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Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

28th November, 1979

To Mickel,
Mr. Hunt

UK CONTRIBUTION ETC.

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In reply to your letter of today's date, I enclose the interim assessment on withholding referred to in your third paragraph. This has been agreed with representatives of the FCO, Cabinet Office, Law Officers Department and Treasury Solicitor.

Copies of this letter and enclosure go to the recipients of yours.

Yr. ew,

A handwritten signature in black ink, appearing to be 'M.A. Hall'.

(M.A. HALL)

Private Secretary

M. Alexander, Esq.,
Private Secretary,
10, Downing Street



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28 NOV 82

EEC CONTRIBUTION: WITHHOLDING

This is an interim note which does not attempt to answer all the questions which a decision to withhold part of our EEC contribution would raise. However, it may narrow the options and identify some of the issues.

Mechanics

2. We have examined each link in the chain by which customs duties, agricultural levies and VAT (the 3 components of the Community's "own resources") are collected in the UK and transferred to the Community; and by which the Community then remits out of the UK the equivalent of our net contribution. The main stages are:

- i. "establishment" and collection of the duties;
"establishment", which includes calculation and notification to the payer is a term of art in Community regulations;
- ii. payment of these duties by Customs staff into the departmental bank account which forms part of the Consolidated Fund;
- iii. transfer from the Consolidated Fund to the EEC No 1 Account with the Paymaster General (there is a No 2 Account relating to the Coal and Steel Community). These transfers to the EEC Account have to be made by the 20th of each month in the case of Customs duties and agricultural levies. The transfers relate to sums collected 2 months earlier (ie in December we pay in the October collections). In the case of the Community's VAT share we make payments on the first working day of each month which represent 1/12th of an estimate made at the beginning of each year. Then an adjustment is made after the end of the year. Failure to make these transfers on the due dates attracts an interest penalty which is at present 17%, increased in respect of the whole period by 1/4% for each month's delay.

From this EEC Account, the Community makes payments in sterling within the UK (eg our Article 131 refunds; payments to us under the Regional Fund; payments to the Intervention Board to finance purchases into intervention from UK farmers);

iv. at intervals the Commission instruct the Treasury to make transfers from the EEC Account with the Paymaster General to their account with the Bank of England. It is from that Bank of England account that the Commission make remittances overseas.

3. If we are to resort to withholding, there seem to be overwhelming advantages in achieving it by stopping remittances from the EEC Account with the Paymaster General to the account at the Bank of England. A stop on collection could only apply to customs duties and agricultural levies, not to VAT where the great bulk of the collection is for our own purposes. But this would be a very drastic course: a dismantling of the external tariff to the Community. It really would look like a permanent breach with the Community. It would also stop the flow of funds into the EEC Account which are used for our own farmers and other EEC beneficiaries. We might well have to make good part or all of that to them out of public expenditure. Moreover we do not want to upset the normal working of customs staff.

4. Stopping payments of duties once "established" into the EEC Account with the Paymaster General would attract the interest rate penalty. It would not of itself stop the flow of money overseas, to the extent that balances remained in the EEC Account. And it would endanger the flow of funds to our own EEC beneficiaries.

5. Interfering with flows out of the EEC Account at the Bank of England would also be unattractive. The Bank might well fear the precedent of interference with a customer account. It would probably be neither a legal nor an appropriate use of the statutory power of direction to the Bank to use that weapon to block the account. And it is much better to have the blocked balances in the EEC Number 1 Account where they are automatically ~~re~~lent to HMG.

6. The Treasury is required by Community regulation to comply "as soon as possible" with instructions to transfer money from the EEC Account with the Paymaster General to the EEC Account at the Bank of England. But there is no prescribed interest rate penalty for delay, though the Court might award such a penalty if it were sought. By stopping transfers at that point we would effectively stop transfers abroad; we would leave untouched the funds out of which UK beneficiaries are paid. And we would ourselves retain the use of the money, since the whole balance of the EEC Account with the Paymaster General is relent without interest charge to the UK Government. The Account is a mere book entry. And any problem of "unscrambling" if a settlement is reached is kept to a minimum.

How Much

7. Perhaps 4 serious possibilities:-

- i. a token amount;
- ii. withhold up/^{to}the amount of our estimated net contribution for 1980, but on an importer benefits basis (1552 meua);
- iii. withhold the net contribution on an exporter benefits basis (1814);
- iv. withhold up to the amount of our VAT tranche (1330 meua).

8. There seems little point in i. The principle underlying both ii. and iii. is to withhold the amount of the Government's claim. The amount yielded by iv. would be somewhat less. On the other hand, to withhold only the VAT tranche might be less offensive to our partners than withholding the customs duties and levies which are "own resources" par excellence. In practice we would not expect to be in default by more than our VAT tranche for many months.

9. If the Commission stopped payments to UK beneficiaries (which would be a considerable further escalation of the dispute) we would have to make them instead. Urgent payments could be made from the Contingencies Fund pending provision in Supplementary Estimates under the cover of the Appropriation Act. In this emergency situation the "new" public expenditure would be matched by "borrowing" from the EEC No 1 Account; and the intention would be that it would be made good out of the Account at the unscrambling stage.

10. It might be 3 to 6 months or so before our withholding created actual financial stringency for the Community.

Legal Aspects

11. In refusing to comply with a valid instruction from the Commission to transfer money to the EEC Bank of England Account we would be failing to carry out a legal obligation. The Commission could go to the European Court and obtain an order directing us to pay. This could happen in a matter of weeks.

12. Our public posture should however be that our action in withholding pending a settlement of our problem was justified because in our view the institutions of the Community had failed in a duty to redress a situation inconsistent with certain basic provisions of the Treaty. This is not the same as saying that we would win a case against our withholding in the European Court on such an argument. The Attorney General has advised that we would not.

13. The question whether we should ourselves initiate Article 175 proceedings in the Court (arguing as in the preceding paragraph) has been considered. Work is in progress to enable the Law Officers to form a final view. However the Attorney General has so far considered it doubtful whether such an action would succeed, and has added that any chances of success would be reduced by prior withholding.

14. The Commission would be under obligation to take us to the Court on withholding but they have some discretion about the speed at which they would proceed. We for our part need to be clear whether we would intend to comply with a Court ruling against us before we had reached agreement on the budget question. If so, withholding would be shown to be little more than a demonstration.

15. The question of UK legislation arises because the Council Regulation governing our payments to the budget is directly enforceable in the UK under Section 2(1) of the European Communities Act 1972. There is a risk of action in a UK Court to oblige the UK Government to meet its obligations, though it is unlikely that the Commission would resort to that as a first step. To eliminate all risk of action in a UK court it would be necessary to legislate to amend the European Communities Act. This would itself appear to be contrary to the Treaty of Rome. The wider implications would clearly need further study.

Implications

16. We do not in this paper attempt to set out a view on whether withholding would exert quicker and/or more effective pressure on other Member States than widespread destruction of Community business and whether it would make easier in the end to get them to concede more of our case. There are differences of view on this. There would be a risk that our partners would refuse to negotiate in the circumstances. But after the French precedent on lamb, which has not been greeted with such a refusal, it would be more difficult for them to take this line, especially if we made it clear that our withholding was temporary, pending a settlement of our budget problem. We need more time to make a considered assessment.

Announcement

17. If it were proposed to withhold, this would require a carefully prepared statement addressed first to the House of Commons. The question could arise swiftly if a second early meeting on the budget were refused at Dublin and the Prime Minister wished to make an early statement on Dublin and the Government's response.

) There would also be a question whether to give some prior warning, general or specific, to other Heads of Government at Dublin.