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PRIME MINISTER

EC BUDGET RESTRUCTURING: THE NEXT PHASE OF THE NEGOTIATIONS

You will have seen the note by officials circulated as OD(81)40. No doubt we shall have an opportunity to discuss it in September. Meanwhile, I should like to comment on the specification of our objections^{res} in paragraph 2. This follows the minutes of an OD meeting last October, where we are recorded as having agreed that our broad aim should be to bring our net contribution "to a level no higher and, if possible, lower than that resulting from the 30 May settlement".

2. I do not recall that we actually discussed this formula last October. In any event, it was then and remains ambiguous. The 30 May settlement did not impose a fixed ceiling. It left us with a net contribution which is not completely predictable, and rises from year to year. Future rises could well be substantial if the agreement were rolled forward: the net contribution figure for 1981 in the 30 May agreement is larger than that for 1980 by an amount explicitly related to the increase in the Commission's estimates of our unadjusted net contribution between those two years. If the Commission were asked to repeat the process, they would be likely to predict sharp increases in our unadjusted net contribution in 1982 and subsequently. The 30 May approach would thus produce sharp increases in our adjusted net contributions also.

3. In any case, as I said in my minute to you of 27 January, we should not regard an outcome on the lines of the 30 May agreement as indefinitely defensible. That agreement was, in my view, a significant step forward; but it left us more disadvantaged in relation to our GNP per head than any other member of the Community.



4. Since then, there have been a number of important developments:-

(i) With colleagues' agreement, I have in my Hague speech committed us publicly to the argument that the Community should adopt a principle which is applied without controversy within national states - that resources should flow from more to less prosperous regions, and not vice versa.

(ii) There is some evidence that we are making an impression with our arguments. For example our Embassy in Bonn recently reported that Chancellor Schmidt told a "European-American workshop" meeting that he did not see why the UK, as one of the poorer countries in the Community, should be a net contributor. We must do nothing to frustrate such developments in others' perceptions.

(iii) The Commission's report on restructuring has publicly described the effects of FEOGA on the UK as "inequitable".

(iv) The ambiguities in the 30 May agreement have, if anything, become more perplexing. (A note on this point is on its way to you.)

(v) The recent report by the NEC of the Labour Party suggests that our continuing net contribution is likely once more to become a damaging political issue, playing into the hands of those who advocate withdrawal.

(vi) It becomes no easier, to put it mildly, to meet our public expenditure targets while continuing to make a net contribution to the European Community.



5. For these and other reasons, I am convinced that our objective in the forthcoming negotiations must be to initiate a process of reform that will lead to the elimination of our net contribution at the earliest possible date. I am under no illusion about the difficulties. But I think we ought to recognise amongst ourselves that we cannot afford to set our sights any lower.

6. It is also critical that we do not give misleading signals to others about the type of settlement that we could accept. Getting the UK to acquiesce in an extension of the 30 May approach is the easy way out for the Commission and the other member states. If the problem of the excessive German contribution could be solved by getting us to pay progressively more, then all the tensions created by Schmidt's insistence on a limit for Germany would evaporate - but we would be left with a continuing and increasing financial cost that could not be justified to UK public opinion.

7. At some stage we shall need to make this plain to the Germans and others. In the meantime the negotiating approach suggested in OD(81)40 - particularly paragraphs 19 and 20 - is not inconsistent with the objective that I have proposed in paragraph 5 above.

8. I am sending copies of this minute to Peter Carrington, Peter Walker, other members of OD and Sir Robert Armstrong.

(G.H.)

4 August 1981