EHG (D)(75)(2)

6 March 1975

EUROPEAN COUNCIL MEETING (DUBLIN)

10-11 MARCH 1975

RENEGOTIATION

Brief by Foreign and Commonwealth Office

INTRODUCTION

1. Our general objectives, and our current tactical appreciation (which may have to be amended on the spot in Dublin) are set out in paragraphs 5(a) and 7-12 of the Steering Brief. Briefly, we should concentrate on getting agreement on the budgetary corrective mechanism and New Zealand, while assuring the other member states that we have no other matters to raise in the context of renegotiation. This will involve setting their minds at rest about steel and perhaps about aid.

2. We hope that the Prime Minister will be invited to speak first, and that after some comparatively brief introductory remarks he will be able to initiate a detailed discussion of the budget mechanism. Here our aim will be to resolve the three outstanding difficulties over the Commission's proposals; and to have an official working party set up to produce a draft statement on the budget mechanism for approval by Heads of Government.

3. Thereafter the Prime Minister will wish to explain our requirements on New Zealand. Again, it will be necessary to set up an official working group to draft a suitable declaration. We have already tabled a text.

/ Organisation

ORGANISATION OF BRIEF

4. This brief has the following annexes:

Annex A	Introductory remarks;
" B	Talking points and background notes on the budget mechanism;
" C	Talking points and background notes on New Zealand;
" D	Background notes on steel;
" E	Background notes on regional policy;
" F	Background notes on aid questions.

ANNEX B to
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RENEGOTIATION: COMMUNITY BUDGET

INTRODUCTION

1. The following papers will be before the meeting:
   (a) the Commission report of 30 January 1975 on the details of the Corrective mechanism (R/340/75) - Appendix A
   (b) a note by the Council Secretariat setting out the position of Member States on (a) (I/52/1/75) - Appendix B

2. This brief is organised as follows:
   (i) initial Speaking Note (paragraphs 3-13);
   (ii) full background on latest state of play and suggested objectives (paragraphs 14-28);
   (iii) Summary of United Kingdom position on the details of the corrective mechanism (paragraph 29);
   (iv) defensive Speaking Notes on:
   - the French theological argument about levies and duties (paragraphs 30-33);
   - the proposal for a ceiling on the size of the refund (paragraph 34);
   - why the United Kingdom's share of Budget contributions will probably decline after 1980 (paragraphs 35-38).

INITIAL SPEAKING NOTE

3. The budget problem is perhaps the most difficult and intractable which we have raised in renegotiation. It is, I think, generally agreed that the existing arrangements are likely to have an unfair impact on the United Kingdom. This was the only conclusion which could be drawn from the Commission's Report last autumn and Heads of Government duly drew it at their Paris meeting when they decided that a corrective mechanism should be set up as soon as possible.

4. At the end of January the Commission produced the very helpful report which is before the meeting and it was decided at the 10/11 February Council that we should take this as a basis for discussion. I very much hope that the meeting today will confirm that decision. We shall be in real difficulties if we further complicate a difficult situation by looking at new ideas. Naturally there will be points on the Commission Report which we or others will wish to raise. But, as M Thorn so rightly said in the Council, the Commission Report must be more nearly a point of arrival than a starting point.

5. It seems to me that there are three main outstanding problems which this meeting ought to try to settle this afternoon. I will explain what they are in a moment. If we can reach a consensus on them then our officials can prepare a draft declaration overnight for us to consider tomorrow. They can at the same time settle all the other points in the Commission's Report on which there are outstanding reserves. These points are in my view subsidiary.

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6. The three main points are:

a. the balance of payments criterion;

b. the size of the refund; and

c. the VAT slice, where the Commission have made the suggestion that the total of this should be a ceiling on a Member State's refund and where the French Foreign Minister put forward a rather different version.

I should like to explain my Government's views on these three points.

7. As my colleagues, the Foreign Ministers, will know, the Commission's suggestion that a Member State with a balance of payments surplus should not qualify would cause us unsurmountable difficulty. The Community should not add to the already stringent criteria about relative GDP per head and relative growth rates an additional criterion relating to the balance of payments. It may not be necessary for me to repeat today why we think that this is irrelevant and would be harmful. I hope that we can agree to drop it.

8. Then there is the size of the refund. We think that the Commission, in their natural efforts to make their report acceptable all round have made these suggestions too restrictive. And the Commission Report does not draw attention to one essential fact, namely that under the procedural arrangements for the corrective mechanism, which we accept, the Member State concerned would be called upon to pay its normal budget share of its refund - in our case let us say 17%, depending on the nature of the

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corrective mechanism. This fact, taken together with the two-thirds limit and the sliding scale system proposed, would mean that the United Kingdom would be unlikely ever to secure a refund of much over half the gap between our GDP share and our budget share.

9. I think that there is general agreement now that this gap is likely to be about 7% in 1980 and to decline thereafter in the natural course of events. I put it to you that it is not an "equitable solution", in the words of the formula about unacceptable situations which gave rise to the title of the Commission paper, for a Member State with a GDP per head below 85% of the Community average to pay 3% or 3½% more than its GDP share of the budget. This would be particularly difficult to defend when certain other Member States with GDP per head well above the Community average would be paying two or three percentage points below their GDP share of the budget. The Community will not function well, to use the wording that Heads of Government adopted in Paris in December, if one Member State is at a permanent disadvantage in this way. What would its attitude be to Community expenditure? What would be the effect on Convergence which, we are all agreed, is our aim?

10. I would be grateful therefore if the meeting could concentrate on this crucial question. We should like to remove the two-thirds limitation and improve the sliding scale arrangements so that the United Kingdom would get back a more substantial part of the gap than the Commission suggest.

11. If an improvement of this kind cannot be made the outcome will come under severe criticism in Britain. I know that each

/percentage

percentage point will cost all of the other Member States something, their budget share, whatever it may be, of the additional refund. But I think that it would be a great mistake for the Community to spoil the ship for a ha'porth of tar. If there is to be a corrective mechanism it ought surely to ensure an actual refund of at least three-quarters of the gap.

12. Finally, I come to the VAT point. I hope that the French Government will be prepared to work on the basis of the Commission version of it since I could not accept theirs. I am bound to say that even the Commission version causes us certain difficulties. In some circumstances it could have an effect on the size of the refund, particularly in the early years of the operation of the mechanism. We do not really accept the logic of what the Commission suggests. But I would be prepared to consider agreeing to the Commission version, namely that the amount of the Member State's VAT contribution for the year should constitute a ceiling on its refund, provided that all the other elements in the arrangement were acceptable.

13. To sum up, this whole question is complicated. In addition to the points I have raised, we could discuss at length whether 85% of Community GDP per head or growth rate at 120% of the Community average are the right percentages for a Member State to qualify. There are other points which Member States might wish to raise. But I should like to suggest that we avoid arguing about these and all make an effort to go along with the Commission's suggestions on these subsidiary points. I hope, Mr Chairman, that you can concentrate the discussion today on the three main

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points of substance I have mentioned and that we can reach a consensus on them this very afternoon so that an agreed draft declaration can be prepared overnight. Even if we cannot reach full agreement this afternoon, a draft declaration should still be prepared by officials tonight, with as few square brackets as possible, so that Heads of Government need spend as little time as possible on this matter tomorrow.

BACKGROUND

BACKGROUND

14. The Paris Summit in December 1974 invited "the Institutions of the Community to set up as soon as possible a correcting mechanism of a general application which, in the framework of the system of "own resources" and in harmony with its normal functioning, based on objective criteria and taking into consideration in particular the suggestions made to this effect by the British Government, could prevent during the period of convergence of the economies of the Member States, the possible development of situations unacceptable for a Member State and incompatible with the smooth working of the Community."

COMMISSION REPORT

15. The Commission report of 30 January 1975 to meet this remit is at Appendix A: and a simple guide to the proposed mechanism at Appendix C. Appendix D shows the impact of the limitations proposed by the Commission on the level of prospective reimbursements, on the basis of assumptions made previously about our unfair contributions.

UNITED KINGDOM ATTITUDE TO COMMISSION REPORT

16. We have accepted the report as a basis for discussion, but sought improvements in two respects:

a. deletion of the balance of payments criterion. We shall need a surplus in order to pay off current deficits. It would be wrong for this to disqualify us from reimbursement;

b. relaxation of the limitations on full reimbursement. The sliding scale and alternative maxima are over restrictive (see Appendix D) and we have sought deletion of the two-thirds limitation and an improvement of the sliding scale system.

/OUTCOME

OUTCOME OF 3/4 MARCH COUNCIL

17. The Council meeting on 3/4 March registered no progress on this issue. It was made clear to the Foreign Secretary beforehand by Herr Genscher, the German Foreign Minister that he would prefer not to go into too much detail in the Council because he would then have to bring out into the open the fact that the German position was still more restrictive than the Commission proposals about the maximum size of prospective refunds. The Secretary of State therefore maintained the UK negotiating position in order to leave maximum freedom of manoeuvre at Dublin.

PREPARATIONS FOR DUBLIN SUMMIT

18. To prepare the ground for the Dublin Summit special approaches have been made to the German, French and Irish Governments. The results of these are as follows:

(a) Germany

19. The main German consideration is cost. Throughout discussions in COREPER and in bilateral talks they have sought estimates of cost and have hinted at the imposition of a cash ceiling on the total reimbursement (and therefore on the German contribution). This could have major disadvantages because:

i. any figure might be regarded as an absolute limit without adjustment for price increases;

ii. with a large Community budget, the ceiling could become a real limit on refunds.

20. The Germans have however now assured us that Herr Schmidt will not put a figure on the table, though he may have one, and a low one, in his mind. The most that the German Foreign

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Office (who are on our side) hope for is that Herr Schmidt might accept the Commission report and possibly show some flexibility on the two thirds limit. This itself does not however significantly limit our refund. In order to improve significantly on the Commission's proposals, we have first to remove the two thirds limit and also to improve the sliding-scale. There is one other idea which might be more negotiable (see paragraph 28 (ii) below).

(b) France

21. The French preoccupation is with preserving the integrity of the "own resources" system. They have consistently tried to claw back what President Giscard conceded at the 1974 Summit, arguing that levies and duties are the instruments of the CAP and Customs Union. Reimbursement of levies and duties would remove Community preference and undermine the "own resources" system. Therefore only the inequitable impact of the VAT tranche should be corrected, leaving the impact of levies and duties out of account. The Commission's report does not support the French view (conceding that the impact of levies and duties should be taken into account), although the proposal that a Member State should not be reimbursed more than its total VAT contribution is a bow in their direction. (Our estimates show that this is unlikely to inhibit our reimbursement in practice. We have maintained our opposition to this particular limitation with a last minute concession to the French in mind).

22. The latest indications of the French position are that they continue to dislike the Commission proposals as too complicated, too bureaucratic, and not sufficiently respecting the principles of Community financing and "own resources". But they recognise that the Commission is the guardian of the pure doctrine, and it would not be easy to argue that it was necessary

/to be

to be purer than the Commission proposed. M Giscard therefore accepts that discussion will be based on the Commission proposal and that the outcome will be something very like the Commission proposal. This should mean that they will not press their version of the VAT point - i.e. only correcting the VAT inequity.

23. But the French ~~would~~ MAY be seeking certain modifications. There is the possibility (no more than that) of a French counter-proposal (although amendments to the Commission proposal are more likely), possibly on the following lines:

(A) an element of degressivity in the application of the proposals to levies and duties;

(B) changes, in a more restrictive direction, in the scales governing reimbursement.

24. (A) above would be completely unacceptable. We think that the size of our refund should gradually decline after 1980 (See /Defensive/ Speaking Notes). But we could not accept automatic tapering.

25. The French say that they do not want a bilateral confrontation with us. We can privately interpret this as meaning that they will not wish to be isolated - while warmly assuring them that we certainly do not want a bilateral confrontation either.

(c) <u>Dublin</u>

26. The handling of this issue by the Irish Presidency will be important. We are concerned that the complication of the Budget question should not lead to difficulties in the Heads of Government discussions. We have therefore proposed to the Irish that the Budget Item should be taken first on Monday afternoon, taking the Commission report as the basis for the

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discussion, but that, rather than taking Heads of Government through the whole paper, the Irish should focus the discussion on the three important issues:

i. the Balance of Payments Criterion;
ii. the size of the Refund; and
iii. the VAT tranche (both the French and the Commission versions).

We have further suggested to the Irish that a drafting group of officials should meet on Monday evening in order to prepare, in the light of the outcome of their discussion that afternoon, a draft conclusion for Heads of Government to consider on Tuesday morning. The latest indications are that the Irish will probably handle the matter as we wish.

(d) Other Member States

27. The Dutch and the Danes will be positively helpful. The Italians, Belgians, Luxembourgers and Irish will seek to promote a consensus. But none of the latter four will be keen to improve on the Commission proposals, when the French (and perhaps the Germans) are trying to pull in the opposite direction.

SUGGESTED OBJECTIVES

28. Our best assessment of what is likely to be attainable is:

i. deletion of the balance of payments criterion (here the French would be isolated if they opposed us).

/ii.

ii. <u>The Size of the Refund</u>

If the Germans are prepared to support us on knocking out the two-thirds limitation, there would be some change of isolating the French on this point. But knocking out the two-thirds limitation without also improving the sliding scale only gives very limited additional returns, beginning in 1979 (never more than £6-7 million). On the other hand, improving the sliding scale without knocking out the two-thirds limit does us no good except for 1977 and 1978. The chances of isolating the French on both the two-thirds limit and improving the sliding scale are poor. It is doubtful if Herr Schmidt would go so far. In these circumstances a possible course of action, after fighting to cut out the two-thirds limit at length, might be to say that we could reluctantly accept it, <u>provided that</u> it applied to the actual net refund received by a Member State at the top of the Commission's sliding scale (i.e. contributing over 130% of its GDP share.) (In the Commission version it applies to the figure for the refund arrived at by the sliding scale and the UK would have to pay its own share of that. The Commission version would give us a net refund of about 54% of our 1980 gap whereas the fallback position proposed would give us a 66% net refund.) This would in fact require some adjustment to the sliding scale, as well as to the present two-thirds (gross) limit; but it could be presented as in the notes as a fall-back position. Once Member Governments have fully realised the implications then resistance will grow. But there is just a chance that if the "fall-back position" were accepted by Heads of Government on Monday, officials could put it into the formula to be submitted on Tuesday.

iii. <u>The VAT Tranche</u>

Provided the French drop their version (correction of the VAT inequity only), our only aim here is to use our concession of accepting the Commission version to extract some benefit. We could say to the French that we would withdraw our reserve on this if they would accept our views on the balance of payments criterion.

SUMMARY OF UK POSITION ON THE DETAILS OF THE CORRECTING MECHANISM

29. (See 1/52/1/75(FIN 30) at Appendix B - page references are to that document)

A. THE CRITERIA FOR AN UNACCEPTABLE SITUATION

I. Economic Situation

1. GNP per head less than 85% of Community average (Page 2)
UK Position: Accept

2. Real rate of growth less than 120% of Community Average (Page 3)
UK Position: Accept

3. Balance of Payments Deficit on Current Account (Page 3)
UK Position: Resist
Fall-back Position (not for use unless, contrary to expectations, we fail to isolate the French on this point): radically to amend by reference to the Community average ratio of liquid external assets to liquid external liabilities so that the balance of payments criterion would be inoperative in any case where the ratio of an individual Member is below this average level.

Talking Points
(Initially)

a. This criterion, unlike the others suggested by the Commission, has no direct bearing on ability to pay. It is irrelevant to the conception of the mechanism proposed by the Commission.

b. It would be difficult to defend a scheme which ceased to operate, despite the continuing inequitable impact of the own resources system and the lack of convergence of economies, just at the point when we were beginning to earn the surpluses necessary to repay our accumulated debt.

c. The situation would be even more patently absurd and unfair if all the rest of the Community were also earning surpluses.

/d.

d. Inclusion of this criteria was strongly criticised in the debate in Parliament on 27 February and presents great political difficulties for the United Kingdom.

(If fall-back position is used):

e. It will be a proper and necessary object of United Kingdom policy to run current account surpluses in the late 1970s and in the 1980s on a scale that will cover repayment of foreign currency debt and produce an improvement in the ratio of liquid external reserves to liabilities.

f. The criterion must thus take account of accumulated liabilities as well as of current payments, and in particular of external liabilities in domestic as well as foreign currency.

g. The only even-handed way for making such adjustment to the balance of payments criterion would be to ensure that the criterion would be inoperative when a Member States' ratio of liquid external assets to liquid external liabilities is below the Community average.

II. <u>Disproportionate contribution to the Budget</u>

1. <u>A share of the budget greater than 110% of its share of Community GNP</u> (Page 3)

<u>UK Position</u>: Accept

2. <u>A Potential Net Foreign Exchange Liability resulting from the operation of the Community budget</u> (Page 4)

<u>UK Position</u>: Accept

B. CORRECTIVE MECHANISM

I. <u>Sliding Scale Arrangements</u>

1. <u>Reimbursement to be calculated according to the Sliding Scale on page 7 of R/340/75 starting from contributions at 105-110% of GNP share</u> (Page 4)

<u>UK Position</u>: Not opposed to principle of graduated arrangements but find this particular formula too restrictive.

/II.

II. Ceilings on reimbursement

1. 2/3 of the total excess contribution (Page 5)

   UK Position: Better to rely on appropriate Sliding Scale arrangements and drop the 2/3rds limit. Combination of both is too severe.

   Fall-back Position. I recognise that there is great difficulty for other member states about my suggestion that we should drop the two-thirds limit and improve the sliding scale. Let me reluctantly put a compromise suggestion to you. My understanding is that the Commission's intention was that a member state in a serious position, that is to say a member state with a budget contribution of more than 130% of its GDP share, should actually receive a refund of two-thirds of the gap between its GDP and its share of the budget. I am prepared reluctantly to accept such an arrangement, that is to say that the two-thirds limit should apply to the actual net sum which the member state concerned would receive by way of refund. Let me make that quite clear. The arrangements would be adjusted so that a member state in a serious situation (as defined above) would get a net refund of two-thirds by adjusting the amount of the gross refund to take account of the member state's own contribution to its refund in the following year's budget.

2. Ceiling of the net potential foreign exchange liability of the Member State (Page 5)

   UK Position: Accept

3. Ceiling of the Member States' VAT Contribution (Page 6)

   UK Position: Reserve our position until the French concede on balance of payments.

III. Provisions for review of Chronic Divergence (Page 6)

UK Position: Accept, on basis that additional measures of support may be forthcoming in event of chronic divergence.

IV. Experimental Period of Seven Years (Page 6)

UK Position: Accept a Review. Commission wording is acceptable. Could not agree to wording implying the mechanism will definitely end after 7 years.

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DEFENSIVE SPEAKING NOTES

Defensive Line on The French theological argument about levies and duties

30. We do not accept the argument about the distinction levies and duties on the one hand and VAT payments on the other. All are equally own resources in Community terms, and represent a real transfer of resources that could be used for other purposes by the Member Stste concerned.

31. The impact of levies and duties has been accepted as relevant in previous stages of the argument, including the Commission's two reports.

32. Equally, the means of ensuring Community preference for Community producers will be achieved as long as the levy or duty is imposed on third-country imports. We do not question that. Since reimbursement would be to Governments, not to individual importers, the mechanism would in no way undermine Community preference.

33. Neither correcting only the VAT inequity nor phasing out the refund on duties and levies over a period of years ("degressivity") could be regarded as righting the inequitable impact of the own resources system. On any plausible forecasts, if levies and duties are left out of the calculation and we recover only the excess of our VAT contributions above an appropriate GNP share, this would give only a small fraction of the amount due under the Commission proposals, which would itself fall well short of full reimbursement; and this will go on being true well into the 1980s, when "degressivity" on the lines the French have in mind would eliminate levies and duties altogether.

/34.

DEFENSIVE LINE IF THE GERMANS OR OTHERS START TO TRY TO PUT A CEILING ON THE SIZE OF THE REFUND

34. We cannot know how big the Community budget will be in 1980 or after. That will depend on the rate of inflation and what new Community expenditure is authorised. As Herr Schmidt said at Paris, quantification more than two years ahead is really not possible. It is much better therefore to talk in terms of percentages. Our best estimate is that there will be a 7% gap between our share of Community GDP and our share of the budget. The question we need to settle is how big a percentage of that gap should be refunded. It is no good trying to translate this into units of account or Deutschmarks or pounds sterling.

If it is necessary to explain why the UK's share of budget contributions will probably decline after 1980

35. UK intra-Community trade will grow as a percentage of our total trade. This will tend to reduce the UK's share of levy and duty payments.

36. For all countries, the share of duty payments in the total financing of the budget will decline as a result of tariff cuts from the Tokyo round and subsequent multilateral agreements to reduce tariff rates. This will increase the share of VAT contributions in the budget and, as the UK's share of VAT contributions is less than her share of tariff receipts, the UK's overall share of budget contributions will decline.

37. The size of the budget is likely to increase faster than levy and duty contributions. Again, this will mean that the share of VAT payments in the financing of the budget would increase and the UK's share of total budget contributions will fall.

38. The UK's share of VAT contributions should fall as the share of consumption in the UK's GDP falls. This will occur as the rate of investment in the UK improves as part of the economic convergence.