

Ref: A0666

PRIME MINISTER

COMMUNITY BUDGET

1. The Chancellor of the Exchequer has sent you a minute on two aspects of the Budget negotiations. They may be referred to at your meeting tomorrow afternoon.
  
2. The first concerns monetary compensatory amounts (MCAs). This problem has become more important than we thought in the summer with the weakening of sterling. United Kingdom MCAs are now back at 12 per cent; so we can no longer argue that the Commission's figures for 1980 exaggerate the difference between our way of viewing MCAs and the view of most other member states that they should be counted as a benefit to us.
  
3. The Government is committed to a gradual reduction in MCAs (and the Minister of Agriculture wants another Green £ devaluation before the end of this year). For this reason and because MCAs are now linked to the ECU and ours are therefore likely to be smaller than when they were calculated in relation to the DM, it is reasonable to assume that the difference will not reach the proportions it did in 1976-77. Moreover, the way MCAs are treated does not affect our gross contribution but only the receipts we are reckoned to have obtained from the Community. It is therefore likely to be important only if we secure a corrective mechanism related to our inadequate receipts. Since, if we secure this at all, we can only expect to get partial adjustment, it is not worth dying in the last ditch over the MCA issue. To the extent that MCAs are not regarded as offsetting our net Budget contribution, then they must be regarded as increasing the resource cost of the CAP to us. We should still be able to deploy this argument if we lost it in the Budget context. You may therefore wish to agree with the Chancellor of the Exchequer that we should not give this point away before Dublin; but we should not make it a sticking point. We should not exclude the possibility of a compromise deal eg splitting the difference.



4. The second point concerns the VAT ceiling. There is no doubt the French will use this as an argument for limiting the size and duration of any Budget refund to us. We, on the other hand, must retain the 1 per cent ceiling as a means of holding down the cost of the CAP and eventually as a weapon for securing agreement to fundamental changes. But we shall needlessly offend the smaller countries if we make too much of the 1 per cent ceiling until our budget problem is solved: the Benelux countries, for general communautaire reasons, and the Irish and Danes, in order to protect the CAP, want to see the 1 per cent ceiling raised.

5. The Chancellor suggests that this situation makes it all the more necessary to solve the budget problem before the ceiling is reached: but this would only get us over 1980. Most people now accept that the ceiling will be reached at least by 1981 when we will still need a refund. It is only true to say, as the Chancellor does, that "once we achieve a settlement we have every interest in upholding the 1 per cent" if our refund is inviolate and cannot be squeezed out by what other member states will consider to be more pressing needs eg to finance CAP commitments. We must therefore have an answer to this dilemma -

i. In the first place we must press for commitments by the European Council to cut the level of CAP expenditure: to the extent we succeed, there will be more headroom to finance our refund;

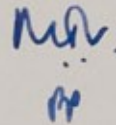
ii. if that fails we would have to try to get our refund financed outside the Budget. This will be difficult for the Germans and others to accept, and the Commission will be very hostile;

iii. we might therefore, as the Chancellor's minute suggests, need to fall back on financing devices within the Budget which avoid our refund appearing as an increase in the total size of the Budget. We cannot assume that this will be any more welcome to other member states, but at the end of the day the Germans might find it less difficult than any of the alternatives. From our side, there is a fear that, if we proposed such a device for our Budget refund, we should appear to be condoning the somewhat similar way in which the milk responsibility levy appears as negative expenditure and thus gets round the curb on CAP expenditure. But the two cases can

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be differentiated: what we are seeking in the Budget is purely re-distributive between member states. The milk co-responsibility levy on the other hand taps another source of income - the milk producer.

6. On the 1 per cent ceiling you may therefore want to agree with the Chancellor on tactics, but emphasise the vital necessity for us not to give way on the 1 per cent ceiling in Dublin even if this were to ease our task on the Budget. You might ask the Chancellor for more details on the "financing possibilities" which he says officials have identified.



ROBERT ARMSTRONG

14 November 1979