Foreign and Commonwealth Office

London SW1A 2AH

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Dear Michael,

Community Budget and Other Issues

In the run up to the European Council on 31 March, we can expect the debate on the budget to get even tougher. There have already been a number of cases where other Member States have put forward tendentious arguments which have been damaging to our position. The French in particular have argued that a major change has taken place since Dublin in that increased tax revenues from higher North Sea oil prices, which have brought us additional Government funds, make help over the Community budget unnecessary. It is also regularly suggested that our budgetary problem would be substantially improved if only we would import from the Community at the same level as the average of our Community partners.

Lord Carrington thinks we must take every opportunity to rebut these arguments firmly and at the moment at which they are put forward. Ministers, particularly in bilateral or multilateral meetings with Community colleagues, ought to be able to counter these suggestions effectively on the spot. The enclosed briefing material may help them to do this.

I am sending copies of this letter to the Private Secretaries of members of the Cabinet, to Genie Flanagan (Dept of Transport) and David Wright (Cabinet Office).

Yours ever

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CONTRIBUTIONS TO THE COMMUNITY BUDGET AND UK TRADE PATTERNS

POINTS TO MAKE

1. Excessive payments tothe EC account for only one third of our budget problem and taxes on imports to even less - the greatest part arises from the low level of Community expenditure in the UK.

2. Any suggestion that we are not 'playing the Community game' is without foundation. Our scrupulous implementation of 'Community preference' gives Community exporters a competitive edge in the UK market. We cannot compel traders not to buy outside the Community; it would contravene Article 110 of the Treaty.

3. Even if it were possible overnight to buy 5% more of our imports from the EC, the gross reduction in our contributions would probably be only some 140 mEUA.

4. Since 1973, the proportion of our trade with the Community has increased steadily. Each of the original members now does a smaller percentage of trade within the Community than they did in 1972:-

[Commission Data]

<u>Intra Community Trade</u>	<u>1978</u>	<u>1979</u>
UK Trade with Community as a percentage of total trade	39.2	42.5
Average of Member States' trade with Community as a percentage of their total trade	51.2	n.a.

[UK Data]

<u>UK Trade with the Community</u>	<u>1972</u>	<u>1979</u>
Exports to the EC as a percentage of total exports to all destinations	30.2	41.7
Imports from the EC as percentage of total imports from all sources	31.6	43.1

/Imports

Imports from EC as Percentage of Total Imports

(from Commission supplementary information)

	1972	1979	Change 72-79
France	56.0	51.4	- 4.6
Italy	49.2	44.7	- 4.5
Germany	53.9	50.1	- 3.8
Belgium/Luxembourg	71.1	69.0	- 2.1
Netherlands	62.3	57.4	- 4.9

5. The UK tends to be a more open economy than any of our competitors. In 1978 our imports were 25% of GDP compared with 20% for Italy, 19% for Germany and only 17% for France.

[Defensive]

6. The increasing volume of trade between the UK and the Community since accession is the result of a purely commercial reaction to the effect on prices of the Common External Tariff. This trend will continue regardless of any revision to the Financial Mechanism.

NORTH SEA OIL AND THE UK ECONOMY

POINTS TO MAKE

1. The UK's budget claim is based on the proposition that with the third lowest income per capita in the Community, we should not be the largest per capita net contributor to the Community budget. This is an inequitable, politically unacceptable and unsound basis for the financing of Community expenditure on common policies.

2. North Sea oil's contribution to the UK economy is fully captured in the figures for GNP per head, which is generally recognised as the best available measure of capacity to pay in international transactions. It is an asset which we would not be without, the benefits of which we recognise, but unlike some other natural resources, e.g. good agricultural land, it is a wasting asset.

3. North Sea oil contributed two and a half per cent of British GNP in 1979. Even at peak production in the mid-1980s it will contribute only 6%. This is less than natural gas contributed to the Dutch economy in 1976-77 (6.5%); it is less than the share of UK GNP accounted for by construction, or by agriculture and food production. At no stage in the foreseeable life of the North Sea oilfields will it significantly affect the UK's relative position in terms of either its share of Community GNP or its GNP per head.

4. Indeed Commission forecasts show that despite the benefit of North Sea oil, the immediate prospect for the UK economy is the bleakest in the Community. It faces a marked contraction of output. Only the Danish economy is also expected to decline, and then by a smaller percentage than that of the UK.

5. The UK remains a predominantly manufacturing and trading country and a substantial consumer of oil. It is still a net importer of oil (and even at peak production will only be a marginal net exporter). Its industries and consumers pay the full market price for oil and thus suffer as much as those in other member states from the depressive effects of higher oil prices. The immediate effect of a price increase is therefore negative both on our balance of payments and on the resources available for domestic use in the economy.

6. Higher oil prices transfer income from UK consumers to the oil companies (higher profits) and the Government (higher tax revenues). The increased Government's revenues are at the expense of consumer

/spending

spending power and there is no resource gain to the economy as a whole.

7. The increase in PRT revenues will in any case be largely offset by the loss in other tax revenues resulting from the lower level of economic activity which higher oil prices have helped to bring about.