



Prime Minister: *Chris Pp* (2) *B*

You have already said that you would like to discuss the present position with the FCS & the Chancellor. I shall

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

PRIME MINISTER

arrange a meeting a.s.a.p. after you return from Cannes. Meanwhile you may like to glance through the

COMMUNITY BUDGET AND CHANCELLOR SCHMIDT *keeper - Pmt*

The November European Council is now only five weeks away. The omens are not favourable for a settlement of our Budget problem. We have not won support from either the Commission or any of the other Member States for a fundamental solution to the Community Budget problem designed on the principles set out in my speech in the Hague of 3 June.

2. Our attempts to get the Germans to acknowledge the benefit to them of such a solution has so far failed to elicit a response, even though Ministry of Finance officials are sympathetic and Schmidt is from time to time reported as saying things which are entirely consistent with our approach. The problem appears to lie in the German Foreign Ministry. Genscher is more concerned with pushing his ideas for European union than in solving the German budget problem. He appears to be worried about the costs to the small rich countries and the "ugly German" image.

3. The only way we are likely to be able to produce a shift in the German position is by engaging the personal interest of Schmidt in a general solution which will serve the interests of both the United Kingdom and Germany.

4. With this possibility in mind, Treasury officials have worked up a new scheme which is designed to meet the criticism made by German officials that the Hague Speech approach is too radical, but without sacrificing the UK interest. We cannot be sure that Schmidt would find it attractive; but there is a family resemblance between the scheme and things which he has said in public, and I think it right to give you the opportunity to consider it.



5. I am therefore sending you with this minute three documents:-

(i) A table with a brief covering note describing the new scheme succinctly and showing its possible effects on the net positions of Member States.

(ii) A Speaking Note which might be used to present the scheme to Schmidt's office on your behalf.

(iii) A more detailed note, for the benefit of Schmidt's advisers, explaining how the scheme was constructed.

6. For the United Kingdom, the scheme produces a zero net contribution to the "allocated Budget" if our GDP per head remains below the Community average. Even if, as a result of an appreciation of sterling, our GDP per head should rise above the Community average, it would still limit the size of our net contribution. For the Germans, the scheme also places an upper limit on their net contribution, as well as reducing it, in practice, to something rather below what they pay under the 30 May agreement. It would probably not involve corrective payments to Germany by other Member States, which should be a helpful feature in view of their sensitivity on that point. And it relieves the poor Member States - Italy, Greece and Ireland - from contributing to UK refunds. The extra costs are borne mainly by the small rich countries according to a formula which reflects their relative prosperity and the amount of their (uncorrected) net receipts from the Budget.

7. It is a less radical scheme than those we have so far shown the Germans to illustrate how the Hague speech approach might work. The new scheme does not attempt to regulate the entire pattern of net benefits and net contributions according to a formula; but only to place a check on the size of net contributions and to distribute the costs of correcting them in an equitable way. It does not eliminate the net benefits of the small rich countries;



but only reduces them. It does not reduce the net receipts of the Irish. For these reason, it could be more negotiable than the full-blooded Hague approach.

8. There is of course no guarantee that Schmidt would be prepared to commit his Government to negotiate on the basis of a scheme on these lines, and there are risks in putting it forward. We might arouse German interest in a scheme which places a limit on both their contribution and ours, but, in doing so, might provoke them into changing the figures at our expense so as to reduce the cost to the small rich countries. Before going forward with this plan, we need therefore to compare it with the other options open to us.

9. As I see it there are two. First, we could soldier on with the Hague approach in the hope of slowly winning support for it. The prospects do not look good at present; but Community moods do change. It is distinctly unlikely that any agreement to negotiate on the basis of the Hague approach will be obtainable this year, and the Belgian Presidency will not be sympathetic. This option is only attractive if we are willing to accept a long delay before the Community Budget problem is settled.

10. The second alternative is to say that we are ready to negotiate on the basis of the Commission scheme. This also does not look a promising way forward to agreement. The Commission scheme has attracted few friends and several enemies - the agricultural States see it as a threat to the integrity of FEOGA, and the French have serious objections of principle to it. Furthermore, it could only eliminate our net contribution if two conditions were satisfied: first, if it were interpreted in a way far more favourable to the UK than the Commission intend; and, second, if it were combined with a reformed Dublin mechanism.

11. I do not pretend that we are faced with an easy choice. I think it would be helpful if we could meet to discuss it with the



Foreign Secretary as soon as you and he get back from Cancun. The case for putting the new scheme to Schmidt is that he might see virtue in it, both as a way of solving the German problem and as a way of preventing another major row in the Community.

12. The postponement of the Anglo-German Summit has deprived us of an obvious early opportunity to present the scheme to Schmidt. We obviously could not wait until the new date of 18 November before trying out the idea on him. If therefore we are to proceed with the proposal, it would I think be necessary for your personal representative to put it on your behalf to a senior official in Schmidt's office before the end of October.

13. I am sending copies of this minute to the Foreign Secretary and Sir Robert Armstrong.

*Peter Jenkins*

for (G.H.)

19 October 1981

(Approved by the Chancellor of the Exchequer and signed in his absence).