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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EC BUDGET RESTRUCTURING: THE NOVEMBER EUROPEAN COUNCIL

Memorandum by the Secretary of State for Foreign and Commonwealth Affairs

1. The attached paper by officials sets out the present situation of the negotiations and the main tactical options for us in the remaining two weeks run-up to the November European Council.

2. As was predictable, the prospect is not an encouraging one. The traditional reluctance to concede a shift from opening negotiating positions until the last possible moment is in full operation. Other Governments are nervous about the very large financial transfer needed if we (and the Germans) are to get satisfaction. And there have been a number of recent changes in government (France, Greece, Ireland) or government crises (Belgium, Netherlands) which have caused delay. As the country holding the Presidency and as the Member State with the biggest interest in change, our task is to bring about some movement and flexibility.

3. Over the next few weeks we shall be seeking to achieve this. At the Foreign Affairs Council on 16/17 November I intend to invite President Thorn to join me in a series of bilateral consultations designed to probe the position of each of the Member States. But to have any chance of success I need to know more clearly what our own objectives for the European Council are. The Anglo-German Summit on 18 November will be a further opportunity to concert with Chancellor Schmidt. Thereafter I think we must be ready to use the few remaining days in key bilateral contacts probably backed up by a message from you to your colleagues on the European Council. The President of the Commission will visit London on 13-24 November. We need to ensure that his efforts complement rather than cut across our own.

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4. So far as the substance of the negotiation is concerned, I think the main issues and our interest are as follows. The chapter dealing with non-agricultural policies is the least contentious. We need to ensure that it does not result in an expansion putting the 1% ceiling at risk (on which we see eye to eye with the Germans, and where the financial trends away from early exhaustion of the existing resources makes this less and less a live issue). Subject to that caveat we need to do as well as we can on such policies as the Regional and Social Funds, where we have hitherto achieved a net gain and which could again in the future affect our net contribution if, as is possible, the Commission scheme forms the basis of the final solution on the budget. And we must at all stages remember that a presentational success on this chapter is a crucial political need for a number of the Member States who will be taking losses, often substantial losses, on the other two. So far as the reform of the Common Agricultural Policy is concerned, we have our own national objectives to pursue. But we shall not achieve them all. There are too many vital, entrenched interests among the other Member States to permit that. The French in particular are shaping up clearly to insist on some of their main agricultural objectives in return for a settlement on the budget. We shall need to consider very carefully how much we can afford to concede in such a trade-off. We may need to distinguish between concessions that would seriously affect our own farming or our overseas interests, which we must resist, and those with mainly financial consequences which could be recovered or largely offset by a satisfactory budget deal. The Minister of Agriculture's paper deals in more detail with this aspect of the negotiations. Finally there is the budget, where the prospects for achieving the kind of overall reform of the Community's financial arrangements, which we have so far advocated, look pretty bleak. We shall first have to see whether the Germans will support the modified limits scheme which we have put to them. If not, or if the reaction from other Member States is hostile, we shall have to consider how we can achieve our budgetary aims within the framework of the Commission's ideas. It is always a great deal easier in the Community to be negotiating on the basis of something the Commission has proposed.

5. We need to face the possibility that the November European Council will not be a full success, with detailed decisions, acceptable to us, taken on all three chapters. While we should, I

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am convinced, keep up as much pressure as we can for making decisive progress, both in advance of the meeting and at it, we need to avoid an all-or-nothing approach which would result in failure on this occasion almost certainly polaristing the subsequent negotiation on a familiar 9:1 pattern, and leading to the sort of parliamentary and public reaction in this country which will be damaging to any party committed to continued membership of the Community.

6. In fact a half-success, with some progress on all three chapters, could suit us pretty well, given that the subsequent detailed negotiation would come to a head when we were no longer inhibited by being in the chair, and when the 1982/3 agricultural prices are up for discussion, giving us the leverage we lack at the moment. A half-success, with credit to the British Presidency for having achieved it, would certainly be a better springboard for achieving our objectives in the next stage of the negotiations than would be a clear confrontation. For these reasons, I favour an approach based on option (iii) in the note by officials. The main problem we shall face in working for such an outcome is that, in order to get something useful on the budget (and without precision on figures I believe we can make some progress there) we shall come under pressure, particularly from the French, to concede something on agriculture. But anything we do concede on agriculture will require much detailed working out in the Agriculture Council and that leads back to the leverage we shall have at the time of the next price-fixing, particularly if we are prepared to be really tough in the opening stages on the prices themselves.

7. As to our third year of refunds under the 30 May agreement, I

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am sure it is right to play this cool and long. If we can get a clear indication from the European Council that the target remains to apply a longer term solution to our unacceptable situation with effect from 1982, then the domestic situation should be reasonably easy to handle, given that our 1981 refunds will be coming in during the first quarter of next year. The last thing we want is to shift the main focus of negotiation away from the Mandate; and to get into a squabble over the figures which will split us from the Germans and which will inevitably be centred on a system and numbers heavily prejudicial to what we are trying to achieve in the wider negotiation.

8. I invite my colleagues to agree that in the run-up to the European Council we should follow the tactics I have suggested.

9. I am copying this minute to other members of OD and to Sir Robert Armstrong.

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Foreign and Commonwealth Office

9 November 1981

BUDGET RESTRUCTURING: PREPARATION FOR NOVEMBER EUROPEAN COUNCIL

Note by Officials

Introduction

1. When the Committee last considered this subject in September, it agreed (OD(81)15th Meeting) that while the UK might not be able to carry the budget restructuring negotiations as far forward as we would like during our Presidency, we should push hard for decisions at the November European Council for a fair and lasting solution to our net contribution problem. We should work for clear guidelines on CAP reform, take a constructive attitude on the development of other policies within the 1% ceiling and, while not ruling out the Commission's ideas for a budgetary mechanism, we should maintain the Chancellor of the Exchequer's 'Hague' approach that the effects of the budget on member states should be based on deliberate decisions reflecting relative prosperity. Although this approach implied that the UK should end up as a net beneficiary, our private fall back position would be to aim for a nil net contribution.

2. This note reviews progress in the negotiations and analyses the tactical choices for the European Council on 26/27 November.

Progress in the Council and Mandate Group

3. The Mandate Group has met weekly since early September, dealing successively with each of the three chapters of the Mandate, namely non-agricultural policies, CAP reform, and budget problems. The Agriculture and Finance Councils held debates on 19 October and the Foreign Affairs Council discussed the Mandate on 26 October.

4. It is generally accepted that the European Council will be asked to consider three interrelated issues: the development of other Community policies, CAP reform and the budget.

Chapter I: Other Policies

5. Apart from the substance, this Chapter is of considerable political importance. Most member states wish to give renewed impetus to the development of Community policies on a broad front. And for Denmark and the Benelux countries it is only in Chapter I that they can look for positive progress to offset the painful concessions they will have to make on

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Chapters II and III. The Italians will also expect to benefit substantially from the new guidelines on the Regional and Social Funds. Several of the ideas put forward by the French in the recent 'relance' memorandum can also be subsumed under this chapter. There is also quite a lot for the UK to play for: there is scope for some modest budgetary improvements from the Regional and Social Funds, and completion of the internal market including services such as insurance will also be to our advantage. While there will also be new efforts to coordinate monetary, economic, social, employment and energy policies, this is unlikely to involve very precise commitments which would tie our freedom of action. No one is arguing that the 1% VAT ceiling should be raised now, and support even for mentioning the possibility in the future is weak.

Chapter II: CAP Reform

6. Discussion on changes in the CAP have brought to the fore highly divergent points of view about how the CAP should be developed. There is no prospect of presenting the European Council with agreed conclusions. While no one disputes the need for price restraint, we are unlikely to get any precise guidelines except in the case of cereals where the Commission have proposed that the Community needs to progress towards the US cereals price by 1988. The Commission have now given up the idea that prices for other commodities should be linked to external benchmarks. There is support for the concept of limiting guarantees to producers once specified production levels are reached. But for cereals and milk products at least, the French and some others want such measures applied so that they hit large scale rather than smaller producers, although this concept is resisted by the Netherlands and Denmark as well as by the UK. The latest Commission proposals for exemptions from coresponsibility levies for milk which go some way to meet French demands contain features which would be unacceptable to us. The concept of income aids as a counterpart to a rigorous price policy has not found much favour, and the Commission's latest proposals include instead the differentiated application of co-responsibility measures as an alternative approach. The French are pressing for the Community to develop an active export policy and to apply stronger import protection particularly for cereals substitutes and they would like to see some commitment to a tax on oils and fats after Spanish accession. All these ideas are being resisted by ourselves and the Germans, with some Dutch support, but it may be difficult to avoid giving some ground if we are to get what we want on the Budget. Similarly we may have to go some way to meet the Italians on Mediterranean agriculture though our aim is to leave any commitment as vague as possible. All member states are likely to pay lip-service at least to stronger discipline on

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tional aids. We have had some useful support from the Germans, and to a lesser extent the Dutch on setting a financial ceiling on the growth of agricultural guarantee expenditure. But the idea is strongly resisted by the other member states.

Chapter III: Budgetary Problems

7. No concrete progress towards an agreed solution has been made. We have demonstrated that even on the most optimistic assumptions about CAP reform and the development of other policies the UK would remain a substantial net contributor in the absence of some form of budget corrective mechanism. But there has been no support for our Hague speech approach. The French and Danes still argue strongly that if there is a budget problem it should be treated as a residual to be dealt with only after the financial effects of CAP reform and the development of other policies have become clear. Together with the Netherlands and Belgium they contend that any eventual compensation must be ad hoc, temporary and degressive. The Commission scheme, which would compensate the UK for a proportion of the difference between its share of Community GDP and the share of CAP guarantee section receipts, has found support only from the Belgians and the Italians. The Germans have argued that their own net contribution should be limited and have invited the Commission to make appropriate proposals but have not put forward any specific proposals of their own. The Commission are confident that their own scheme provides the only basis on which agreement will prove possible. We have not ruled out the possibility, but have said that we could only consider it if it were accompanied by the continuation of an appropriately amended Financial Mechanism. We have put to the Germans a scheme based on the Hague speech approach, but limited to net contributors and any possibility of reaching agreement on a method of this kind will depend on their reaction.

The Objectives of Other Member States

8. The German Government have not made up their minds as to what they want. Some are arguing for a direct limit on the German net contribution to the budget while at the other extreme, some would be content with some modest alleviation of the German contribution to the UK refunds. The former arrangement would be anathema to several member states involving as it would payments by them to the Germans, but the latter arrangement might be acceptable. The Germans are prepared to contemplate additional expenditure on other policies only to the extent that savings on the CAP are achieved though their ideas for the CAP are different from ours. As far as we

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know, the French have not considered what final outcome they want to achieve. But what seems to be emerging more clearly is a determination to win substantial concessions from us over the CAP for whatever they are forced to concede on budget mechanisms. They may also seek to make a link with the outstanding issues on the common fisheries policy. While they key to the negotiations will lie with what we can bring the French and Germans to accept, in contrast to the negotiations leading to the 30 May Agreement their positions are still wide apart on all three chapters. The Italians will hope that, as a less prosperous member state, they will not have to contribute to our refunds, and will concentrate mainly on maximising their financial gain from the CAP and other policies. So far the Greeks have followed a similar line but no one yet knows the attitude of the new government. The Benelux countries have shown some flexibility as regards the UK budget problem but will be concerned to minimise the cost to them. The Danes have taken the most extreme position in resisting our claims and criticising the Commission's proposals. The statements made in public will make it difficult for them to accept a settlement which will satisfy us. The Irish are concentrating on defending the benefits they have secured from the CAP and avoiding any restraints on the future expansion of Irish agriculture.

Some tactical issues

9. There are important links between the three Chapters. Our essential objective is to achieve a satisfactory conclusion on Chapter III. But to achieve this, we shall have to be prepared to make concessions to the French, in particular on Chapter II on which we have our own objectives of getting clear guidelines for the reduction of CAP surpluses and the cost of their disposal. The French objectives of increasing agricultural protection and discriminating in favour of small producers are contrary to UK interests and do not deal with the underlying problems of the CAP. Other member states will not be prepared to agree to anything on Chapter III unless equivalent progress is made on Chapter I.

10. Our objective remains to avoid linking fisheries with restructuring. Otherwise our fisheries objectives might be achieved only at an excessively high cost in terms of restructuring yet might still be criticised by the fishing industry in the belief that their interests had been sacrificed. Our aim is to reach agreement on a CFP at the Fisheries Council on 30 November/1 December or shortly thereafter. If we do not succeed, however, and if we have not reached agreement on restructuring at the November European Council it will become increasingly difficult to keep the two issues disentangled.

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11. There is also the problem of our 1982 refunds. Under the 30 May Agreement "For 1982 the Community is pledged to resolve the [budget] problem by means of / structural changes... If this is not achieved the Commission will make proposals along the lines of the 1980-1981 solution and the Council will act accordingly". If no agreement is reached on a more lasting solution, therefore, we are entitled to 1982 refunds on the basis of the 30 May agreement. These refunds for 1982 would mainly be provided for in the 1983 budget, which does not come forward in draft until June 1982. So technically there is no need to settle this matter as soon as this November (although there is a minor problem about advances in the 1982 budget itself which will be adopted in December of this year). There are several reasons for not pressing the issue at this stage:

- our whole posture is that we want a lasting solution, taking effect from 1982
- pressure from us for a third year of 30 May refunds would bring us into conflict with the Germans, who believe that their share in the financing of our refunds is excessive
- given the way the current drop in the Community's agricultural spending is affecting the UK's unadjusted net contribution some member states will seize the opportunity to urge that the 30 May arrangements provided for a minimum net contribution by the UK, not a minimum net refund
- the whole negotiation for a third year of refunds under the 30 May agreement will be on a basis and about figures which will prejudice what we are trying to negotiate for a long term settlement
- finally, if 1982 becomes the first year of the new system it could well be financially preferable for us to having a third year of the old.

For all these reasons we should go for a decision at the November European Council that the new system, whatever it is, will apply from 1982. A third year under the 30 May system should be a fall-back, only to be used if the Mandate negotiations get irremediably stuck.

Options for European Council

12. We have always recognised that however successful we were on 26/27 November, a lot of work would be needed after November, at least on Chapters I and II, to turn

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the European Council's conclusions into operative legal measures. It is increasingly difficult to be optimistic that we shall reach complete agreement on the main points of substance in November. In particular the French seem bent upon a long negotiation, and their Government is not so organised as to be able to reach decisions quickly. The Germans have not yet brought themselves to the point of decision so, although we may still hope to influence them they are for the moment another obstacle to progress. But there will be some intensive negotiations over the next few weeks in which we might improve the position. There will be meetings of the Foreign Affairs Council on 16/17 and 19 November, while the Anglo-Italian and Anglo-German summits on 9/10 and 18 November will provide further opportunities to bring pressure to bear. The question therefore is how far we should try to go towards our objectives at the European Council in November. The options seems to be as follows:-

i. We could go all out for a full settlement on the substance in November, including agreement on the detailed arrangements for solving our budget problem, recognising that we would in all probability fail. (Obviously it would not be in our interests to reduce our objectives to what others are prepared to agree to, merely in order to achieve a quick settlement in November). Since there is no agreement in sight even on the basis for negotiation on the budget, we could not realistically expect to get decisions in November. The 1% VAT ceiling is not an imminent constraint and so we cannot use it as a lever to force others into a quick settlement. To go all out for a full settlement and fail would polarise positions, probably on a 9:1 basis and thus make more difficult the achievement of our objectives in subsequent negotiations. Moreover to pursue such a course while we hold the Presidency would not be easy; and failure would make it more difficult to avoid an early negotiation on our 1982 refunds.

ii. We could acknowledge that a budgetary settlement needs more time, and concentrate our negotiating efforts on CAP reform and the development of other policies. This would undoubtedly be the easiest course for us to pursue as Presidency. But we should lose the leverage the other two chapters give us to secure what we need on the budget and it would be seen as a loss of resolve on the part of the UK. Moreover, our 1982 refunds might then need to be negotiated on the basis of 30 May Agreement. This course cannot therefore be recommended.

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iii. We could aim to make roughly parallel progress on all three chapters, which would imply at best settling only on the basic features of a budget solution in November leaving the negotiation of the figures until later. We should have to insist that we could only adopt conclusions at the European Council on Chapters I and II if we got parallel satisfaction on Chapter III. We should under this option be able to use a link with the 1982 agricultural price fixing to enable us to achieve satisfaction when the budget figures were negotiated and possibly also to ensure that further work on Chapters I and II was acceptable to us. Under this option it should be possible to get agreement that the new budget system should come into effect in 1982.

iv. We could decide now to defer the crunch on all three chapters until next spring when it would inevitably coincide with the agriculture price fixing. This option would fail to meet the timetable laid down in the 30 May Mandate and would imply a lack of resolve on our part. It would not allow us to claim any credit for the UK Presidency in achieving progress on the Mandate and we would have lost such opportunity as holding the Presidency gives us to influence the outcome in our favour. It would, however, maintain the Mandate work as a coherent whole and would not in practice impede work on specific measures where work was sufficiently advanced and we could pursue selectively whatever was appropriate in the national interest. But this is not an option to be recommended.

<u>Anglo-German Summit</u>

13. We shall want to use the Anglo-German summit to try to maintain our joint approach and if possible to agree on a method for dealing with the budget problem. We shall also want to try to maximise our common ground and minimise our differences on agriculture. If Ministers decide that we should try to make parallel progress on all three chapters at the November European Council (Option iii) it will be necessary to take a final view on precisely what we could realistically aim to achieve in the light of the Anglo-German summit.

/CONCLUSION

CONCLUSION

14. However successful we are on CAP reform and the development of other policies, a budget corrective mechanism will be essential to deal with the United Kingdom's net contribution problem. Our arguments that the Community should have a policy for distributing the budget according to objective criteria such as relative wealth and population size have made no headway and show no signs of doing so. We are therefore faced with the options set out in paragraph 12 above. Ministers are invited to consider what general approach they want to adopt in the remaining weeks before the European Council.

Cabinet Office
3 November 1981