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Ref: A0619

Agree A?

CONFIDENTIAL covering SECRET

PRIME MINISTER

Community Budget

You agreed that we should produce for the Restricted Meeting on 14th November a paper which would set out the questions which need to be considered in deciding what might be an acceptable outcome in Dublin. I have now discussed this with Sir Michael Palliser and Sir Kenneth Couzens, and a paper with which they are in general agreement is attached.

2. I originally proposed that this paper should be handed round for your meeting but not circulated outside No. 10 and the Cabinet Office. As it has come out, I think that it should be circulated in advance - it does not lend itself to easy assimilation on a quick read-through - and as it discusses possibilities and asks questions without (on major matters) suggesting answers, it is not likely to be potentially damaging to our negotiating position. Both Sir Michael Palliser and Sir Kenneth Couzens share my view that it would be useful for Ministers to have such a paper in front of them, so as to help focus the discussion. I hope therefore that you will agree that I should send one copy to each of the participants at your Restricted Meeting, with an appropriate warning about its sensitivity.

A

3. I shall be submitting separately, and not for circulation, a note on the means at our disposal for being difficult, if we cannot achieve our objectives at Dublin.

RA

(Robert Armstrong)

9th November 1979

SECRET

COMMUNITY BUDGET AIMS

Note by the Cabinet Office

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1. This note is designed to help Ministers form a view as to what might be a tolerable outcome at the European Council in Dublin on 29/30 November.

2. All the numbers in the paper are quoted in sterling, with equivalents in units of account, converted at the exchange rate used in the Community's draft budget for 1980 of 1.4813 = £1, noted in the margin.

3. In considering figures, there are two complications Ministers will need to have in mind.

4. The first complication is the treatment of monetary compensatory amounts (MCAs). The Commission's reference paper of September (COM(79) 462 Final)
1814 meua estimates our net contribution in 1980 as £1,225 million if MCAs are attributed to
1552 meua the exporter and £1,050 if they are attributed to the importer. We are still maintaining the view that MCAs should be attributed to the exporting country, but in their latest paper the Commission side with most other member states who take the opposite view, and we are unlikely to win the point. The Chancellor of the Exchequer will be writing to his colleagues explaining how this difference could affect the negotiations, but for the purpose of this paper, possible refunds are
1552 meua compared with an assumed net contribution of £1,050 million.

5. The second complication is whether or not we contribute to our own refund. The net gain from any refund we receive will depend on whether, as is the case with the present Financial Mechanism, we are called upon to contribute to our own refund. The Irish and the Italians will try to get exemption as countries with below average GNP, in which case we must try to do the same. But it is not very likely that any of us will succeed. Since our marginal rate of contribution to the budget is 17 per cent, the net benefit we receive from any given refund would then be lower by that amount. In this paper (as in the Commission's latest document) the net figures are used, followed by gross figures in brackets.

6. We are seeking a corrective mechanism to produce "broad balance" between our contributions and our receipts starting in 1980 and lasting as long as the problem lasts. In the Commission's latest paper discussing a range of possible solutions

(COM(79) 620 Final), those which it quantifies would reduce our net
415 meua contributions by amounts ranging from £280 million (£340 million
1075 meua (net) gross) to £725 million (£880 million) i.e. reductions of between
1140-480 meua 30 and 70 per cent. There is no doubt that several member states, including notably the French, have in mind figures at the bottom of this range. The French also appear to be thinking of a corrective which would last for only a year or so. The Germans are hoping that part of the gap between our stated requirements and what the French and others have in mind could be met by the evolution of the future pattern of Community expenditure more in our favour, and this line would suit the Italians too.

7. There are thus three interconnected elements in what might be an acceptable outcome for the United Kingdom. These are:-

I. The amount of the relief as compared with our expected net contribution.

II. The duration of any arrangement.

III. Various ways in which the solution might be phased.

The following paragraphs discuss these in turn.

I. THE MINIMUM ACCEPTABLE REFUND

8. It is not realistic to expect that we can secure a refund which will wholly cover our net contribution. The signs at the moment are that we shall, at best, be offered the removal of the existing constraints on the Financial Mechanism. As compared with the refund of £170 million (£200 million gross) which we expect to get for 1980 this would produce a refund of £350 million and thus reduce our net contribution by only a third. The Prime Minister has already let it be known (to Mr Roy Jenkins and Chancellor Schmidt) that a cut of one half in our refund would not be acceptable. On the other hand, if we could achieve a lasting reduction of three quarters, it would be widely recognised as a major achievement. It is within this area that Ministers may wish to consider what, having regard to the other elements, could be a politically acceptable result.

Why?

No

9. There are certain considerations which could be used to justify an outcome which still left us paying a modest net contribution:

a. We should obviously pay less than the Federal Republic of Germany (net contribution for 1980 estimated at £750 million before allowing for any refund to us). The more appropriate comparison is with France, next to us in the league table of GNP per head although substantially above our own. On the Commission's estimate, France
118 meua will be a net contributor of only £80 million in 1980. To the extent that she will contribute to our refund, her net contribution will go up as ours comes down. If the aim was to produce a net contribution which more or less equalled France we would both be paying about
450 meua £300 million. Would it be acceptable if our net contribution lay somewhere between that of France and Germany? No. - less than France

b. A possible line of argument would be to refer back to the indications we were given at the time of entry that the proportion of the budget spent on the CAP might decline to as little as 40 per cent of the total. If this had in fact happened and the extra within the present budget had been allocated to the Regional and Social Funds then our net
630 meua contribution might have been of the order of £430 million. Such a line of reasoning would suggest a readiness to accept the entry terms (in spite of our poor economic performance) but not the unforeseen and unwelcome rise in the cost of the CAP.

c. We could say that it was reasonable for the United Kingdom to
160 meua regard as a net contribution its share (£110 million) of the administrative costs of running the Community.

10. Apart from the figure, Ministers will wish to be satisfied that, whatever the corrective mechanism, it will operate to reduce our refund in any foreseeable situation in the future. The possibility of the United Kingdom becoming an above average GNP member has already been considered by OD and a line approved. The Commission's latest paper (paragraph 21) offers one possibility for achieving a level of refund which comes close to our objective but only operates on our excess contribution. This is the system of weighting the baseline from which excess gross contributions are estimated (thereby increasing our refund) so as to take account of our below average GNP per head.

Besides being a difficult concept for some other member states to accept, it would not by itself protect us in future years if the gap between our gross contribution and our weighted GNP share were to narrow while our receipts continued to be below the Community average. The only way to avoid this risk is to have a corrective mechanism which takes account of our inadequate receipts as well as our excess contribution i.e. is based on our net position. The Commission's paper makes it clear that this threshold is going to be extremely difficult to cross. If it can be done at all, it would help us if we could agree that any refund in respect of our low receipts would be earmarked for public expenditure consistent with Community policies and eg subject to annual discussion with the Commission. We should want to ensure that the refund so far as possible related to planned rather than additional public expenditure.

II. DURATION OF ANY ARRANGEMENT

11. We have a very strong case for arguing that any corrective mechanism should not be subject to a time limit. The Commission say that our problem is temporary, and some of our partners may well argue for an arrangement for a limited period. But it would be intolerable for the Government (and the Community) to face the prospect of another negotiation on this issue in two or three years' time. The Financial Mechanism was for seven years with a review after five years. A review clause in any arrangement would be acceptable. But should the absence of any time limit be a sticking point or would, say, a five-year arrangement with provision for extension if necessary be an acceptable fall-back?

III. PHASED SOLUTIONS

12. The question whether we can gradually build up to "broad balance" may present itself in several forms:-

a. We may be offered partial relief through the Financial Mechanism with indications that the future pattern of the Community budget will evolve in our favour. If these were vague assertions of the kind which were made at the time of our entry negotiations, we could not regard them as "bankable assurances" and they would not carry conviction with public opinion in the United Kingdom: we could not accept them. On the other hand, specific commitments (such as the Italians are seeking) that the proportion of the budget spent on agricultural support would decline could be helpful to us. Much would depend on the form of the wording. Ministers will wish to consider how far they could accept commitments of this kind as a contribution towards achieving the negotiating objective.

b. Chancellor Schmidt has spoken about settling "principles" in Dublin. If this meant no more than recognition of a United Kingdom problem it would not be acceptable. If however Heads of Government agreed that the United Kingdom net contribution needed to be reduced by a specified percentage and settled the question of duration, leaving the Finance Council (or the following European Council) to decide on methods by which this could be achieved, would that be a possible outcome? Another possibility is that we would be offered the changes in the Financial Mechanism necessary to rectify our excess contributions with an agreement to return to the problem of our inadequate receipts (and no doubt the 1 per cent VAT ceiling and ways of holding down the budgetary cost of the CAP) at the next meeting. In return for any of these understandings we should no doubt be expected to subscribe to statements that the problem could be expected in due course to solve itself through structural changes, that the solution must not call into question the principle of "own resources" and that there was no question of applying the principle of juste retour.

No.

c. Some countries like the Belgians and the Danes might say that because of their own public expenditure problems any agreed level of refund for the United Kingdom could only be reached in stages. This would to some extent be the obverse of the French wish to see any arrangement rapidly phased out, but if the size and duration of the eventual relief we were offered was satisfactory, some phasing need not be ruled out.

ISSUES FOR CONSIDERATION

13. i. In a package dealing satisfactorily with ii. and iii. below, what would be the minimum proportionate reduction in our net contribution on which we would be ready to settle (paragraphs 5 and 6 above)? Could we agree to get there by stages (paragraph 9c.)? If so, what would be the acceptable level for a first stage?

ii. Is it necessary, to ensure a lasting solution, that the mechanism should relate not just to our excess contribution but also to our inadequate receipts (paragraph 7)?

iii. What can we accept on duration (paragraph 8)?

iv. To what extent should we be willing to see our objective partially met by future commitments (paragraph 9a.)?

v. What would be the minimum degree of detail which would have to be settled in Dublin (paragraph 9b.)?

14. The discussions leading up to and including the Dublin meeting will cover all these aspects. Other member states will see a link between eg duration and the amount of the refund. The same will be true for us. It will be the package as a whole which will determine whether what can be negotiated at Dublin constitutes an acceptable settlement or whether we should need to put into operation the contingency plan approved by OD on 24 October.

Cabinet Office

November 1979

EUROPEAN COUNCIL, DUBLIN

29/30 NOVEMBER 1979

INDEX OF BRIEFS

EEC Heads of Governments' Meeting in Dublin

29-30 November 1979

BRIEF ON THE UK ECONOMY

Summary/Points to make

1. GDP fell in the third quarter from the high second quarter level and the short-term prospects are gloomy. Most forecasters expect GDP to fall next year. Longer-term prospects should be brighter.

2. Measures were taken in November, including the raising of the MLR, to bring the money supply under control and the forecast PSBR back to the Budget target.

3. Rate of retail price inflation has accelerated this year, to 17¼% in October over a year earlier.

4. Balance of payments current account was in deficit by more than £2 billion in the first half of 1979, but average deficit has been lower recently. Sterling has strengthened since interest rates went up.

5. Economic strategy gives priority to:-

   i. Effecting long-term, permanent reduction in inflation by firm monetary and fiscal policies;

   ii. Promoting a freer working of the market economy and an economic environment conducive to renewed growth by reducing government intervention in the market and government claims on resources, and by tax reforms to improve incentives.

LIST OF ATTACHMENTS (Revise) (page 8)

Briefs on Arguments

1. North Sea oil and the UK economy
2. North Sea oil prices
3. The UK's pattern of trade (Parts A and B)
4. Commonwealth quotas
5. The nature of Own Resources
6. "Juste retour"
7. Community Budget not an instrument of redistribution
8. Swings and roundabouts
9. Another renegotiation
10. 1% VAT limit
11. The wider effects of Community membership
12. Solution to last as long as the problem
13. CAP : Benefits to UK Farm Sector

Briefs on UK contribution

1. The UK net contribution in 1980 : Tables I-IV
2. The UK net contributions after 1980
3. Technical notes : including tables on UK's budget problems in 1980
4. Country fact sheets

Briefs on Solutions

1. Summary table of options
2. Existing financial mechanism
3. Article 131
4. Action on receipts
5. Expenditure framework
6. A "weighted" financial mechanism
7. Failsafes on the net position
8. GNP per head :market exchange rates and PPPs (Revise)
9. Financing a refund
10. Timing of payments