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PRIME MINISTER

OUR EEC CONTRIBUTION: NEXT STEPS

It may help if I record some views on the next steps on our EEC contribution, which we are to discuss at your meeting tomorrow, 21st December.

Receipts

2. This is the critical area. We have on offer an improved Financial Mechanism which would reduce our gross contribution so as to bring it in line with our share in Community GNP. There is some degree of recognition in the Dublin communique that the UK has a special case for improved receipts, and the study which the Dublin Council asked the Commission to undertake is part of that. But my impression is that the most any of our partners are at present thinking of as additional receipts for the UK is 200 or 300 meua a year, perhaps for a limited period. We need much more than that to achieve an equitable and defensible settlement.

3. Much the best solution would be an arrangement which guaranteed us a certain proportion of average Community receipts, with or without cosmetic matching with UK public expenditure already included in existing programmes. Some form of Special Fund for the UK (whether as a branch of the Regional Fund or otherwise) could serve the same purpose. A combination of methods might meet our needs if the



components were on the right lines. But I do not at present see how our needs could be met on the necessary scale and for a long enough period unless two principles were recognised. The first is that the UK has a special case for extra receipts because it is below average GNP per head and because its receipts are so low. The second is that our receipts must rise at least in line with average receipts in the Community, or with some other suitable dynamic factor. A temporary allocation or fund in money terms could mean that we had no permanent settlement and that our problem would rapidly return.

4. I see no serious difficulty about devising a method, or producing matching UK expenditure, provided our partners are really ready to accept an increase in our receipts on the necessary scale. However, I have no illusions about the effort that will be required to reach that position.

Restructuring

5. The paper by officials seems to me to demonstrate that a dramatic degree of restructuring of the Budget would be required to give us any very significant reduction in our net contribution, even over 3 or 4 years. I am sure that we should make every attempt to get the Budget restructured in the right direction but I would not expect this to do much to reduce our present net contribution. In the absence of the right mechanisms for our gross contribution and for receipts, that effort would be needed to prevent further deterioration in our contribution position. The paper by officials brings out that restructuring means for us getting down the cost of the guarantee section of the CAP borne on the Community Budget. In spite of a growing recognition that this

/expenditure



expenditure is running out of control I believe that administering a check to CAP costs on the necessary scale is still likely to be even more difficult than protecting the UK from paying for it by limiting our net contribution with the aid of financial and receipts mechanisms.

1980 Budget

6. We shall need to discuss tactics following the rejection by the Parliament of the 1980 Budget in more detail, perhaps at a later meeting. However, I think that in the period immediately ahead we may have to give a lower priority to the principle of the supremacy of the Council of Ministers over Parliament on expenditure; and say publicly that while we are in our present net contribution position we are obliged to consult our national interest in getting that redressed, and consider whatever is proposed on the 1980 Budget accordingly. If we made it clear that this was the principle on which we were operating, it would leave open the possibility that once a satisfactory settlement had been reached on our net contribution, we might be prepared to return to the principle of the supremacy of the Council. The French are known to be deeply concerned at the risk of an alliance between the majority in the Parliament and a minority in the Council hostile to CAP expenditure of the present scale and form. They would have an interest in seeing us return to the principle of the supremacy of the Council.

7. I think this means that in the re-presented 1980 Budget we would look for the strongest limitation we could get, consistent with the reasonable interests of British farmers, on guarantee section expenditure; and the best improvement we

/ could



could achieve in expenditure yielding us gains in receipts. We would need throughout to keep in close touch with our MEP's, especially in order to explain to them changes in our policy.

8. Like the Foreign Secretary, I would favour further exploratory work on other Community matters which our partners might attempt to relate to the UK contribution question. I think we have to be careful to measure the economic costs to the UK of any steps we take in these areas, and I think stress should be on exploring measures which are either inevitable or which cost us little or nothing in economic terms.

New Figures

9. I think we have to face the need before long to update the familiar Commission figures of e.g. 1552 meua for our net contribution on an importer benefits basis and 520 meua for the potential benefit from an unrestricted Financial Mechanism.

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The Annex to this minute explains our latest forecasts. I think there is a case for making public, perhaps in an arranged question, our latest estimate of our net contribution on the basis of the present exchange rate; and for making clear also that we shall be claiming for 1980 under the existing Financial Mechanism. The effect would be to leave our net contribution after the claim at about the familiar £1,000m. level. There is a case for using as the base the Budget for 1980 as rejected by Parliament. If our net position is improved in the course of settling the Budget it would be reasonable to take credit for that as part of our effort to solve the problem.

10. The revised figures for 1980 reflects again the upward trend of our net contribution which we know will continue at a rapid pace into 1981 and later years unless present arrangements are changed. Until we achieve a satisfactory solution,



this is a formidable problem for public expenditure and for the borrowing requirement.

11. I understand that we shall be looking at the implications of withholding and of a policy of obstruction at a later meeting, as well as at a paper about our legal case for redress under the Treaty (Article 175). In the very last analysis withholding tackles directly the impact on the borrowing requirement, though we would all prefer a satisfactory settlement without it.

12. I know the Lord Privy Seal is planning an intensive programme of visits to carry our case further. I would be very ready to assist by way of visits to key fellow-Finance Ministers.

13. I am copying this minute to the Foreign & Commonwealth Secretary, the Lord Privy Seal, the Minister of Agriculture, the Secretary of State for Energy and to Sir Robert Armstrong.

G.H.

(G.H.)
20 December, 1979



EEC CONTRIBUTION: NEW FIGURES

1. The figures we have hitherto used for our net contribution in 1980, and for the benefit to us of an unrestricted Financial Mechanism, have been those quoted by the Commission in their Reference Paper of September 1979. The Commission used for their calculations:-

a. the latest information they then had about the prospective 1980 Budget;

b. a constant real exchange rate for the UK at the level of February 1979 ie. on expectation that the nominal rate would fall in line with relative UK inflation .

2. We have now re-worked the figures, since the assumptions at a. and b. above are now quite unrealistic. The basis we have used are:-

i. the 1980 Budget in its latest form ie. as rejected by the Parliament;

ii. two variants on the exchange rate:-

a. The Commission's method, by which the rate falls to reflect the difference between our inflation rate and that of the Community as a whole;

b. the current rate extended unchanged into 1980, irrespective of relative inflation rates (relative inflation rates are only one factor affecting our exchange rate);

iii. MCA's take account of the recent 5 per cent Green Pound devaluation, but assume no further change under either exchange rate variant.



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NET CONTRIBUTIONS TO 1980 BUDGET AND EFFECTS OF FINANCIAL MECHANISMS

	September Reference Paper Basis		- Latest Information - Commission Method:			
	Meua	£m ¹	Exchange Rate falls to reflect inflation differential		Constant nominal exchange rate	
	Meua	£m ¹	Meua	£m ¹	Meua	£m ²
<u>UK NET CONTRIBUTION</u>						
i. importer benefits treatment of MCAs	1552	1090	1700	1195	1780	1160
ii. exporter benefits	1814	1280	1920	1350	1910	1250
<u>BENEFIT OF UNRESTRICTED FINANCIAL MECHANISM</u>						
a. Gross	630	445	730	515	500	325
b. Net	520	365	600	420	400	260
<u>CLAIM FOR 1980 UNDER PRESENT MECHANISM</u>						
	n/a		425	300	215	140
	n/a		345	240	175	115

1. Method implies exchange rate of £1 = 1.42 Eua
2. Method implies exchange rate of £1 = 1.53 Eua

NB The benefit from the Financial Mechanism, restricted or unrestricted, is very sensitive to assumptions about relative inflation rates and the exchange rate.



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