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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

10 March 1982

A J Coles Esq
No.10 Downing Street

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Dear John,

THE MANDATE : BILATERAL TALKS WITH THE ELYSEE

The Chancellor has studied Sir Robert Armstrong's minute and draft brief of 5 March and would like to offer the following thoughts.

The Chancellor begins from the premise - which he assumes his Ministerial colleagues will all share - that the Government needs to obtain a really good budget settlement - as close as possible to the figure of 150 million ecus for our net contribution to the allocated budget included in the illustrative table which we discussed with the Germans in January. In the Chancellor's view, a really good settlement is needed for reasons of domestic politics and in order to swing public opinion in the UK behind the Community over the longer term. It is also needed for reasons of public expenditure and economic management. It is important to note in this context that the net contribution figures discussed in Brussels relate only to that part of the budget which the Commission say they can allocate between Member States. They take no account of (a) our contribution to the unallocated budget (some £150 million a year, including aid and food-aid, or some £50 million excluding these items); or (b) the continuing cost in inflationary times of receiving refunds in arrears (perhaps £100 million a year at a time of 10 per cent inflation); or (c) trading losses outside the budget on food imports from our Community partners (some £200-250 million a year in most recent years). Items (a) and (b) are reflected in Public Expenditure White Paper figures for our net budget contribution substantially higher than the figures discussed in Brussels. Item (c), though not part of our budget contribution, is a charge on consumers and uses up taxable capacity.

The Chancellor regards the latest French request for bilateral talks as an encouraging sign. It suggests that the French Government are beginning to feel domestic political pressures

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for a quick conclusion to the annual farm price fixing and that they now recognise that a solution to the UK's budget problem will be a pre-requisite for this. A bilateral understanding between the French and ourselves is likely to be a crucial element in any budget settlement - if only because the French are likely to end up financing between 40 per cent and 55 per cent of our refunds, the precise percentage depending on how much the Germans contribute.

On the other hand, the Chancellor believes that we need to be extremely cautious about making, or appearing to make, concessions of substance at this stage. If we even hinted at the possibility of a rate of compensation of 80 per cent, for example, the French would almost certainly report this back to the Germans and others. An 80 per cent rate (implying a UK net contribution of perhaps some 430m ecus for 1982) would then tend to be regarded as the UK's starting position in the next round of the negotiations. (We should also remember that, as part of a package settlement, we could well find ourselves being pressed to concede more on agriculture than our own interests would suggest.)

In the Chancellor's view, there are two additional reasons for caution at this stage. The first is that we cannot in practice settle the budget problem bilaterally with the French. Other Member States, too, will be concerned with financing our refunds. For the French themselves, the amount they contribute to our refunds is likely to be critical, and that will depend on how the refunds are financed - in particular, how much the Germans contribute - as well as on the total amount of the refunds. If we cannot reach a complete deal with the French at this stage, we must keep firmly up our sleeves concessions which we might be prepared to make later in order to clinch a deal.

The second consideration is that the French almost certainly have a keener interest in a quick solution than we do. The onus should therefore be on them, not us, to start offering concessions.

In the Chancellor's view, issues such as the 1 per cent VAT ceiling and our interests in future price fixing negotiations will likewise need careful handling. The new budget settlement is likely, by one means or another, to fix our net contribution after refunds at some percentage of our net contribution before refunds. And the latter is likely to rise if the 1 per cent ceiling is raised. Hence it will continue to be in our interests to maintain the 1 per cent ceiling; and we must avoid hinting at this stage that we might be prepared to raise it, just as we must avoid later any moral commitment to raise it. We have

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to assume that the line we take on this and on the price fixing, will be reported back to the Germans; and we need to have this in mind in what we say bilaterally to the French.

In the Chancellor's view, these considerations point to amending the brief so as:-

i. to avoid any form of words which could be construed as hinting that we might come down to an 80 per cent compensation rate;

ii. to insist that the French must drop their arguments about degressivity and the "overpayment" in all cases (not just in the 80 per cent case);

iii. in the interests of keeping the bidding low, to focus on the actual outcome for 1981 rather than the average outcome for 1980 and 1981; and

iv. to avoid any form of words suggesting that we might be prepared to raise the 1 per cent VAT ceiling or that a budget settlement would remove any overriding UK national interest in the annual price negotiations.

... The attached copy of the draft brief includes some specific amendments covering the above and certain other points.

One further point which the Chancellor would like to make is that a great deal of money is likely to be involved in the technical specification of any mechanisms for UK refunds (see the paper on the "arithmetic of Commission schemes" which Mr Hancock sent to you yesterday, especially table 2). It is of interest in this connection that relating our refunds to the total budget (excluding UK refunds), rather than the more narrowly defined "allocated budget", could be worth something like 10 percentage points on the rate of compensation. In other words, an 85 per cent settlement applied to the total budget should give us a similar amount of refund to a 95 per cent settlement applied to the allocated budget alone. If the rate of compensation figure itself should become an emotive issue at some stage in the negotiations, therefore, the idea of applying a somewhat lower percentage to the wider total might just possibly turn out to be useful.

Copies of this letter go to Brian Fall in the FCO and to Sir Robert Armstrong.

Yours ever,

John Kerr.

J.O. KERR
Principal Private Secretary

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30 MAY MANDATE: BILATERAL TALKS WITH ELYSEE

Draft brief for Sir Robert Armstrong

Objective

1. To establish the basis for an agreement with the French President covering the essential components of a solution to the problems of the 30 May Mandate and CAP prices which France and the United Kingdom would then go on to sell to the Commission and the other Member States.

Coverage

2. The following subjects either ought to be included in any such agreement, or are likely to be necessary to secure the agreement of the French Government:-

(i) The figures for a budget settlement.

(ii) How to finance it.

(iii) Duration and review.

(iv) CAP prices.

(v) Small milk producers.

(vi) Fish.

Figures for budget settlement

3. Mitterrand criticised Giscard for the 30 May Agreement. His political requirement is therefore to be able to present the new settlement as less favourable to

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the United Kingdom. HMG, by contrast, needs, as a minimum, to do better than the 30 May Agreement.

4. Because the Commission over-estimated the UK's unadjusted net contribution for 1980 and 1981, the 30 May Agreement did not work out as intended but will in fact be much more favourable to the UK.. The effect of the figures quoted in the agreement would have been to allocate 34% of the unadjusted net contribution to the UK, the rest of the Community giving relief for the other 66%. In the event the UK share looks like being very much less than 34%, as shown in the table below.

mn ecus

Year	Unadjusted Net Contribution	Net Contribution after Adjustment	UK Share
As implied by Commission figures			
1980	1784	609	34%
1981	2140	730	34%
What actually happened (according to latest estimates)			
1980	1527	352	23%
1981	1590	180	11%

The average UK share for 1980 and 1981 combined works out at 17%.

5. The UK has already conceded that the new settlement should be based on out-turn figures and not on estimates. In fact this gives security to both sides, not just the French; but Mitterrand could present the change as a victory for France if it helped him.

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(might satisfy the political requirements of both sides — a formula which

6. In the talks with the Elysee we should explore in confidence the possibility of a formula which would be better for the UK than the intention underlying the 30 May figures but somewhat worse than ~~how~~ they actually worked out for 1981. ~~Both sides could thus satisfy their political requirements.~~

7. In 1982 the UK's unadjusted net contribution is thought likely to lie in the region 1700-2350 million ecu. In the years ahead it will probably rise at least in line with inflation and perhaps a bit more, although a shift in the balance of Community expenditure would help. Assuming that it rose at 10% a year, and that the settlement was for 4 years covering 1982-85 inclusive,* then it would reach 2300 million ecu starting from a base of 1700 million ecu in 1982 ~~(ie less than the higher end of the range quoted above for 1982)~~. It would reach ~~3200~~ 3100 million ecu if the starting figure for 1982 was 2350.

8. The following table shows what our net contribution would be after adjustment if the unadjusted net contribution were shared between the Community and the UK in the proportions at the top of each column. The left hand column is the 95%/5% split which would be necessary to keep the UK's net contribution after

/adjustment

*See para 13 below.

adjustment to about 150 million ecu a year. The right hand column is the intended 30 May split. The table thus defines the area within which s olution needs to be found.

mn ecus

	95/5	90/10	80/20	75/25	66/34
1700	85	170	340	425	580
2350	120	240	480	590	800
3200	160	320	640	800	1090

9. Sir R. Armstrong should make it clear at the outset that the UK is not prepared to accept:-

(i) degressivity in a sense which goes beyond the automatic result of the percentage sharing formula described in para. 8 above.

<u>or</u> (ii) Adjustment of the formula to take account of any part of the "900 mecus overpayment".

He might then begin by pointing out that a 95%/5% split would be likely to produce a figure for future years of roughly the same size as the one that actually occurred in respect of the 1981 budget. The French side will presumably reject this out of hand. Sir R. Armstrong should then suggest that UK Ministers might be prepared to consider a new solution of 90%/10%. He should not give any cause for the French to take away the impression that the UK would go any further than this. He should however seek to draw the French on their own calculations.

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9A. If they were to propose 85%/15%, Sir Robert Armstrong should agree to report their suggestion to British Ministers. If the French propose any solution less favourable to the UK than this, then Sir R. Armstrong could agree to report their suggestions to British Ministers but should say that he sees no prospect of agreement and decline to contemplate any change in the UK position on CAP prices or small milk producers.

10. In fact, an 85%/15% split would be a better deal for the UK than the figures which HMG accepted on 30 May 1980. Mitterand could defend it in France by pointing out that it would be less favourable to

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X the UK than the way the 30 May Agreement actually worked out in practice for 1981.

11. It will be important to ensure that there is no misunderstanding with the French about the basis of the figures under discussion. The percentages and figures discussed above all relate to our net contribution, not to the receipts gap identified by the Commission, ie the gap between our GDP and actual shares of receipts from the Community budget. If the French want to follow up the Commission's approach, they should understand that the correction will need to be applied not just to the receipts gap but also to the contributions gap, ie the gap between our actual and our GDP shares of gross contributions to the Community budget. (The two gaps taken together amount to our net contribution.) This would mean that the financial mechanism would have to be amended to remove the constraints which at present prevent it from operating.

Finance within the 1% ceiling

12. The UK should be prepared to explore the possibility of French agreement to the following use of Article 200 which has already been suggested in informal discussions

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in Brussels. The refunds to the UK (and corresponding relief for Greece, Ireland, Germany and, if necessary, Italy) should be financed through the own resources system in the normal way up to the point where the 1% ceiling is reached. At that point the Council of Ministers should agree to finance through Article 200 a block of expenditure equivalent in size to the cost of the refunds scheme to the Community budget. All the Member States would subscribe financial contributions under Article 200 in the same proportions as their VAT share of own resources. The justification would be ~~to~~ to prevent the UK refunds from constraining ~~enable the regular~~ expenditure ~~of the~~ on Community policies. ~~to go ahead while the future of the 1% ceiling was examined.~~ It would not therefore be necessary for Member States to seek budgetary authority from their parliaments for a payment explicitly benefitting the UK.

Duration and Review

13. Provided that the French accepted a review and if they made a proposal on figures which we could accept, then Sir R Armstrong could say that British Ministers might be prepared to contemplate ~~concede~~ a duration of four years. If he is referring back to the Prime Minister on figures, he could also offer to ~~submit~~ report to her a proposal for four years with a review, if the French press for this.

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CAP Prices

14. Sir R Armstrong should say that the French must realise that the UK could not be expected to accept any CAP price settlement more costly than what was acceptable to the Germans and the Dutch. But, in return for an acceptable budgetary settlement, he should offer, on the Prime Minister's behalf, an assurance that the UK would in the end agree to an average level of price increases acceptable to the Germans and the Dutch. If the French raise the subject of MCAs, He should ~~[however]~~ make it clear that we cannot accept the Commission's proposal for ~~[reducing our m.c.a]~~ revaluing the Green pound which, as it stands, would bear too hard on British farmers.* The French government would, of course, have to understand that the UK could not move to that position immediately, but would only make the necessary concessions at the final stage of the negotiation of the price package.

Small milk producers

15. Sir R Armstrong should begin by stressing that the United Kingdom's concern with the milk surplus was sincere. We believe that this year's price settlement must include measures to curb the surplus. ~~We would hope that the French government would share our desire to contain the costs of milk surpluses~~

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* It was agreed at OD(E) that the decision on the Green £ would have to await the prices settlement.

~~to the Community budget~~] However, we recognise that the position of small milk producers constitutes a political problem for the French government, and as part of a general settlement, including a satisfactory settlement of the budget issue, we should be prepared to see something done to help small milk producers involving a cost to the Community budget within the ceiling of 120 million ecu a year, as discussed at the meetings of Foreign Ministers in January. But we have genuine problems about the idea of giving this assistance through exemptions from or abatements of the ~~a degressive~~ co-responsibility levy and considered that the form of the Community assistance would need to be negotiated between experts.

(If necessary, Sir R Armstrong should make it clear that any agreed support for small producers on top of this figure would have to be financed nationally.)

Fish

16. We should make it clear to the French that we are not making a link between fish and the solution to the 30 May Mandate issues and the CAP prices package. On the other hand, we should take the opportunity to warn the French President of the danger of allowing the matter to drift on unresolved until the end of the year. We might therefore suggest for his consideration that he and the Prime Minister should instruct their fisheries Ministers as follows:-

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(i) A solution to the fisheries problem should be found before the end of the year;

X (ii) Both sides would need to look again at ~~compromise on~~ the outstanding problems of access and quotas;

(iii) Each side should recognise that the other had an important presentational problem in persuading its industry to accept a negotiable settlement;

(iv) For that reason, both sides should co-operate over the presentation so as to facilitate the task of selling the negotiated settlement to both industries.

Guarantee of good behaviour

17. We understand that French Ministers are very worried at the prospect of being held to ransom by the UK at the price fixing every year over one issue or another. Like their predecessors in 1980, they are trying to think of a way of stopping us doing this.

18. If this anxiety is raised, Sir Robert Armstrong should point out that the UK agreed to the price fixing in 1981 very quickly (as quickly as any other

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Member State) because the 30 May Agreement had disposed of the budget problem for 1981, so that the UK was able to concentrate on the agricultural rather than the financial aspects of the price decisions. If the budget issue could now be put on one side for 5 (or 4) years, the UK would similarly in future years have no ~~overriding~~ reason to block the price fixing in order to obtain a budgetary settlement ~~national interest to protect in the price negotiations~~. Even so, there could still be genuine differences of view between the two governments about agricultural policy issues - for example, over the proper balance to be struck between the interests of consumers and tax payers on the one hand and those of producers on the other; and over the effects of the CAP on international trade; but these differences of view between the UK and France would be no different from, and no greater than, those which would or might exist between various other governments - eg between Germany and Italy over Mediterranean products.

19. Sir R Armstrong should not mention fish in this context. If the French were to raise it, Sir R Armstrong should say that we assume that that will have been settled (see para 16) and that therefore the possibility of bad behaviour does not arise.