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OD(79) 9th Meeting COPY NO 42

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

MINUTES of a Meeting held
at 10 Downing Street on
MONDAY 8 OCTOBER 1979 at 2.30 pm

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs and Minister of Overseas Development

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon Sir Ian Gilmour MP
Lord Privy Seal

The Rt Hon John Nott MP
Secretary of State for Trade

SECRETARIAT

Sir John Hunt
Mr M D M Franklin
Mr D M Elliott

SUBJECT

UNITED KINGDOM COMMUNITY BUDGET CONTRIBUTION:
CORRECTIVE MECHANISMS

UNITED KINGDOM COMMUNITY BUDGET CONTRIBUTION: CORRECTIVE MECHANISMS

Previous Reference: OD(79) 6th Meeting

The Committee had before them a Note by the Secretaries (OD(79)25) covering a Note by Officials setting out a range of possible corrective mechanisms to reduce the United Kingdom net contribution to the Community budget, and proposing a line to be taken in exploratory discussions with the Commission and subsequently with other member states.

THE CHANCELLOR OF THE EXCHEQUER said that at the 18 September Finance Council he had made clear our requirements for a solution to our budgetary problem, but he had not at that stage suggested any precise corrective mechanisms. The Commission's proposals were expected at the end of October or early November: and we needed to influence them whilst they were in a formative stage. The Note by Officials showed that in theory we could achieve our objective of broad balance through any one of the possibilities identified in paragraph 16 of his earlier memorandum OD(79)24, but suggested that in terms of negotiability a hybrid solution involving a reformed Financial Mechanism containing an element to compensate us for our inadequate receipts was likely to be more acceptable to the Commission and our partners than a straightforward no net contribution rule. He had reservations on two aspects. First, he was not satisfied that the qualifying criterion - that only member states who were net contributors with below average GNP over a three-year period should be eligible for a refund - was sufficiently robust. A 13 per cent appreciation in the sterling exchange rate would for example bring us up to the average of an enlarged Community. Second, on financing, we needed a procedure which acted as quickly as possible in terms of cash flow and thus avoided our making a permanent loan to the Community. The system of monthly payments agreed for Greece in her accession treaty might provide a useful precedent.

In discussion there was support for the view that it would be unacceptable for the United Kingdom to receive no relief on its very large net contribution if our GNP per head were to rise marginally above the Community average. The experience of the previous Government in negotiating the existing Financial

Mechanism demonstrated that the improbable could not be excluded: we should not make the same mistake again. While participation in the European Monetary System (EMS) exchange rate mechanism might reduce the scope for sterling appreciation it would not remove the possibility entirely, and it would in any case be wrong to base a decision on whether or not to join fully in the EMS solely on this factor. The averaging and phasing-out arrangements proposed in paragraphs 5 and 6 of the Officials Note might not constitute a sufficient safeguard. Another possibility might be to provide that the corrective mechanism should apply to net contributing countries with GNP per head which did not exceed 105 per cent or 110 per cent of the Community average. The safest assurance would be to provide that no country should make a net contribution which exceeded a certain proportion of its GNP. On the other hand it was argued that the Committee did not have sufficient evidence to assess how great was the possibility that the United Kingdom would rise above the Community average GNP even in an enlarged Community. It would be counter productive in the difficult negotiations ahead to seek to over ensure against remote contingencies. Our immediate need was to cover the critical period during which the Government were seeking to turn the British economy around. The accession of Spain and Portugal was some way ahead and we could if necessary work for delay in their accession if otherwise there was any risk that we might lose the benefits of a corrective mechanism. Alternatively, we could seek agreement that the corrective mechanism should be subject to review after, say, 5 years.

In discussion on the nature of the corrective mechanism it was suggested that the simplest solution lay in one of the straightforward rules illustrated in Table 7 of the Officials Note. It would be preferable to avoid depending upon a rebate related to our inadequate receipts: this might lead to pressure for higher Community expenditure. It did not seem realistic to expect France and Germany to pay refunds directly to the United Kingdom outside the framework of the Community Budget. On the other hand it was argued that if we were to have any chance of securing a decision at the November European Council we should not make proposals which would involve fundamental changes in the Community's financial system or lead our partners to challenge us on the grounds that we were proposing a *juste retour*.

Our partners were ready to consider doing something about the problems of the United Kingdom but they did not wish to reopen discussion about the Community's own resources system. In this connection, it was important to note that we could secure relief of 1400 - 1500 mua within our VAT contribution, while still paying our levies and duties in full. Although it would need radical change, the Financial Mechanism was a useful Community precedent on which to build. Securing a substantial reduction in the United Kingdom's net contribution was more important than the precise means adopted. But we should give the Commission a clear indication of our ideas since it was very important that their next report was as helpful to us as possible. We should continue to press for a broad balance between our contributions and our receipts.

THE PRIME MINISTER, summing up the discussion, said the Committee had identified several possible ways of ensuring that the United Kingdom continued to receive some relief even if we became an above-average GNP member. The Chancellor of the Exchequer should provide the Committee with further information on what developments of exchange rates and relative growth rates would be required for the United Kingdom to reach that situation in the present Community and in a Community enlarged to include Greece, Spain and Portugal. Pending further consideration of this aspect, the Commission should be told that the Government considered some provision to cover this contingency was necessary without going into detail at this stage. Subject to this point, the Committee agreed that the United Kingdom Permanent Representative should put the conclusions in paragraphs 22 and 23 of the note attached to OD(79)23 to the Commission but should place greater emphasis on the possibility of a straight limit to our net contribution rather than the modifications to the financial mechanism identified in paragraph 22.

The Committee -

1. Took note, with approval, of the Prime Minister's summing up of their discussion.

2. Invited the Foreign and Commonwealth Secretary to be guided accordingly in formulating instructions for the United Kingdom Permanent Representative to the European Communities.

3. Invited the Chancellor of the Exchequer to circulate a note on the factors relevant to the relationship between the United Kingdom GNP and the average Community GNP over the next 5 years.

Cabinet Office

9 October 1979