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Prime Minister B²



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

This is all v. technical and the higher figures for 1982/83 are, for the moment, out for internal purposes. But they are nonetheless worrying; if they remain unchanged, they will cause political (and financial) problems next year.

4th August 1981

M O'D B Alexander Esq.
Private Secretary
10 Downing Street
LONDON
SW1

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5/8

Dear Michael,

UK NET CONTRIBUTION TO COMMUNITY BUDGET

The preliminary figures for this year's public expenditure survey show an unwelcome increase of £173 million, compared with the last White Paper, in our net payments to European Community institutions in 1982-83, partially offset by a reduction of some £120 million in the current year. The Chancellor has suggested that the Prime Minister will wish to note both (a) the reasons for these revisions to the figures and also (b) our expectation that the discussions in the Community this autumn over calculation of our refund entitlement for 1980 could be troublesome.

The increase in our forecast net payments to Community institutions in 1982-83 is more than accounted for by a higher forecast net contribution to the Community Budget. (The footnote to the table below explains the difference between these two aggregates.) The comparison between the new figures for our net budget contribution and those in the last White Paper is as follows:-

Net contributions to Community budget (£ million)

	1981-82	1982-83	1983-84	1984-85
Last White Paper revalued (Cmd 8175)	529	566	600	..
Survey report	425	745	625	690
Difference	-104	+179	+ 25	..

Note: The above figures relate exclusively to our net budget contributions (as in table 2.2.1 of Cmd 8175). They differ from the programme 2.7 figures for net payments to European Community institutions in including overseas aid attributed to the aid programme but excluding net receipts from the European Coal and Steel Community and capital subscriptions to the European Investment Bank.

/The new

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The new figures for 1982-83 differ from the White Paper figures in being precarious forecasts rather than stylised assumptions. The changes compared with the White Paper reflect this change of status as well as developments since the turn of the year. Within the total changes, there are three factors which call for special comment - one favourable and two unfavourable. The favourable factor is a higher than expected level of receipts, including CAP guarantee receipts. The unfavourable factors are the high level of the sterling/ecu exchange rate this year, compared with February of last year, and revised assumptions on the calculation and payment of our budget refunds.

Taking these in order, the UK's share of receipts from CAP guarantee expenditure has recently risen substantially above the levels previously foreseen - partly as a result of decisions taken by the Agriculture Council in April. Our future receipts share depends critically on market developments and cannot be predicted with any confidence. Our own projections differ considerably from those of the Commission. We have thought it reasonable at this stage to assume a receipts share of around 8 per cent, for the time being at least, as against around 6 per cent in the past. These and other higher receipts are reflected in the lower net contributions figures for 1981-82. In 1982-83 and later years, however, the reduction in the net contribution is assumed to be offset, or partially offset, by a consequential reduction, lagged one year, in our budget refunds.

The relatively high £/ecu exchange rate this year is significantly affecting the timing of our VAT contributions, as between this year and next. The method of paying VAT own resources to the Community is such that if, as is happening in 1981, the sterling/ecu exchange rate during the year is higher than it was in February of the preceding year, there is a temporary reduction in our net contribution during the year in question, followed by a higher net contribution in the succeeding year. A considerable amount of the UK's net contribution has in effect been switched from the current year into 1982-83; and we are also expecting some of the 1983-84 net contribution to be switched back into 1982-83. The annexed note (for connoisseurs only) explains in more detail how this curious system works.

On budget refunds, the last public expenditure White Paper made the stylised assumption that from 1982-83 onwards our net refunds would adapt to keep our net contribution constant in real terms. With the passage of time, however, it is no longer satisfactory to make this assumption for 1982-83. We have instead made a calculation of what our refunds might be on the basis prescribed in the 30 May agreement for the 1980 and 1981 budgets.

/In practice,

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In practice, as the Prime Minister may recall from earlier briefing, there is disagreement in the Community on whether the 30 May agreement should be read as prescribing a minimum net refund to the UK or a minimum net contribution by the UK. We have argued, with some support from the Commission, that the agreement provides for a minimum net refund to the UK, equivalent to some 66 per cent of our unadjusted net contribution in 1980 and 1981 as projected by the Commission last May, while other Member States have argued that the agreement provides for minimum net contributions by the UK of the amounts stated in the agreement. The sums involved in this difference of interpretation are substantial - some £80-90 million in 1981-82 and perhaps some £180-200 million in 1982-83. We have thought it best to assume at this stage in the survey that the outcome will lie halfway between these two extremes.

We have also assumed that all our refunds - supplementary measures as well as financial mechanism - will be converted from ecus into sterling at the average exchange rate for the budget year to which they relate rather than at the rates prevailing when the payments are made. The financial mechanism regulation provides specifically for this, but the supplementary measures regulation does not mention the point. We have argued with the Commission that the same exchange rate must apply to the two channels for our refunds, which are supposed to be interchangeable; but they have not as yet conceded the point. If we lose the argument, our net contribution in 1981-82 is likely to be some £50-60 million higher. It could rise by a further £15 million on top of this if we fail to qualify under the financial mechanism and have to take all our refunds in the form of supplementary measures. (In another year, the exchange rate convention for which we are arguing might well be to our disadvantage; but there can be no certainty about this, and a bird in the hand is worth two in the bush.)

These problems over our refunds in respect of the 1980 Budget will have to be discussed in the Community in the autumn. The discussions are likely to be controversial, and may come to a head at a particularly unfortunate time, when we are trying as Presidency to pave the way for a satisfactory agreement on reforming the Community Budget in the longer term. We shall need to consider the tactical options carefully. When we know the outcome we shall have to look again at the projections of our net contribution.

The figures shown in the survey report for 1983-84 and 1984-85 are based on the stylised assumption that the 30 May agreement will be extended into later years. This is not of course our negotiating objective - see the Chancellor's minute of August 4 - but we do not want to count our chickens before they are hatched and there is no obviously better assumption to use for survey purposes.

W. H. H. / Pa.
This will follow - I am getting Cabinet Office advice on it. /I am Th.

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I am copying this letter to Francis Richards (FCO),
Kate Timms (MAFF) and David Wright (Cabinet Office).

Yours ever,
Peter

P.S. JENKINS
Private Secretary

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 August 1981

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

Dear Mr Alexander

UK NET CONTRIBUTION TO THE COMMUNITY BUDGET

... The attached annex should have been enclosed with Peter Jenkins' letter to you of 4 August.

Would you also please amend the penultimate paragraph of the letter, line 5, to read "4 August".

I am copying this letter and enclosure to the recipients of Peter Jenkins' letter.

Yours sincerely
David Barton

D.J. BARTON

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COMMUNITY BUDGETVAT CONTRIBUTIONS AND CHANGES IN THE EXCHANGE RATE

There are four main stages each year in the calculation and payment of our VAT contributions to the Community budget:

- (1) Our VAT contributions to the budget are estimated initially in sterling.
- (2) These sterling figures are converted into ecus at the conventional 'budget exchange rate' for the budget concerned and entered in the budget on this basis: ^{the} 'budget' rate is the rate which obtained on the first working day of February of the preceding year.
- (3) During the budget year, we pay over each month one-twelfth of the ecu sums in the budget, converted into sterling, not at the budget exchange rate in (2) above, but at the sterling/ecu exchange rate prevailing in the middle of the month preceding the month of payment.
- (4) In August of the following year, a 'VAT adjustment' payment is made, or received, to take account of (a) errors in the budget projection of the VAT base and (b) changes in the sterling/ecu exchange rate between stages (2) and (3) above.

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The net effect is that our VAT liability is calculated in sterling, as a percentage of our sterling VAT base, both at the initial stage of estimation and in the final reckoning. But the monthly payments which we make on account during the year, being denominated in ecus, produce the 'wrong' sterling amounts if the exchange rate during the year differs from the 'budget' exchange rate.

2. In the case of the 1981 budget, the average sterling/ecu exchange rate during the year (stage 3 above) is likely to be well above the 'budget' rate (stage 2 above) of 1.58.

(The average rate so far this year has been about 1.87.)

Hence we expect to pay over during this year significantly less sterling than our VAT base justifies. This 'underpayment' will have to be made good by means of a VAT adjustment in the summer of 1982 (stage 4 above) which will increase our net sterling contribution in that year. In terms of financial years, this will be reflected in a lower net contribution in 1981-82, followed by a higher net contribution in 1982-83.

3. The 1982-83 figure is likely to be further increased by the very high 'conventional' sterling/ecu exchange rate for the 1982 budget of 1.92 (based on the actual rate of the first working day of February this year). This will be reflected in 'overpayments' of VAT in sterling terms during 1982 if (as we assume) the average exchange rate for that year is lower than 1.92.