Qz 02364

MR ALEXANDER

cc: Sir Robert Armstrong

EUROPEAN COUNCIL: MANDATE

In connection with the Prime Minister's meeting this evening, I attach the draft of guidelines for the budget chapter, with commentary. These have been prepared by officials of the Treasury, FCO, Cabinet Office and UKREP. Ministers will wish to consider whether the text is acceptable, and if so, whether we should discuss it with the French and the Germans (and the Commission) before the European Council.

2. A copy of this minute with the enclosure goes to the Private Secretary of the Foreign Secretary and the Chancellor of the Exchequer.

M D M FRANKLIN

19 November 1981

Encl.

GUIDELINES FOR BUDGET CHAPTER

TEXT	COMMENT
1. The object of the Community budget is to finance agreed Community policies.	Community orthodoxy.
At the same time the creation or recurrence of an unacceptable situation for any member state must be avoided	30 May agreement language. "Creation or recurrence" hints at a German problem.
and the overall convergence of the economies of member states must be fostered, without imposing an undue burden on any member state.	Important for Italians - supported by Ireland, Greece and UK. A peg in the Treaty for making relative prosperity a key factor in any arrangements.
2. In the long term the reconciliation of these objectives will be achieved through the development of Community policies and of the balance between them. The conclusions reached in Chapters I and II above are a first step in that direction.	Broad agreement on this, which accords with 30 May agreement. Progress on Chapter I (development of Community) policies) a vital political need for Benelux (and France - relance) if they are to make concessions on budget. Italians also seeking progress here. French aiming for concessions to their views on Chapter II.
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.	French and Danes do not yet admit corrective arrangement will be needed but we have presented figures, which have not been controverted, showing that measures contemplated under Chapters I and II cannot solve our problem in the short run. Text makes it clear that permanent mechanism is not envisaged.
4. The corrective arrangement will need to deal not only with the problem already recognised by the Financial Mechanism [was agreed] but also with the imbalance in the distribution of expenditure, notably FEOGA guarantee expenditure.	Picks up Commission's reference to FEOGA but makes clear problem is wider. Useful recognition that problems arise both from excessive (gross) contributions and from inadequate receipts. (We would need financial mechanism as well as FEOGA scheme if we were to get enough for UK out of Commission approach.)
The arrangement will be based on objective criteria so that there is no need for an annual negotiation.	It should be agreed that annual negotiation would be disruptive and unsatisfactory. Useful peg to introduce objective criteria.

These criteria should include not only the progress made in reducing the problem of unacceptable situations through the development of Community policies,

Another bow to those who attach importance to Chapter I.

but also the relative size of the member state(s) in question and the relationship of their GDP per head to the Community average.

Our objective criteria.

5. The financing of the corrective arrangement will be achieved within the 1% ceiling and without putting at risk the financing of other agreed Community policies, if necessary by a method which avoids any net budgetary impact.

Community orthodoxy favours financing by own resources (like 30 May refunds but this is unlikely to be possible within 1% ceiling. It might be possible to avoid a net budgetary impact by balancing receipts and contributions in a budgetary sub-head summing to zero.

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.

Average GDP criterion benefits Ital Ireland and Greece. Net contributo criterion benefits Germany.

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.

1982 implementation avoids issue of third year refunds for UK under 30 May agreement. 31 December 1981 deadline follows intention expresse in the 30 May agreement itself.

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.

Five year review included to meet wishes of those (including France, Denmark, Netherlands) who insist arrangement must be temporary but text maintains presumption that it will continue ''until any changes are needed''.

BELGIAN ECONOMIC SITUATION
FUNDING NATIONAL INSURANCE

The national insurance fund was (correctly) reported in the British press last week to have only enough money to cover one more week's unemployment benefits. However, this situation not unusual at this time of year in Belgium and our embassy believe that the funds required ~~to~~ ("complementary credits") to keep payments flowing will either be authorised by decree of the caretaker government or parliament will be summoned to vote the money. This would probably have been done already but for the holding of general elections earlier this month.

Underlying Problems

Balance of payments deficit.

Growth of PSBR from 6.2% of GNP in 1976 to a forecast of nearly 14% this year.

Loss of competitiveness in Belgian industry

Investment funds preempted by support for ageing industries, eg steel and textiles.

Indexation of wages and salaries, social security benefits etc.

Recent Developments

The consumer price index rose by 7.8 per cent in the twelve months to October

The unemployment rate rose by 21.6 per cent in the twelve months to October, when it reached 9.9 per cent.

Industrial production declined in the most recent month for which figures are available, July and as a result was down by 7.7 per cent compared to a year earlier.

Interest rates: Treasury Bills are at 15½ per cent, Bank rate at 13 and commercial bank loans to prime customers at 15 or 16 per cent.

The Belgian franc is comfortably within its margin for fluctuation in the EMS.

R. R. Garside

R R GARSIDE
November 1981