Ref: A09508

CONFIDENTIAL

PRIME MINISTER

Visit of Chancellor Schmidt: EEC Budget

In connection with the briefing you have asked whether we could not find an early solution to our problem with the Community budget by relating contributions to GNP shares. You may care to see the attached note prepared by a group of officials chaired by Mr. Franklin of the Cabinet Office. It has also gone to the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary.

2. The short point is that adjusting our gross contribution to GNP shares would not be enough. Our real problem is with the net contribution and to tackle that adequately we have to adjust the level or pattern of expenditure or to have a mechanism which, more effectively than the 1975 Financial Mechanism, will reduce the net amount we finally pay over. If we go too bald-headed for a solution based on ability to pay, we shall be accused of asking for each country to get back just what it puts in, the so-called juste retour which is anathema to most of our Community partners. For this and the other reasons explained in paragraph 8 of the note, we have so far been careful not to commit ourselves to precise remedies. The first requirement is to get the Community to agree that there is a problem which must be dealt with. There is some evidence that the Germans are at least privately recognising that something must be done. I suggest your aim during the visit this week should be to get the German Chancellor to acknowledge that need publicly and invite him to say how he would go about putting it right.

John Hunt

9th May 1979

EEC RESOURCE TRANSFERS AND CONVERGENCE: OBJECTIVES AND STRATEGY UP TO THE JUNE EUROPEAN COUNCIL

NOTE BY OFFICIALS

THE PROBLEM

1. Despite having the third lowest GNP per head in the Community, we are at present (depending upon the Budgetary attribution of Monetary Compensatory Amounts (MCAs)) either the largest or the second largest (after Germany) net contributor to the Community Budget. Under Article 131 of the Accession Treaty our contributions are tapered but this transitional arrangement comes to an end in December 1979 and, without it, we would already be the largest net contributors regardless of the treatment of MCAs. The Commission figures for net transfers under the 1978 Budget are at Annex A. The total balance of payments cost to the United Kingdom is greater because of the trade effects of the Common Agricultural Policy (CAP). (Our specific objectives on the CAP are outside the scope of this Note and are being dealt with separately.)

2. This highly unsatisfactory position has arisen -

i. partly because we import proportionately more foodstuffs and industrial goods from non-Community countries, and therefore collect proportionately more agricultural levies and customs duties than do other member states. Such levies and duties are part of the Community's Own Resources and so we contribute about 19.3 per cent to the Community's resources compared with our 15.8 per cent share of GNP; but

ii. mainly because the CAP accounts for 70-75 per cent of all Community expenditure and has grown rapidly since we joined. Since we have only a relatively small agricultural sector, we get back only about one third of our contribution.

3. The Financial Mechanism, negotiated in 1975 to deal with our problem of excessive gross contributions as the transitional arrangements were phased out, might lead to a refund for the first time in respect of 1979. The Mechanism contains an elaborate set of criteria which severely restrict its applicability and the amount of any refund. Moreover, it is directed at our gross contributions whereas it is our net contribution which is so unacceptably high.

4. The problem is likely to get worse unless early remedial action is taken. The need to get agreement to any increase in the Community's own resources will eventually give us a powerful lever; this may not occur until well on into the 1980's, and the more successful we are in reducing CAP expenditure the further off it will be. Moreover, enlargement of the Community to include three Southern European States starting with Greece on 1 January 1981 will tend to focus attention away from the United Kingdom's problem. It is therefore important that we make significant progress in negotiating our objectives during the course of this year.

AIMS

5. We have sought to secure recognition by the rest of the Community that such a disproportionate net contribution by the United Kingdom and to a lesser extent by Italy, who are among the less prosperous member states, is intolerable and incompatible with the preamble to the Treaty which calls for the reduction of differences between the economies of the various regions of the Community. At some stage, Ministers will wish to take a view on this. Thus we have so far urged the Community to commit itself to the principle that the effects of its policies taken as a whole should contribute to and not militate against the objectives of convergence in economic performance. While this clearly implies a significant improvement on the present situation, we have not so far specified precisely what level of net United Kingdom contribution we are aiming at.

6. At the March European Council in Paris, the United Kingdom tabled the draft formula at Annex B. Not surprisingly, the other member states were reluctant to enter into such a firm commitment: they argued that the budget transfers are the inevitable result of agreed Community policies and that they are not of major importance in determining economic performance which depends essentially on the right national economic policies. Moreover, any improvement in our net position inevitably means a decrease in the net benefits (or increase in the net contributions) of at least some other member states. There has however been a growing awareness both among member states and the Commission of the perverse effects of the Community Budget and it was possible to secure agreement in March that this will be a major subject at the European Council in June on the basis of an in-depth study. The text of the March European Council's conclusions on this point are at Annex C.

7. At the Finance Council which followed the European Council, the in-depth study was remitted to the high level Co-ordinating Group on which we are represented by the Permanent Secretary to the Treasury. This Group has held several meetings and will report to the Finance Council on 14 May. (The Finance Council will also meet on 18 June just before the European Council on 22/23 June, whose agenda will be finally prepared by the 12 June Foreign Affairs Council.) While we aim in the preparatory work of the Co-ordinating Group to advance our cause, acceptance of the commitment embodied in the formula at Annex B can only be achieved at the highest political level.

METHODS

8. So far we have concentrated on securing recognition of the need for remedial action rather than ourselves suggesting how this should be done. This is an essential first step in the argument and one which may be less difficult to get agreement on than the adoption of specific remedies. Also it avoids being side-tracked by the offer of apparent but inadequate remedies without the principle having been accepted. By keeping our options open we do not alienate potential support by backing one method rather than another. Finally, there are tactical advantages in engineering that proposals come from the Commission. Moreover, once the principle has been accepted we shall be able to test against it the effect of various possible solutions and build up our case for adequate remedial action.

9. In theory, the problem could be solved through some combination of the following -

a. reducing existing Community expenditure which is disadvantageous to us, notably the CAP;

b. increasing Community expenditure in existing or new areas of benefit to us;

c. introducing the principle of ability to pay into the own resources system (eg a progressive key for VAT contribution);

d. amendment of the Financial Mechanism or establishing an overall corrective mechanism to complement or replace it.

10. In practice, each of these would take varying times to get accepted and especially to have their effect. Only (d) could be expected to have its full impact from the moment of agreement, (unless the principle of progressivity - (c) - could be introduced even before the need for additional own resources). So far, we have advocated moves along the lines of (a) to (c). We have pressed for a freeze on agricultural prices designed to reduce Community expenditure on the CAP. We have encouraged increases in the Regional and Social Funds from which we secure a net benefit and we have suggested that more should be done to help industrial restructuring and urban renewal. However, it is clear that a reduction in CAP expenditure can only be achieved gradually, that increases in non-agricultural expenditure, especially after enlargement, are unlikely to bring us more than a modest benefit (unless they were specifically geared to the United Kingdom's problems) and that, given the importance of levies and duties for the United Kingdom a very high degree of progressivity on the VAT element would be needed simply to offset the regressive effects of the existing arrangements. Moreover, at a preliminary discussion of the Commission's ideas on progressivity at a joint Council of Finance and Foreign Ministers on 2 April, there was considerable resistance from other member states. It is therefore probable that, even assuming considerable success on all these fronts, the United Kingdom would still be left as a substantial net contributor. We shall probably have to argue for some sort of overriding corrective mechanism or equalisation fund. It would however be premature for us to advance proposals of this kind until we have established the principle set out in Annex B and the other approaches have been seen to be explored. Even then, a proposal for a new corrective mechanism would come best from the Commission.

WORK IN HAND

11. In addition to contributing to the work of the Co-ordinating Group, and without prejudice to the tactical considerations discussed above, officials are preparing papers for Ministers on the following -

a. the attribution of MCAs for the purposes of calculating budgetary receipts. There is a complicated dispute between us and the other member states which is preventing an agreed assessment of the size of the United Kingdom's problem;

b. the scope for increasing our net benefit from the non-agricultural expenditure. A working party under Department of Industry chairmanship is examining ways of improving our net gain from existing funds and from possible new expenditures eg on transport infrastructure and urban renewal;

c. ways in which the Financial Mechanism might be changed (it is due for review in 1981);

d. forms which a new "override" mechanism might take;

e. additional material on the perverse resource effects of the CAP and the impact of Community Budget transfers on the economies of member states, to be used for developing our case and with a view to possible publication;

A report on (a) will be ready in time for the May Finance Council and on the other aspects by the end of the month.

TACTICS LEADING UP TO THE JUNE EUROPEAN COUNCIL

12. Following the General Election, it will be desirable to give an early indication of the Government's concern. There will be opportunities for doing this at the bilateral summit with Chancellor Schmidt scheduled for 11/12 May, at the informal meeting of Community Foreign Ministers on 12/13 May and at the Finance Council on the 14 May. There would be advantages in following these meetings up with other early bilateral contacts in Community capitals.

13. The purpose of these contacts would be to give an early indication of the policy of the Government, to establish the strength of our case and to show readiness to explore any possible avenue towards a solution.

14. A major effort will have to be made between now and the end of the year to get other member states to agree that action is necessary to make the effects of the Budget less perverse. At the June Council we should seek endorsement of the principle that, within three years, net resource transfers resulting from Community policies taken on a whole shall contribute to rather than hinder the achievement of convergence by being properly related to the relative economic

strength of member states. We should also seek agreement that remedial action is necessary and that the Commission be given a specific mandate to come forward with precise proposals in time for decisions at the December meeting.

15. In the meantime, we should obviously exploit any immediate opportunities for reducing the burden on the United Kingdom. During this period, the most significant contribution would be through action designed to reduce agricultural surpluses, in particular freezing CAP prices for 1979/80.

CONCLUSIONS

16. Ministers are invited -

a. to endorse the general approach in this note;

b. to take note of the work in progress as detailed in paragraph 11.

c. approve the tactics proposed in paragraph 12-13 above.

NET CONTRIBUTIONS TO AND RECEIPTS FROM THE COMMUNITY BUDGET IN 1978

EXCLUDING THE EFFECTS OF ARTICLE 131 REFUNDS

	Recorded Transfers (UK and Italian Import MCAs attributed to exports)	MCAs (UK and Italian Import MCAs)	Adjusted Transfers (Import MCAs attributed to UK and Italy)
	MEUA	MEUA	MEUA
Benelux	+ 415.4	- 43.1	+ 372.3
Denmark	+ 620.4	- 239.1	+ 381.3
Germany	- 213.6	- 173.0	- 386.6
France	+ 47.4	- 287.7	- 240.3
Ireland	+ 517.8	- 210.4	+ 307.4
Italy	- 672.9	+ 418.5	- 254.4
Netherlands	+ 265.4	- 179.8	+ 85.6
United Kingdom	-1423.9	+ 714.6	- 709.3

UK DRAFT

ANNEX B

THE NEED FOR PROPER USE OF COMMUNITY RESOURCES

The European Council had a valuable discussion about the present use of the Community's instruments and financial resources. It noted that the growing imbalance in agricultural markets has led to increased expenditure on agricultural support and that such expenditure needs to be reduced through the elimination of agricultural surpluses. It further noted the need to use the Community's resources so as to give greater priority to meeting social needs and supporting industrial reconstruction. The Council reaffirmed that steps must be taken to strengthen the economic structure of the less prosperous regions to enable them to bridge the gap between them and the more prosperous member states, both by their own efforts and with Community help. In this connection, and in order to promote the Community's objective of convergence in the economic performance of member states, the European Council agreed that, within three years, net resource transfers resulting from Community policies taken as a whole shall contribute to rather than hinder the achievement of convergence by being properly related to the relative economic strengths of member states. The European Council invited the Commission to make suggestions at its June meeting as to how progress towards these aims could be achieved.

IV Convergence

The implementation of the EMS, which will constitute an important contribution towards the development of stable and lasting growth in the Community, must be supported by increased convergence of the economic policies and performances of the Member States.

The European Council invited the Council (Economics and Finance) to strengthen the means of co-ordinating economic policies, on a proposal from the Commission. It took note with interest of suggestions which the Netherlands delegation made in this connection.

Achievement of the convergence of economic performances requires measures for which the Member States concerned are primarily responsible, but in respect of which Community policies can and must play a supporting role within the framework of increased solidarity.

The European Council took note of the communication which it had requested the Commission to draw up on this subject. It had an exchange of views on the means for arriving at improved convergence.

It emphasised the need for the Community Institutions to ensure more efficient use of the existing instruments in order to attain this objective.

It invited the Council and the Commission to examine in depth how the Community could make a greater contribution, by means of all its policies taken as a whole, to achieving greater convergence of the economies of the Member States and to reduce the disparities between them.

To this end, it asked the Council to examine, in the light of the above guidelines, what action should be taken on the proposals contained in the above communication from the Commission and to submit a report at the next meeting of the European Council.

V. Common agricultural policy

The European Council had a detailed exchange of views on the common agricultural policy, in the light of a communication from the Commission. It confirmed the importance which it attaches to the fundamental objectives of this policy which is one of the achievements in the construction of Europe.

It noted that growing imbalances on agricultural markets have led to an increase in expenditure on agricultural support.

It considered that a prices policy suited to the situation and a search for measures adapted to each type of production are likely to correct the imbalances which have become apparent on certain markets and to avoid the build-up of surpluses.

The European Council expressed its interest in the improvement of the agricultural structures policy, particularly in favour of the least favoured regions of the Community, and invited the Commission to submit additional proposals in this sector.

Also, with a view to enlargement, the Council hoped that the efforts to improve structures undertaken in favour of the Mediterranean regions would be continued so that the interests of all agricultural producers in the Community received equal consideration.

The European Council invited the Council (Ministers for Agriculture) to examine those improvements which are necessary for the proper functioning of the common agricultural policy with due regard to the objectives laid down in the Treaty of Rome.

P.S. [illegible] 11/5

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PS/~~PUS~~ PUS

At the PUS's request, copies have gone to
Private Secretary
PS/Lord Privy Seal
Mr Cartledge, No 10
Mr Vile, Cabinet Office.
[illegible]
9/5

EEC/TURKEY

1. The PUS asked whether the figures for German and French aid to Turkey in paragraph 14 of the interdepartmental official paper on Turkey included German and French aid to Turkey under EEC auspices on which there is a separate paragraph (16) for the UK.

2. The figures in paragraph 14 do not include EEC aid. The figures for Germany and France are as follows:

Third Financial Protocol

Germany 71.5 mua or $97.5 million
France 45.5 mua or $62 million

Emergency Assistance

Germany 23.3 mua or $32 million
France 14.8 mua or $20.2 million

3. These figures show that the Germans have rather more committed to Turkey under EEC arrangements than the UK and the French rather less. This of course weakens the strength of the argument with German and French interlocutors. On the other hand, it is still a useful argument with non-EEC contributors such as the Japanese.

D A Gore-Booth
Financial Relations Department

9 May 1979

cc: Mr Daunt, SED, Mr Ford, EID (E)

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