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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EEC BUDGET CONTRIBUTION : THE NEXT STEPS

Memorandum by the Chancellor of the Exchequer

On 10 July, OD endorsed in broad outline the strategy for securing a reduction in the UK's net contribution to the Community Budget sketched out in my paper "EEC Budget : Post-Strasbourg Strategy" - OD(79)18. This note reviews progress in the two months since then and considers how we should now proceed if the Prime Minister is to have the best possible chance of achieving a successful outcome when the issue comes again to the European Council on 29-30 November. In particular I seek my colleagues' agreement to the line I am proposing to take in Brussels on Monday next when Finance Ministers will be considering the Commission's "reference paper" on the financial consequences of the Community's budgetary system.

THE COMMISSION REFERENCE PAPER

2. At its June meeting, the European Council asked the Commission to prepare a reference paper:

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"describing the financial consequences of applying the budgetary system on the situation in each Member State, especially in 1979 and 1980",

and at the same time,

"to examine the conditions under which the corrective mechanism decided on in 1975 can play its part in 1980 and the extent to which it fulfils the objectives assigned to it."

3. The European Council instructed the Commission to submit its paper to the Finance Council so that Member States could "give their opinions and present their requests in concrete form". On 10 July, this Committee agreed that the Commission should be pressed to complete its paper in time for this "debat d'orientation" to take place at the September Finance Council (17th). This would help to ensure that the Commission produced its proposals for a solution by mid-October. If the European Council is to take decisions in November, it needs enough time to consider the Commission papers.

4. The Commission has made an effort and has met the September deadline. For the UK the main value of the paper lies in its estimates of net contributions in 1979 and 1980. As previously, the Commission has drawn up these tables on two bases: with MCAs attributed to importers in one case and to exporters in the other. These figures fully substantiate the UK claim that by 1980 it will be far and away the largest net contributor to the Community Budget, however MCAs are treated. The paper also demonstrates the nature of the UK problem by noting that in 1980, our share of Community expenditure will be 10 per cent, our share of Community GNP 16 per cent and our contribution to Community revenues over 20 per cent.

#### ATTITUDES IN OTHER MEMBER STATES

5. The summer holiday season is not a good time for setting up bilateral meetings. Contacts with other capitals have so far

been limited and largely confined to officials. Such soundings as we have been able to take suggest that opinion in other Member States has shifted somewhat towards acknowledging that the UK has a problem and that something should be done to relieve it. But they are still far from accepting the need for corrective action on the scale that we regard as necessary. Expressions of sympathy from officials, or even junior Ministers, are of limited value when several of the countries which will have to bear the cost of any solution are suffering from domestic budgetary constraints. All the signs are that a decision to solve the UK's budgetary problem will be reached only at the highest political level.

ALLIANCES - (i) GENERAL

6. It is the position of Chancellor Schmidt which will, I believe, in the end prove critical: probably only he would be able to move the French from their hostility to the idea that the UK has a problem, or one which the Community must solve. For the rest, we shall probably do better with the smaller countries, Denmark and Holland, than with the theoretically more natural allies, Italy and Ireland. Italy now has a different interest and the Irish are keeping a quiet, and perhaps a rather apprehensive, place in the background. Denmark and Holland do acknowledge a problem, though they might not go the whole way with us; but in their present economic difficulties they will not find it easy to contemplate big solutions.

ALLIANCES - (ii) ITALY

7. The Commission's figures show Italy as the largest single net beneficiary from the Budget in both 1979 and 1980. This is a dramatic reversal of the 1978 position. The Italians themselves appear to expect reversal - though not on quite the scale the Commission foresees. So the UK and Italy will no longer join forces in complaining about net budgetary contributions.

8. Instead, the Italians will stress the non-budgetary costs to them of the CAP. The reference paper already contains a rather grudging acknowledgement of these costs. The Italians will

probably demand that the Commission's analysis on this point should be strengthened and extended.

9. On substance the UK has nothing to fear from an extended analysis. If properly carried out this would show that the UK also incurs non-budgetary costs. But, tactically, it would enable other Member States to play for time and to inject into the discussion their pet arguments about the unquantifiable benefits of membership. It would also, as we have always feared, open the way for special concessions to Italian interests which could be very costly to the UK. The UK should argue that the first thing for the Community to concentrate on, in the light of the figures in the Commission paper, must be the budgetary costs.

10. As there is no obvious solution that would simultaneously resolve both the Italians' difficulties and our own, the best we can hope for is that we do not become direct competitors in the search for a better deal.

#### THE SEPTEMBER FINANCE COUNCIL

11. At next week's Finance Council my Community colleagues will be looking to me for a statement of the UK's objectives as a framework for discussions leading up to the November European Council. I intend to build on the Commission's paper which displays the UK problem. I will rehearse again the proposition that the UK ought to be making no net contribution.

12. I propose when speaking to make the following points:

(i) The structural character and growing scale of the problem

The Commission's paper demonstrates beyond dispute the size and seriousness of the UK's budgetary problem. It shows that by 1980 the UK will be far and away the largest net contributor. The problem is not only large, but will continue to grow unless solutions are found.

(ii) Timetable for action

The Commission has now identified the problem and thereby fulfilled the first part of its remit from the European Council. It must now tackle the second part and put forward proposals for a solution. The Commission should circulate its proposals in time for discussion at the Finance Council on 15 October. The November Council is only a few days before the European Council on 25 November and is far too late.

(iii) Requirement for solution

As a country with a GNP per capita significantly below the Community average, the UK should not be a net contributor to the Community Budget. If this is acceptable, the approach to the solution should:

- a. act on our own contribution and thus compensate us not only for our excessive gross contribution, but also for our low level of receipts, which accounts for over half our problem;
- b. last as long as the problem; and
- c. not require any expansion of the Community Budget;

(iv) False trails

The UK does not at this time want to rule out any approach which would solve the problem. But it does not see any scope for an adequate solution through:

- a. reform of the ERM or its financing, however desirable and necessary that may be;
- b. increased-UK receipts from the Regional and Social Funds. The UK should receive more but could not conceivably offset its imbalance that way; and
- c. loans, which the Commission has rightly pointed out, do not constitute a transfer of resources. They bear interest and they have to be repaid: and if we wanted loans we would get them from other sources.

(v) A corrective mechanism

Some form of corrective mechanism will be necessary. The Financial Mechanism provides a precedent. It might well be a starting point for a solution. But to meet our case adequately any mechanism would have to operate on both sides of the account, compensating the UK for the low level of its receipts as well as its excessive gross contribution. And it would have to be different from the type of restrictions which, as the Commission has shown, prevent the UK from

deriving any substantial benefit from the existing Financial Mechanism. It must, in short, satisfy the conditions of (iii) above.

#### THE CAP AND THE 1% VAT LIMIT

13. It will be seen from this that I propose to say the minimum about the related issues of reforming the CAP and of what happens when the Community reaches the limit of its resources by using up what is available under the "1 per cent VAT" contribution. Either might later on be turned to good account. But we must get the UK budgetary problem sorted out on its own merits. Discussion of the VAT ceiling would hopelessly clog up the argument. Moreover the UK cannot possibly gain by getting into the lead on the CAP. The Germans and the Danes both rightly fear the way CAP financing has developed as a real threat to the Community. They and perhaps others would no doubt welcome it if the UK would lead the attack. But we must decline to do this. It would be too easy then for the French to claim that we were - as usual - hostile to the concept of this fundamental aspect of the Community. We should confine ourselves to the support of others on these issues.

#### CHOICE OF MECHANISM

14. If my colleagues agree that this is the right approach, I suggest that we should authorise our officials, within this framework, to take whatever opportunities are available to influence the Commission's work on "solutions". They should take care to say nothing inconsistent with the proposition that the UK should not be a net contributor to the Budget.

15. My officials are continuing to work on the details of various approaches. My colleagues might like to be reminded of the broad kinds of a mechanism I discussed earlier in Annex B to OD(79)18. We have to bear in mind that none of them would limit directly the UK's payments to the Community Budget, since these consist of revenues which under the Own Resources System are the legal

property of the Community. Instead, they would have to operate in arrears, providing the UK with refunds of the contribution it had already paid. The size of the refunds would depend on the provisions built into the mechanism. They could be financed either inside or outside the Budget.

16. The possibilities are:

(i) a radically improved Financial Mechanism. So long as refunds under the Financial Mechanism are related to a Member State's excess gross contribution, this could only form part of a solution.

(ii) a mechanism under which the Community would compensate the UK for the low level of Community expenditure in the UK by means of a straightforward cash payment. This might, for example, be calculated so that it raised UK receipts per capita to a given proportion of the Community average. It would not involve matching increases in UK public expenditure, but on the contrary would be a direct offset to such expenditure.

(iii) a "hybrid" mechanism (whether or not based on the present Financial Mechanism) with elements operating on both sides of the account i.e. providing for both a refund of excess payments and a cash payment to increase UK receipts.

(iv) a straightforward rule limiting the UK's net contribution. This ceiling could be expressed in various ways e.g. as a proportion of the total Community Budget, or of the UK's GNP, or of its gross contribution.

17. It would be wrong even to attempt to decide for ourselves now what precise solution to go for, let alone to table a take-it or leave-it formula. We need to test out the ground. The Germans might find a straightforward mechanism, designed to produce some

given figure, desirable. But there may well be a disposition elsewhere to start with the Financial Mechanism, even if, to get an adequate result, the solution would then be rather complex.

#### FUTURE BI-LATERAL CONTACTS

18. We will need to follow up my statement at the Finance Council with a programme of bi-lateral contacts, at Ministerial as well as official level. We must ram home the message, and push for a readiness to contemplate remedial action on the right scale. I intend to play an active part in this process and I hope my colleagues will agree to do the same.

19. We already have several important opportunities. The Prime Minister is seeing Mr. Martens of Belgium this week. The next meetings in the series of regular, six-monthly Anglo-German and Anglo-French summits will take place on 31st October and 5th/6th November respectively: the former will be crucial. The Prime Minister is also seeing the Luxembourg Prime Minister on 22nd October. We should, as I imply in paragraph 11 above, pay particular attention to some of the smaller and wealthier Community countries which are at present substantial beneficiaries from the Budget - Denmark, the Netherlands and Belgium. We must also maintain contact with the Italians, even though we no longer rely on them to any exclusive extent. Finally, with the Irish in the Presidency, there is a clear case for keeping in touch with Dublin.

#### CONCLUSIONS

20. I invite my colleagues:

(i) to endorse the line that I propose to take at next Monday's Finance Council, as set out in paragraphs 12 and 13 above;

(ii) to agree that in talking to the Commission and to our Community partners officials may discuss possible



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mechanisms within the framework suggested in paragraphs 15-18 above, but to note that a final choice can only be made at a later stage, when we have a better idea of what might provide negotiable.

H.M. Treasury

(G.H.)

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