PRIME MINISTER

OD: Restructuring the Community Budget

The only paper before the Committee is the Report by Officials, with a cover Note by the Secretary of the Cabinet (OD(80)57), discussing how best we can exploit the mandate to restructure the Community Budget. It looks in substance at various possibilities but does not deal in detail with immediate issues like what happens when the Community hits the 1 per cent VAT ceiling (on which you but not all OD Ministers have already had papers). The report by officials tries to estimate the extent to which the different solutions would reduce our net contribution; but the key figures are summarised in a note attached to this brief.

2. No substantive decisions are called for at this stage; but it is important that the Committee should give a sufficient steer on our objectives and the possible means for attaining them to clear the way for early exploratory contacts with our partners and the Commission. We shall in particular need to have a clear view of our aims in time for the 17 November Anglo-German Summit. Specific tactical issues will be brought before Ministers, in OD(E) or OD, in separate papers as the negotiations proceed.

3. Ministers will want to express general views on the importance of the exercise and the relative merits of the different approaches. The two issues likely to cause most discussionare CAP reform and the idea of a possible Community oil levy. It would be preferable not to rule out any options at this stage but be ready on tactical grounds to explore them without commitment.

HANDLING

4. You will probably find it convenient to base discussion on the cover Note, referring as necessary to the main Report. The sequence of discussion might then be:

(a) Objectives (paragraph 3). There should be general agreement that we must aim at a permanent solution giving us at least as much relief as the arrangements for 1980 and 1981. Reference to the additional aim of reducing the resource cost of the CAP would lead on to discussion of the first of the means open to us, viz:

(b) Reform of the CAP (paragraph 5). The Committee may not be ready to resolve the incipient conflict between the two possible approaches - price restraint and quantitative limitation - on both of which officials are in any case doing further work (see paragraphs 28 and 31 of the main Report). But you will want the views of the Minister of Agriculture, the Chancellor and the Foreign and Commonwealth Secretary in particular on the tactical and domestic implications of both approaches. The Chancellor is likely to argue that we should try to agree with the Germans on a tough price policy. Mr Walker will be afraid that this will damage our own industry. The discussion is bound to turn towards the 1981 CAP price fixing and how our line on that will fit with our broader objectives. But since the Committee will not have the facts e.g. on the income position of British farmers, you may wish to suggest that officials should urgently prepare a paper on the prospects for next year's agricultural price fixing and our longer term objectives for the CAP so that OD(E) can agree a line before the Anglo-German summit meeting. Are the other conclusions in paragraph 37 of the main Report also agreed, especially the idea of a limit on the proportion of the Budget devoted to agriculture?

(c) On non-agricultural Community expenditure (paragraph 6), is it agreed that this can make only a small contribution to the solution but that we should be ready to look constructively at any proposals and take our studies of the more promising possibilities further? The Chancellor, the Secretary of State for Employment and the Secretary of State for Industry may want to comment.

(d) Introducing progressivity into the VAT system (paragraph 7 of the cover note and paragraphs 44 and 56 of the main Report). Is it agreed that, while there may be little hope of negotiating such a change within the present 1 per cent ceiling, we should float it none the less for tactical reasons? The Chancellor and the Foreign and Commonwealth Secretary/Lord Privy Seal may have comments.

(e) On an oil import levy, the paper does not ask for substantive conclusions but for authority for further study (paragraphs 53 and 70). You will nevertheless want to get the reactions of the Secretaries of State for Energy and Industry, who fear that such a scheme would create problems for the North Seal fiscal regime, open the door to increased Community influence on our oil policies and undermine the competitiveness of our energy intensive industries. The Foreign and Commwealth Secretary, the Chancellor and the Lord President, on the other hand may press its potential as a new Community policy from which the UK could expect to be the main beneficiary.

(f) Corrective Systems (paragraph 8 of the cover Note). Is it agreed (paragraph 70) that we should contrive to get this subject aired in the restructuring discussions without being labelled as its authors? The Chancellor is likely to see particular attraction in the solution but the Foreign and Commonwealth Secretary will be cautious about its acceptability.

(g) Negotiating style and tactics (paragraph 9). Most of this should be uncontentious. The question whether and if so, under what conditions we might accept an increase in the 1 per cent ceiling need not be decided now, but you may want to hear from the Chancellor, the Foreign and Commonwealth Secretary and the Lord President on this point.

CONCLUSIONS

5. Subject to the discussion you may be able to conclude that the Committee -

(i) Endorses the general approach proposed in OD(80)57 and the official Report and agrees that further work should proceed as suggested.

(ii) Authorises early contacts at official level with the other member states and the Commission to explore and influence their thinking on the restructuring exercise.

(iii) Invites OD(E), before the Anglo-German Summit, to consider our tactics for the 1981 CAP price fixing and how they should be aligned with our wider objectives for restructuring the Community Budget.

M D M FRANKLIN

10 October 1980

CONFIDENTIAL

BUDGET RESTRUCTURING: THE BASIC FIGURING

1. Our unadjusted net contribution in 1981 is assumed to be 2,200 million units of account (meua). It will be held at about this level in real terms so long as the 1 per cent limit holds.

2. The paper assumes that our aim should be to get this down to 5-600 meua which would be a reduction of 1600 or approximately three-quarters. This is better than the 30 May Agreement which secured a reduction of two-thirds.

3. The scope for savings on CAP is potentially very large but the options in the paper are not costed. Every 1 per cent reduction in CAP guarantee expenditure saves us 15-20 meua if the pattern of expenditure is assumed to remain unchanged. If 20 per cent of the cost were paid by national governments in proportion to the existing CAP receipts we might save nearly 300 meua.

4. Benefitting from increases in non-agricultural expenditure depends on the resources available (and the current dispute over the 1981 budget shows how difficult it is to retain even the present share against pressure from rising CAP costs on the one hand and the 1 per cent ceiling on the other). Our earlier target of reducing CAP expenditure to 55 per cent of the budget - a highly ambitious one - would, if the resultant savings were spent on regional and social funds, reduce our net contribution by up to 500 meua depending on how the CAP was cut (figure based on previous work). But we do already have on the table in Brussels a suggestion for aids to coal investment which would give us a net benefit of about 80 meua over three years.

5. If the present 1 per cent VAT tranche was made progressive, we would get a saving of up to 500 meua (400 meua in a Community of 12). But this is very unlikely to be negotiable except in the context of raising the 1 per cent ceiling.

6. An oil levy at say $2 per barrel (about 6 per cent at current oil prices) would give us a net gain of 860 meua if we could get 25 per cent share of the resultant expenditure - not an unrealistic target. So this scheme could give us more than half of what we want. On top of the 860 meua budgetary gain there would be a resource benefit to the UK of 580 meua.

7. The budget corrective mechanisms discussed in Section VIII are simply designed to give us what we want: but their effect on other countries would be more transparent than the other alternatives. Taking Scheme B, Germany would be better off by 600 meua as compared with the way they have to finance the 30 May Agreement. France and Italy would also gain at the expense of Denmark and the Benelux. But these figures assume that our net contribution is cut by three-quarters: the gains and losses would be smaller if the reduction was only two-thirds. They also assume that administration costs are allocated as a benefit to Belgium and Luxembourg.