMOUNT BY WHICH A MEMBER STATE IS BETTER OFF IN AGGREGATE THAN THE COMMUNITY AVERAGE. THE LATTER AMOUNT MIGHT IF CALCULATED AS THE DIFFERENCE BETWEEN A MEMBER STATE'S GDP PER HEAD AND COMMUNITY AVERAGE GDP PER HEAD, MULTIPLIED BY ITS POPULATION SIZE OR (EQUIVALENTLY) AS THE DIFFERENCE BETWEEN A MEMBER STATE'S ACTUAL GDP AND WHAT ITS GDP WOULD BE IF IT HAD COMMUNITY AVERAGE GDP PER HEAD. DIFFERENT SCALING PERCENTAGES WOULD OF COURSE BE POSSIBLE.

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4. COLUMN 3A OF THE TABLE SHOWS HOW THE PATTERN OF 'CORRECTED' NET CONTRIBUTIONS AND RECEIPTS MIGHT HAVE LOOKED UNDER THIS SCHEME IN 1981. THESE ESTIMATES ARE BASED ON THE FIGURES PROVIDED BY THE COMMISSION AT THE END OF THE SUMMER. THE 1 AND 1 HALF PERCENT SCALING PERCENTAGE USED IN THIS TABLE (SEE PARA 3) PRODUCES A NET CONTRIBUTION BY GERMANY BELOW THAT PROJECTED UNDER THE 30 MAY ARRANGEMENTS (COLUMN 2). OTHER SCALING FACTORS WOULD OF COURSE BE POSSIBLE.

5. COLUMN 3B ILLUSTRATES HOW THE PATTERN MIGHT LOOK IF A HIGHER £/ECU EXCHANGE RATE WERE TO LIFT UK GDP PER HEAD, EXPRESSED IN ECUS, SLIGHTLY ABOVE THE COMMUNITY AVERAGE.

6. COLUMNS 1-3B RELATE TO THE 'ALLOCATED' BUDGET ONLY, AS DEFINED BY THE COMMISSION. COLUMN 4 GIVES UK ESTIMATES OF NET CONTRIBUTIONS TO, AND RECEIPTS FROM, THE REST OF THE BUDGET.

7. AS EXPLAINED IN FOOTNOTE 4, GERMANY WOULD NOT BE AT ITS LIMIT IN THE EXAMPLES ILLUSTRATED IN THE TABLE. THE UK WOULD BE THE ONLY COUNTRY AT ITS LIMIT. GERMANY WOULD HOWEVER CONTRIBUTE SUBSTANTIALLY LESS THAN UNDER THE 30 MAY ARRANGEMENTS TO THE UK'S REFUNDS.

8. A NOTE EXPLAINING THE SCHEME IN MORE DETAIL IS BEING SENT OUT FROM LONDON AND WILL BE AVAILABLE ON THURSDAY.

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 30 MAY MANDATE : BUDGET

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1. IT IS CLEAR FROM ALL OUR CONTACTS WITH THEM OVER RECENT MONTHS THAT THE GERMANS ARE NOT GOING TO BUY OUR 'HAGUE' APPROACH, DESPITE THE EVIDENT FINANCIAL ATTRACTIONS FROM THEIR POINT OF VIEW. ON THE OTHER HAND, THEY HAVE NOT YET DECIDED ON AN APPROACH OF THEIR OWN.
2. IN THESE CIRCUMSTANCES, MINISTERS HAVE DECIDED THAT A FURTHER ATTEMPT SHOULD BE MADE IN ADVANCE OF THE ANGLO-GERMAN SUMMIT MEETING ON 18 NOVEMBER AND OF THE EUROPEAN COUNCIL TO ESTABLISH COMMON GROUND BETWEEN US ON THE BUDGETARY CHAPTER OF THE NEGOTIATIONS. WITH THIS IN MIND OUR ORIGINAL 'HAGUE' APPROACH HAS BEEN MODIFIED TO MEET GERMAN CONCERNS AND TO APPLY LIMITS ONLY TO NET CONTRIBUTORS. THIS RESULTS IN LESS RADICAL CHANGES, BOTH IN METHODOLOGY AND IN FINANCIAL TERMS, THAN WHAT WE HAVE SO FAR BEEN PROPOSING.
3. MY TWO IFTS CONTAIN AN EXPLANATORY NOTE EXPLAINING THE REVISED APPROACH WITH AN ILLUSTRATIVE SET OF FIGURES. YOU SHOULD TRANSMIT THESE AT THE EARLIEST POSSIBLE OPPORTUNITY TO THE CHANCELLOR'S OFFICE, LEAVING ANY POSSIBLE TRANSMISSION OF THEM TO OTHER GERMAN DEPARTMENTS TO THE CHANCELLERY ITSELF AND NOT MENTIONING YOUR DEMARCHE TO OTHERS.
4. WHEN HANDING OVER THE TWO PIECES OF PAPER YOU SHOULD MAKE IT CLEAR THAT THEY DO NOT AS YET REPRESENT A FORMAL BRITISH GOVERNMENT POSITION. WE IN FACT CONTINUE TO BELIEVE THAT THE 'HAGUE' APPROACH IS A MORE LOGICAL WAY OF PROCEEDING AND ONE MORE LIKELY TO CONFORM TO THE COMMUNITY'S LONGER TERM INTERESTS. NEVERTHELESS, WE ATTACH GREAT IMPORTANCE TO ESTABLISHING COMMON GROUND WITH THE GERMAN GOVERNMENT AS THE ONLY OTHER CURRENT NET CONTRIBUTOR TO THE COMMUNITY BUDGET. IN THESE CIRCUMSTANCES,

/THE PRIME MINISTER

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THE PRIME MINISTER WOULD BE PREPARED TO CONSIDER THE ALTERNATIVE APPROACH WHICH HAS BEEN CAREFULLY TAILORED TO TAKE ACCOUNT OF THE MAIN CRITICISMS MADE OF THE 'HAGUE' APPROACH IN ANGLO-GERMAN BILATERAL CONTACTS BUT WE RETAIN THE CONCEPT OF LIMITS ON NET CONTRIBUTIONS WHICH SCHMIDT HAS ADVOCATED. MOREOVER, THIS SEEMS TO US TO FIT IN WELL WITH THE FORM OF WORDS PROVIDED BY THE GERMAN GOVERNMENT FOR INCLUSION IN THE DRAFT EUROPEAN COUNCIL CONCLUSIONS.

5. YOU SHOULD ADD THAT WE WOULD BE GRATEFUL FOR A CLEAR REACTION TO OUR LATEST THINKING BY THE END OF THIS WEEK. IF IT WERE THOUGHT USEFUL BY THE GERMANS, FRANKLIN COULD COME TO BONN FOR A CONTACT WITH THE CHANCELLERY ON THE AFTERNOON OF 5 NOVEMBER. YOU SHOULD EXPLAIN THE SHORT DEADLINE BY POINTING OUT THAT TIME IS NOW VERY SHORT BEFORE THE EUROPEAN COUNCIL IF, AS BOTH WE AND THE GERMANS WISH, DECISIVE PROGRESS IS TO BE MADE AT THAT MEETING. AS PRESIDENCY, WE HAVE A DIFFICULT TASK IN THE WEEKS AHEAD: AND BEFORE TRYING TO PERSUADE OTHERS TO ACCEPT THE NEED TO ADJUST THEIR POSITIONS (MOST OF WHICH ARE AT THE MOMENT QUITE UNACCEPTABLE TO EITHER THE BRITISH OR THE GERMAN GOVERNMENTS), WE NEED TO KNOW WHERE WE ARE BETWEEN OURSELVES (BRITISH AND GERMANS).

6. IN THE LIGHT OF THESE DEVELOPMENTS WE DO NOT THINK THE TIME IS RIGHT FOR AN INVITATION TO GENSCHER TO VISIT LONDON AS SUGGESTED IN YOUR TELEGRAM 818. SUCH AN INVITATION COULD WELL RESULT IN DELAYING THE GERMAN REACTION TO OUR NEW SCHEME UNTIL THE VISIT COULD BE ARRANGED. NOR DO WE THINK GENSCHER WOULD BE THE RIGHT PERSON TO APPROACH ABOUT THE NEW SCHEME, WHICH SHOULD GET A MORE SYMPATHETIC HEARING FROM THE CHANCELLOR'S OFFICE.

7. BEFORE HANDING OVER TABLE IN MIFTS, PLEASE CHECK THE FIGURES ON THE TELEPHONE WITH CULPIN (TREASURY) - 233-5582.

CARRINGTON

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DEPARTMENT OF INDUSTRY
 ASHDOWN HOUSE
 123 VICTORIA STREET
 LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
 SWITCHBOARD 01-212 7676

Secretary of State for Industry

31 October 1981

Michael Alexander Esq
 10 Downing Street
 London SW1

Prime Minister

(4)

MS *MS*

Dear Michael

COMMUNITY AID FOR HOUSING IN NORTHERN IRELAND

My Secretary of State has seen a copy of Mike Hopkin's letter to you of 20 October. He was very glad that the Commission have made additional aid available to Northern Ireland.

2 My Secretary of State has noted that the Chancellor of the Exchequer has agreed to the condition set by the Commission that this grant should be additional to the Government's planned expenditure on housing in Northern Ireland. However, he considers that colleagues should be aware that this condition sets a precedent which the Commission may try to exploit in other areas. For example, the draft regulation on the co-ordination of European Regional Policy and the administration of the European Regional Development Fund (published 21 October) proposed that all payments from the Fund should depend on satisfactory evidence of additionality.

3 At the same time, the Commission have proposed a substantial increase in the non-quota section of the Fund. The allocation of money from this section would be at the Commission's discretion, as was the money made available for Northern Ireland housing. The Commission may, therefore, deploy the arguments outlined in paragraph 4 of Mike Hopkin's letter in discussions about the Fund. This is worrying because the Commission's proposals for allocating the Quota Section, if agreed, would mean that any net benefit to the UK from the Fund as a whole would depend on what we could secure from the non-quota section.

Yours ever

Richard Riley

*Letter copied to all members of OD(E), plus
 Welsh office, Welsh office, Environment,
 Lord Privy Council's office, + RTA.*

RICHARD RILEY
 Private Secretary



10 DOWNING STREET

Prime Minister.

Apart from Mr Franklin I have not included any officials in this meeting since I think you will want to focus on a general review of how we play the hand between now & November 26 e.g. should the Foreign Secretary tour the capitals of the Nine in order to try to induce some sense of urgency in your partners.

I see no reason to delay long on the latest Treasury scheme. It can do no harm to try it on the Germans that I do not think they will buy it.

And

30.10.87.

Ref. A05872

MR ALEXANDEREC Budget Mandate

The Prime Minister may find it helpful for her meeting with the Foreign Secretary and the Chancellor on Monday morning to have the attached copy of a draft note by officials on where the negotiations have got to and what are the options for the forthcoming European Council. Copies of the paper are also going to the Foreign Secretary and the Chancellor. In its final form, it will go to OD for discussion on 12th November with a covering note by the Foreign Secretary and probably a paper from the Minister of Agriculture on CAP reform.

FLAG "A"

2. I suggest that the Prime Minister's meeting might consider -

i. the immediate question of whether to try out on the Germans the new budget limits scheme set out in the Chancellor's minute of 19th October (as modified by Mr Kerr's letter to Mr Scholar of 29th October). The merits and demerits of this scheme were analysed in my minute of 20th October. Our information is that thinking in Bonn is moving more towards some variant of the Commission's scheme. President Thorn is due to see Chancellor Schmidt next week, to try and find out what it is the Germans really need. Should we get our new scheme to the Germans first or should we wait to find out what Chancellor Schmidt tells the Commission?

FLAG "B"

FLAG "C"

FLAG "D"

ii. more generally, what are the prospects for the European Council taking perhaps a preliminary view on the options set out in the note by officials (paragraph 12). The Foreign Secretary is likely to say that there is no realistic possibility of completing the negotiations successfully this time round and may plump for a phased negotiation along the lines of option (iii). The Chancellor may not dissent, but he is keen to get a limits mechanism and does not like the Commission's scheme which, although capable of giving us an adequate result (if coupled with a revised financial mechanism) would be less certain in its effects.

3. Whatever preliminary conclusions the meeting comes to, the Prime Minister may want to ask the Foreign Secretary, in his paper to OD, to set out a clear "game plan" for the short time remaining before the European Council. Once Ministers have decided what we should go for at the European Council, it may well be desirable for the Prime Minister to send a message to other Heads of Government; ask the Foreign Secretary to visit at least the main capitals (Bonn is already covered by the Anglo-German summit), or both.

RA

ROBERT ARMSTRONG

30 October 1981

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BUDGET RESTRUCTURING: PREPARATION FOR NOVEMBER EUROPEAN COUNCIL

Note by Officials

Introduction

1. When the Committee last considered this subject in September, it agreed (OD(81)15th Meeting) that while the UK might not be able to carry the budget restructuring negotiations as far forward as we would like during our Presidency, we should push hard for decisions at the November European Council for a fair and lasting solution to our net contribution problem. We should work for clear guidelines on CAP reform, take a constructive attitude on the development of other policies within the 1% ceiling and, while not ruling out the Commission's ideas for a budgetary mechanism, we should maintain the Chancellor of the Exchequer's 'Hague' approach that the effects of the budget on member states should be based on deliberate decisions reflecting relative prosperity. Although this approach implied that the UK should end up as a net beneficiary, our private fall back position would be to aim for a nil net contribution.

2. This note reviews progress in the negotiations and analyses the tactical choices for the European Council on 26/27 November.

Progress in the Council and Mandate Group

3. The Mandate Group has met weekly since early September, dealing successively with each of the three chapters of the Mandate, namely non-agricultural policies, CAP reform, and budget problems. The Agriculture and Finance Councils held debates on 19 October and the Foreign Affairs Council discussed the Mandate on 26 October.

4. It is generally accepted that the European Council will be asked to consider three interrelated issues: the development of other Community policies, CAP reform and the budget.

Chapter I: Other Policies

5. Apart from the substance, this Chapter is of considerable political importance. Most member states wish to give renewed impetus to the development of Community policies on a broad front. And for Denmark and the Benelux countries it is only in Chapter I that they can look for positive progress to offset the painful concessions they will have to make on

/Chapters II

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Chapters II and III. The Italians will also expect to benefit substantially from the new guidelines on the Regional and Social Funds. Several of the ideas put forward by the French in the recent 'relance' memorandum can also be subsumed under this chapter. There is also quite a lot for the UK to play for: there is scope for some modest budgetary improvements from the Regional and Social Funds, and completion of the internal market including services such as insurance will also be to our advantage. While there will also be new efforts to coordinate monetary, economic, social, employment and energy policies, this is unlikely to involve very precise commitments which would tie our freedom of action. No one is arguing that the 1% VAT ceiling should be raised now, and support even for mentioning the possibility in the future is weak.

Chapter II: CAP Reform

6. Discussion on changes in the CAP have brought to the fore highly divergent points of view about how the CAP should be developed. There is no prospect of presenting the European Council with agreed conclusions. While no one disputes the need for price restraint, we ^{are} unlikely to get any precise guidelines except in the case of cereals where the Commission have proposed that the Community needs to progress towards the US cereals price by 1988. The Commission have now given up the idea that prices for other commodities should be linked to external benchmarks. There is support for the concept of limiting guarantees to producers once specified production levels are reached. But for cereals and milk products at least the French and others want such measures applied so that they hit large scale rather than smaller producers, although this concept is resisted by the Netherlands and Denmark as well as by the UK. The latest Commission proposals for coresponsibility levies for milk which go some way to meet French demands contain features which would be unacceptable to us. The concept of income aids as a counterpart to a rigorous price policy has not found much favour, and the Commission's latest proposals include instead the discriminatory application of guarantees as an alternative approach. The French are pressing for the Community to develop an active export policy and to apply stronger import protection particularly for cereals substitutes, and for an early commitment to a tax on oils and fats. This is being resisted by ourselves and the Germans, with some Dutch support, but it may be difficult to avoid conceding

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to the French something of what they want. Similarly we may have to go some way to meet the Italians on Mediterranean agriculture though our aim is to leave any commitment as vague as possible. All member states are likely to pay lip-service at least to stronger discipline on national aids. We have had some useful support from the Germans, and to a lesser extent the Dutch on setting a financial ceiling on the growth of agricultural guarantee expenditure. But the idea is anathema to most other member states.

Chapter III: Budgetary Problems

7. No concrete progress towards an agreed solution has been made. We have demonstrated that even on the most optimistic assumptions about CAP reform and the development of other policies the UK would remain a substantial net contributor in the absence of some form of budget corrective mechanism. But there has been no support for our Hague speech approach. The French and Danes still argue strongly that if there is a budget problem it should be treated as a residual to be dealt with only after the financial effects of CAP reform and the development of other policies have become clear. Together with the Netherlands and Belgium they contend that any eventual compensation must be ad hoc, temporary and degressive. The Commission scheme, which would compensate the UK for a proportion of the difference between its share of Community GDP and the share of CAP guarantee section receipts, has found support only from the Belgians and the Italians. The Germans have argued that their own net contribution should be limited and have invited the Commission to make appropriate proposals but have not put forward any specific proposals of their own. The Commission are confident that their own scheme provides the only basis on which agreement will prove possible. We have not ruled out the possibility. But have said that we could only consider it if it were accompanied by the continuation of an appropriately amended Financial Mechanism. But depending on the German position there is still a possibility of reaching agreement on a scheme based on the Hague speech approach, but limited to net contributors.

The Objectives of Other Member States

8. The German Government have not made up their minds as to what they want. Some are arguing for a direct limit on the German net contribution to the budget while at the other extreme, some would be content with some modest

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alleviation of the German contribution to the UK refunds. The former arrangement would be anathema to several member states, but the latter arrangement might be acceptable. The Germans are prepared to contemplate additional expenditure on other policies only to the extent that savings on the CAP are achieved though their ideas for the CAP are different from ours. As far as we know, the French have not considered what final outcome they want to achieve. But what seems to be emerging more clearly is a determination to win substantial concessions from us over the CAP for whatever they are forced to concede on budget mechanisms. They may also seek to make a link with the outstanding issues on the common fisheries policy. While the key to the negotiations will lie with the French and Germans, in contrast to the negotiations leading to the 30 May Agreement their positions are wide apart on all three chapters. The Italians will hope that, as a less prosperous member state, they will not have to contribute to our refunds, and will concentrate mainly on maximising their financial gain. So far the Greeks have followed a similar line but no one yet knows the attitude of the new government. The Benelux countries have shown some flexibility as regards the UK budget problem but will be concerned to minimise the cost to them. The Danes have taken the most extreme position in resisting our claims and criticising the Commission's proposals. The statements made in public will make it difficult for them to accept a settlement which will satisfy us. The Irish are concentrating on defending the benefits they have secured for the CAP and avoiding any restraints on the future expansion of Irish agriculture.

Some tactical issues

9. There are important links between the three Chapters. Our essential objective is to achieve a satisfactory conclusion on Chapter III. But to achieve this, we shall have to be prepared to make concessions to the French, in particular on Chapter II. The French objectives of increasing agricultural protection and discriminating in favour of small producers are contrary to UK interests and do not deal with the underlying problems of the CAP. Other member states will not be prepared to agree to anything on Chapter III unless equivalent progress is made on Chapter I.

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10. Our objective remains to avoid linking fisheries with restructuring. Otherwise our fisheries objectives might be achieved only at an excessively high cost in terms of restructuring yet might still be criticised by the fishing industry in the belief that their interests had been sacrificed. Our aim is to reach agreement on a CFP at the Fisheries Council on 30 November/1 December or shortly thereafter. If we do not succeed, however, and if we have not reached agreement on restructuring at the November European Council it will become increasingly difficult to keep the two issues disentangled.

11. There is also the problem of our 1982 refunds. Under the 30 May Agreement "The Community is pledged to resolve the [budget] problem by structural means.... If this is not achieved the Commission will make proposals along the lines of the 1980-1981 solution and the Council will act accordingly". If no agreement is reached on a more lasting solution, therefore, we are entitled to 1982 refunds on the basis of the 30 May agreement. These refunds for 1982 would mainly be provided for in the 1983 budget, which does not come forward in draft until June 1982. So technically there is no need to settle this matter as soon as this November (although there is a minor problem about advances in the 1982 budget itself which will be adopted in December of this year). There are several reasons for not pressing the issue at this stage:

- our whole posture is that we want a lasting solution, taking effect from 1982
- pressure from us for a third year of 30 May refunds would provoke the Germans, who believe that their share in the financing of our refunds is excessive
- discussion on rolling over the 30 May arrangements is bound to be controversial; some member states will seize the opportunity to urge that the 30 May arrangements provided for a minimum net contribution by the UK, not a minimum net refund

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- an argument about the scale of the third year of refunds under the 30 May agreement will prejudice the figures we might negotiate as the basis for a long term settlement

- finally, if 1982 becomes the first year of the new system it should be better for us than having a third year of the old.

For all these reasons we should go for a decision at the November European Council that the new system, whatever it is, will apply from 1982. A third year under the 30 May system should be a fall-back, only to be used if the Mandate negotiations get irremediably stuck.

Options for European Council

12. We have always recognised that however successful we were in reaching agreement on 26/27 November, a lot of work would be needed after November, at least on Chapters I and II, to turn the European Council's conclusions into operative legal measures. It is increasingly difficult to be optimistic that we shall reach complete agreement on the main points of substance in November. In particular the French seem bent upon a long negotiation, and their Government is not so organised as to be able to reach decisions quickly. The Germans have not yet brought themselves to the point of decision so we may still hope to influence them but for the moment they are another obstacle to progress. But there will be some intensive negotiations over the next few weeks in which ^{we} might improve the position. There will be meetings of the Foreign Affairs Council on 16/17 and 19 November, while the Anglo-Italian and Anglo-German summits on 9/10 and 18 November will provide further opportunities to bring pressure to bear. The question therefore is how far we should try to go towards our objectives at the European Council in November. The options seems to be as follows:

- i. We could go for a full settlement on the substance in November, including agreement on the method of dealing with our budget problem and the resulting figures, recognising that we would in all probability fail. (Obviously it would not be in our interests to reduce our objectives to what others are prepared to agree to, merely in order to achieve a quick settlement in November). But there is no agreement in sight even on the basis for negotiation on the budget since

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neither the Commission approach nor our own command significant support and no other specific proposals have been put forward. The 1% VAT ceiling is not an imminent constraint and so we cannot use it as a lever to force others into a quick settlement. To go for a full settlement and fail would polarise positions, probably on a 9:1 basis and thus make more difficult the achievement of our objectives in subsequent negotiations. To embark on such a course while we hold the Presidency could put us in a very difficult position; and we might find it more difficult to avoid an early negotiation on our 1982 refunds.

- ii. We could acknowledge that a budgetary settlement needs more time, and concentrate our negotiating efforts on CAP reform and the development of other policies. This would undoubtedly be the easiest course for us to pursue as Presidency. But we should lose the leverage the other two chapters give us to secure what we need on the budget and it would be seen as a loss of resolve on the part of the UK. How our 1982 refunds are to be handled might then need to be negotiated on the basis of 30 May Agreement. This course cannot therefore be recommended.
- iii. We could aim to make roughly parallel progress on all three chapters, which would imply settling only on the basic features of a budget solution in November leaving the negotiation of the figures until later. This would involve taking a tougher line on CAP guidelines than option i. since we would not in November have any certainty about the outcome on the budget, but not so tough a line as in option ii. where the agreed CAP guidelines would have to be presentable as a positive achievement in their own right. We should have to insist that we could only adopt conclusions on Chapters I and II if we got parallel satisfaction on Chapter III. We should under this option be able to make a link with the 1982 agricultural price fixing to enable us to achieve satisfaction when the budget figures were negotiated. Under this option it should be reasonably easy to agree that the new budget system should come into effect in 1982.

/(iv.)

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iv. We could decide now to defer the crunch until next year when it would inevitably coincide with the price fixing. This option would fail to meet the timetable and would imply a lack of resolve on our part. It would not allow us to claim any credit for the UK Presidency for achieving progress on the Mandate and we would have lost the opportunity that holding the Presidency gives us to influence the outcome in our favour. It would, however, maintain the Mandate work as a coherent whole and would not in practice impede work on specific measures where work was sufficiently advanced and we could pursue selectively whatever was appropriate in the national interest. But this is not an option to be recommended.

Anglo-German Summit

13. We shall want to use the Anglo-German summit to try to maintain our joint approach and if possible to agree on a method for dealing with the budget problem. We shall also want to try to minimise our differences on agriculture. If Ministers decide that we should try to make parallel progress on all three chapters at the November European Council (Option iii) it will be necessary to take a final view on precisely what this means in the light of the Anglo-German summit.

CONCLUSION

14. However successful we are on CAP reform and the development of other policies, a budget corrective mechanism will be essential to deal with the United Kingdom's net contribution problem. Our arguments that the Community should have a policy for distributing the budget according to objective criteria such as relative wealth and population size have made no headway and show no signs of doing so. We are therefore faced with the options set out in paragraph 12 above. Ministers are invited to consider what general approach they want to adopt in the remaining weeks before the European Council.

Cabinet Office
30 October 1981

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plg

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

29 October 1981

at Birmingham

And

29/10

Dear John,

PROVISION FOR UK REFUNDS - 1982 EC BUDGET

- .. The Lord President has asked me to send you the attached briefing note on this subject which he has received from the Lord Privy Seal's office. I am sending copies also to the Private Secretaries to all Members of the Cabinet with a request that it should be drawn to the attention of other Ministers in their Departments.

You may like to note that copies have also been sent to the backbench MPs who are taking part in the regional exercise to promote support for our EC Membership.

Yours ever,

David.

D C R HEYHOE
Private Secretary

J F Halliday, Esq
Principal Private Secretary to the
Secretary of State for the Home Department
50 Queen Anne's Gate
LONDON

Enc

PROVISION FOR UK REFUNDS IN 1982 EUROPEAN COMMUNITY BUDGET

On a proposal by a Danish Socialist Member, the European Parliament's Budget Committee on 20 October voted by a narrow majority (16-14) to amend the 1982 draft Community Budget to place half of the provision for supplementary measures for the UK in respect of 1981, totalling some £430 million, into the 'reserve' chapter of the budget. The amendment says that the money will be made available to the UK when 'clear proof has been provided that expenditure under this heading really is for special programmes and does not amount to a payment by the Community enabling the UK Government to reduce its expenditure on structural policy'.

The 'supplementary measures' provisions forms part of the arrangements to refund part of the UK's budget contribution under the agreement of 30 May 1980. Contrary to the view implied in the amendment, the money is allocated to specific public expenditure programmes in the UK, of which full details are publicly available. All are vetted and have been approved unanimously by the Member States. If this money were not received, public expenditure could not be maintained at its present level, and there is therefore a genuine element of additionality involved.

The amendment was supported by Socialist, Liberal and Communist members of the Committee, with the deciding vote being cast by the British Socialist member, Mr Richard Balfe.

The next stage in the procedure is for the proposed amendment to go to the plenary session of the Parliament in the first week in November. If it is approved there, it will go to the Budget Council, made up of Finance Ministers of the Member States. The Council, which has already approved the expenditure, regards it as 'obligatory', that is to say the Parliament does not have the power to block it. In the Council's view therefore, the amendment can be rejected by a qualified majority vote in the Council. The Parliament on the other hand regards the expenditure as 'non-obligatory', ie that it has the power to block it. The Budget Committee vote is therefore hardly the end of the story. The November plenary session of the Parliament is not likely to approve the amendment. Approval requires an absolute majority, that is 218 of the 434 seats. The European Democratic Group (Conservative) and the Christian Democrats, whose members on the Budget Committee opposed the amendment between them hold 172 seats. British Members from the European Democratic Group (EDG) have strongly criticised the amendment, and say that there is 'absolutely no danger' that any part of the UK refunds will in the event be withheld. Mr John de Courcy Ling, of the European Democratic Group (EDG) in the Parliament, has described Mr Balfe's support for the amendment as 'using British money to pursue a domestic party political vendetta'.

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

29 October 1981

M Scholar Esq.
10 Downing Street
LONDON
SW1

forming on 2 Nov.
BF 30.10.81
Paul

Dear Michael,

THE COMMUNITY BUDGET AND CHANCELLOR SCHMIDT

In his minute of 22 October to the Prime Minister, Lord Carrington suggested that it might be tactically wise that the proposed table to be given to Chancellor Schmidt's office should show a lower net German contribution. This question will no doubt be tackled at the Prime Minister's meeting on 2 November, and the Chancellor has suggested that it might be helpful to circulate in advance the attached alternative version of the table.

The new table shows two possible 'corrected' patterns of net contributions, one more and the other less favourable to the Germans. The new Column 3b is identical with Column 3a in the table attached to the Chancellor's minute of 19 October. The new Column 3a is derived by applying lower scaling factors to the limits formulae (1½ per cent in the case of the 'ability to pay' formula).

The new table is designed to appeal to the two different schools of thought within the German government. From the standpoint of national financial advantage, Column 3a would clearly be preferable for them. Their net contribution would fall by some 350 million ecus compared with their post-30 May position (as we interpret it), and the upper limit on their net contribution would be a little below 2 billion ecus (see footnote 3 to the table). This compares with a reduction in their net contribution of only some 150 million ecus in Column 3b and an upper limit on their net contribution of a little over 2½ billion ecus. The disadvantage of Column 3a, from a German point of view, is that it would take more away from the small rich countries, those net receipts would be reduced to about 100 million ecus each. One might hazard the guess that Schmidt and the Finance Ministry would prefer Column 3a, while Genscher and the Auswaertiges Amt would prefer Column 3b. The UK's position would not be affected.

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If we were to show two columns, as in the new version of the table, it would probably be best to drop the column in the earlier table which illustrated how the picture might look if the UK became more prosperous than the Community average. Otherwise the table would become too complicated. The point that the UK too would become a net contributor if we were more prosperous than average could then be made orally. Consequential amendments would be needed in the two accompanying notes.

Copies of this letter go to Brian Fall and David Wright.

*Yours ever,
J.O. Kerr.*

J.O. KERR
Principal Private Secretary

NET CONTRIBUTIONS AND RECEIPTS BEFORE AND AFTER CORRECTION

Million ecus estimates for 1981

	'Uncorrected' pattern	Post 30 May pattern	Possible 'corrected' patterns under proposed scheme	
	1	2	3a	3b
Germany	-1650	-2155	-1810	-2015
France	135	- 305	- 445	- 425
Netherlands	370	275	80	125
Belgium	450	380	105	160
Denmark	405	370	70	120
Luxembourg	285	280	130	165
UK	-1865	- 455	-	-
Italy	1020	775	1020	1020
Ireland	710	695	710	710
Greece	140	140	140	140

Notes

- Column 1 is the average of the two cases illustrated in the Commission's paper SEC(81)1.281.
- Column 2 assumes that Greece does not contribute to the UK refunds.
- The upper limits on the German net contributions in Columns 3a and 3b would be some 1950 million ecus and some 2500 million ecus respectively. On the figures used here, these limits would not be 'binding' in either case - see the accompanying specification note, paragraph 7 - but the proximity of the German uncorrected net contribution to the upper limit would be reflected in more modest German contributions to the UK refunds than under the 30 May system.
- The figures relate to the 'allocated' budget only. No account is taken of net contributions to the 'unallocated' budget, which includes aid, unallocated administration, ERDF non-quota section, transport infrastructure, various items of fisheries expenditure, disaster relief, Greek refunds etc.

Emp. Pl. Budget

Ref: A05835

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PRIME MINISTER

Community Affairs


The Chancellor of the Exchequer should report on the outcome of the 21st October Fiscal Council, which proved unable to find a basis for agreement on the harmonisation of excise duties on alcoholic drinks. This issue, including the question of the United Kingdom's wine/beer duty ratio, will now revert to the European Court.

2. The Foreign and Commonwealth Secretary will wish to report on the 26th-27th October Foreign Affairs Council. Although a full afternoon was devoted to the 30th May Mandate, no change in familiar national positions emerged. Little progress was made towards an agreed Community position on textiles for the impending negotiations on a new Multi-Fibre Agreement, mainly because delegations could not agree on whether cutbacks in existing quota levels should be sought from the supplying countries. The Council will meet again on 10th November in a further attempt to reach a decision. The Council reached conclusions satisfactory to the United Kingdom on aspects of the accession negotiations with Spain and Portugal; the granting of Community aid for Sony (UK); and the preparation of a Community position for the global negotiations.

3. The Minister of Agriculture could report on ^{the} 27th October Fisheries Council. As foreshadowed in the Cabinet last week, the Council did not take any decisions but enabled Ministers to outline their priorities on the main outstanding questions in advance of the 30th November Council. In an unusual exchange, the Danish Minister withdrew his assent to the extension of the Conservation Regulation agreed at the September Council, but the Presidency ruled that the other member states were free to continue to apply it when it expired.

4. The Secretary of State for Energy could report on the 27th October Energy Council, which reached decisions on measures to limit the effect of oil supply shortfalls and made substantial progress on energy pricing. The Council also noted that the Commission's paper on energy strategy would be relevant to the European Council's discussions on the mandate.

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5. There will be an informal meeting of Finance Ministers in London on 30th-31st October. Next week the Development Council meets on 3rd November.

RA

Robert Armstrong

28th October 1981



MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

As.

From the Minister

CONFIDENTIAL

The Rt Hon Lord Carrington PC KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London
SW1A 2AL

The Prime Minister has reserved her right to comment on the conclusions - & indeed to reject them - when they are submitted to her.

Phil 27/10
23 October 1981

D. L. Owen

30 MAY MANDATE: DRAFT EUROPEAN COUNCIL CONCLUSIONS

I have now seen the draft European Council conclusions on the Common Agricultural Policy which it is proposed that we should table as Presidency in the special Mandate Group next week. This contains a number of square-bracketed passages, some of which it is proposed that we should support, in particular Alternative A in paragraph 1 on price policy and Alternative C in paragraph 8 on the rate of growth of agricultural guarantee expenditure (where it is proposed that we should seek to insert the figure "2").

I understand the need to take up these opening positions from a tactical point of view in the circumstances of these particular negotiations. But I must put on record that if (which is, I admit, unlikely) there appeared at a later stage to be any prospect of these particular formulations, or anything substantially like them, being adopted by the European Council I should have to oppose them strongly as they would in my view have disastrous consequences for United Kingdom agriculture.

I hope in any case that we shall have an opportunity at an appropriate stage to discuss in some detail where we should be aiming to get to at the European Council.

May I also take this opportunity to underline how important it is to continue to take a very firm line against further reliance on the linear co-responsibility levy approach and against any element of discrimination in the guarantee arrangements in favour of small farmers and against larger ones (paragraph 2 of the draft conclusions)? The Commission are now showing signs of caving in to pressure from other Member States on both these points. As I have pointed out before, the Germans take a very different view from us, particularly where milk is concerned. I believe that we

/must take...

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must take particular care not to let ourselves get led away from our present firm position on these points in the interests of Anglo-German co-operation, however much common ground we may have on other aspects of the Mandate.

Finally, we must be on our guard against French pressure for a forthcoming statement on the dismantling of MCAs (not as yet covered in the draft conclusions). I am convinced that we should in no circumstances go further than the text agreed by the European Council in December 1978 (in resolution on the establishment of the European Monetary System). We will be providing a brief for the Mandate group to this effect.

I am sending a copy of this letter to the Prime Minister, members of OD(E), Secretaries of State for Northern Ireland, Scotland and Wales, and Sir Robert Armstrong.

23 OCT 1978

11 02 23
10 09 00

PETER WALKER

CONFIDENTIAL



P. W. 22/10

Eno Pd

Foreign and Commonwealth Office
London SW1

22 October 1981

Dear Lord President.

DEBATE ON EC DOCUMENT: COMMISSION REPORT ON THE MANDATE

As you have announced there is to be a full-day debate on Thursday 29 October on the EC Commission report on the Mandate.

I have been giving thought to the terms of the motion for debate. Given the importance of the subject, a simple 'take note' motion would clearly be inadequate, but we do not wish to give any hostages to fortune as far as the negotiations themselves are concerned. I therefore suggest the following:

'that this House takes note of the Report of the European Commission on the Mandate of 30 May 1980 (COM (81)(300)) and fully supports Her Majesty's Government in their determination to negotiate a satisfactory solution to the problems of budgetary contributions, to achieve necessary reforms of the CAP and to give an impetus to the development of Community policies.'

Both Douglas Hurd and I would plan to take part. We would argue that the Commission's report, while not fully satisfactory in all respects, does provide a key opportunity to solve our budget problems, to secure improvements to the CAP and to improve the balance of Community spending policies. After outlining our positive approach to the substance of the negotiations, we would compare this with the defeatism and insularity of the Labour Party's EC policy.

/Since

The Rt Hon Francis Pym MC MP
Privy Council Office
Whitehall
London SW1

Since there will not now be time to discuss all this in 'L' Committee, I am copying this letter to the members of 'L' and OD(E) and to Sir Robert Armstrong, with the request that if they have any comments they should let me know before the end of the week.

Yours sincerely

Sydney A. Arkin

⌘ Humphrey Arkin .

B/F H Mr Alexander (ov)

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Envo Pol



B/F 30 Oct

PM/81/49

PRIME MINISTER

Community Budget and Chancellor Schmidt

1. In his minute of 19 October Geoffrey Howe put forward a new scheme for dealing with the Community Budget problem and suggested that we might try to get the Germans to agree to support it. I welcome his suggestion that we should meet to discuss it after our return from Cancun. It may be useful, in preparation for our meeting, if I set out the points which concern me about this approach.

2. I entirely agree with him that we must do all we can to secure an agreement with the Germans on a joint approach to the Community budget problem. This will be the surest way to avoid reverting to a 9:1 confrontation such as we saw in 1980. I am not however very optimistic about the chances of securing their agreement to a detailed scheme of the kind proposed, as opposed to a more general statement of agreed guidelines. My worry is that Genscher and the officials who advise him will see a fully worked out scheme of this kind as merely another version of our radical approach to re-organising the Community's finances and that it will not meet their concern to depart from Community orthodoxy as little as possible. This said, it clearly would be a major step if we could get the Germans to agree to a scheme of this kind I have no objection to trying it out on them.

/3. If we

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3. If we are to put this to the Germans we shall need to be careful about how we present it. I am particularly concerned about the table which it is proposed to hand over to Schmidt's office which shows a very small reduction in the German net contribution compared with the very large reduction for ourselves. I think it is for consideration whether it would not be tactically wiser to show a rather lower contribution figure for the Germans, perhaps rather nearer to their "uncorrected" figure shown in column 1 of the table. I am also concerned about the zero position shown for the UK which plays straight into the hands of those who argue that our only concern is to obtain a "juste retour". In presenting the scheme I think we should adopt a rather more political approach than that suggested by the Treasury drafts, avoiding as far as possible the technical details. I think our aim should be to emphasise the modesty of the changes implied by the scheme rather than its generality. And we should make it absolutely clear that the figures shown in the table are illustrative only; by scaling down, a lower German net contribution (and, correspondingly, lower net benefits for the small rich countries) would be possible.

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


(CARRINGTON)



NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

p.a.
wm
27/10

Michael Alexander Esq
10 Downing Street
LONDON SW1

20 October 1981

ms

Dear Michael,

COMMUNITY AID FOR HOUSING IN NORTHERN IRELAND

My Secretary of State has asked me to send you, for the information of the Prime Minister, details of an encouraging development in the European Community, which should be of considerable benefit to our housing programme in Northern Ireland and should help to underline the benefits we are squeezing from Community membership.

In July Mr Tugendhat alerted Mr Atkins to the likelihood of an offer by the European Commission of assistance for housing in Northern Ireland. The offer was a response by the Commission to the particular problems of Northern Ireland which had been highlighted in the integrated operations document we prepared for the Commission earlier this year, and to the debate in the European Parliament on 18/19 June. During the last three months, contacts at Ministerial and official level have developed the Commission's proposals to the extent that the Commission have now made a firm proposal for financing this in the 1982 Community Budget, and are in the course of preparing a Regulation to control payment of the grant.

In negotiation with the Commission we have established that

- the scheme, and its underlying financing arrangements, will result in the United Kingdom's net contribution to the Community budget being lower than it would otherwise have been;
- although Commission grant would be at a rate of up to 50%, the Commission acknowledge that the United Kingdom contribution would be funded exclusively from within existing public expenditure ceilings;
- the scheme will extend only to Northern Ireland (if the Commission had proposed extending it to other countries, this would have diluted the benefit to the UK);
- the mechanics of the scheme will fully reflect the mechanics of housing finance;
- the grant will take the form of supporting the overall housing programme in Northern Ireland, and payment will be based on the applications we make to the Commission.

/...

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The Commission for their part have said from the beginning that they will only be able to pursue this scheme (which is unusual in providing Community assistance for housing, and equally unusual in applying only to one area in one member state) on the condition that we would add the grant to our planned public expenditure for housing. We have had to consider very carefully whether the grant can be accepted on this condition, but it became apparent that this money would only be paid if we agreed to this condition; in view of this, and on the basis that payment is of considerable value (both financial and political) to HMG, my Secretary of State has sought and obtained the agreement of the Chancellor of the Exchequer to accepting the proposed grant on the terms suggested.

The conditions of our agreement are to be recorded in writing (on the basis of a draft being agreed with the Treasury) to avoid any possible scope for subsequent misunderstanding of the conditions on which we have accepted the grant.

At this stage our acceptance relates only to a sum of 28m ECUs which the Commission proposed should be allocated in the 1982 Budget to this scheme. As you may have seen from UKREP's telegrams, the Council of Ministers has decided that this budgetary provision cannot be approved until the necessary Regulation has been made. This was to be expected, but we are ensuring that the Council minutes record an understanding that funds will be made available once the Regulation has been made. The Commission are currently hard at work on the Regulation, and are in close informal touch with our officials, who in turn are working closely with other Departments involved and with the Cabinet Office.

Both the Irish Government and the Irish Commissioner (Mr O'Kennedy) are taking a close interest in the Commission's proposal - Mr O'Kennedy untruthfully claims he is responsible for it - and we are taking care to ensure that the Irish are kept in touch with our thinking. The Irish and the British delegations made supportive declarations at the Council of Ministers meeting on 19 October and we may well be seeking Irish help in lobbying Council members at a later date. Meanwhile we are taking steps to ensure that it is we, not the Irish, who get the credit for having encouraged the Commission's initiative, and developing it to the benefit of the housing programme in Northern Ireland.

I am copying this letter to Private Secretaries, to Members of OD(E), to the Secretaries of State for Scotland, Wales, Environment, and Industry, to the Lord President (because of public interest) and to Sir Robert Armstrong.

Yours sincerely
M W Hopkins

M W HOPKINS

BB

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BF
Cabinet Office are considering whether this needs revision before the meeting between the PM, Pcs and the next week.

Ref. A05765

MR. ALEXANDER

WH
21/10

Community Budget and Chancellor Schmidt

In his minute to the Prime Minister of 19th October, the Chancellor of the Exchequer suggests that we should try out on the Germans a new scheme for the Community budget which might appeal to the Federal Chancellor and increase the chances of getting an early settlement of the budget problem.

2. As compared with our present approach which implies adjusting the net contributions and benefits of all member states according to the criteria of relative prosperity (and population size), the new Treasury scheme:-

- (i) Applies only to net contributors.
- (ii) Puts less prosperous net contributors, i. e. the United Kingdom (and potentially Portugal) at zero.
- (iii) Limits the net contribution of more prosperous net contributors i. e. Germany.
- (iv) Exempts the other less prosperous member states from contributing to our refund.

3. The results are illustrated in the first table attached to the Chancellor's minute. Putting the United Kingdom at zero is consistent with the last OD discussion (OD(81) 15th Meeting) which concluded that, while we should at that stage base our approach on the net beneficiary objective implied in the Chancellor's Hague speech, we could accept the aim of making no net contribution as a fall-back.

4. The advantages of the new Treasury scheme are:-

- (i) It should be attractive to the Federal Chancellor, who has made it clear that he wants some limitation on the German net contribution.
- (ii) It should be more acceptable to Italy and Ireland since it leaves their net benefit untouched.
- (iii) Dropping the idea of a generalised budget adjustment might make it easier for the countries like the Benelux to accept, even though they will be the main payers.

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5. The disadvantages of the scheme are:-

- (i) It clearly puts our net contribution at zero (unless our GDP rises above the Community average), which will revive the argument that Britain wants the juste retour.
- (ii) The smaller prosperous countries will still object to a limit on the German net contribution (even though they would probably not be required under the scheme to make direct payments to Germany).
- (iii) We may find that what we are offering the Germans may prove to be more than their minimum political requirement.

6. This last point is the nub of the tactical question. We want to keep the Germans with us over the budget issue, so that it does not deteriorate once again into a 9:1 situation. There is a risk, as the Chancellor points out in paragraph 8 of his minute, that the Germans may seek to modify this scheme to improve their own position at the expense of ours, whereas all they may actually need for domestic political purposes is a relatively small measure of relief. On the other hand, we know that Herr Genscher is much less anxious to push the German budgetary demands than the Federal Chancellor; and the more other member states are forced to accept by way of limit on the German net contribution, the less they will be willing to contemplate by way of reduction in our net contribution. The Treasury scheme is nicely judged in that it gives the Germans only very modest relief; it might therefore serve to cement the alliance for the next stage of the negotiations without giving them too much.

7. Is there a better alternative? The Chancellor's minute (paragraphs 9 and 10) discusses two. He is no doubt right in suggesting that sticking to our present line is only attractive if the Government are willing to accept a long delay (and probably eventually to withhold). The alternative would be to back the Commission's scheme. OD agreed that we should not rule it out as the basis for a possible solution, provided it could be beefed up to meet our needs and was accompanied by a reformed financial mechanism. The German Foreign Ministry is currently urging the Commission to modify their scheme to take account of German needs. This could take one of two forms: either giving the Germans the same rebate as us on the difference between their GDP share and

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their receipts from FEOGA, or simply using this measure to determine how much the other member states (except the least prosperous) would pay towards our refund. Other member states would certainly refuse the first even if the Commission could be brought to propose it. If they were to propose the less radical alternative, it is just possible that some of the other member states like the Dutch might be prepared to look at it. For them the Commission scheme has the advantage that it is not based on measuring net balances. And there might be some people in Bonn who would be ready to settle on that basis.

8. The Prime Minister will obviously wish to know the Foreign and Commonwealth Secretary's views; and may wish, as the Chancellor suggests, to have a small meeting on her return from Cancun. Our appreciation is that there would be no harm in trying out the scheme on the Germans (without necessarily committing the Prime Minister), principally as a means of showing our desire to work closely with them and perhaps to establish more clearly what their minimum requirement is. But we should continue to keep the Commission's scheme in a suitable form alive as, perhaps, in the end, a more negotiable alternative.



ROBERT ARMSTRONG

*(approved by Sir R Armstrong
& signed on his behalf.)*

20th October, 1981

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Also Pst
Budget

Ref. A05753

PRIME MINISTER

Cabinet: Community Affairs

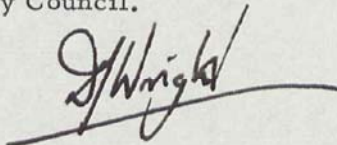
If not covered under the Foreign Affairs item, you might wish the Foreign and Commonwealth Secretary to report on the successful outcome of the 13th October meeting of Foreign Ministers of the Ten. The meeting agreed a new "London" Report, providing for improvements in the political co-operation machinery, which is expected to stand as one of the basic texts in the political co-operation canon. An EC/Asean (Indonesia, Malaysia, Philippines, Singapore, Thailand) Ministerial meeting also took place in London on 13th-14th October.

2. The Foreign and Commonwealth Secretary might also comment on the implications for the United Kingdom and the Community of Chancellor Schmidt's illness, the victory of Mr. Papandreou's Socialist Party in the Greek elections, and the long heralded but limited French ideas for a "relance" of the Community.

3. You will wish the Chancellor of the Exchequer to report on the 19th October Finance Council, which will have discussed insurance again and had its orientation debate on the Mandate.

4. The Minister of Agriculture might similarly report on the orientation debate which will have taken place at the 19th October Agriculture Council; the continuing legal dispute with the Commission on poultry meat, on which the deadline for our response to the Commission's reasoned opinion has now been extended to 30th October; and on the mini-package successfully negotiated at the 29th September Fisheries Council.

5. The following Councils will take place before the Cabinet next meets: 21st October Fiscal Council, 26th October Fish Council, 26th-27th October Foreign Affairs Council, 27th October Energy Council.



ROBERT ARMSTRONG

(Approved by Sir R. Armstrong
and signed on his behalf)

19th October, 1981

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Prime Minister: *Genscher* (2) B

You have already said that you would like to discuss the present position with the FCS & the Chancellor. I shall

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

PRIME MINISTER

arrange a meeting a.s.a.p. after you return from Cannes. Meanwhile you may like to glance through the

COMMUNITY BUDGET AND CHANCELLOR SCHMIDT *paper - Runt*

The November European Council is now only five weeks away. The omens are not favourable for a settlement of our Budget problem. We have not won support from either the Commission or any of the other Member States for a fundamental solution to the Community Budget problem designed on the principles set out in my speech in the Hague of 3 June.

2. Our attempts to get the Germans to acknowledge the benefit to them of such a solution has so far failed to elicit a response, even though Ministry of Finance officials are sympathetic and Schmidt is from time to time reported as saying things which are entirely consistent with our approach. The problem appears to lie in the German Foreign Ministry. Genscher is more concerned with pushing his ideas for European union than in solving the German budget problem. He appears to be worried about the costs to the small rich countries and the "ugly German" image.

3. The only way we are likely to be able to produce a shift in the German position is by engaging the personal interest of Schmidt in a general solution which will serve the interests of both the United Kingdom and Germany.

4. With this possibility in mind, Treasury officials have worked up a new scheme which is designed to meet the criticism made by German officials that the Hague Speech approach is too radical, but without sacrificing the UK interest. We cannot be sure that Schmidt would find it attractive; but there is a family resemblance between the scheme and things which he has said in public, and I think it right to give you the opportunity to consider it.



5. I am therefore sending you with this minute three documents:-

(i) A table with a brief covering note describing the new scheme succinctly and showing its possible effects on the net positions of Member States.

(ii) A Speaking Note which might be used to present the scheme to Schmidt's office on your behalf.

(iii) A more detailed note, for the benefit of Schmidt's advisers, explaining how the scheme was constructed.

6. For the United Kingdom, the scheme produces a zero net contribution to the "allocated Budget" if our GDP per head remains below the Community average. Even if, as a result of an appreciation of sterling, our GDP per head should rise above the Community average, it would still limit the size of our net contribution. For the Germans, the scheme also places an upper limit on their net contribution, as well as reducing it, in practice, to something rather below what they pay under the 30 May agreement. It would probably not involve corrective payments to Germany by other Member States, which should be a helpful feature in view of their sensitivity on that point. And it relieves the poor Member States - Italy, Greece and Ireland - from contributing to UK refunds. The extra costs are borne mainly by the small rich countries according to a formula which reflects their relative prosperity and the amount of their (uncorrected) net receipts from the Budget.

7. It is a less radical scheme than those we have so far shown the Germans to illustrate how the Hague speech approach might work. The new scheme does not attempt to regulate the entire pattern of net benefits and net contributions according to a formula; but only to place a check on the size of net contributions and to distribute the costs of correcting them in an equitable way. It does not eliminate the net benefits of the small rich countries;



but only reduces them. It does not reduce the net receipts of the Irish. For these reason, it could be more negotiable than the full-blooded Hague approach.

8. There is of course no guarantee that Schmidt would be prepared to commit his Government to negotiate on the basis of a scheme on these lines, and there are risks in putting it forward. We might arouse German interest in a scheme which places a limit on both their contribution and ours, but, in doing so, might provoke them into changing the figures at our expense so as to reduce the cost to the small rich countries. Before going forward with this plan, we need therefore to compare it with the other options open to us.

9. As I see it there are two. First, we could soldier on with the Hague approach in the hope of slowly winning support for it. The prospects do not look good at present; but Community moods do change. It is distinctly unlikely that any agreement to negotiate on the basis of the Hague approach will be obtainable this year, and the Belgian Presidency will not be sympathetic. This option is only attractive if we are willing to accept a long delay before the Community Budget problem is settled.

10. The second alternative is to say that we are ready to negotiate on the basis of the Commission scheme. This also does not look a promising way forward to agreement. The Commission scheme has attracted few friends and several enemies - the agricultural States see it as a threat to the integrity of FEOGA, and the French have serious objections of principle to it. Furthermore, it could only eliminate our net contribution if two conditions were satisfied: first, if it were interpreted in a way far more favourable to the UK than the Commission intend; and, second, if it were combined with a reformed Dublin mechanism.

11. I do not pretend that we are faced with an easy choice. I think it would be helpful if we could meet to discuss it with the



Foreign Secretary as soon as you and he get back from Cancun. The case for putting the new scheme to Schmidt is that he might see virtue in it, both as a way of solving the German problem and as a way of preventing another major row in the Community.

12. The postponement of the Anglo-German Summit has deprived us of an obvious early opportunity to present the scheme to Schmidt. We obviously could not wait until the new date of 18 November before trying out the idea on him. If therefore we are to proceed with the proposal, it would I think be necessary for your personal representative to put it on your behalf to a senior official in Schmidt's office before the end of October.

13. I am sending copies of this minute to the Foreign Secretary and Sir Robert Armstrong.

Peter Jenkins

for (G.H.)

19 October 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).



10 DOWNING STREET

Miss Stephens is arranging
a meeting to take place
as a.p. after Commem.

Paul

GRS 1600

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FM PARIS 171052Z OCT 81

TO IMMEDIATE FCO

TELEGRAM NUMBER 897 OF 17 OCTOBER 1981

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COMMUNITY RESTRUCTURING: FRENCH GOVERNMENT TACTICS

1. FOLLOWING THE PUBLICATION OF THE FRENCH MEMORANDUM ON REVIVING THE COMMUNITY, M CHANDERNAGOR'S PRESS CONFERENCE ON 13 OCTOBER (MY TEL NO 884) AND RECENT DISCUSSIONS WITH FRENCH OFFICIALS IN THE MANDATE GROUP AND BILATERALLY, IT MAY BE USEFUL IF THIS POST ATTEMPTS AN ANALYSIS OF THE FRENCH GOVERNMENT'S TACTICS. THIS MAY BE HELPFUL IN PREPARING BRIEFING FOR THE LORD PRIVY SEAL'S VISIT TO PARIS ON 23 OCTOBER.

2. THE FRENCH MEMORANDUM IS THE PRODUCT OF A LONG PERIOD OF GESTATION WITHIN THE NEW FRENCH ADMINISTRATION. SOME OF THE DELAYS AND UNCERTAINTIES CONNECTED WITH IT HAVE BEEN CAUSED BY A CERTAIN INCOHERENCE WHICH AFFECTS THIS GOVERNMENT. IT IS WORTH RECALLING SOME OF THE MAIN EPISODES IN THE EVOLUTION OF THE FRENCH ATTITUDE. ON 28 MAY, NOT QUITE THREE WEEKS AFTER MITTERRAND'S PRESIDENTIAL ELECTION VICTORY, AND BEFORE THE PARLIAMENTARY ELECTIONS HAD PRODUCED AN OVERWHELMING VICTORY FOR THE SOCIALIST PARTY, M CHEYSSON TOLD YOU THAT THE FRENCH GOVERNMENT WANTED A PERIOD OF DELAY (2 OR 3 MONTHS) FOR REFLECTION ON EUROPEAN QUESTIONS. IN GENERAL THE FRENCH GOVERNMENT WANTED THE COMMUNITY'S PROBLEMS TO BE GIVEN A WIDER DIMENSION. IN A LETTER DATED 1 JUNE HE CONFIRMED THAT FRANCE WOULD BE READY TO RESUME DISCUSSIONS ON THE MANDATE FROM THE BEGINNING OF THE AUTUMN. ON 11 JUNE AT THE JUMBO ECONOMIC AND SOCIAL AFFAIRS COUNCIL M DELORS FORESHADOWED THE IDEAS WHICH HAVE SINCE BEEN ASSEMBLED UNDER THE HEADING "EUROPEAN SOCIAL AREA". AT THE EUROPEAN COUNCIL AT LUXEMBOURG ON 29/30 JUNE PRESIDENT MITTERRAND, AFTER EARLIER EFFORTS BY FRENCH OFFICIALS TO SAY THAT HE WOULD NOT BE ABLE TO CONTRIBUTE TO A DISCUSSION ON THE COMMISSION'S PAPER ABOUT IMPLEMENTATION OF THE 30 MAY MANDATE, ACQUIESCED IN THE SETTING UP OF THE MANDATE GROUP WHICH BEGAN WORK IMMEDIATELY AFTERWARDS. HE TOO SPOKE ABOUT THE EUROPEAN SOCIAL AREA. ON 8 JULY YOU SPOKE OF EUROPEAN "RENEWAL" IN YOUR KEYNOTE SPEECH AT STRASBOURG. LATER IN JULY THE TERM "RELANCE EUROPEENNE" BEGAN TO BE USED BY FRENCH OFFICIALS. AT HIS MEETING WITH MRS THATCHER ON 29 JULY AND AT THE ANGLO/FRENCH SUMMIT ON 10/11 SEPTEMBER PRESIDENT MITTERRAND DID NOT OFFER ANY DETAILED EXPLANATION OF WHAT HE HAD IN MIND. IT WAS INDICATED IN PARIS THAT HE WOULD REVEAL HIS IDEAS AT HIS FIRST PRESIDENTIAL PRESS CONFERENCE ON 24 SEPTEMBER. IN THE EVENT HE DID NOT DO SO AND FRENCH OFFICIALS FELL BACK ON PROMISING A MAJOR INITIATIVE VERY SHORTLY. M CHANDERNAGOR IS KNOWN TO HAVE BEEN TINKERING WITH THE TEXT OF THE FRENCH MEMORANDUM UP TO THE LAST MOMENT BEFORE IT WAS DISTRIBUTED. IN THE END THE FIRST RECIPIENT OF A FULL EXPOSE OF THE FRENCH IDEAS WAS CHANCELLOR SCHMIDT AT LATCH ON 7/8 OCTOBER.

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13.

3. I THINK THE PICTURE WHICH EMERGES IS OF A NEW FRENCH GOVERNMENT WHICH KNEW THAT THE COMMUNITY PROBLEMS WERE GOING TO BE VERY DIFFICULT FOR FRANCE, BUT WHICH WAS AT FIRST TOO BUSY WITH THE PARLIAMENTARY ELECTIONS AND ORGANISING ITSELF TO PAY MUCH ATTENTION TO THEM. IT FOUND, WHEN IT HAD TIME TO LOOK AT THE PROBLEMS, THAT PROGRESS ON ANY ASPECT OF THE 30 MAY MANDATE WAS GOING TO BE COSTLY FOR FRANCE, WHILE REMEMBERING THAT PRESIDENT MITTERRAND DURING HIS ELECTION CAMPAIGN HAD DECLARED THAT HE WOULD BE A TOUGHER DEFENDER OF FRENCH INTERESTS THAN PRESIDENT GISCARD HAD BEEN. BY THIS TIME IT WAS ALSO BECOMING CLEAR THAT IT WAS GOING TO BE VERY DIFFICULT TO FIND THE FUNDS TO FINANCE SOCIALIST RECONSTRUCTION IN FRANCE EVEN WITHOUT HAVING TO CONTRIBUTE RESOURCES TO COMMUNITY RECONSTRUCTIONS. IN THE COURSE OF THE SUMMER ANY IDEA WHICH SENIOR MEMBERS OF THE GOVERNMENT MAY HAVE HAD OF WORKING OUT A COMPREHENSIVE FRENCH SOLUTION TO THE QUESTIONS POSED BY THE 30 MAY MANDATE SEEMS TO HAVE EVAPORATED. THE FEELING SEEMED TO GAIN GROUND THAT FRANCE COULD BEST DEAL WITH THE SITUATION BY BEING RELATIVELY INERT ABOUT THE 30 MAY MANDATE AND THINKING UP AN ALTERNATIVE CONCEPT FOR REVIVING THE COMMUNITY WHICH WOULD IF POSSIBLE PERFORM A CUCKOO FUNCTION IN THE MANDATE NEST, WITHOUT FRANCE APPEARING TO REPUDIATE THE MANDATE DIRECTLY. THE FRENCH ADMINISTRATION HAS BECOME INCREASINGLY CONSCIOUS OF THE DANGERS FLOWING FROM THE EXISTENCE OF A GERMAN PROBLEM, AS FRANCE CANNOT AFFORD TO HAVE A DIRECT CLASH WITH THE FRG. THE DEVALUATION CRISIS ON 4 OCTOBER BROUGHT A SHARP REMINDER OF THIS. THE REACTION ON THE FRENCH SIDE APPEARS TO BE TO LEAVE IT TO THE FRG TO MAKE THE RUNNING WHILE STONEWALLING AS FAR AS POSSIBLE ON THOSE ASPECTS OF THE 30 MAY MANDATE ON WHICH THE UK IS PARTICULARLY KEEN. IT SEEMS VERY LIKELY THAT PRESIDENT MITTERRAND AND HIS ADVISERS WERE INDEED MOVED BY CONSIDERATIONS RELATED TO GERMANY WHEN POSTPONING THE LAUNCHING OF THEIR MEMORANDUM TOWARDS THE END OF SEPTEMBER. THE MEETING BETWEEN PRESIDENT MITTERRAND AND HERR SCHMIDT AT LATCH SEEMS TO HAVE ENABLED THE FRENCH GOVERNMENT TO TAKE SOME MEASURE OF THE GERMAN ATTITUDE IN THESE MATTERS AND TO MAKE A FIRST ATTEMPT TO HITCH THE FRENCH MEMORANDUM TO HERR GENSCHER'S PROPOSALS FOR PROGRESS TOWARDS EUROPEAN UNION WHICH THE FEDERAL GERMAN GOVERNMENT HAD ENDORSED ON 18 SEPTEMBER.

4. AGAINST THIS BACKGROUND IT IS PERHAPS EASIER TO UNDERSTAND WHY THE FRENCH MEMORANDUM ADDRESSES ITSELF SERIOUSLY TO ONLY ONE FAIRLY LIMITED SECTOR OF THE 30 MAY MANDATE, IE TO THE NEW POLICIES VOLET. IT IS A SURPRISINGLY UNAMBITIOUS PRODUCT FOR 4 MONTHS REFLECTION. THE FRENCH GOVERNMENT ESCHEWS ANY PROPOSALS FOR ACTUAL DEVELOPMENT OF THE COMMUNITY AND ITS INSTITUTIONS AND SIMPLY LISTS A FAIRLY LENGTHY SERIES OF PIECEMEAL MEASURES WHICH, IF ADDED TO THE STATUS QUO, WOULD MAKE IT EASIER FOR THE FRENCH GOVERNMENT TO PURSUE ITS CHOSE POLICIES AT HOME. THE PRINCIPAL MESSAGE OF THE DOCUMENT SEEMS TO BE THAT MORE ATTENTION SHOULD BE PAID TO THE SOCIAL AND EMPLOYMENT ASPECTS OF MACRO-ECONOMIC

POLICY, THAT THERE SHOULD BE TOUGHER COMMUNITY MEASURES OF PROTECTION AGAINST MANUFACTURED GOODS FROM JAPAN AND THE USA, THAT THERE SHOULD BE HARMONISATION OF ATTITUDES TOWARDS INWARD INVESTMENT (PRESUMABLY FROM JAPAN AND THE US), THAT THERE SHOULD BE PROTECTION AGAINST CEREAL SUBSTITUTES WHILE THE COMMUNITY'S OWN AGRICULTURAL EXPORTS SHOULD BE INCREASED, THAT MCAS SHOULD BE ELIMINATED SO THAT COMPETITION TO FRENCH AGRICULTURAL PRODUCTS WOULD BE REDUCED WITHIN THE EC, THAT MORE ATTENTION SHOULD BE PAID TO EXTERNAL COMMUNITY BORROWING FOR THE FINANCING OF INTERNAL NATIONAL INVESTMENT, THAT THERE SHOULD BE COOPERATION IN SCIENTIFIC AND TECHNOLOGICAL RESEARCH AND IN THE DEVELOPMENT OF HIGH TECHNOLOGY INDUSTRIAL SECTORS, THAT NEW ENERGY SOURCES SHOULD BE VIGOROUSLY DEVELOPED, AND THAT COOPERATION WITH THE DEVELOPING WORLD SHOULD BE INCREASED IN ORDER TO PROVIDE EUROPEAN INDUSTRY WITH BETTER MARKETS. AFTER ALL THIS HAD BEEN SET IN TRAIN, THE NEED FOR BUDGET RESTRUCTURING COULD BE EXAMINED (AND, IF POSSIBLE, FOUND UNNECESSARY).

5. THERE ARE OF COURSE NUMEROUS WELCOME IDEAS IN THE FRENCH MEMORANDUM. SOME OF THE ISSUES ARE ALREADY UNDER DISCUSSION IN OTHER COMMUNITY FORA. USEFUL PROGRESS COULD BE MADE IF VARIOUS OF THE FRENCH IDEAS WERE PURSUED AT THE SAME TIME AS THE MORE CRUCIAL ISSUES RAISED BY THE 30 MAY MANDATE. UNFORTUNATELY, THERE HAS BEEN GROWING EVIDENCE SINCE MID-SEPTEMBER THAT THE FRENCH GOVERNMENT MAY BE MOVING INTO A POSITION WHICH WOULD PLACE IT DIRECTLY ACROSS THE PATH OF PROGRESS TOWARDS RESOLVING ON A PERMANENT BASIS THE PROBLEM OF UNACCEPTABLE SITUATIONS. M CHANDERNAGOR'S SHARP REMARKS AT HIS PRESS CONFERENCE ABOUT JUSTE RETOUR, THE VERY NEGATIVE BRIEFING WHICH APPEARS TO BE REACHING THE FRENCH PRESS, AND THE LINE RECENTLY TAKEN BY FRENCH OFFICIALS THAT ANY BUDGETARY SOLUTION MUST BE THE RESIDUAL OF DISCUSSION ON THE OTHER TWO VOIETS AND MUST BE LIMITED, TEMPORARY AND DEGRESSIVE, DO NOT SUGGEST THAT THE NEW GOVERNMENT HAS DECIDED TO TAKE A CONSTRUCTIVE ATTITUDE TOWARDS THE UNITED KINGDOM'S MAJOR INTERESTS IN THIS AREA. THE APPARENT FRENCH ATTEMPT TO ELUDE A DISCUSSION OF CAP AT THE NOVEMBER EUROPEAN COUNCIL (BONN TELEGRAM NO 77-, PARA 4), WHICH UNDER THE FRENCH FORMULA WOULD ALSO PREVENT SUBSTANTIVE DISCUSSION OF THE BUDGETARY ASPECT, WOULD HAVE THE UNHELPFUL RESULT OF LEAVING ONLY ONE VOIET ON THE TABLE, NAMELY NEW POLICIES, AND THE FRENCH WOULD PROBABLY TRY TO ARGUE THAT THE RIGHT TEXT FOR THAT SUBJECT WAS THE FRENCH MEMORANDUM.

6. SO FAR THE FRENCH GOVERNMENT HAS NOT SOUGHT TO DELAY THE MANDATE GROUP DISCUSSIONS, ALTHOUGH IT HAS NOT GONE OUT OF ITS WAY TO BE HELPFUL EITHER. BUT THE UNWILLINGNESS OF THE FRENCH TO RISE TO THE CHALLENGE OF THE 30 MAY MANDATE CAME OUT VERY CLEARLY IN THE DISCUSSIONS BETWEEN SENIOR OFFICIALS LED BY MR FRANKLIN ON THE UK SIDE ON 14 OCTOBER. THE PROBLEM REMAINS OF TRYING TO

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CONVEY DECISIVELY TO THE FRENCH GOVERNMENT, AS MR FRANKLIN AND MR HANCOCK TRIED TO CONVEY ON THAT OCCASION TO M ACHARD AND HIS COLLEAGUES, THAT IT WILL BE IN THE FRENCH GOVERNMENT'S OWN INTEREST TO BE MORE HELPFUL OVER BUDGET RESTRUCTURING. THE FRENCH GOVERNMENT PROBABLY UNDERSTANDS THAT IT IS GOING TO HAVE TO MAKE SOME CONCESSIONS, BUT RECKONS TO MAKE ONLY THOSE ON WHICH THE FRG WOULD IN THE LAST RESORT INSIST, HOPING THAT THE "BRITISH PROBLEM" CAN BE PLAYED INTO THE MORE DISTANT FUTURE WHEN, AS THEY WOULD SEE IT, ELECTORAL EXIGENCIES AND CHANGE IN THE UNITED KINGDOM MIGHT REDUCE BRITAIN'S STRENGTH AS A NEGOTIATOR.

7. WHEN HE MEETS M CHANDERNAGOR ON 23 OCTOBER THE LORD PRIVY SEAL WILL, I THINK, NEED TO CONTINUE THE LONG TASK OF TRYING TO IMPRESS ON HIM THE BRITISH GOVERNMENT'S DETERMINATION TO INSIST AND PERSIST WITH ITS CASE AND TO SECURE A SATISFACTORY AND EQUITABLE COMMUNITY SETTLEMENT, WHICH ALONE IN THE LONG RUN CAN PROVIDE A SOUND FOUNDATION FOR THE RELAUNCHING OF THE COMMUNITY WHICH FRANCE NEEDS AS MUCH AS ANY OF HER PARTNERS.

FCO PLEASE PASS SAVINGS TO ALL

HIBBERT

FRAME GENERAL
ECD(I)
WED

[REPEATED AS REQUESTED]

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A GENERAL SCHEME FOR CORRECTING NET CONTRIBUTIONS

1. This note outlines a possible scheme for correcting member states' net contributions to the Community budget.
2. The main features of the scheme would be:
 - (1) The Community would place upper limits on the net contributions of all member states (not just the UK and Germany).
 - (2) The limits would be calculated in accordance with a formula based on relative prosperity and population size. The net contributions of member states with less than average prosperity would be limited to zero. The limits for the more prosperous member states would vary directly with their size and relative prosperity.
 - (3) The Community would decide on the overall scale of the limits in the light of the Community's needs and what the main net contributor countries could afford.
 - (4) The financing of any budget refunds made necessary by the limits would be shared between the more prosperous member states in proportion to the difference between (a) their uncorrected net positions and (b) the limits on their net contributions given by the formula in (2) above. The less prosperous member states would not be expected to contribute to the refunds and would thus be better off than under the 30 May arrangements.
3. Column 3a of the table shows how the pattern of 'corrected' net contributions and receipts might have looked under this scheme in 1981. The figures have been scaled so as to produce a net contribution by Germany slightly below that projected under the 30 May arrangements (column 2). Other scaling factors would of course be possible.

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4. Column 3b illustrates how the pattern might look if a higher £/ecu exchange rate were to lift UK GDP per head, expressed in ecus, slightly above the Community average.

5. A separate note discusses the suggested scheme in more detail. As explained there, Germany would not be at its limit in the examples illustrated in the table. The UK would be the only country at its limit. Germany would however contribute less than under the 30 May arrangements to the UK's refunds.

6. As also explained in the separate note, the limits formula could be designed so that the limits would rise over time in line with either the Community budget total or the GDP of individual member states. It would be for consideration which of these specifications would be preferable. The note touches also on methods of implementation and legal implications.

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NET CONTRIBUTIONS AND RECEIPTS BEFORE AND AFTER CORRECTION

Million ecus estimates for 1981

	<u>'Uncorrected'</u>	<u>Post 30 May</u>	<u>Possible 'corrected'</u>	
	<u>pattern</u>	<u>pattern</u>	<u>patterns under</u>	<u>proposed scheme</u>
	1	2	3a	3b
Germany	-1650	-2155	-2015	-1935
France	135	- 305	- 425	- 395
Netherlands	370	275	125	125
Belgium	450	380	160	150
Denmark	405	370	120	100
Luxembourg	285	280	165	155
UK	-1865	- 455	-	- 70
Italy	1020	775	1020	1020
Ireland	710	695	710	710
Greece	140	140	140	140

Notes

1. Column 1 is the average of the two cases illustrated in the Commission's paper SEC(81)1.281.
2. Column 2 assumes that Greece does not contribute to the UK refunds.
3. Column 3a is based on forecast average exchange rates for 1981 and assumes that UK GDP per head, in ecus, is some 93 per cent of the Community average. Column 3b illustrates how the pattern might look if the £/ecu exchange rate were 10 per cent higher and UK GDP per head, in ecus, rose in consequence to some 101 per cent of the Community average (see paragraph 4 of note).
4. The figures relate to the 'allocated' budget only. No account is taken of net contributions to the 'unallocated' budget, which includes aid, unallocated administration, ERDF non-quota section, transport infrastructure, various items of fisheries expenditure, disaster relief, Greek refunds etc.

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SPEAKING NOTE FOR USE WHEN THE NEW SCHEME IS PRESENTED TO
SCHMIDT'S OFFICE.

1. The Federal Chancellor has said from time to time that some form of correction should be applied to the German contribution to the Community Budget.

2. You will know that, in the discussions so far, the UK for its part has been advocating a different approach, admittedly more radical, but one which we felt, and indeed still believe, would serve to provide a lasting as well as a short term solution to the Community Budget problem.

3. However, it seems that our partners are not yet ready to accept our approach and the November Council is now less than a month away. We shall continue to advocate our approach as the right objective for the Community in the longer term, because we believe that it would provide a permanent release from financial in-fighting, and enable the Community to cope with the strains of enlargement. But we see that the Community is not willing to take such a large step all at once, and we are all pledged to find a structural solution to the Budget problem by 1982.

4. One option we have considered is to fall back on developing a special continuing arrangement for the UK alone. The Commission seem to be following that approach. We should regret being forced to abandon the search for a

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Community scheme and to fight instead for a special solution for the UK. We should very much prefer to continue to seek a more generalised and rational solution. The German idea of applying correctives to contributions could be a way forward. Can we develop it together?

5. Both German and United Kingdom officials have had difficulty in devising a general scheme of correctives that stands a reasonable chance of being negotiable. UK officials have recently made a new attempt which I should like to show you. [Table and cover note.] A detailed note of how we arrive at the figures shown in that table is also available. But in essence the scheme is pretty straightforward.

6. The starting point is a combination of the UK position - namely that, as one of the poorer Member States, we ought not to be transferring resources to the richer Member States - with what we understand to be the German position. Our understanding is that you are willing to accept that Germany should make a significant net contribution to the Budget, but that it should be reduced by comparison with the effect of the 30 May agreement and that it should be limited in future instead of being open-ended.

7. The essential characteristics of our new scheme are the following:-

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- (i) The Community would place upper limits on the net contributions of all Member States. It is a general scheme, not an ad hoc scheme.
- (ii) These limits would be based on relative prosperity and population size - the best available measures of ability to pay.
- (iii) Unlike the 30 May agreement, the corrective payments to the UK would be financed by the more prosperous Member States in proportion to the difference between their net benefits and what their net contributions would be if the corrective limits applied to them.
- (iv) The result is that a country like Germany, which would be relatively close to its limit, would contribute only modestly to the corrective payment to the UK instead of massively as under the 30 May agreement. The main burden of financing the corrective payments to the UK would fall on the small rich countries.
- (v) The less prosperous countries would not contribute to financing the corrective payments at all and would therefore be better off than under the 30 May agreement.

8. My impression is that the scheme would thus achieve what you want. You will tell me if I am wrong.

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9. There is a choice to be made in the design of the scheme on which it would be helpful to know the view of the German government, Should the limits on the net contributions of the more prosperous countries rise over time in line with the size of the Budget? Or should they rise in line with the growth of GDP in those countries? If the first choice were made, Germany would pay more as Community activities expanded. If the second, Germany would tend to pay more as its national income rose.

10. The British government is quite convinced that the Community's best interests will be served by a general scheme for removing the perversities of the present way of financing the Budget, rather than by the kind of purely ad hoc arrangement suggested by the Commission. We have endeavoured in our new suggestion to meet what we believe to be your concerns. The Prime Minister has asked me to say that she hopes that Chancellor Schmidt will find this new suggestion attractive as the basis of a proposal which our two governments might take to the European Council.

GENERAL SCHEME FOR CORRECTING NET CONTRIBUTIONSA POSSIBLE SPECIFICATION

1. This note discusses in more detail a possible specification for a general scheme for correcting net contributions. It deals in turn with:

- i. possible limits formulae,
- ii. binding and non-binding limits,
- iii. financing of refunds in proportion to 'headroom', and
- iv. implementation and legal aspects.

Possible limits formulae

2. If the limits are to reflect relative prosperity and country size, the formula used to determine them would need to include as variables some combination of GDP, GDP per head and population size. These variables would establish the relative levels of limits as between individual member states.

3. The overall scale of the limits would be a matter for the Community to decide, having regard to the Community's needs and what the net contributor countries could afford. There would be a choice between making the limits -

- (a) some proportion of the gross budget total, or
- (b) some proportion of a member state's GDP (or GDP per head), reflecting its ability to pay.

In case (a), the limits would rise automatically over time in line with the size of the gross budget. In case (b), they would rise automatically in line with the prosperity of the net contributor countries.

4. Table 1 gives examples of the two kinds of formula. The 'budget percentage' formula, shown in the upper portion of table 1 would set the limits at a percentage of the gross budget total given by the difference between a member state's share in Community GDP and population. It would be necessary to apply a scaling factor (see

columns 5 and 6) so as to produce whatever overall scale of limits was desired. The factors of 2 and $2\frac{1}{2}$ used in these examples are, of course, merely illustrative. It will be noticed that they have the effect of reducing Germany's net contribution to below its level under the 30 May arrangements.

5. The 'ability to pay' formula, shown in the lower portion of table 1, sets the limits at some small percentage of the amount (column 4) by which a member state is better off in aggregate than the Community average (viz the difference between the member state's GDP per head and Community average GDP per head, multiplied by its population size, or the difference between the member state's actual GDP and what its GDP would be if it had Community average GDP per head).

6. As table 1 illustrates, the scaling factors could be chosen in any individual year to produce an identical outcome from the two formulae. If, however, the factors were fixed for a period of years, the two formulae would give different results after the first year (see paragraph 3 above).

binding and non-binding limits

7. If a member state's uncorrected net contribution exceeded the limit set by the formula, the member state would be entitled to a refund of the difference. In the examples illustrated (see Table 2), only the UK would have a limit which was 'binding' in this sense. If a lower scaling factor were used, however, or if Germany's uncorrected net contribution rose above the projected level, Germany's limit could also be binding.

Financing of refunds in proportion to 'headroom'

8. As noted in the main paper, the financing of any reimbursements made necessary by the 'binding' limits would be shared between the more prosperous member states in proportion to the amount of 'headroom' each of them had within their formula limits - that is, in proportion to the difference between (a) their uncorrected net positions and (b) the formula limits on their net contributions. The less prosperous member states would not be expected to contribute.

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9. Table 2 illustrates the arithmetic. The 'headroom' of each more prosperous member state inside its formula limit (column 3) is calculated as the difference between its uncorrected net contribution (column 1) and its limit (column 2). In both the examples shown, the sum requiring to be financed is 1864 million ecus. In the 'lower scale' example, the more prosperous member states cover this requirement by contributing 41.4 per cent of their 'headroom'. In the 'higher scale' example, they contribute 34.5 per cent of their 'headroom'.

Implementation and legal aspects

10. The Community would aim to develop its policies with a view to having as few binding limits as possible and minimising the need for further 'correction'. Some corrective payments would however be needed in the foreseeable future.

11. The corrective payments would preferably be made during the year to which they relate, on the basis of projections made by the Commission. In the event of faulty projections, adjustments could be made in the following year. Alternatively, the corrective payments could be made as early as possible in the year following the year to which they relate.

12. The corrective payments could in principle be financed from own resources. But the complexity of the arithmetic makes this rather unattractive. There could also be problems in relation to the 1 per cent VAT ceiling. A simpler arrangement would be to handle the reimbursements and their financing through some kind of clearing account within the budget, supervised by the Commission. This would raise some legal questions, particularly as regards contributions to the reimbursements. If the Community had agreed that the scheme could be implemented, however, the legal problems would not be insuperable.

TABLE 1 : ILLUSTRATIVE FORMULAE FOR LIMITS ON NET CONTRIBUTIONS

'BUDGET PERCENTAGE' FORMULA	Estimates for 1981					
	1	2	3	4	5	6
	Budget total B	Share in Community GDP $Y_i/\Sigma Y$	Share in Community Population $N_i/\Sigma N$	Limits before scaling $B \left(\frac{Y_i N_i}{\Sigma Y \Sigma N} \right)$ million ecus	Limits after scaling factors of: 24	Limits after scaling factors of: 3
Germany	16868	0.2865	0.2267	1009	2523	3026
France	16868	0.2275	0.1986	487	1219	1462
Netherlands	16868	0.0576	0.0522	91	228	273
Belgium	16868	0.0426	0.0368	98	245	293
Denmark	16868	0.0258	0.019	115	287	344
Luxembourg	16868	0.0014	0.0013	2	4	5
UK	16868	0.1932	0.2068	-229	-573	-
Italy	16868	0.1378	0.2113	-1239	-3098	-
Ireland	16868	0.0055	0.0126	-119	-297	-
Greece	16868	0.0222	0.035	-215	-538	-

'ABILITY TO PAY' FORMULA	Limits based on scaling factors of			
	1.94 %	2.33 %	%	
	Aggregate Prosperity Differential $N_i (y_i - \bar{y})$	million ecus	million ecus	million ecus
Germany	129772	129772	2523	3026
France	62764	62764	1219	1462
Netherlands	11683	11683	228	273
Belgium	13094	13094	245	293
Denmark	14903	14903	287	344
Luxembourg	120	120	4	5
UK	-29515	-29515	-573	-
Italy	-159690	-159690	-3098	-
Ireland	-15601	-15601	-397	-
Greece	-27530	-27530	-538	-

TABLE 2 : DERIVATION OF "CORRECTED" NET CONTRIBUTIONS

Million ecus estimates for 1981

	1	2	3	4	5
	Uncorrected net contribution	Limits on net contributions (2½% scaling)	"Headroom" inside limits (1-2)	Corrective payments (3 x 0.4141)	Corrected net contribution (1+4)
<u>Lower Scale Example</u>					
Germany	-1651	-2523	872	- 361	-2012
France	134	-1219	1353	- 561	- 427
Netherlands	373	- 228	601	- 249	124
Belgium	451	- 245	696	- 288	163
Denmark	404	- 287	691	- 286	118
Luxembourg	284	- 4	288	- 119	165
UK	-1864	-	-1864	[-1864]	-
Italy	1018	..	..	-	1018
Ireland	709	..	..	-	709
Greece	142	..	..	-	142
<u>Higher Scale Example</u>		(3% scaling)		(3 x 0.3453)	
Germany	-1651	-3026	1375	- 475	-2126
France	134	-1462	1596	- 551	- 417
Netherlands	373	- 273	646	- 223	150
Belgium	451	- 293	744	- 257	194
Denmark	404	- 344	748	- 258	146
Luxembourg	284	- 5	289	- 100	184
UK	-1864	-	-1864	[-1864]	-
Italy	1018	..	..	-	1018
Ireland	709	..	..	-	709
Greece	142	..	..	-	142

TABLE 3 : MEMORANDUM ITEMS

	1	2	3	4	5	6	7
	Marginal financing share, 1982	GDP (000 mecus)	GDP share %	Population (millions)	Population % share	GDP per head	GDP per head as % of Community average
	(a)	(b)	(b)	(c)	(c)		
Germany	27.8	622.7	28.7	61.3	22.7	10158	126.3
France	24.3	494.5	22.8	53.69	19.9	9210	114.5
Netherlands	5.3	125.1	5.8	14.11	5.2	8869	110.3
Belgium	3.9	92.4	4.3	9.86	3.7	9369	116.5
Denmark	2.0	56.1	2.6	5.13	1.9	10946	136.1
Luxembourg	0.2	3.0	0.1	0.36	0.1	8376	104.1
UK	22.4	420.0	19.3	55.9	20.7	7513	93.4
Italy	13.3	299.5	13.8	57.14	21.1	5242	65.2
Ireland	0.8	11.9	0.6	3.42	1.3	3480	43.3
Greece	-	48.2	2.2	9.45	3.5	5128	63.8

(a) Source: Based on Draft 1982 Budget

(b) Source: Latest Treasury estimates

(c) Source: European Economy, 1980 figures

Prime Minister

Ref: A05699

MR ALEXANDER

The Prime Minister may like to have some account of how the discussions on budget restructuring are going.

2. The Mandate Group of officials is meeting each week, and will make an interim report to the Foreign Affairs Council on 26/27 October. Finance and Agriculture Ministers will have had separate discussions in their respective Councils on 19 October. Once these Ministerial discussions have taken place, the intention is to use the Mandate Group to prepare draft conclusions for the European Council. It will be up to us as the Presidency to prepare drafts which reflect the different positions; but we shall clearly aim for as much common ground as possible consistently with our own objectives. The draft conclusions will cover: reform of the CAP, the development of other Community policies, and how to deal with unacceptable budgetary situations.

3. No one seriously contends that there will have to be a continued corrective for the United Kingdom, although the French and the Danes argue vigorously that it can only be temporary and degressive. But there is no support for our more radical approach for a budgetary policy which would regulate the net contributions and net benefits of all member states. There is strong opposition from the Benelux countries and Denmark to doing anything for the Germans. This is also the declared French position, although there is no evidence that the new French Government has seriously applied itself to the issue. We may know more after this week's meeting between the Federal Chancellor and the President. Most French energies have gone into preparing a memorandum (promised shortly) on how they would like to see the Community develop. The Italians are not being unhelpful, and will probably concentrate on protecting the interests of their Mediterranean producers. So far, the Commission

I should prefer to talk to the F.S. & Ch. 26. This is a very worrying news, and will just cause difficulties in the House. We cannot go on paying the sums we are paying now.

*1. See A (overleaf): Agree that the Foreign Secretary should put a paper to SD on budget restructuring after the Anglo German summit, in early November?
2. See B (last page): Your diary is so crowded that I do not think a meeting of this kind can be fitted in before the Fisheries Council. Agree that Lord Carrington and Mr Walker should hold a meeting and nominate you on the outcome?*

*WR
12/10*

are maintaining a robust line on the need to get decisions at the European Council at the end of November and, although they are unlikely to drop their own scheme for dealing with our budget problem, are working closely with the British Presidency on other matters, including guidelines for the reform of the CAP.

4. The real enigma is with the Germans. They have not resolved their internal differences. Herr Genscher and the German Foreign Ministry want to play down the German budget problem (and to argue that it only arises because of British mendacity). The Chancellor and the German Finance Ministry would like a ceiling on the German net contribution and are tempted by our approach, while remaining sceptical of its negotiability. We are doing all we can to keep the Germans in our camp, and the Prime Minister's forthcoming meeting with the Federal Chancellor (October 29/30) will be important in this respect. The Treasury is currently considering whether there is some way of modifying our position to increase our chances of securing German support. If the Chancellor and the Prime Minister agree, this could be discreetly tried out on the Germans, in advance of her meeting with the Federal Chancellor.

5. Only after that meeting will it be possible to make an assessment of what it would be realistic to attempt to achieve at the European Council itself. Should we aim to set up a negotiation on figures, with the risk of failure? Or should we aim this time round to get some agreement on principles and the kind of long term solution we want, without putting figures on the table until we are out of the chair? If the real crunch is postponed until the Spring, would we then want to make another link with CAP prices? Should we go for guidelines for the reform of the CAP even if nothing is agreed on the budget?

A | The Prime Minister may think that the Foreign Secretary should be invited to put a paper to OD on these issues during the first half of November.

6. The discussions about Community policies on employment, energy, research, the Regional and Social Funds etc do not seem likely to present us with any insuperable difficulties and we may hope to get from the European Council a

useful impetus on issues like insurance (if it is not settled beforehand) and air fares. The only real danger lies in the French making a link with fisheries. This still seems a very likely tactic for them. On the other hand, the successful negotiation of a 'mini-package' at the last Fisheries Council has created some momentum to go for an overall settlement, and it may be possible to manoeuvre the French into a position where it would be difficult for them to stand out alone in blocking progress on the remaining issues on quotas and access. At the least, if we have got the French into that position, it will be more difficult for them to use the fisheries issue to force us to concede a less satisfactory budget deal. The Prime Minister might wish to discuss the prospects on fish with Mr Walker, and the Foreign Secretary and the Chancellor, before the next Fisheries Council at the end of October.

RA

ROBERT ARMSTRONG

9 October 1981

PART 11 ends:-

24. 9. 81

PART 12 begins:-

9. 10. 87