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EUROPEAN COUNCIL, LUXEMBOURG

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RESTRUCTURING OF COMMUNITY BUDGET

Brief by the Foreign and Commonwealth Office

INTRODUCTION

1. The European Council is unlikely to have a detailed discussion on restructuring - it is far too early for that - and the Prime Minister will probably not wish to go beyond the Main Points to Make below. The Reserve Points to Make are included in case there is more detailed discussion, either in the European Council itself (possibly proposed by Chancellor Schmidt), or in the margins of the meeting.

OBJECTIVES

(i) to seek confirmation from Heads of Government that they see restructuring as the Community's next major task and that the timetable should be observed; in particular the Commission's paper is of central importance and we want to ensure that they will seek views and reactions of Member States bilaterally before presenting formal proposals.

(ii) to emphasise our view that restructuring should be carried out within the 1% VAT ceiling;

(iii) to seek agreement that decisions taken before restructuring discussion begins should not jeopardise its success (ie. indirect reference to need to limit cost of 1981/2 price fixing).

MAIN POINTS TO MAKE

2. Hope that European Council can get restructuring exercise off to a good start with general statement on importance of the exercise.



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3. 30 May commitment to a review major turning point in Community development. Valuable opportunity to set house in order. Cannot be shirked. Triple challenge of:

- (a) 1% ceiling;
- (b) enlargement;
- (c) commitment to avoid unacceptable situation.

4. Must keep to timetable ie Commission paper by June 1981, aim at solution by end 1981, otherwise likely dislocation of Community business. UK preliminary thought - approach open-minded. Committed to finding Community solutions to Community problem. Hope that Commission in preparing paper will seek views of Member States bilaterally.

5. Fundamental problem, rapid growth/dominance of CAP and stunted growth of other policies. Former must be controlled to make way for latter.

6. Must find solution within 1% ceiling. To raise would be unacceptable to several Member States and would only make problem worse. If raised no effective restraint on CAP spending, no limit on cost of enlargement; and UK problem would get worse.

7. Noted with interest German Government's statement on need for prudent price policy, in context of growing structural surpluses; and on need for growth in agricultural expenditure to be markedly under growth in own resources. Agree price restraint a central element in CAP reform. Support idea of setting a ceiling on agricultural expenditure.

8. Must ensure that we do not take decisions, eg in 1981 price fixing which will make the problems worse and thus risk jeopardising the success of the restructuring exercise before it has started. Hope we can all agree on this. Specifically, should ask Finance Ministers to explore ways of setting a ceiling on agricultural expenditure for 1981.

RESERVE POINTS TO MAKE

Agriculture

9. We do not have any specific proposals to put forward - far too early for that and we need the Commission's report. But preliminary



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thinking shows that there are a number of ways of approaching the problem and we shall have to examine them all. None are necessarily excluded at this stage.

10. The CAP must be a main area to consider. We confirm our support of the principles and objectives of the policy. But in the restructuring context we must look at the way it works. The surpluses it creates and the high cost of the policy undermine Community finances and political support. We must move towards a more market-orientated CAP with prices less likely to encourage surpluses.

11. Our aim should be:-

- (a) elimination of structural surpluses, especially milk;
- (b) reduction in CAP's share of budget;
- (c) progress towards prices which will not generate structural surpluses;
- (d) preservation of healthy agricultural industry.

12. Believe central element must be policy of severe price restraint, especially on products in structural surplus. Do not exclude combining it with direct income aids to help those hardest hit, provided suitable aids, unrelated to production, can be devised.

13. Recognise price restraint by itself unlikely to be sufficient in short term. Will need to be supplemented by action which bears directly on increases in production particularly of surplus products.

14. Across the board extension of basic co-responsibility levy principle does not tackle essential problem. It is a way round the 1% ceiling, is likely to become a tax on consumers and does not help over resource costs of surpluses.

15. If we can reduce CAP share of Community budget, there should be room for expansion of non-agricultural expenditure (Social and Regional funds, possible new policies such as coal, transport,

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fisheries, energy, urban decay). But this cannot by itself solve the restructuring problem.

16. We may have to look at other approaches, perhaps on the revenue side.

17. In all this, we must be guided by the need to:

- (a) provide permanent solution to problem of unacceptable situations;
- (b) deal with financial problems of enlargement.

BACKGROUND

18. Ministers agreed our general preliminary strategy on restructuring in OD on 13 October. They also decided at their 3 November meeting how the 1981 CAP price fixing might be played in relation to our long term restructuring objectives.

19. At the European Council there is likely to be resistance to any detailed discussion of this subject. We do not wish to press for this. Initial indications from the French were that they do not wish to discuss it at all. However, Presidency have helpfully included it in message to Heads of Government, so subject cannot be avoided altogether.

20. In bilateral contacts general impression has been that, with possible exception of Germans, others' work much behind our own. It would therefore not be realistic to seek agreement on detailed conclusions. But it will be helpful if Heads of Government emphasise the importance of this exercise.

21. Discussion will give opportunity to stress need to keep to timetable set by Foreign Affairs Council ie Commission proposal by June, aim at solution by end of 1981 (though others recognise privately that discussion likely to go on into 1982).

22. Only French and Germans share our firm views on need to maintain ceiling, although others particularly the Dutch, recognise that it is important lever in restructuring. The Italians and Irish are in favour of going over the ceiling. However, if we can make clear our view that the restructuring exercise must be



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carried out within the framework of the 1% VAT ceiling, and seek support for it, this should help to ensure that the Commission paper restricts itself to solutions which are feasible within the ceiling.

23. On CAP President Giscard is likely to be particularly sensitive. Chancellor Schmidt said in his statement of Government policies on 24 November (as he had previously told the Prime Minister) that the cost of the CAP should increase by considerably less than the growth in own resources. He also called for 'a stronger application of free market principles' to deal with CAP structural surpluses and for 'a prudent price policy which must be aimed principally at the restoration of market equilibrium'. It remains to be seen whether Schmidt will be willing to annoy Giscard by launching into a detailed discussion on CAP reform. The Prime Minister may wish to adjust her own interventions in the light of the German position. But it should be possible, with Schmidt's support, to press for agreement in principle that decisions affecting restructuring (eg. 1981 price fixing) before June 1981 should not jeopardise its success. More specifically we might aim for agreement to ask Finance Ministers to explore ways of setting a ceiling on the growth of agricultural expenditure in 1981.

24. The Prime Minister might also emphasise the need for greater budgetary discipline in the CAP and support any proposal for a ceiling on CAP expenditure. There are three main alternatives:-

- (a) a ceiling set at the level of CAP expenditure contained in the 1981 Budget;
- (b) that CAP expenditure should only be allowed to grow at a rate below the growth in own resources;
- (c) that CAP expenditure should be kept within the headroom permitted by the 1% ceiling.

The Prime Minister will be familiar with the pros and cons of these alternatives from her discussions with colleagues on 12 November.

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25. We accepted in the text of the 30 May Agreement that the 1981 review would not call into question 'the basic principles of the CAP'. The principles enshrined in the Treaty are the objectives of the CAP contained in Article 39. Others, especially the French, argue that the principles are: Community preference, market unity and financial solidarity and try to interpret them in a highly specific fashion. While such principles are implicit in the operation of the CAP and we can accept them provided that they are interpreted flexibly it would be essential to avoid language in any communique which implied our acceptance of total Community financing of CAP (and thereby precluded any move towards national financing).

26. It would not be sensible to discuss the 1981 price fixing in any but the most general terms: the Commission's proposals will not emerge before January. They may or may not be accompanied by a package of economy measures aimed at extending the principle of co-responsibility. We have so far only had brief, generalised indications of Commission ideas on the latter. But happily they do not seem to be restricting their approach to a simple extension of the basic co-responsibility levy which we should have to oppose. On prices, most Governments except the German and ourselves seem to be contemplating increases of the order of 8-12%. Farming organisations including the NFU, are pressing for around 16%. Mr Jenkins told the Prime Minister on 3 November that the Commission would propose 'moderate price increases just in double figures.'

27. On non-agricultural policies, provided CAP share of budget can be cut, there will be scope for expansion. UK approach would be positive. But non-agricultural expenditure in itself cannot solve restructuring problem. If it is to play a useful role, new expenditure would have to provide disproportionate net benefit to UK (or any other Member State in an unacceptable situation).

28. May be some mention of idea originally mooted by Schmidt and Giscard of ceiling on net benefits/contributions. Schmidt reiterated to Prime Minister on 16/17 November need to bring this subject out into open. Our line is that we hope the Commission will consider this along with other ideas in the preparation of its paper

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on restructuring (due in June 1981). As Schmidt himself recognised, the smaller States are unlikely to find this attractive. There might be some benefit in it for us, although it would depend how it worked.

FOREIGN AND COMMONWEALTH OFFICE

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