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MR COLES

cc: Private Secretaries to:-

The Foreign and Commonwealth Secretary
The Chancellor of the Exchequer
The Minister of Agriculture, Fisheries and Food
Sir Robert Armstrong

30 MAY MANDATE: MEETING OF FOREIGN MINISTERS ON 8/9 MAY

1. A meeting has been arranged under the Prime Minister's Chairmanship for 5.30 pm on Thursday 6 May to discuss the handling of the next meeting on the Mandate on 8/9 May. The Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Minister of Agriculture and Sir Michael Butler have been invited to attend.

2. The meeting of the Foreign Affairs Council on 27 April established where the other Member States at present stand on the figures which might apply for our refunds. It appeared that, with certain reservations by individual countries, the others are prepared to offer refunds costing 800 million ecus a year for 3 or 4 years. 800 million ecus would almost certainly be less than 50% of our unadjusted net contribution for 1982, whereas the UK objective agreed by Ministers is that the refunds should be 90%.

3. Positions are thus a long way apart. On the other hand, the other member states did indicate that they were prepared to accept the Thorn/Tindemans non-paper (Annex A) as a basis for negotiation. This will give us the opportunity to press for our objectives on duration, review and risk-sharing as already agreed by Ministers. (Our negotiating instructions as at present agreed are set out in Annex B.)

4. The meeting of the Agriculture Council on 28-30 April concluded with a price fixing package which was acceptable to most member states but subject to general reserves by the UK

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and Greece, and reserves on the agreement on wine by Italy and on beef by Ireland. In making a reserve on the price increases and the budgetary cost, the UK stated that progress on the three chapters of the Mandate had to be taken in parallel. Although the UK achieved improvements in several areas we imposed reserves on a number of specific points where the package fell short of our agricultural policy objectives.

5. From the UK standpoint the package is open to criticism in relation to the agricultural chapter of the Mandate. The average level of price increase is 10.3%. It is estimated by the Commission to be twice as costly as their original proposals and will thus make the UK budget problem still worse. In the milk sector no specific measures have been agreed to tackle the surplus problem, nor has the aim of reducing the gap between Community and world prices of cereals been implemented this year although a coresponsibility mechanism has been agreed for application in future.

6. The Agriculture Council is scheduled to meet again on 10/11 May and it is likely that the remaining reserves of other member states can be fairly readily disposed of, and a clear 9 to 1 position would then emerge.

7. Against that background, Ministers will need to consider at their meeting on 6 May:-

(i) whether the Foreign Secretary should have authority to go beyond Annex B at the meeting on 8/9 May without further reference to his colleagues in London;

(ii) what the Government should do if the 8/9 May meeting fails.

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Prospects for a solution on 8/9 May

8. Decisions on tactics need to be informed by a realistic assessment of what is likely to be achievable this weekend. The gap between our position and what is offered by other member states is large - see paragraph 3 above. The French, in particular, are well dug in. President Mitterrand has apparently decided that the settlement must cost the French budget less than the 30 May settlement, which would, according to sources close to him, permit a refund of at most 1,200 million ecus in 1982, or 73% of the unadjusted net contribution forecast by the Commission estimate - namely 1620 million ecus. Statements by several French Ministers indicate that the Government has decided to do everything it can think of to avoid being "blackmailed" by our agricultural veto. If the 8/9 May meeting fails, they may decide to introduce national aids and to sit out the resulting crisis in the Community. Alternatively they may try to force through a majority vote on the price package and, although it seems unlikely that they would succeed, the crisis would be heightened by their attempt.

9. As the crisis deepens in May and June, pressures on the other member states' governments to secure a farm settlement will build up. On the one hand, this will mean that they will be increasingly anxious to settle the budget problem. On the other hand, their incentive to find a way round our veto, whether by national aids or majority voting, will be greatly increased. It seems doubtful whether agreement will be reached on 8/9 May, given the distance between our position and that of other member states, but we cannot rule out a serious effort by others to reach a settlement and the Foreign Secretary will need to be prepared to react if things go that way. If a serious negotiation did develop, it would be very damaging, particularly in present circumstances, if he were to refuse to take part in it. Therefore, if a real willingness to settle is shown, he may need to get in touch with his Ministerial colleagues over the weekend.

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Figures

10. Sir Michael Butler's judgement is that it will be hard work to achieve every percentage point above a 66% refund. (66% is the same proportion as that underlying the 30 May agreement; but the UK has agreed that the new arrangement should be calculated on out-turn figures so that there would be no possibility of a repetition of the freak result of that agreement.) It should, in his view, be possible to achieve something in the range 70-80%, but it is too early to say how far up that range we shall be able to get.

Opening position

11. The Foreign Secretary's opening position on figures at the meeting on 8/9 May might be on the following lines:-

> "The UK does not regard 800 million ecus (probably less than 50% of our uncorrected net contribution) as a serious proposal. Our position continues to be that we are willing to be a net contributor on a very modest scale, by which we mean something of the order of 10% of our net contribution before refunds (say, a net contribution after refunds of approaching 175 million ecus for 1982 on the basis of the Commission's latest estimates for our unadjusted net contribution in that year). But this is not necessarily our last word on the figures and what happens next depends on what response we get from other member states. We have already made it clear that we are willing to have the agreement expressed in terms of components of our net contribution, on the lines of the non-paper, if that is helpful to other member states, provided that all the relevant components are covered and the implications for our net contribution are clear."

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The aim would be to focus the negotiation as far as possible on our net contribution and to establish an initial negotiation "bracket" of 50% to 90% of our uncorrected net contribution.

Subsequent flexibility

12. Ministers may feel able to approve the following guidelines for the conduct of the subsequent discussions:-

a. it would not be right to settle for refunds amounting to less than 80% of our unadjusted net contribution at the discussion on 8/9 May;

b. we should be prepared to relax our 90% figure in return for agreement by the others to raise their offer substantially above its existing level;

c. we should not, however, go below 85% unless and until the others have come up to 66% or more.

Possible concession on levies

13. If we appear to be entirely unyielding in our negotiating style, there is a risk that the French will win the others over to their point of view, so that the other representatives will go back to their capitals convinced that in the end we shall give way. In order to prevent this, Ministers may wish to give the Foreign Secretary authority to show some flexibility in our position, provided that our position on figures (see previous paragraph) is not thereby jeopardised. One possible concession which Ministers might wish to consider concerns the definition of the 'contributions gap'. Paragraph 3 of the non-paper (Annex A) is confined to the VAT element in the contributions gap. Lord Carrington's letter to Tindemans about the non-paper said that we must have this extended to cover the whole of the contributions gap, ie to include agricultural levies and customs duties. (The arithmetic of the various gaps is explained in the note at Annex C.) Other countries feel strongly that, no matter what was done on 30 May 1980, compensation should not this time be related to levies and duties because that would call in question the principle of own resources. We, of course, think this argument is nonsense; but it will be seen from the table in Annex C

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that agricultural levies element is much smaller than the customs element in 1982 - 75 million ecus on the Commission's 1982 budget figures compared with 400 million ecus for customs duties. The levies element could vary in later years but is likely to remain a relatively small part of our total budget problem.

14. Ministers may therefore wish to consider whether to modify our demand to one that paragraph 3 be extended to cover VAT plus customs duties only, ie without levies. This would in fact be a major concession of principle on our part and not without the risk of encouraging demands to go further (extension to duties, etc). It should not therefore be offered, if at all, unless the Foreign Secretary judged that it could produce some loosening up of our partners positions. If so, he might need to go no further on 8/9 May than indicate that he would be prepared to discuss with his colleagues modifying our demand to exclude levies if that would help them to solve the problem.

<u>A gesture on the "over-payments"</u>

15. The unexpected effect of the 30 May agreement has almost certainly increased the determination of other member states to drive a hard bargain this time. We have been arguing that we are still a substantial net contributor in 1980 and 1981 taken together; that the French have done much better than expected on 30 May, as well as us; and that no other member state has had to pay in more than they contracted to pay on 30 May. Even so, it is a fact that we agreed to contribute far more than now expected. Ministers may therefore wish to consider giving the Foreign Secretary discretion to make a gesture during the 8/9 May meeting if he judges that it would clinch a settlement. A simple gesture involving a once-for-all cost to the UK would be to agree to waive our right to those refunds to which we are entitled in respect of 1981 but which are not yet approved. This would avoid the need for the other member states to take any more decisions about programmes to benefit us in respect of 1981. It would cost us some 145 million ecus net

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and save them a similar amount. But we would still receive a further payment of about 127 million ecus in respect of 1981 in August once we are able to certify that the expenditure concerned has in fact taken place. It would increase our net contribution for 1980 and 1981 combined from 10% of our unadjusted net contribution for those years to 14%.

16. This gesture could have considerable political mileage, especially in relation to the French government who could claim to have recovered some of the ground given away by Giscard. But there is a considerable danger of signing off a substantial sum of money without getting anything in return. This concession might therefore be made, if at all, only if the Foreign Secretary judged that it would precipitate an agreement. If made too early, it could provoke other member states to demand very much more expensive ideas for dealing with the "over-payment".

If the 8/9 May meeting fails to reach agreement

17. Our chances of a successful outcome eventually will be reduced if the other member states and the Commission are able to say that we are making no effort to help find a solution. We need to wear down the opposition to our point of view by frequent contact. Therefore if the meeting produces no solution, as is probable, and if the tactical situation does not argue against it, we should work to ensure that the Presidency finds a new date for a resumption of the negotiations on the budget after about a week's pause for reflection.

Technical points

18. There are certain extra financial risks to the UK in the non-paper as drafted. These relate particularly to the 'tolerance margin' (see Annex C, paragraph 4) and the payment of refunds 'net' of our contribution towards them. It will clearly be essential to resolve these issues in such a way that we could be sure of actually receiving the rates of refund agreed at Ministerial level.

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One year solution

19. The Foreign Secretary has asked officials to consider the possibility of a one year solution. The argument in favour of this course is that we might secure a better deal on the Falkland Islands this year and on the Mandate next year if they could be separated in time. Monsieur Thorn has already suggested this expedient as a way out of the present impasse.

20. The 30 May agreement provides that, if longer term arrangements cannot be agreed in time, a solution will be implemented for 1982 "along the lines of the 1980-1981 solution". We might appeal to this agreement and argue for a repetition of the proportionate split underlying the arrangement negotiated for 1980 and 1981, ie in effect a 66% refund.

21. But this would not remove our difficulties in the current negotiations. The other member states would almost certainly argue that:-

(i) as the UK agreed to a net contribution of 609 million ecus for 1980 and 730 million ecus for 1981, we should accept a basic figure of 850 million ecus for 1982;

(ii) that figure should be further increased (ie the refund further reduced) to take account of the "over-payment" in 1980 and 1981; and

(iii) the UK should give a solemn undertaking not to use the 1983 farm price negotiations as a means of achieving a better deal for subsequent years.

22. Even if we did get agreement on a 66% refund, which seems unlikely, we should thereby have created a most damaging precedent for next year's negotiations and it is very difficult to see how we would ever get agreement to a higher percentage refund for 1983 and the following years.

Points for decision

23. Ministers are invited to consider the following questions at their meeting on 6 May:-

(i) Is it agreed that the Foreign Secretary's opening position on figures should be as proposed in paragraph 11?

(ii) Are the guidelines on subsequent flexibility, as suggested in paragraph 12, agreed?

(iii) Should the Foreign Secretary have discretion to offer the possible concession on levies in the circumstances described in paragraph 14?

(iv) Should the Foreign Secretary have discretion to offer a gesture on the "over-payment" in the circumstances described in paragraph 16?

(v) Do Ministers accept the arguments against a one year solution in paragraphs 20-22?

(vi) Is it agreed that the Foreign Secretary should seek further authority by telephone if he judges that a serious attempt at reaching agreement is being made - see paragraph 9?

(vii) If the 8/9 May meeting fails to reach agreement should we aim to ensure that a new date is fixed for further negotiations after about a week's pause for reflection - see paragraph 17?

(viii) Subject to any new decisions under (i) - (vii) above, is the present negotiating authority as defined in Annex B confirmed?

D.H.

D J S HANCOCK

5 May 1982

ANNEX A

NON PAPER

Subject: specific details of items 2 and 3 of the document of 18 January 1982 from the Council General Secretariat

1. The Community will grant compensation to the United Kingdom for 5 years, starting in 1982.

2. The basic amount of this compensation will be set at a uniform level for 1982, 1983 and 1984 of /¯x million ECU_7. This amount represents y % of the objective indicator for 1981. If this ratio between the compensation and the objective indicator varies in 1982, 1983 or 1984 by more than 10 %, a correction will be made on the basis of a Commission proposal, on which the Council will take a decision by a qualified majority.

3. A further correction will be made if the United Kingdom's V.A.T. share exceeds its GDP share. This compensation will represent z % of the difference.

4. The amount of compensation for 1985 and 1986 will be decided on by the Council before the end of 1984 acting unanimously on a proposal from the Commission.

ANNEX B

NEGOTIATING INSTRUCTIONS PREVIOUSLY AGREED BY MINISTERS

These instructions relate to the "non-paper" of Annex A. They were most recently set out for Ministers in Mr Hancock's minute of 1 April to Mr Coles and take account of the Prime Minister's comments in Mr Coles' reply of 2 April.

(i) Duration The UK should aim for a five year settlement but could accept if necessary a five year agreement whereby firm arrangements covered only the four years 1982-85 inclusive, with the arrangements for 1986 to be decided by the formula in paragraph 4 of the non-paper.

(ii) Review A review at the end of the period is essential, but it need not be expressed in terms which appeared to prejudge whether compensation should continue after the end of the 5 year period.

(iii) Flexibility or "risk sharing formula" The agreement needs to provide for compensation to be adjusted automatically to changes in circumstances to avoid an annual negotiation over figures (see paragraph 2 of the non-paper). The UK would propose that if the ratio gave too much compensation, the refund would be reduced by an agreed percentage of the excess; an d if the ratio gave the UK too little, then the refund would be increased by the same percentage of the shortfall. Ideally the risk sharing percentage should be the same as the basic compensation percentage - ie Y % of the objective indicator for 1981.

(iv) Tolerance Margin The UK should argue for the tolerance margin proposed in paragraph 2 of the non-paper to be reduced from 10% to 5% and that the risk sharing formula should apply to the whole of the excess or shortfall if the margin is greater than 5% of the objective indicator.

(v) Contributions Gap The UK should insist that the whole of this is covered, and not just the VAT element.

(vi) Financing The UK could accept ad hoc methods of financing outside the own resources system, such as the use of Article 200 of the Treaty, provided that such a device does not open up a means of evading the 1% ceiling. If necessary to secure an otherwise acceptable settlement the UK could accept a commitment to review the own resources system in the context of enlargement, but only on the clear condition that there is no commitment whether explicit or implicit to raise the 1% VAT ceiling.

ANNEX C

FORECAST OF GAPS IN 1982

million ecus

	One Commission estimate	Treasury estimates
Objective receipts indicator gap	1200	1000-1450
Levies and duties gap	295	475
(Of which, agricultural levies)		(75)
VAT gap	125	175-225
Unadjusted net contribution	1620	(say)1650-2150

As the above table illustrates, there are great uncertainties as to the size of our net contribution for 1982 - and, a fortiori, for the later years. These uncertainties relate mainly to the total size of the budget, whose agricultural component still cannot be predicted with any confidence even for 1982, and to our share of total receipts. They relate also to our share of gross contributions (where we believe the Commission figures to be too low) and the method of calculation used.

On the Commission figures shown, a 90 per cent compensation rate which excluded compensation for levies and duties would give us a refund of 1193 million ecus for 1982 - equivalent to 74 per cent of our net contribution before refunds.

On the Treasury's range estimates, a 90 per cent compensation rate which excluded compensation for levies and duties would give us a refund of 1075-1500 million ecus for 1982 - equivalent to some 65-71 per cent of our net contribution before refunds.

The levies element in the levies and duties gap averaged a little under 50 million ecus a year in 1980 and 1981. The Commission's 1982 budget figures imply, however, that it could be around 75 million ecus for 1982. A 90% compensation rate for the receipts gap, the VAT gap and custom duties gap (excluding levies) would be equivalent in 1982 to 86% of our total net contribution on the Commission estimate and 86-87% on the Treasury estimates.

If however the receipts gap for 1982 exceeded that for 1981 by more than 10 per cent, these refund figures would be reduced by up to some 125 million ecus under the risk-sharing provisions in the Presidency non-paper, as now interpreted by the Commission. The percentage refund would fall correspondingly by some $5\frac{1}{2}$-$7\frac{1}{2}$ per cent.