European Policy
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PM Alexander
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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

6th February, 1980

Dear George,

EEC BUDGET

..... I attach a letter that the Chancellor has written to M. Monory, the French Minister of the Economy. I would be grateful if you could arrange for its onward transmission to M. Monory. We understand that M. Monory does not read English very well and so would be grateful if the Paris Embassy could arrange for him to receive a translation with the original. We would be very grateful if the two versions could reach M. Monory by Friday, as M. Monory and the Chancellor will meet at the Finance Council in Brussels on Monday, 11th February.

I am copying this letter to Tim Lankester (No.10), Michael Richardson (Lord Privy Seal) and David Wright (Cabinet Office).

Yours sincerely

John Wiggins

(A.J. WIGGINS)

G.H. Walden, Esq.,
Private Secretary,
Foreign & Commonwealth Office

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

6 February, 1980

Dear Rene,

NORTH SEA OIL AND THE BRITISH ECONOMY

I understand that when the Lord Privy Seal visited you in Paris recently you said that you thought that the behaviour of oil prices had brought about - even since Dublin - such a substantial improvement in the UK economy as to remove any force from our argument that the size of the UK's net contribution to the Budget of the European Economic Community is disproportionate and inequitable.

I would like to try to persuade you that this is not so.

I do not think it can be disputed that the measure of GNP per head is the only valid test of capacity to pay in international transactions, just as capacity to pay governs the domestic taxation system. Any natural endowment - say in agricultural land in other Community member countries - will be reflected in their GNP. We have included the North Sea oil benefits in our GNP calculations. In 1979 oil contributed 2 per cent to the British GNP, which was after all less than the growth of the German or French economies in that single year. And the UK still had the third lowest GNP per head in the Community. This ranking in relative prosperity is most unlikely to change in 1980, even at the latest level of oil prices. If ever the effects of North Sea oil, together with progress in other areas of our economy were found to place us at the higher end of the table of Community GNP per head, our approach to the UK's contribution to the Budget could indeed be different.

In making this point about GNP per head and capacity to pay I am not seeking to say that the funds transferred to the Budget from the UK do not belong to the Community. Of course they do. I understand and accept the concept of

/"ressources

Monsieur R. Monory

"ressources propres". But the money is not collected and transferred without effect on the UK economy. It affects the taxable capacity available to me for other domestic purposes, and cuts into the standard of living which UK citizens would otherwise enjoy. The proposition that the transfer of own resources could have an adverse effect on the economy of a Member State was explicitly recognised in the preamble to the Financial Mechanism:

> "Whereas conditions incompatible with the proper functioning of the Community could arise when a Member State's economy, whilst in a special situation, is forced to bear a disproportionate burden in the financing of the Community budget."

I believe the development of the Community has long since carried it past the point where it can afford to ignore both economic effects and equity in the way it raises and disposes of its "own resources".

Of course North Sea oil brings great benefits to the UK which would be in very great economic difficulty without them. The oil contributes to GNP, improves real income, helps the current account of the balance of payments and reduces the real burden of taxation compared with what would otherwise be the case. But the UK is not like Saudi Arabia or even Norway. It is primarily a manufacturing and trading economy which has 30 per cent of its GNP in exports and which is still importing more oil than it exports. It cannot therefore escape either the contractionary effects of higher oil prices on world activity or their inflationary effects on its domestic costs and prices. Higher oil prices are less immediately damaging to the UK than to most industrial countries. But they are damaging none the less. There is a world of difference between "suffering less" and "making a large net benefit". This is particularly true when applied to an economy half the size of Germany's and two thirds that of France which is growing at a much slower rate than either of them and may be faced in the immediate future with an actual contraction of output.

I have occasionally heard argument that with oil production of say 600 million barrels a day, each $1 increase in the price of oil "benefits the UK by $600 million". This is quite wrong because the UK consumes oil as well as producing it. We are not yet net exporters of oil. Even when we reach that stage, our net exports will be small in relation to our own oil consumption, the high cost of which affects UK users of oil as it does those in other countries. And we do not expect to be net exporters of oil for more than a few years.

/We admire

We admire the effort which France has put into investment in nuclear energy and I recognise that the financing of this investment must give you cause for concern in your management of the French economy. I imagine that, directly or indirectly, financing nuclear investment has added to French borrowing overseas. North Sea oil too represents a huge capital investment, largely financed from overseas, and this capital is now having to be serviced. Alongside the impact on the invisible account of our balance of payments of our Community net contribution we now have heavy remittances of profits and interest overseas from North Sea investment. These factors have greatly reduced and at times eliminated our invisible surplus. I receive additional Petroleum Revenue Tax when North Sea oil prices rise but many fields still have capital allowances to offset against their profits before incurring tax liabilities. And because the higher oil price depresses the economy there is a lower yield from the main consumption and income taxes to set against extra revenue from Petroleum Revenue Tax. In struggling to reduce public expenditure I have had to tell my colleagues in our Government that there is no great bonanza of North Sea tax revenue arising from recent oil price increases to absolve us from painful efforts to reduce public borrowing.

So I cannot agree with the view that the scale of the benefit from North Sea oil has somehow solved all the deep seated problems of the British economy and made it well able to afford the transfer of real income arising from our present net contribution to the Community Budget. We recognise and accept that the main responsibility for putting our economy right rests on us and you know the efforts we are making. But we are entitled to ask that the Community should not add to our task by asking of us an inequitable contribution.

I would not like to end this letter without assuring you that our own problems do not make us blind to those of our partners. In particular I would like to acknowledge that, as you say to the Lord Privy Seal, the higher cost of your own oil imports next year and the scale of your investment in the provision of nuclear energy must indeed make more difficult your handling of the French economy.

I look forward to seeing you at the Finance Council on 11th February.

Yours very sincerely

Geoffrey

(GEOFFREY HOWE)