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## 10 DOWNING STREET

From the Private Secretary

12 June 1986

Dear Colin,

EUROPEAN COMMUNITY BUDGET

The Prime Minister held a meeting this morning with the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food in order to discuss the United Kingdom strategy on the Community budget, on which the Chancellor of the Exchequer had minuted the Prime Minister on 21 May. Sir David Hannay and Mr. Williamson were also present.

The Foreign and Commonwealth Secretary said that he agreed broadly with the conclusions in paragraph 42 of the note which the Chancellor of the Exchequer had sent forward on 21 May. There were, however, important tactical issues which would affect the United Kingdom's approach to Community business and, in particular, the handling of the revised 1986 budget and the 1987 budget. It would be possible to hold these two budgets within the 1.4 per cent VAT ceiling. If the European Court of Justice were to give its decision at the beginning of July on the lines expected in the case brought by the Council against the European Parliament, the United Kingdom Presidency would need to take steps to establish a valid Community budget for 1986. This would probably be completed in September. Although this budget would incorporate a supplementary element, it would not be too difficult to present this politically, as it would include a substantial amount - extra abatement and Social Fund payments in particular - for the United Kingdom.

The Chancellor of the Exchequer said that it was necessary to take account not just of the United Kingdom's net contribution which did now benefit as a result of the Fontainebleau agreement but also of the public expenditure costs as a whole and of the non-budgetary costs for the economy. He had set out a strategy in the note which he had sent forward on 21 May but it was also important that we should not allow a presumption to be created that there would be an increase in the VAT ceiling to 1.6 per cent, particularly as other member states were already inclined to accept that such an increase would be required. It should not be forgotten that maintenance of the 1.4 per cent ceiling would permit real growth in Community expenditure in 1987 and 1988.

The Prime Minister said that she was strongly in favour

059



of sticking rigidly to the Fontainebleau text. We should say that there was no question of increasing the VAT ceiling before 1 January 1988 and that, as to the situation after 1 January 1988, we would consider it. The onus was on other member states to show, if they could, that an increase in the VAT ceiling was then needed.

Sir David Hannay said that there must, of course, be no presumption that the VAT ceiling would be raised. Equally, there were very strong reasons now against saying that we had decided not to increase the ceiling from 1 January 1988. Our tactical objective must be not to polarise opinion or to unite other member states in favour of an early decision to increase the ceiling.

In discussion it was pointed out that:

- (i) we must respect the 1.4 per cent VAT ceiling in the 1986 and 1987 budgets but there were different ways of keeping within the ceiling and avoiding overruns. There would be a temptation in the Community to do this by deferring expenditure. This would add to the pressure for an increase in the ceiling. A better approach would be to look for actual savings and, where possible, reductions in commitments;
- (ii) it was recognised that some potentially useful measures such as a possible scheme for reducing the amount of land ("set-aside") devoted to cereals production would not have a favourable budgetary impact in the short term. The net saving from changes in the beef regime might also be small. On the other hand, some savings could be sought both on structural fund expenditure and in the agricultural sector, for example in the management of disposal programmes and by revising the division of some expenditure between the Community and national budgets;
- (iii) although it might be necessary to accept that in 1986 exceptional circumstances, the change in the dollar/ecu rate, applied to the financial guideline for agricultural expenditure, this element of budgetary discipline had proved helpful in the agricultural price fixing and we should certainly not let up in our support for it;
- (iv) there was a good measure of agreement between the United Kingdom, France and Germany on the handling of significant budget issues over the next year or two. The longer we could stay in this company, while protecting our essential interests, the better;
- (v) there was unlikely to be serious discussion of Community finance at the European Council on 26-27 June. At the end of 1986 the Commission would produce a report on future financing, as foreseen

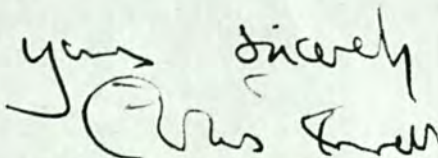


in the Fontainebleau text. This document would probably be divisive, and disagreement between member states which were net contributors to the Community budget and others in favour of larger spending would become more apparent. It seemed probable, however, that the United Kingdom approach of standing pat on the Fontainebleau text could be held for a good time in 1987;

- (vi) there would be a discussion at the European Council on 26-27 June on the external aspects of agriculture. We had achieved in recent months a much greater perception of the need for action on agriculture by all the major industrialised countries. The United Kingdom had taken the initiative on this at the Tokyo Economic Summit, and must take a lead on ensuring that the Economic Summit conclusions were followed up. But we should be careful not to turn this exercise on the need for international action into an attack on the common agricultural policy. We needed to keep the support of other member states and, in particular, of the French for the changes which had to be made;
- (vii) it was quite probable that some other member states would put forward requests for additional financing through an intergovernmental agreement in 1987. It was even conceivable that there would be such an agreement without British participation. Our policy, however, should be opposed to such an agreement which undermined the Treaty limits on Community spending

Summing up the discussion the Prime Minister said that it was quite clear that in the 1986 and 1987 budgets the 1.4 per cent VAT ceiling must be respected. We should stand on the Fontainebleau text. In order to reduce the pressure for an increase in the ceiling, we must try to correct a situation in which the Commission claimed that the budgets for 1986 and 1987 were insufficient to meet the requirements. For this purpose we should seek savings in commitments on the structural funds and expenditure savings, where this was feasible, both on agriculture and in other sectors. In her briefing for the European Council on 26-27 June she would need to have examples of potential savings. She would also need a clear indication of how we intended to make progress in international discussion of agricultural surpluses and protectionism.

I am sending copies to Rachel Lomax (H.M. Treasury), Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food), Sir Robert Armstrong and to Sir David Hannay (UKREP, Brussels).

Yours sincerely  


CHARLES POWELL

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Foreign and Commonwealth Office.