

CONFIDENTIAL

BF
Cabinet Office are considering whether this needs revision before the meeting between the PM, PCs and Chbx next week.

Ref. A05765

MR. ALEXANDER

wh
21/10

Community Budget and Chancellor Schmidt

In his minute to the Prime Minister of 19th October, the Chancellor of the Exchequer suggests that we should try out on the Germans a new scheme for the Community budget which might appeal to the Federal Chancellor and increase the chances of getting an early settlement of the budget problem.

2. As compared with our present approach which implies adjusting the net contributions and benefits of all member states according to the criteria of relative prosperity (and population size), the new Treasury scheme:-

- (i) Applies only to net contributors.
- (ii) Puts less prosperous net contributors, i. e. the United Kingdom (and potentially Portugal) at zero.
- (iii) Limits the net contribution of more prosperous net contributors i. e. Germany.
- (iv) Exempts the other less prosperous member states from contributing to our refund.

3. The results are illustrated in the first table attached to the Chancellor's minute. Putting the United Kingdom at zero is consistent with the last OD discussion (OD(81) 15th Meeting) which concluded that, while we should at that stage base our approach on the net beneficiary objective implied in the Chancellor's Hague speech, we could accept the aim of making no net contribution as a fall-back.

4. The advantages of the new Treasury scheme are:-

- (i) It should be attractive to the Federal Chancellor, who has made it clear that he wants some limitation on the German net contribution.
- (ii) It should be more acceptable to Italy and Ireland since it leaves their net benefit untouched.
- (iii) Dropping the idea of a generalised budget adjustment might make it easier for the countries like the Benelux to accept, even though they will be the main payers.

CONFIDENTIAL

CONFIDENTIAL

5. The disadvantages of the scheme are:-

- (i) It clearly puts our net contribution at zero (unless our GDP rises above the Community average), which will revive the argument that Britain wants the juste retour.
- (ii) The smaller prosperous countries will still object to a limit on the German net contribution (even though they would probably not be required under the scheme to make direct payments to Germany).
- (iii) We may find that what we are offering the Germans may prove to be more than their minimum political requirement.

6. This last point is the nub of the tactical question. We want to keep the Germans with us over the budget issue, so that it does not deteriorate once again into a 9:1 situation. There is a risk, as the Chancellor points out in paragraph 8 of his minute, that the Germans may seek to modify this scheme to improve their own position at the expense of ours, whereas all they may actually need for domestic political purposes is a relatively small measure of relief. On the other hand, we know that Herr Genscher is much less anxious to push the German budgetary demands than the Federal Chancellor; and the more other member states are forced to accept by way of limit on the German net contribution, the less they will be willing to contemplate by way of reduction in our net contribution. The Treasury scheme is nicely judged in that it gives the Germans only very modest relief; it might therefore serve to cement the alliance for the next stage of the negotiations without giving them too much.

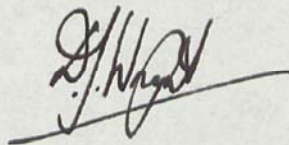
7. Is there a better alternative? The Chancellor's minute (paragraphs 9 and 10) discusses two. He is no doubt right in suggesting that sticking to our present line is only attractive if the Government are willing to accept a long delay (and probably eventually to withhold). The alternative would be to back the Commission's scheme. OD agreed that we should not rule it out as the basis for a possible solution, provided it could be beefed up to meet our needs and was accompanied by a reformed financial mechanism. The German Foreign Ministry is currently urging the Commission to modify their scheme to take account of German needs. This could take one of two forms: either giving the Germans the same rebate as us on the difference between their GDP share and

CONFIDENTIAL

CONFIDENTIAL

their receipts from FEOGA, or simply using this measure to determine how much the other member states (except the least prosperous) would pay towards our refund. Other member states would certainly refuse the first even if the Commission could be brought to propose it. If they were to propose the less radical alternative, it is just possible that some of the other member states like the Dutch might be prepared to look at it. For them the Commission scheme has the advantage that it is not based on measuring net balances. And there might be some people in Bonn who would be ready to settle on that basis.

8. The Prime Minister will obviously wish to know the Foreign and Commonwealth Secretary's views; and may wish, as the Chancellor suggests, to have a small meeting on her return from Cancun. Our appreciation is that there would be no harm in trying out the scheme on the Germans (without necessarily committing the Prime Minister), principally as a means of showing our desire to work closely with them and perhaps to establish more clearly what their minimum requirement is. But we should continue to keep the Commission's scheme in a suitable form alive as, perhaps, in the end, a more negotiable alternative.



ROBERT ARMSTRONG

*(approved by Sir R Armstrong
& signed on his behalf.)*

20th October, 1981

CONFIDENTIAL