



10 DOWNING STREET

Prime Minister ⁽²⁾

For Thursday's E(A) meeting. This will be difficult as both sides feel strongly about their positions. The Chancellor will be raising this at his bilateral on Wednesday evening. Without rules on attribution and non-additionality, Chancellor feels there is a major loophole in public expenditure controls. (It is difficult to have much faith in the "forward look" when no Minister, other than the Chancellor, has much incentive to keep Community expenditure down.

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PRIME MINISTER

Community Expenditure Programmes and Control of United Kingdom
Expenditure

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B References: E(A) 17 (Memorandum by the ^{Chief Secretary} Chancellor of the Exchequer)
E(A) 18 (Note by the Secretaries)
~~E(A) 19 (Memorandum by the Trade and Industry Secretary)~~
The Foreign and Commonwealth Secretary ^{and SS/DTI} may also circulate a memorandum or minute.

PURPOSE OF MEETING

1. To consider proposals by the Chancellor of the Exchequer that certain types of Community expenditure programmes should either be paid for by the relevant spending Departments out of their PESC allocations, or should be matched by off-setting savings in the Department's budget.

BACKGROUND

2. With the exception of the United Kingdom share of Community aid programmes (which is directly financed by the Overseas Development Administration out of its budget), the United Kingdom share of Community expenditure programmes is financed out of PESC Programme 2.7 under the heading "net payments to the Community". For the major expenditure programmes and in accordance with existing Government policy, a system has been evolved to ensure that the broad principle of "non-additionality" is applied, ie that Community expenditure should not add to United Kingdom domestic public expenditure. Thus the Common Agricultural Policy replaces a domestic agricultural support system, and the bulk of the receipts from the European Regional Development Fund (ERDF) quota section and the Social Fund are paid into the Consolidated Fund to offset United Kingdom payments to the Community. It is also agreed policy that public sector bodies receiving funds from Regional and Social Funds should use these to finance existing programmes rather than additional expenditure.

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3. For some smaller Community programmes and for future programmes, however, arrangements for non-additionality have not been fully worked out. This is the main element of the present disagreement. In particular, in the case of Community receipts going to help small and medium-sized enterprises and Community finance for certain research and development programmes there has hitherto been no specific agreed system to ensure non-additionality. As Community programmes of this sort, especially in the research field, are on the increase, the Chancellor would like to establish a system to ensure that they do not add to public expenditure.

4. The Chancellor's proposals contain three main elements:

a. The present system for ERDF quota-section and Social Fund receipts should remain unchanged, as should the present system of attribution to the budget of the Overseas Development Administration (ODA) of the United Kingdom share of Community aid programmes.

b. Non-quota receipts from the European Regional Development Fund (ERDF) going to the private sector should be matched by offsetting savings in the budgets of the Department of Trade and Industry and the territorial Departments concerned.

c. In the case of new Community expenditure programmes, particularly in the research field, the United Kingdom share of the costs (or in certain cases the receipts) should either be borne on the budget of the Department concerned (instead of on PESC Programme 2.7), or where this is inappropriate be matched by off-setting savings in the Department's budget. A number of new programmes on which decisions are about to be taken in the Community would be affected; one of these is ESPRIT, for which the European Council on 4-6 December will be asked to agree a financial provision.

5. Other Ministers do not dispute the need for public expenditure control but consider that the Chancellor's proposed system would have very serious drawbacks. Their arguments are based on three main points:-

- (i) since Community expenditure is not wholly within their control (the European Parliament, for example, can increase some expenditure and there is nothing that we can do about it), it is wrong that higher Community expenditure should result in an automatic cut in their departmental budgets which reflect their priorities;
- (ii) if higher Community expenditure is going to lead to an automatic cut in a departmental budget, there will be no incentive to support such Community programmes even if the United Kingdom gets a disproportionately high return from them. At the extreme, Departments will try to minimise the amount of money available to private industry or research establishments, since higher amounts would mean a greater cut in the Department's own budget. Thus we would not be maximising receipts from the Community;
- (iii) if the United Kingdom automatically opposes every Community proposal for more expenditure, we shall be seen to be not judging proposals on their merits and other member states will take less notice of our views.

May appear as a minute | The objections, as voiced at official level, are set out in E(A) 18. The Trade and Industry Secretary has also recorded his own strong objections in E(A) 19 and the Foreign and Commonwealth Secretary may also put in a paper recording the objections he sees in terms of Community policy.

6. More specifically, the DTI and the territorial Departments object to the proposal for ERDF non-quota section receipts going to the private sector to be matched by off-setting savings on their budgets. The ODA objects to the continuation of the existing policy, ie the attribution principle for Community aid expenditure, and want the costs of such expenditure to the United Kingdom to be met from Programme 2.7 rather than from the ODA budget.

7. It should be noted that in terms of overall Community expenditure, the sums involved are small. Most of the new programmes are in the research field. Research and development is expected to rise only from 2.5% to 4% of the total as a result of the Commission proposals currently on the table (and these proposals could well be whittled down). The current Commission proposals on ERDF non-quota receipts for the private sector involve only some £10 million per annum over a five year period, compared to total annual United Kingdom ERDF receipts of some £300 million in 1983 and probably more in later years.

MAIN ISSUES

8. The main issues therefore are:-

- (i) Whether Community expenditure programmes should be treated in the same way as departmental domestic expenditure programmes for the purposes of public expenditure control.
- (ii) Whether Departments would be given an incentive by the Chancellor's proposals not to maximise United Kingdom receipts from the Community.
- (iii) What the impact would be of the Chancellor's proposals on Community policy.
- (iv) Whether there are acceptable alternative ways of controlling Community expenditure.

Community expenditure programmes versus domestic programmes

9. The arguments on the principle of whether Departments should be expected to bear the cost of Community expenditure programmes on their own budgets, or whether Community expenditure should be seen as a whole not appropriate for division between the individual Departments, have been fully set out in the various papers. The spending Departments argue that most of the Community expenditure programmes concerned do not replace domestic programmes, and are not of a sort which they would necessarily choose to implement, even in cases where they are of benefit to the United Kingdom. In many cases programmes are adopted because of

a process of political or financial bargaining; because an expected net benefit to the United Kingdom will help offset our net budget contribution; or because the United Kingdom is outvoted. It can therefore be argued that it is wrong to expect individual Departments to bear the costs of programmes that are beyond their control or which have been accepted for wider political or budgetary reasons. In particular, if individual Departments had to bear the cost of or find off-setting savings for such programmes, there would undoubtedly be some distortion of Government priorities, as they would have to cut domestically financed programmes to which they attach priority in favour of lower-priority Community programmes. The Foreign and Commonwealth Secretary is likely to refer to the fact that, in the one case where a system of attribution applies (the Overseas Development Administration), Government policy of increasing the proportion of bilateral aid expenditure has been thwarted by the rise in Community aid expenditure, as the latter has had to be financed by squeezing out bilateral programmes. There could also be problems of financial management, given the mis-match between Community and United Kingdom financial years and financial management, and the difficulties of forecasting likely Community expenditure and receipts over more than a very short period. A certain amount of extra administrative work could also be involved in the system proposed by the Chancellor, because of the need to decide in each case whether the new programme should be dealt with under the proposed new system, and how the burden of off-setting savings or attribution should be shared between responsible Departments - for instance, a single Community research programme can involve the Departments of Trade and Industry, Energy, and Education and Science.

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10. The Chancellor accepts that Departments cannot always control Community expenditure in their areas. He takes the view, however, that this is a price of Community membership which must be accepted by the individual Departments, and that the uncertainties are no different in kind from other uncertainties that Departments have to take into account in their domestic public expenditure planning. It may also be argued that many of the new Community expenditure programmes,

eg in the research field, are in practice similar to domestically financed activities, and that public expenditure constraints dictate that where the United Kingdom is forced to accept Community programmes we should cut the relevant domestic programmes, even though given the choice we would give higher priority to the latter. As for cases where Community funds are paid direct to the private sector, this undoubtedly does add to overall domestic public expenditure, and it can be argued that the fact that these funds go via Brussels does not mean that they should be treated differently from other taxpayers' money being paid in the form of domestic subsidies by individual Departments to the private sector.

The problem of maximising United Kingdom receipts from the Community budget

11. If the principle of off-setting savings/attribution at the level of individual Departments were accepted, there would be various ways in which it could be implemented. The Chancellor is likely to opt for savings to offset the net United Kingdom contribution for new Community programmes involving public sector programmes^①; and savings to offset the forecast of receipts for ERDF non-quota aid to the private sector and for other Community support for the private sector^②, eg in programmes such as ESPRIT. The results of using the second method, however, are likely to be perverse, as it will give an incentive to reduce the amount of receipts which the United Kingdom receives from individual Community programmes, while leaving unchanged the level of the United Kingdom contribution. This is a point which the Trade and Industry Secretary has already made very strongly in OD(E) when the question of finding off-setting savings from his budget for ESPRIT was inconclusively discussed.

Impact on Community policy

12. The Foreign and Commonwealth Secretary is likely to express concern about the effect of the Chancellor's proposals on the United Kingdom's overall Community policy. If Ministers know that they will invariably have to find off-setting savings for any Community expenditure programme which is adopted, they are

likely to judge Community programmes almost entirely on this basis (except in rare cases where the programme directly replaces a domestic one) rather than on their merits. This could make the United Kingdom's general negotiating position in the Community harder, as our partners will see our procedures as basically inimical to Community principles. This could make more difficult our attempts - which are now having some success - to push Community expenditure in more acceptable directions.

Other approaches

13. It can be argued that there are two basic problems which need to be dealt with. First, there is that of keeping Community expenditure under control so that the public expenditure burden on the United Kingdom is kept to a minimum. Second, in cases where new Community expenditure is agreed, there is the need to ensure that it does not add to United Kingdom public expenditure. The Chancellor's proposals address chiefly the second problem. On the other hand, if we are successful in dealing with the first, the second could be minimised. Ministers have already endorsed proposals for improving financial planning and control at the Community level, and proposals are also being discussed at official level within Whitehall for improvement in the United Kingdom system for co-ordinating policy on different Community expenditure programmes (the "forward look"), so that we can keep these within a generally agreed level. Spending Ministers may argue that these proposals should be a main plank in the fight to minimise the impact of Community programmes on public expenditure.

14. All are likely, however, to accept that such methods will never be totally successful, and there will continue to be occasions when the United Kingdom has to accept Community programmes which are basically additional to domestic ones, and which Ministers see as of lower priority than existing or planned domestic programmes. In such cases, as suggested in E(A)18, the alternative way of achieving non-additionality would be to do so at the level of Programme 2.7, with any unavoidable increases in Programme 2.7 being met at the overall level of United Kingdom public expenditure. There is likely to be strong pressure from a number of Ministers for this sort of approach to be adopted.

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HANDLING

15. You will wish to ask the Chancellor of the Exchequer to introduce his proposals, and the Trade and Industry Secretary to outline his objections, as his Department will be the one chiefly affected by the Treasury proposals. A number of other spending Ministers have a direct interest and will wish to comment: the Energy Secretary as a large proportion of Community research is in the energy field; the Environment Secretary because of his interest in the ERDF and because the Chancellor's proposals would affect a proposed Community expenditure programme on the Environment; the Minister of Agriculture because some Community research programmes are in his area; and the Secretaries of State for Scotland, Wales and Northern Ireland as some of the Community expenditure concerned would be in their areas and they would need to find the necessary offsetting savings (for instance for Community regional expenditure in Northern Ireland). The Foreign and Commonwealth Secretary will want to speak about the problems of the Overseas Development Administration and the likely impact of the Chancellor's proposals on general Community policy. Finally, a number of other members of the Committee may wish to comment because of the potential impact of the Treasury proposals on their Departments should new Community activities be proposed in their areas.

CONCLUSIONS

16. You will wish the Committee to reach conclusions on the following:-

- (i) whether the present system of attribution for Community aid expenditure should continue unchanged;
- (ii) whether ERDF non-quota receipts going to the private sector should be matched by off-setting savings on the budgets of the relevant Departments;
- (iii) whether the Chancellor's proposals on new Community programmes are acceptable. A specific decision is also needed on the treatment of ESPRIT, given the possibility of a decision on it at the Athens European Council;

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- (iv) if the Chancellor's proposals are not acceptable, whether the question should be remitted for fuller study by officials of ways in which the basic principle of non-additionality could be maintained without necessarily having an automatic cut in a departmental budget when Community expenditure rises; or whether the matter should now be taken to full Cabinet (the Trade and Industry Secretary has warned that he would not be prepared to accept the Chancellor's proposals unless they were endorsed by Cabinet).

17. It is possible that you may be able to reach agreement on the following basis:

- no change for the present in the arrangements for existing programmes, including attribution of Community aid expenditure to the ODA budget;
- instruction to officials to work out the "forward look" procedures for better control of Community expenditure;
- officials to report back to Ministers whether the non-additionality principle should be applied to new programmes by application to a departmental budget or alternatively at the level of all public expenditure (after exhausting any savings under programme 2.7);
- in the interim no absolute rule for new programmes. For ESPRIT (the only important Community programme on which a decision is imminent), financing to be settled without requirement of off-setting savings from DTI budget but without prejudice to attempt to find such savings as the programme develops. For other programmes, savings to offset wholly or substantively new Community programmes to be negotiated ad hoc between the Chancellor and the departmental Ministers concerned.

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