

12 September 1979

MR. TUGENDHAT

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Call on the British Prime Minister, Mrs. Thatcher at
10, Downing Street, Thursday 11 September 1979 at 3 pm

INTRODUCTION

No 10 and the Foreign Office, which will be briefing, are aware that you want a wide ranging, rather discursive discussion with the Prime Minister. Their briefing will cover the points below which were suggested by you. I have laid most emphasis on the first two items since these are the most urgent but less on institutional questions, since in the absence of the report from the Wise Men, this will inevitably be a less well focussed discussion. We have also been warned that the Prime Minister may raise the question of British staffing in the Commission. This is a familiar subject, and Mr. Pratley will supply briefing on latest developments for your call on Lord Soames.

I THE REFERENCE PAPER ON BUDGETARY MATTERS

2. This is a good paper from the UK point of view. It brings out the facts concerning the UK net deficit, its causes and shows clearly that the existing financial mechanism, though never designed to offer a complete return to parity, is not, and is not likely, to provide even the partial compensation intended. It points clearly towards a revised mechanism. The study is a good base for the next stage, the presentation of proposals by the Commission, though much work will have to be done between now and then by the UK in whose court the ball now lies. The utmost importance of the skilful presentation of the UK case should not be underestimated: discussion of the reference paper in the Commission has already shown how hard it will be to get out proposals satisfactory from the UK point of view: this is the mere reflection of an attitude that will be even tougher in capitals and in the Council.

3. Timing of a solution and the tactics leading up to it

Before getting down to details of tactics in the Council, you need to go over a number of relevant background factors.

4. The United Kingdom needs a solution urgently and it is right

to make the Dublin Summit the target. It would be unwise on the other hand as regards timing to become impaled on a hook in public so that the pressure of domestic public opinion forces HMG to take less than they might otherwise have got had they been able to bargain for somewhat longer. An agreement in principle at Dublin, with the details finally agreed at the next European Council - the solution however back dated to 1 January 1980 - may prove a more realistic aim. The important thing is for the government to retain some freedom of manoeuvre on timing.

5. The pressures from other Member States will of course be to spin matters out; and attempts will be made to link the solution of the UK problem to any one, or a combination of the following :

- (a) the exhaustion of the existing resources of the Community and the introduction of a new own resource;
- (b) control of the CAP;
- (c) the entry of Greece.

HMG will not find it difficult to resist following these suggestions though, since it is in the UK interest to maintain a positive attitude on all three topics, the tactics pursued to keep the solution of the UK budget problem separate will have to be skilful.

6. The following considerations are relevant. As regards the exhaustion of own resources: when the ceiling on existing financing is reached, as will happen by the latest in 1981, it seems most unlikely that the Council will by then have agreed on a new one. This means that compulsory expenditure, notably FEOGA Guarantee, will have to take precedence over non compulsory expenditure (regional, social funds) and for a period at least, the UK imbalance would be likely to get even worse. Reaching the ceiling on own resources and sticking there does not therefore offer ready financial relief to the UK. When a new resource is agreed, even if it does involve progressivity i.e. a criterion assessing ability to pay, the degree of progressivity likely to be agreed would only offer marginal relief to the UK. Solutions are not to be looked for here. You are responsible for making the proposal on a new own resource and will not do this until after the Dublin Summit, precisely to reduce the chances of the two issues being confused. Delay beyond the end of this year will however be impossible.

7. As regards control of the CAP, there are already signs that attempts will be made to link solution of the UK budget problems to this. The UK must resist this, on timing grounds alone. Equally, HMG must continue to work actively for changes in the CAP (see below paragraphs 17 -20). Since however there is an undeniable link between excessive FEOGA guarantee expenditure and the size of the UK deficit, the best tactic would be to occupy the enemy territory by arguing that the UK wishes to see major changes in the CAP, that these are in the interests of the whole Community and are a matter of urgency. The UK recognises that with the best will in the world they will however take a bit of time to bring about, and rather longer for the budgetary savings to be felt. Until such time therefore as these budgetary effects begin to have a significant impact,

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and until there is a better balance in Community expenditure, the UK needs a special budgetary arrangement that deals with its particular problem. If the UK can present its special needs as being of temporary, if indefinite, duration, it has a correspondingly greater chance of obtaining more generous terms. A three or five year review clause would be a price worth paying for a solution which made a significant immediate dent in the deficit.

8. As regards enlargement, it is unlikely that an explicit link will be made between the UK budget problem and the entry of Greece in 1981 and subsequent enlargement. It is nevertheless a consideration that will be in the forefront of Ministers' minds since what is now conceded to the UK will inevitably be a precedent. There is no guarantee, on the basis of present Community expenditure (or indeed likely future patterns) that Greece, and more particularly Spain, can be absolutely sure of always being a net beneficiary from the Community budget or even in balance. It is for this reason, among others, that you are strongly against the UK trying to get her partners to accept, either in public or in private, the principle that member states with below average GNP per caput income should not be net contributors to the Community budget. While this is entirely logical, it is not politic. A bid for a special, temporary arrangement (from which Italy can also be legitimately excluded) will involve fewer presentational difficulties for the UK's partners. It also has European Parliamentary advantages (see paragraph 26 below) as well as advantages in relation to Greece which now has the right of consultation and has already, if unsuccessfully, tried to extract assurances about future rights in relation to EMS related interest subsidies.

9. Tactics in the Council and with member states

This is the background against which the Council discussion will take place. We can be certain that other member states will seize all opportunities available either to undermine the validity of the paper by querying its methodology or its calculation or to obfuscate the subject by introducing extraneous considerations. Or both. The UK must make certain therefore that its side of the case is clearly heard. The UK has been asked to "present (their) requests in concrete form". While the UK does not have to present every detail of its request on 17 September in the ECOFIN Council, it cannot and should not try to postpone any longer at least giving an outline.

10. There are two aspects to the request: the method of the solution and the amount involved. In your view at the next ECOFIN Council the Chancellor should state the type of solution the UK wants (see annex attached) but should not name a figure. The figure which will obviously be more ambitious than the UK is likely to achieve should be revealed subsequently in confidential bilateral meetings which it is essential take place at Ministerial level in all capitals before the ECOFIN Council 15 October when the matter is bound to come up again. (Given the early appearance of the study, two bites at the cherry in Council is virtually inescapable.)

11. The UK should bear in mind that other member states, while beginning to accept that the UK budgetary deficit cannot be allowed to continue in its present proportions, are still thinking in terms of rectifications whose extent is much smaller than anything HMG is

likely to regard as adequate. In your view, the UK has already left it dangerously late to do an education job in capitals (you would have liked to have seen lobbying in July). Now that the Commission study is out however you cannot stress too much the urgency and importance of intensive high level contacts between HMG and her Community partners. They are not going to make concessions without a great deal of persuasion and without some counterpart (see paragraph 29 below). HMG must prepare this as well for Dublin.

12. Types of mechanism

Because of the system of own resources whereby customs duties, agricultural levies and up to 1% of VAT levied on a uniform base belong to the Community as of right, with the member states acting only as agents in their collection, it is not possible for the UK simply to decide either unilaterally or in conjunction with its partners to pay less. Its share in Community financing being a figure automatically arrived at, the only way in which the UK can achieve a lower net contribution is by getting money back.

13. This is what happens in the case of the existing financial mechanism. The chief drawback of this mechanism from the UK point of view, apart from its internal limitations, which are set at levels which have effectively prevented it from operating in the past and are likely to continue to do in the future, is that it works solely in relation to the gross contribution, thus in no way touching the problem of an inadequate return on Community expenditure. Since this is a good half of the problem, and since no early solution to an improved UK 'take' is in sight the new solution should ideally operate directly on the net deficit i.e. the gap between contributions and expenditure. This should be the UK's aim but it will not be achieved without a struggle. The existing financial mechanism broke new ground in so far as it was an explicit recognition that a member state's contribution to the financing of the Community could be disproportionately greater (the language of the regulation) than its ability to pay as measured in GNP terms. It did not however constitute any recognition, explicit or implicit, of the idea that financial benefits received could legitimately be assessed against financial contributions made, it always being asserted that Community policies are for specific purposes and that the concept therefore of the juste retour is neither legitimate nor indeed relevant. The UK is bound to encounter tough resistance on a long standing and deeply held doctrinal point. The best way of countering it is not to meet it head on, but to deflect it by the firm statement that the UK is only looking for an arrangement of temporary duration - "arrangement", or a word akin to it, would be preferable to the use of the words "solution" - (though the mechanism itself must be capable of being permanent, as well as automatic in its operation).

14. Possible mechanisms are dealt with in more detail in the Annex.

15. The Italian angle

The reference paper shows clearly that unlike the UK,

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Italy's budget deficit of 1978 was not the result of structural factors but rather was anomalous and unlikely to be repeated in the foreseeable future when Italy can expect to be in growing surplus. The Italian Government is nevertheless reported to be very dissatisfied with the paper as it has emerged largely because of the feeble effort made by the Commission to fulfil that part of the Council's mandate of particular interest to Italy i.e. that concerning the economic and social impact on the country of Community membership. There appears to be some disposition to attribute this outcome, which has made the Italians feel very isolated, to a British plot. (The real reasons for this failure on the part of the Commission, which you can go into if necessary, are partly political and partly derive from the inherent difficulty of such a study made virtually impossible by the speed at which the paper has had to be produced). Whether such a study, if done, would produce the result expected by the Italians i.e. that Italy does less well out of the Community than say France or Germany, is an open question. It might well. The Italians do however have a legitimate complaint in so far as the Commission has not proved able to fulfil the mandate adequately.

16. As a result the Italian Government appears to be in a mood where it could well seek to undermine the credibility of the paper when it is discussed in Council on 17 September. HMG would be well advised therefore to talk to the Italians beforehand to seek to :

- (a) reassure them of a continued desire to work together in the whole area of convergence (redistribution etc);
- (b) offer them help in getting the sort of study they want done properly;
- (c) get them, in return, to be helpful to the UK over the budget contribution and, in particular, not join in a general destruction of the reference paper.

It is unlikely that with the best will in the world the Commission could do a really adequate study of the sort demanded by the Council in the time available - just over a month (such a paper would have to be out by the beginning of November) and it might be worth trying to persuade the Italians to take such a large subject in slower time. If however they are insistent that an adequate study be produced in time for the European Council, the UK should offer support.

II CONTROL OF THE CAP

17. Controlling and then reducing surplus production has been an urgent task for the Community for some time. Other member states are at last beginning to recognise this though, as last year's price settlement showed, they are not yet sufficiently willing to accept the consequences to rein in the agricultural ministers. Control of CAP is a policy priority with which the UK is closely associated and, despite the changed situation of UK agriculture (green pound now much the same value as sterling), HMG must continue to push actively for it if they are to retain credibility - not least in relation to the issue of the budget contribution.

18. Does Mrs Thatcher's government intend to pursue the previous government's policy of expanding UK agricultural production? If so, some of the increase is bound to take place in products in surplus

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in the Community. Despite UK comparative advantage in agriculture and the small size of the UK agricultural sector, its expansion, in surplus products at least, will not be regarded by other member states - or the Commission - as compatible with a policy of bringing surpluses under control. It also needs to be remembered that British farmers can now only be awarded significantly higher prices to compensate for more intensive farming, increased costs etc, by increases in the common price. In other words the time when greater financial rewards to encourage expansion of UK agricultural production could be given without affecting common price levels is now over. As regards prices therefore the British farmer now finds himself in more or less the situation in which the German farmer has been for some time, but without the latter's low cost inflation rate. Indeed maintaining common price levels will almost certainly hit the UK farmer directly and harder than his less intensive continental or Irish counterpart. There may be some hard choices in store.

19. Much the same considerations apply in relation to continued access for New Zealand dairy products. Support for this access, which displaces Community production and costs the Community budget some 250 meua, will be viewed as incompatible with expansion of UK production in surplus products.

20. Bringing the CAP under control will not be easy and some solutions more radical than a price freeze will almost certainly have to be sought (separation of production and social costs and the introduction of income maintenance payments). A first step in institutional terms however will be to bring the agriculture Ministers into some more coherent relationship with other Councils, notably the Finance and Budget Ministers. If HMG is serious about bringing Community expenditure not only under control but also in to better relationship with Community priorities, they, as well as other governments need to devote a lot more attention to and attach more importance to, the Budget Council. The budget process at present conducted, with agricultural prices being fixed quite separately and without regard to other expenditure, does not properly reflect or contribute to the ordering of the Community's priorities.

III INSTITUTIONAL MATTERS (see also preceding paragraph 20)

21. Immediately before the publication of the report of the Three Wise Men (and the Spierenburg report) is not a particularly good moment to attempt a sustained discussion of institutional matters. You might offer to write to the Prime Ministers on this subject after the reports have appeared.

22. In addition to the point about greater coherence between the work of the different Councils (not a new point, though possibly not one the Prime Minister has focussed on previously) you might mention :

- (a) size of the Commission;
- (b) attitude to a role of the Parliament.

23. Size of the Commission

I do not suggest you spend much time on this point if you

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are going to write later. Your views have not changed since the Spring, when you took the line :

The Commission is the object of particular attack in the United Kingdom and it is widely claimed to be in the UK interest to see the number of Commissioners reduced to one per country, thus depriving the larger member states of their second Commissioner. This analysis of UK interests appears to spring from two hypotheses: an exaggerated view of the power of the Commission to encroach upon the sovereignty of the UK on the one hand and an overestimate of the capacity of the UK to take care of its interests by itself on the other. Whatever the intentions of the Founding Fathers, it is now the case that the balance of power between Community institutions has shifted decisively in favour of the Council of Ministers away from the Commission which, these days, far from having too much power has barely enough to discharge its role as guardian of the Treaties and initiate proposals with the necessary integrity. A really weak Commission, defenceless against pressure from the stronger member states will be a politically biased Commission. This is no more in the UK interest than in that of any other member state. Indeed it is less in the UK's interest than in that of some. The UK is not among the strongest member states economically and she needs the Commission, the only institution whose avowed purpose it is to embody the Community rather than the national interest, to hold the ring against pressure against some of the stronger member states. In addition, she is demandeur on a number of issues where important changes in the conduct of Community policy are required if the UK interest is to be satisfied. The necessary proposals will have to come from the Commission. None of these considerations therefore are ones which lead to the conclusion that it is sensible for the UK at this juncture either to weaken the Commission as a whole or to give up the advantage which she possesses within it of having two Commissioners instead of one.'

24. Despite the fact that our preview of the Spierenburg report shows that he challenges these views (rather effectively) your analysis remains valid so far as the UK interest in relation to the Commission is concerned. The point you need to get across to HMG is :

- (a) that it requires unanimity in the Council to change the size of the Commission;
- (b) the UK interest in relation to the Commission is not the same as that of either France or Germany and the UK should not be beguiled into thinking so.

25. Attitude to the European Parliament

It would be a pity if the UK were to join those member states, notably France, which pursues a policy of deliberately and continuously snubbing the European Parliament. This is not consonant with British traditions or behaviour and the UK is unlikely therefore to do it with conviction or well. In any case, in the next few months HMG needs the help, or at a minimum, the neutrality of the Parliament over the budget issue.

26. Any settlement of the UK budget problem is likely to have

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financial implications of a kind that the Parliament is entitled by law to be consulted over. The old Parliament was not consulted until after the event concerning the existing financial mechanism and they protested. The new Parliament is already on the look out. The budgetary powers of the Parliament and the political appetite of the directly elected assembly have grown apace since then and a failure to consult could be counterproductive from the UK's point of view. The Commission will therefore let the Parliament have all the relevant documents. Even those Parliamentarians friendly on the substance would be alienated by a failure to respect the institution's rights. A hostile resolution in plenary could in turn be exploited in capitals against the UK interest. The most helpful role to be played by HMG would be to ensure that the Conservative delegation in the European Parliament does its best to keep the atmosphere sweet and does not aid and abet an aggressive assertion of Parliamentary rights.

IV THE UK'S FUTURE IN THE COMMUNITY

27. You will want to draw out the Prime Minister's thinking on this. Since entry into the Community, the UK has remained on the fringe. This is partly the result of the legacy of painful years of negotiation; partly the fact that the UK's economic performance has not equipped her for a leadership role. The rest has been politically self inflicted; since entry ^{the UK} has been at best neutral and at worst hostile to Community initiatives. The UK's partners have come to expect the UK merely to react and seldom, if ever, to propose. The UK's geographical position also means that unlike France or Germany, it is possible for the rest of the Nine to a great extent to ignore the UK if it chooses not to play a constructive role.

28. The present government is thus faced with a considerable leeway to be made up. A good start has been made and a testing period is now ahead. The UK expects a positive response from her partners over her budget contribution; the UK in turn must expect to have to offer some counterpart - something that the rest of the Nine can take back to sell to their respective domestic opinion as part of a worthwhile bargain. The time is also coming when it would be opportune for the UK to begin to take bigger initiatives unrelated to her immediate requirements so as to justify her claim to be one of the "big" countries of the Community.

29. The Counterpart

There are a number of possibilities of which the most obvious is a fisheries settlement. This is likely to be high on the French list of requirements - President Giscard has more or less said as much. In your view the UK will not get a better deal through further significant delay - rather the opposite. Willingness on the part of the UK to settle over fish thus enabling a common fisheries policy at last to be put in place would be a useful weapon in clinching the budget deal.

30. EMS

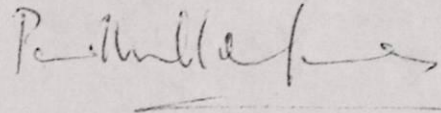
The situation as regards EMS has changed somewhat since the government came to power and for reasons unconnected with any

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feeling of altruism towards the UK there is for the time being likely to be little pressure in either France or Germany on HMG to enter the system in full. It nevertheless remains an aim of the Community that the EMS should become a central instrument of Community policy to which all member states should belong. It is not therefore in the UK's partners' minds, a question of whether the UK should enter but only when. The UK should continue to adopt a friendly stance towards the system and, in the context of the budget settlement, it would do no harm and some good explicitly to underline British willingness to enter the system as soon as possible. If the UK were able to enter the system at the time of the Dublin European Council, this would be an offer the rest could not refuse.

31. Energy

There is probably little scope for major initiatives here either in the context of the budget question or more generally. The UK could still however assume a higher profile and more active role and seek to lead the debate more than it does. Without hurrying after the French on the question of the revision of the Euratom Treaty (given German sensitivities, the French should be left to make their own running) the UK could come down more firmly than in the past in favour of the development of nuclear energy. This would please the French and help tilt the balance away somewhat from the strong anti-nuclear lobbies in Germany and the Netherlands in particular.



Pauline Neville-Jones
12 September 1979

to make the Dublin Summit the target. It would be unwise on the other hand as regards timing to become impaled on a hook in public so that the pressure of domestic public opinion forces HMG to take less than they might otherwise have got had they been able to bargain for somewhat longer. An agreement in principle at Dublin, with the details finally agreed at the next European Council - the solution however back dated to 1 January 1980 - may prove a more realistic aim. The important thing is for the government to retain some freedom of manoeuvre on timing.

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