Ref: A05949

PRIME MINISTER

EC Budget Restructuring: Preparation for the European Council

PURPOSE OF DISCUSSION

1. To agree the approach the United Kingdom should adopt in the run up to the European Council on 26-27 November.

BACKGROUND

2. OD approved a plan of campaign on the mandate in September (OD(81) 15th Meeting). You have since been kept abreast of developments and at your meeting with the Chancellor of the Exchequer and the Foreign Secretary on 2 November (Mr Alexander's letter to Mr Fall of the same date) you agreed to try out on the Germans a new approach to the budget problem. The Committee will have before it a memorandum by the Foreign and Commonwealth Secretary covering a note by officials (OD(81) 54), and a memorandum by the Minister of Agriculture, Fisheries and Food (OD(81) 53).

3. The Foreign Secretary's note summarises the present state of progress and recommends option (iii) in the Note by Officials viz that our aim should be agreement on the basic features of a budget solution; guidelines for the CAP; and fresh impetus on certain other Community policies, leaving both the details of the budget settlement and the implementation of the CAP guidelines to be decided in the spring of 1982. Even that objective may appear optimistic in the face of evidence that the Italians and the smaller countries may be trying to postpone any decisions until next year. Although not definitive so far, the German response to our new budget scheme is not encouraging. The signs are that they regard a small

net contribution as an unrealistic objective for the United Kingdom, and that they have in mind an outcome more in line with the 30 May agreement leading to a United Kingdom net contribution reduced to about one third of the uncorrected amount. On the other hand there are signs that the French are at last beginning to take up a position, though not a very forthcoming one.

4. The memorandum by the Minister of Agriculture (OD(81) 53) brings out some of the difficulties in handling the CAP in the budget negotiations. For domestic public opinion we need clear statements on price policy; limiting the open-endedness of guarantees, particularly for surplus commodities; state aids; and containing the growth of expenditure. But there will be pressure for concessions which would be biassed against our industry and to some extent against these objectives. Mr Walker proposes concessions only on multi-annual export agreements and on the stabilisation of imports of cereals substitutes: these would be made in the context of a good deal on the budget. He argues that we should not be prepared to make concessions, even of a generalised kind, to favour smaller enterprises as the French wish. Attached to his memorandum is an Annex giving in more detail the line which he proposes: it has not been discussed interdepartmentally and OD will probably not wish to endorse it at this stage.

HANDLING

5. You may wish to invite the Foreign and Commonwealth Secretary to open by introducing his paper and explaining the approach he recommends. Since the Minister of Agriculture's memorandum is also fundamental to the overall strategy it may be helpful to invite him to introduce it early on in discussion.

6. To focus subsequent discussion it may be helpful to consider in turn the progress on the three chapters of the mandate and then to consider the prospects and tactics for the European Council.

(i) Non-Agricultural Policies

7. The Foreign and Commonwealth Secretary may say that for several member states this part of the work represents the only positive element of the mandate and that agreement on it could offer some worthwhile advantages for the United Kingdom without committing us to unwelcome elements of significance. But the Secretaries of State for Industry and Energy may be more cautious.

(ii) CAP

8. The Minister of Agriculture is likely to stress the difficulty of making worthwhile progress on this chapter. While agreeing to the United Kingdom adopting a firm tactical position on prices and agricultural expenditure, he is concerned that some member states, especially France, will press for discriminatory measures to protect their small farmers and that other member states (including Germany) may be more ready to go along with this than we are. If concessions on the CAP have to be given in order to secure our budget objectives, he would want them limited to measures which would impinge relatively indirectly on United Kingdom farmers eg long term export contracts and arrangements to limit Community imports of cereals substitutes from third countries; but this may cause difficulties for the Secretary of State for Trade.

9. The Treasury representatives are likely to argue that reform of the CAP is important in its own right and that we must maintain a strong line. But some concessions will be necessary to secure the agreement of France and others to a budget mechanism.

10. The Committee should be able to agree that any concessions on the CAP should be made only when it is clear that they are buying real and worthwhile benefits in the mandate package as a whole. If the Foreign Secretary's approach to the November European Council is agreed, this would imply that specific concessions should be held back, probably until the 1982 agricultural price fixing. But to get what we want on the budget in November it may be

necessary to accept certain concessions at the European Council: eg the principle of certain measures directed towards protecting small farmers and limited action on imports of cereal substitutes to get what we want on the budget at that stage. The Minister of Agriculture might be invited to propose for agreement by OD(E) a formulation which would be acceptable for use in November. You will not wish to be committed to the Annex in Mr Walker's paper.

(iii) Budget

11. Given the current state of the negotiations, the choices facing Ministers appear to be the following. All are consistent with the idea of parallel progress on all three chapters recommended by the Foreign Secretary (option (iii) in the Note by Officials):

i. to stick with the ambitious approach which the Chancellor put forward in his 'Hague' speech by which every member state's net contribution or net benefit would be decided in advance according to their relative prosperity. This may be the Treasury's preferred course if the German response has been unhelpful. It might be the right one if it is apparent that no progress at all is possible in November, but not if we wish to get some measure of agreement;

ii. to put forward the revised Treasury scheme which is limited to net contributors and puts the United Kingdom at zero, or making only a token net contribution to the allocated budget. This would only make sense if the Germans were willing to support it in terms acceptable to us;

iii. to be ready to negotiate on the basis of the Commission's scheme. There is no guarantee that this would be successful; the scheme has been strongly criticised by some of the smaller member states. Moreover to give the United Kingdom an acceptable outcome the details would have to be right and the scheme would have to be accompanied by an extension of the Financial Mechanism and the removal of the present constraints on its effectiveness. The Treasury representatives may argue that it is too risky. On the other hand, our own approach is even less acceptable to the other member states and, if the Commission shew some readiness to modify their scheme in favour of Germany, the Germans may join the Italians and the Belgians in supporting it. It can be made to produce an acceptable result for the United Kingdom, though with less certainty than a scheme of budget limits. It would deal with one of the basic criticisms of opponents of the Community at home, namely that Britain is paying for the excesses of the CAP; and negotiating on the basis of a Commission proposal is always an advantage;

iv. not to aim for agreement on a method of dealing with the budget problem, as in the three preceding options, but to go for general guidelines. A draft of what these guidelines might look like is attached. The Foreign Secretary may favour going straight for this approach; or it could serve as the fallback from any of the others mentioned above. It will leave more to be negotiated in 1982 but may be the most that can be achieved this time. Would it be sufficient to justify any movement on other parts of the negotiations, eg the CAP?

1982 Refunds

12. The Foreign and Commonwealth Secretary will probably argue that we should not allow the question of a third year of refunds to distract from the main mandate negotiations. We should aim to get agreement in November that 1982 should be the first year of the new system whatever it is. The Treasury representatives will probably argue that we should revert to the 30 May agreement for the 1982 refunds only if it later becomes clear that the mandate negotiations are irremediably stuck.

Operational Steps

13. The Foreign and Commonwealth Secretary may wish to set out the practical arrangements he envisages for the period up to the European Council. He has in mind using the Foreign Affairs Council on 16-17 November to take the views of other member states bilaterally on the mandate. The Anglo-German summit on 18 November will provide a further opportunity to try to concert with the Germans. Another meeting of the Foreign Affairs Council (or the Mandate Group) may be held on 19 November. In the few remaining days before the European Council, it may well be desirable for the Foreign Secretary or another emissary to have further bilateral contacts, especially with the French. This would be the moment, if any, for you to send a message to the other Heads of Government.

CONCLUSIONS

14. You may wish to cover the following in your summing up -

i. agreement that we must aim for some decisive progress at the November European Council as recommended by the Foreign Secretary;

ii. agreement that we should not allow the question of our 1982 refunds to become a major issue in November;

iii. conclusions on how far we can modify our current stance on the CAP in order to secure a satisfactory outcome on the budget (Mr Walker to consult OD(E) if necessary);

iv. which of the options on the budget we should go for (paragraph 11 above);

v. operational decisions eg about messages to other Heads of Government or additional bilateral contacts before the European Council.

11 November 1981

RtA

ROBERT ARMSTRONG

GUIDELINES FOR BUDGET CHAPTER

1. The objectives of the Community budget are to finance agreed Community policies while avoiding the creation or recurrence of an unacceptable budgetary situation for any member state and while contributing to the overall convergence of the economies of member states.

2. In the long term the reconciliation of these objectives will be achieved through the development of Community policies and the balance between them. The conclusions reached in Chapters I and II above are a first step in that direction.

3. But the process of reconciling the objectives by these means will take a period whose length cannot be predicted with any precision and, in the meantime, a budgetary corrective arrangement will be needed, if unacceptable budgetary situations are to be avoided.

4. The corrective arrangement will need to deal not only with the problem already recognised by the Financial Mechanism but also with the imbalance in the distribution of expenditure, notably FEOGA guarantee expenditure. The arrangement will be based on an objective criteria so that there is no need for annual negotiations. These criteria should include not only the progress made in reducing the problem of unacceptable situations through the development of Community policies, but also the relative size of the member state(s) in question and the relationship of their GDP per head to the Community average.

5. So long as the financing of the corrective arrangement can be achieved within the 1 per cent ceiling it will be financed under normal budgetary rules. Otherwise, an alternative method will be used which avoids any net budgetary impact. The financial effects of the corrective arrangement will have regard to whether the payments come from member states below or above the Community average GDP per head and whether or not they are net contributors.

6. The corrective arrangement will apply with effect from the Community's 1982 budget year. The Council, acting on a proposal of the Commission, will take the necessary detailed decisions by 31 December 1981.

7. The detailed arrangements so agreed will be reviewed after five years to consider the progress made towards the Community's long term budgetary objectives and whether any changes are needed.