cc: HMT MAFF CO

MASTER CONFIDENTIAL

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DSG

bcc: D. Hancock. (CO)

SUBJECT

10 DOWNING STREET

From the Private Secretary

21 October 1982

Dear Brian,

COMMUNITY BUDGET

The Prime Minister held a meeting at No. 10 Downing Street on Wednesday 20 October to discuss the Foreign and Commonwealth Secretary's minute of 15 October on the Community budget problem and the papers circulated to OD (OD(82)68 and OD(82)69). The Chancellor of the Exchequer, the Foreign and Commonwealth Secretary and the Minister of Agriculture attended, each accompanied by an official.

1982 refunds

The meeting agreed that, if no decisions had been taken to implement the 25 May Agreement by the time of the European Council, the United Kingdom would have a strong moral case for withholding. It was possible that the Commission and other member states, except France, would consider that such action had been justified by the French reneging on the Agreement. On the other hand, legislation setting aside the Treaty would cause anxieties even among those who sympathised with our predicament and the sum in dispute was likely to be less than 65 million ecus.

Summing up this part of the discussion, the Prime Minister asked the Chancellor of the Exchequer to consider how soon withholding would need to start in order to secure before the end of the financial year 1982/83 the money to which the United Kingdom was entitled under the 25 May Agreement. Consideration should also be given to the practicability of withholding without legislation - for example with the cooperation of the Commission.

1983 and later

The meeting agreed that, even though it might be true that the rest of the Community, except France, would tolerate withholding in relation to the 25 May Agreement, it should not be assumed that the same tolerance would be shown for withholding in relation to an agreement for 1983 and later. The view attributed to Mr. Tugendhat and his cabinet in Mr. Kerr's letter to Mr. Coles of 19 October was suspect. The view of one Commissioner was not necessarily a dependable guide. The French Commissioner and the French Government would almost certainly exploit withholding for their political ends and in the absence of a negotiated agreement would probably carry the general opinion of the rest of the Community along with them.

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The Minister of Agriculture said that he had reconsidered the possibilities for exploiting the 1983 farm price negotiations to create a bargaining position over the budget. Clearly, in the light of the vote on 18 May 1982, no such link should be made overtly. On the other hand, it would be possible for the United Kingdom to register opposition commodity by commodity on merits until such time as a budget deal had been done. At that point we could, without admitting why we had changed our minds, agree to accept the majority view in order to enable the price agreement to be implemented. Our bargaining position was strong because all the other member states would need, for political reasons, a higher price settlement than would be acceptable to the UK. France, Greece and Italy had an inflation rate way above that of the United Kingdom. Ireland, Denmark and Belgium all had minority governments and their farmers were in serious financial difficulties. Even the new German government would require a substantial price increase. They would not wish to alienate the farmers' vote in the period before the election in March. It was pointed out that under the terms of the "gentlemen's agreement" Germany would be obliged to reduce their positive MCA by 3.8%. Thus, if the average price increase were 5%, German farmers would receive only 1.2%.

In discussion it was agreed that this tactical possibility might have advantages over an early threat to withhold in respect of 1983 and later. It would not be without cost at home. The Minister of Agriculture would be required to say that he disagreed with proposals on merits and then suddenly say that he accepted them. It would be essential to ensure that the negotiations on the price review and the negotiations on the budget proceeded in parallel so that the other member states would have the incentive to meet us on the budget at the right time. One of the things that had gone wrong in 1982 was that the budget negotiations had lost momentum just as the price negotiations were reaching their climax. It was for consideration whether we should confine our opposition to the main commodities under discussion, so that we were not in a minority of one in relation to them all.

In discussion of the review, the Foreign Secretary said that we could not be sure that M. Thorn would in fact propose one in November. At the Informal Meeting of Foreign Ministers over the weekend Thorn had indicated that he might not make such a proposal until after the German elections. This would present the Government with a problem because Thorn would not propose a lasting solution for the United Kingdom either.

The meeting agreed that it was not possible to predict when the Community would run out of money. The latest assessment was that the ceiling on own resources would not be hit in 1983 and possibly not in 1984 either, but that it probably would be hit in 1985. Co-responsibility levies were a means of avoiding the constraint and would figure substantially in the Commission proposals for 1983. It should not be assumed that the only proposal that would be discussed was a straight increase in the 1% ceiling. There were other ways of increasing revenue from own resources, for example by an oil levy. If an oil levy were

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introduced and the revenue used to reduce the rate of VAT called up from member states, then it could be argued to be in the United Kingdom's financial interest. On the other hand, the latest advice from our Embassies in Paris and Bonn was that the French and German governments would veto an oil levy. The arguments against it on grounds of industrial costs were in any case strong.

In further discussion it was agreed that the United Kingdom should now put the pressure on and get a negotiation going. The British Commissioners had not been active in furthering our interests and there was a good case for the Prime Minister talking to at least Mr. Tugendhat in the near future.

Summing up the discussion, the Prime Minister said that the solution potentially on offer would be a very bad deal for the United Kingdom and very difficult to defend to Parliament and the country. The United Kingdom's negotiators should, therefore, never attempt to secure too little. We should not encourage the Commission to propose a review or hasten to welcome one if it were proposed. We should only agree to a review on the clear conditions that one of its objectives should be to find a lasting solution to the British budget problem and that there was absolutely no commitment to any increase in own resources as a result of the review. The proposals in paragraphs 12(i) and (ii) of the Foreign Secretary's minute of 15 October were essential conditions for any settlement for 1983 and later years. A further 250 million ecu could be conceded in full and final settlement of the "over-payment" claim if the Community agreed to 66% refunds plus satisfactory risk-sharing, as proposed by the Foreign Secretary, for an indefinite period up until such time as there was agreement on a fundamental change in the system. The United Kingdom should argue strongly for such an indefinite commitment. Without such a commitment no further restitution of over-payments should be conceded without further discussion in the Ministerial group. The tactical plan to exploit the 1983 price review suggested by the Minister of Agriculture should be further pursued - the United Kingdom would retain the option of withholding if it failed.

The Prime Minister said that she would interview Mr. Tugendhat on a convenient occasion and seek to convince him of the need to fight more effectively for British interests within the Commission. The Foreign and Commonwealth Office should supply briefing on how such an interview might most effectively be conducted with an explanation of the terms of the British Commissioners' appointments and period of office.

I am sending copies of this letter to John Kerr (HM Treasury), Robert Lowson (MAFF) and to Richard Hatfield (Cabinet Office).

Yours ever

John Coles.

Brian Fall, Esq.,
Foreign and Commonwealth Office.