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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

# COMMUNITY BUDGET RESTRUCTURING: PROGRESS REPORT

Note by the Secretary of State for Foreign and Commonwealth Affairs

Last October we discussed in OD a Report by Officials on Future Community Strategy: Restructuring the Community Budget (OD(80) 57). It was agreed that officials should have exploratory discussions with other Member States and the Commission. Officials have now prepared a progress report which I am circulating for the information of the Committee.

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Foreign and Commonwealth Office
28 January 1981

RESTRUCTURING THE COMMUNITY BUDGET: PROGRESS REPORT

Report by Officials

1. When OD considered the Note by the Secretary of the Cabinet (OD(80) 57) at their meeting on 13 October (OD(80) 20th Meeting) they agreed that exploratory bilateral contacts on budget restructuring should proceed. This note reports on the outcome of those contacts and on other relevant developments since October.

2. A list of the meetings during which there has been discussion of budget restructuring and/or reform of the Common Agricultural Policy (CAP) is at Annex 1.

3. The outgoing Commission put in hand certain basic studies but recognised that the formulation of proposals would have to be taken up by the new Commission. Mr Thorn and his colleagues can be in no doubt that the restructuring mandate represents one of their most important and immediate tasks. The Dutch, who are in the Presidency for the first half of 1981, are urging the Commission to present their proposals under the 30 May mandate in time for discussion at the European Council at the end of June.

4. The general presentation we have given of our approach to budget restructuring, in accordance with the line agreed by OD, has been listened to with interest and with some support. We have been careful to avoid giving the impression that we already have cut and dried solutions of our own. Nevertheless, there have been some encouraging developments -

a. The firm support of both Germany and France - reiterated by President Giscard at the last European Council meeting - for the maintenance of the present limit of one per cent on VAT contributions. While other countries are not willing to endorse the one per cent ceiling as an aim in itself, there is a realistic understanding that the Community will have to learn to live with existing own resources at least for the time being. This was also recognised by Mr Roy Jenkins but it remains to be seen whether the new Commission will be content to put forward proposals which are compatible with the ceiling or whether they will wish to indicate the conditions under which, in their view, an increase in the ceiling would be justified;

b. the announcement of the new German Coalition Government that, after 1981, the rise in expenditure on the Common Agricultural Policy (CAP) should be markedly less than the rise in own resources. In the immediate future, we are hoping to secure German support for laying down an effective financial ceiling within which the 1981 decision on agricultural prices and related measures will be taken. In bilateral discussions we shall indicate our broad support for the German ideas for imposing a financial limit on the growth in the CAP in the longer term. We have to keep in mind however that the Germans would accept in order to reduce the budgetary cost of the CAP, co-responsibility levies and economies of types which would not be in the United Kingdom's interests.

c. The approach of the 1 per cent ceiling and the prospects of enlargement are forcing all member states to face up to restructuring seriously.

5. Less satisfactory have been French attempts to block other Community decisions, especially external trade, in advance of the restructuring exercise. They have argued that until the Community has completed its discussions especially on the CAP it is not possible to enter into long-term commitments eg on New Zealand butter or agricultural imports from Cyprus. It remains to be seen whether their primary motive is to avoid difficult decisions before the French Presidential elections or whether the linkage with budget restructuring will prove a continuing obstacle. Conversely, the French are anxious for a satisfactory settlement of 1981 CAP prices before their elections whereas our aim must be a settlement which, having regard to the interests of our own industry, is consistent with our longer-term objectives for restructuring and CAP reform. The Commission agreed in December a paper setting out ideas for CAP reform. Some of these are unhelpful to the United Kingdom and we have commented on them as well as on the price level to be proposed for 1981.

6. While everyone is a long way from admitting it in public, our exploratory bilateral talks have shown a growing realisation that reform of the CAP and the development of alternative Community policies will not, by themselves, be sufficient to prevent the recurrence of an "unacceptable budgetary situation" for the United Kingdom, and certainly not by 1982. We have been careful not to stress this conclusion ourselves but to allow it to emerge from a realistic assessment of what can be done within the 1 per cent ceiling. The reluctance of others to admit it stems from -

i. strong dislike among the smaller member states of the Schmidt/Giscard idea for limits on net contributions and benefits; and

ii. the realisation that, to do so, would mean admitting that Community policies were not capable of producing an acceptable budgetary situation for all member states.

7. As regards i. the German Chancellor made it clear to the Prime Minister that he is still greatly interested in the idea of limiting net benefits as well as net contributions although his officials have so far refused to discuss it. Predictably, large net beneficiary countries have made it clear that they see little justification for such limitations. The objection at ii. is clearly one which we are going to have to overcome sooner or later. The Community cannot totally ignore the budgetary consequences of its policies which at present have a random and often perverse effect. Having got the Community at long last to recognise that there is such a thing as an "unacceptable budgetary situation" we now need to take the Community's thinking on to a further stage of consciously deciding what the redistributive effect of the budget should be.

8. Officials have therefore considered ways in which the budgetary position of member states could be adjusted on logical principles and not simply by way of arbitrary corrections of the kind discussed in the report by officials attached to OD(80) 57 (paragraphs 57-63). Two approaches are envisaged both of which start from the premise that the pattern of distribution between member states emerging from the present budget arrangements needs to be changed; both are also compatible with the maintenance of the 1 per cent VAT ceiling.

9. The first - which we call the <u>objective budget approach</u> - involves comparing the actual distribution of contributions and benefits with an "objective" distribution which would reflect relative prosperity. The latter would represent a long-term target for the Community to aim at. In the meantime while the necessary changes in policies were taking place, a partial adjustment would be made to bring net contributions and benefits closer to the "objective". The extent to which the actual distribution would be adjusted towards the long-term objective could be decided, say, for a period of three years at a time (although the amount of adjustment necessary would have to be worked out annually). A problem with this approach is the substantial scale of transfers which could be required after enlargement to the poorer countries, particularly Spain.

10. Another approach - which we call the two budget approach - would involve splitting the budget in two: a "central budget" financing CAP guarantee expenditure, industry, energy, research and administration. This would be made distributionally neutral between member states ie each would get out as much as it contributed; and a "structural budget" for expenditure intended to promote economic convergence like the Regional and Social Funds, FEOGA guidance expenditure and the EMS interest rate subsidies. The distribution of expenditure under the structural budget would be consciously decided at the outset, fixing the net amount by which member states with below average GDP would benefit, thus enabling the cost of enlargement to be contained. There would be a transitional period moving from the post-30 May situation, to a pre-determined level of net contributions and benefits under the two-budget approach.

11. Tables illustrating these two approaches are at Annex 2. The figures are not definitive but both approaches are of course capable of achieving the objectives which Ministers have laid down. Anticipating future negotiations, they assume that the United Kingdom might actually end up as a net beneficiary.

12. Both approaches could serve to direct discussion on to the proposition that the redistributive effects of the Community budget as a whole should be willed as a matter of policy rather than resulting from the chance outcome of the cumulative effect of individual policies. Our purpose in exposing these ideas is a tactical one, to start a train of thought in the minds of others which would be helpful to us when the substantive negotiations begin. At this stage we would not wish to go too far in exposing these ideas and run the risk of arousing adverse reactions. Moreover there are in any case problems such as the scale of budgetary transfers required and the risks of trade diversion by member states trying to offset the loss of their present budgetary benefits. But we consider it would be worth exploring our ideas with the staff of the Commission, who have already expressed some interest in our ideas on budget adjustment mechanisms, and with the Germans as a means of encouraging them to develop their own thinking on the subject. Only in the light of their reactions would it be sensible to consider carrying the discussion forward with other member states. In the meantime however we should certainly try to persuade other member states of the view that the overall distributive effects of the budget must be a matter of conscious Community policy.

Cabinet Office

27 January 1981

ANNEX 1

BILATERAL CONTACTS ON BUDGET RESTRUCTURING

| Date | Country | Department | Level |
|---|---|---|---|
| 16 Oct | Germany | MAFF | Official |
| 27 Oct | President elect Thorn | PM/Foreign Secretary | - |
| 30 Oct | Netherlands | MAFF | Ministerial |
| 31 Oct | Germany | FCO/Cabinet Office | Official |
| 6 Nov | France | FCO/Cabinet Office | Official |
| 16/17 Nov | Germany | Prime Minister | - |
| 18/19 Nov | Greece | FCO/Cabinet Office | Official |
| 19 Nov | Ireland | MAFF | Official |
| 23/24 Nov | Italy | Prime Minister | - |
| 24 Nov | Commission | FCO | Official |
| 26 Nov | Belgium | FCO | Official |
| 2 Dec | Greece | MAFF | Ministerial |
| 4 Dec | Denmark | MAFF | Official |
| 5 Dec | Netherlands | FCO | Ministerial |
| 11 Dec | Italy | FCO/Cabinet Office | Official |
| 17 Dec | Denmark | FCO | Ministerial |
| 17 Dec | Netherlands | FCO | Official |
| 19 Dec | France | FCO | Ministerial |

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TABLE 2 : DUAL BUDGET APPROACH : ILLUSTRATIVE EFFECT OF CENTRAL AND STRUCTURAL BUDGETS COMBINED*

NET CONTRIBUTIONS (-) AND RECEIPTS (+) OVER TRANSITIONAL PERIOD

MEUA

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 ⌿ |
|---|---|---|---|---|---|---|
| Germany | -1900 | -1650 | -1400 | -1335 | -1145 | -955 |
| France | - 400 | - 420 | - 445 | - 575 | - 635 | -695 |
| Netherlands | + 450 | + 340 | + 230 | + 90 | - 35 | -155 |
| Belgium | + 500 | + 380 | + 265 | + 125 | - | -125 |
| Denmark | + 500 | + 390 | + 280 | + 160 | + 50 | - 65 |
| Luxembourg | + 300 | + 240 | + 180 | + 115 | + 55 | - 5 |
| Italy | + 650 | + 680 | + 710 | + 740 | + 770 | +800 |
| UK | - 750 | - 540 | - 330 | - 120 | + 90 | +300 |
| Ireland | + 650 | + 550 | + 450 | + 350 | + 250 | +150 |
| Greece | nil | + 30 | + 60 | + 90 | + 120 | +150 |
| Spain | na | na | na | +180 | + 240 | +300 |
| Portugal | na | na | na | + 180 | + 240 | +300 |

*excluding aid

⌿ This postulated final composition of the structural budget is assumed to be a political decision, but taking account of member states' relative prosperity and population size, and their non-budgetary resource transfers. Alternatively the global sum of net benefits could be decided at the outset, but with the precise distribution allocated according to a formula.

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ANNEX 2

TABLE 1: OBJECTIVE DISTRIBUTION OF NET BUDGETARY CONTRIBUTION (-) AND RECEIPTS (+) (See paragraph 11)

MEUA

| | Unadjusted net contribution to allocated expenditure | Position after 30 May agreement | Possible intermediate stage: for Community of 10 (25% of Col 1 + 75% of Col 5) | for Community of 12 (25% of Col 1 + 75% of Col 6) | Objective distribution: for Community of 10 | for Community of 12 |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| Germany | -1350 | -1900 | - 950 | -1050 | - 815 | - 965 |
| France | NIL | - 400 | - 295 | - 400 | - 395 | - 535 |
| Netherlands | + 550 | + 450 | + 75 | + 45 | - 85 | - 125 |
| Belgium | + 600 | + 500 | + 95 | + 70 | - 70 | - 105 |
| Denmark | + 550 | + 500 | + 90 | + 80 | - 60 | - 75 |
| Luxembourg | + 300 | + 300 | + 70 | + 70 | - 5 | - 10 |
| Italy | + 850 | + 650 | + 790 | + 665 | + 770 | + 605 |
| UK | -2150 | - 750 | - 235 | - 355 | + 400 | + 245 |
| Ireland | + 650 | + 650 | + 210 | + 195 | + 60 | + 45 |
| Greece | NIL | NIL | + 150 | + 125 | + 200 | + 165 |
| Spain | na | na | na | + 395 | na | + 525 |
| Portugal | na | na | na | + 170 | na | + 230 |

Notes: Column 1: From Commission estimates for 1981

Columns 5 and 6: Distribution obtained from formula: Net position = Budget x Population share x (1 - GDP per head as percentage of Community average) ÷ 2

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