(2)

Prime Minister

Para. 13 might provide the way forward on the Budget.

A.J.C. 14/3

Ref. A083/0822

MR COLES

As you know, I paid a further visit to Monsieur Thorn in Brussels on Friday 11 March 1983 at 10.30 am.

2. I found Monsieur Thorn under the weather: suffering from an infection acquired from his wife who had brought it back from Moscow, and feeling sorry for himself about the amount of travelling he was doing (after seeing me he was going straight to Bonn for lunch, and then to Rome for dinner).

3. I said that we had been studying the European Commission's Green Paper with interest, and we thought that it contained some useful ideas for a lasting solution to the budgetary problem, which was something the Community needed for its own sake, quite apart from British needs. The idea of revenue related to agricultural indicators seemed well worth further study, though not all members might welcome it. We favoured the development of beneficial new policies. But neither of these courses seemed to be likely to meet the size of our problem, and it would be necessary to consider either some kind of financial equalisation system or something on the lines of the Chancellor of the Exchequer's VAT adjustment scheme as a safety net.

4. But all this would take time, and could not in any case offer a solution for 1983. I rehearsed once again the political reasons which made it necessary for the British Government to have by June a solution for 1983 and later years, until a lasting solution could be brought into effect. There was not much time. The Prime Minister therefore hoped that the European Council later this month would invite the Commission to work out proposals both for a lasting solution and for a solution for 1983 and later, so that decisions could be taken at the Foreign Affairs Council towards the end of May.

5. Monsieur Thorn renewed his expression of his desire to be helful, and his understanding of the need for a solution by June. He was, however, very insistent that any interim solution must appear and be presented in the context of progress towards a lasting solution.

He clearly did not like the idea of being asked by the European Council in March to produce proposals for an interim solution as well as proposals for a lasting solution. He evidently feared that British insistence at the European Council upon immediate work towards an interim solution would be regarded by some other member states and by the European Parliament as evidence that the British were not interested in a lasting solution but only in getting their money back. An interim solution which was not seen as being in the context of progress towards a lasting solution was likely to be unacceptable to the European Parliament. It was evident that Monsieur Thorn was worried, not just that the Parliament might reject an interim solution, but that it might censure the Commission - with the result that he and his colleagues on the Commission would all be dismissed. That would not help the British or anyone else, he said.

6. Monsieur Thorn implied that members of the European Parliament would become easier to handle as their election came nearer. He spoke with derision of the Parliament's recent resolution in favour of a 7 per cent increase for 1983 in agricultural prices. He regretted that both the Americans and the Community were accumulating surpluses of agricultural products, for which there was in effect only one significant customer - the Soviet Union. He commented on the fact that the United Kingdom was among the member states increasing butter production. He thought that there would be pressure upon the Community to dispose of some of its surpluses into the Third World.

7. When I pressed him on the need to arrive by June at a solution of the budgetary problem for 1983 and later, and drew attention to the shortage of time if there was no request to the Commission at the March European Council to bring forward proposals for such a solution, Monsieur Thorn said that there would be no objection to there being bilateral discussions between the British and the Commission on an interim solution; but he would not want to open up the discussion of an interim solution until the Commission had put forward its proposals for a lasting solution. At the March meeting of the European Council he intended to give the Council a lengthy resumé of the position, on the basis of which he would seek instructions to make proposals for a lasting solution. He intended

that these proposals should be presented in April. It would then become evident that there was no possibility of working out the proposals in detail and reaching agreement in time for the discussions of the 1984 budget in May, and that therefore an interim solution was necessary. In that context, such a solution would be much easier to negotiate, both with the other member states and with the Parliament. He agreed that the timetable was tight, but he did not think it by any means impossible. He recognised the political importance for us of a solution by June; he also said that it would be important to get as many decisions as possible on this and any other Community matters taken by the end of June, so that the Community interests were set out before the Greek Presidency began. The decisions could be decisions in principle, subject to being worked out later.

8. Monsieur Thorn referred at one point to the arguments for new own resources over and above the 1 per cent VAT limit. I said that it remained the view of the British Government that there was no need for such an increase: if the growth of agricultural surpluses was controlled as it should be, the buoyancy of VAT revenue should give sufficient own resources to allow for the development of Community policies even after enlargement. Monsieur Thorn expressed the hope that our opposition to new own resources should not be expressed unconditionally: it would tactically be more helpful if we were able to say that we could contemplate no increase in own resources unless agricultural surpluses were controlled.

9. It was evident that Monsieur Thorn believed that, now that the German elections were over, the Federal Chancellor would not insist on arbitrarily limiting the German contribution to additional expenditure or to British refunds, if it was in the context of a package that was otherwise acceptable to the German Government. But he said that he thought that the German Finance Minister still needed to be persuaded of this.

10. I asked Monsieur Thorn about his recent visit to President Mitterrand. He said that he had found Monsieur Mitterrand in a strongly anti-American mood, which he feared was going to colour the French view on the Community's discussions with the Americans

about agricultural matters and, later on, at the Williamsburg Summit. The fall in the value of the franc was also very much in Monsieur Mitterrand's mind. He would have liked to reach agreement with the Germans even before the second round of the French elections for a revaluation of the mark upwards in the EMS as well as some devaluation of the franc, but the Germans were playing very hard to get. Monsieur Mitterrand was clearly envisaging that there would have to be further economic measures in France, which would involve further reductions in expenditure, and Monsieur Mitterrand's attitude made it clear that he would be very difficult about paying more for Britain. Monsier Thorn said that this made it the more important that the discussion of the budgetary problem should start from the lasting solution, and encompass an interim solution only in the context of some progress on that.

11. One of the matters Monsieur Thorn had discussed with Monsieur Mitterrand was enlargement. It seemed that the French Government had decided not to block the entry of Spain in 1985 - perhaps because it would be difficult for the French Government to be seen to be resisting the entry of Spain under a Socialist Government. Monsieur Mitterrand would, however, want the negotiations for enlargement to reach their crucial stage during the French Presidency in the first half of 1984. He realised that that was not likely to come about unless there was a definite commitment by the Community by the end of June 1983.

12. I also had some discussion with Mr Christopher Tugendhat. Sir Michael Butler was present during this discussion and is reporting on it by telegram. Mr Tugendhat took very much the same line with me as he had taken with the Foreign and Commonwealth Secretary on 10 March; and I took very much the same line with him as Mr Pym had taken. Mr Tugendhat made much of the point that it would not be in the interests of the United Kingdom to press for an interim solution at the same time as calling for proposals for a lasting solution; any agreement in the Council of Ministers would, he said, be only half an agreement, because the Parliament would not endorse it unless it could be presented in the context of progress towards a lasting solution. I formed the view, however,

that Mr Tugendhat was at least as worried as Monsieur Thorn, not so much about the possibility of rejection by the Parliament, but at the possibility of censure on the part of the Parliament which would involve the Commission's dismissal and the loss of his job.

13. I also met Monsieur Davignon over lunch with Sir Michael Butler. Monsieur Davignon was a great deal less concerned about the possibility of the Commission being dismissed, no doubt because he confidently expects that in that event he would return, perhaps as President. He also, however, started by arguing that we should not address the interim solution until after the Commission had brought forward proposals for a lasting solution. Whe we pressed him on the shortage of time, he wavered a little, and began to think that we might be able to finesse the matter at the March meeting of the European Council, if the Council were to "confirm" its desire for a lasting solution, to invite the Commission to make early and specific proposals for such a solution, and to suggest that, if it appeared to the Commission that such a solution might not be available in the necessary time scale, to consider what interim arrangments might be appropriate and make proposals. Sir Michael Butler is reporting in more detail on this and other matters that arose in the course of the discussion with Monsieur Davignon.

14. I am sending copies of this minute to the Private Secretaries to the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer.

RtA

ROBERT ARMSTRONG

14 March 1983

Euro Pol

10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG

YOUR VISIT TO BRUSSELS

Thank you for your minute of 14 March which the Prime Minister has read and noted.

A. J. COLES

15 March 1983

Mr. F.E.R. Butler
As requested.
D.H. 11/3.

NOTE ON THE BUDGET OF THE EUROPEAN COMMUNITIES

The Community Budget covers both expenditure and revenue and is required by Article 199 of the Treaty of Rome to be in balance. The Budget is concerned basically with making provision for, and setting the limits on, expenditure to be incurred within the framework of agreed Community policies; it is therefore effectively the equivalent of the UK's Supply Estimates. The Budget is denominated in European Currency Units (ecu). For budgetary purposes the spot rate at 1 February is used throughout the budgetary procedure: for the 1982 budget this rate is £0.523058 = 1 ecu (£1 = 1.9118 ecu).

This note contains information on the following:

EXPENDITURE

2. The expenditure side of the Budget contains Sections for each of the Community Institutions:-

Council;
Parliament (established under the Treaties as the 'Assembly');
Commission;
Court of Justice;
and for the Court of Auditors (which is treated for this purpose as if it were an institution).

The main Community policies (eg. the Common Agricultural Policy, the Regional Development and Social Funds, Research and Investment and Aid) are provided for in the Commission's Budget, which accounts for some 98% of total Budget expenditure. The Budgets of the other Institutions relate almost entirely to their administrative and running expenses. The budget of each Institution is divided into Titles, Chapters, Articles and, finally, Items. These are numbered on a decimal basis; thus Item 1140 is part of Article 114 of Chapter 11 in Title 1.

3. Commitments and payments - The detailed rules applicable to the Budget are laid down (as provided for under Article 209 of the Treaty of Rome) in the Financial Regulation of 21 December 1977 as amended.(1) This provides for the Budget to prescribe the limits on both commitments and expenditure for the year; these limits are known as commitment appropriations and payment appropriations, respectively. Where action can be completed within the year (eg. staff pay and administrative expenditure) the same figure is used for both commitment appropriations and payment appropriations and is then known as an 'undifferentiated appropriation'. Where new commitments give rise to a flow of payments to be made in future years (eg. Regional Development and Social Funds), there is a 'differentiated appropriation', with different limits laid down for commitment appropriations and payment appropriations.

4. Obligatory and non-obligatory expenditure - There are two types of budget expenditure: obligatory (or compulsory) and non-obligatory (or non-compulsory). The distinction is of considerable practical significance because of the rules governing the relative degree of control of each type of expenditure by the Council and the Parliament (see paragraph 21 below). The two categories of expenditure are not defined in the Treaty, and the principles underlying the definition have not been agreed. However, the Council and the Parliament have followed, broadly, a working classification prepared by the Commision, under which expenditure for programmes laid down by the Treaties (such as the European Agricultural Guidance and Guarantee Fund (EAGGF) or arising from firm international agreement (eg. aid) has been classified as obligatory, while all other expenditure (eg. staff

(1) Amended by: (i) Regulation 1252/79 of 25 June 1979 (OJL 160 of 28.6.79); and,
(ii) Financial Regulation of 16 December 1980 (OJL 345 of 20.12.80)

pay, administration, research and the Regional Development and Social Funds) is non-obligatory. It has been accepted that most new items entered in the Budget should be classified as non-obligatory. The dispute over the 1982 budget centres on this hitherto unsettled question of the correct classification into obligatory expenditure, where the Council has the last word, and non-obligatory expenditure where the Parliament has the control (see paragraph 30) subject to its margin of manoeuvre under the maximum rate provisions (see paragraphs 21-22).

REVENUE

5. Apart from a very small amount of miscellaneous revenue, the Budget is financed from the Communities' Own Resources. The essential feature of the Own Resources system is that Own Resources, although collected by Member States, belong to the Community from the time of collection. The European Communities are therefore unique among international institutions in that, like a national Government, they have their own independent source of revenue.

6. Own Resources comprise the following:

(i)(a) agricultural levies collected mainly on trade in agricultural products between the Community and the rest of the world;

(i)(b) Sugar and isoglucose levies collected on the production and storage of sugar and isoglucose;

(ii) customs duties collected under the Common External Tariff on imports to the Community from the rest of the world;

(iii) the product of a notional rate of VAT levied on a Community harmonised base at a rate not exceeding 1%.

Levies and duties are separate, identifiable, taxes and have been used to finance the Budget since 1971. Member States receive, in arrears, refunds of ten per cent of their levies and duties, ostensibly for 'collection costs'. VAT Own Resources is not a separate tax; the payments made by Member States are calculated by applying a given percentage rate to the harmonised base. This base is the total expenditure on a range of goods and services, the same for all Member States, which was agreed in 1977. While the base broadly includes the goods and services on which domestic Valued Added Tax is levied in all Member States, it does not correspond to the actual base for VAT in any of them.

7. VAT Own Resources contributions began on 1 January 1979, and nine of the ten Member States contribute on this basis. Greece, which joined the Community on 1 January 1981, has not yet passed the necessary legislation to implement the Sixth VAT directive

(which defines the harmonised base). It was agreed during the accession negotiations that she need not do so before 1984. Therefore she pays a financial contribution based on her share of Community Gross National Product.

8. The total amount to be collected from Member States through this third element of Own Resources is the balance between the expected yield of levies, duties and miscellaneous revenue on the one hand and total payment appropriations on the other. These arrangements impose a ceiling (the so-called '1% VAT ceiling") on Community revenue which will probably be reached soon on present trends. This ceiling can only be raised by unanimous Council decision after consulting the Parliament. An increase must also be ratified by the appropriate constitutional bodies in all Member States; this would be likely to take considerable time. Several Member States, including the UK, have stated strongly that the 1 per cent ceiling must be maintained; they attach great importance to it because of its constraint on Community spending.

9. A table showing the financing of the 1982 Budget as declared adopted by Mme Veil, President of the European Parliament, on 21 December 1981 on a full Own Resources basis is attached. (Annex I).

30 MAY AGREEMENT ON THE UK CONTRIBUTION TO THE EUROPEAN COMMUNITY BUDGET

10. Agreement on a solution to the problem of the excessive UK net contribution to the Community Budget was reached during the meeting of the Foreign Affairs Council at Brussels on 29-30 May 1980. On the basis of Commission estimates, the Agreement provided for the UK to receive net refunds of 1175 mecus and 1410 mecus in respect of its net contribution to the 1980 and 1981 Budgets, respectively. For 1982 the Community pledged itself to resolve the problem by structural changes (in budget expenditure) but if this goal was not achieved, a solution along the lines of that agreed for 1980 and 1981 would be adopted.

11. Refund payments are disbursed through the 1975 Financial Mechanism Regulation, as amended, and, for the balance, as Community financial support for certain UK public sector infrastructural investment programmes (Supplementary Measures). They are made primarily from the budget of the following year, though 'advance payments' can be made from the budget to which the refunds relate.

12. Regulation 2743/80 of 27 October 1980[2] was adopted by the Council to give effect to the revision of the 1975 Financial Mechanism. The amended Financial Mechanism applies to the UK only. Payments under it are provided for in Chapter 81 of the Budget. The first

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[2] OJ L284 of 29 October 1980.

payment of £210.5 million (75 per cent of the total estimated entitlement) was made in January 1981, but had to be repaid and regranted as supplementary measures support in December 1981 since outturn data for 1980 revealed that the UK's share of gross contributions did not exceed its share of Community GDP by the requisite margin of 10 per cent. If, as seems likely, this result was repeated in 1981, the Mechanism will remain inoperative and the whole of the UK's refunds for that year will also have to take the form of Supplementary Measures support.

13. Regulation 2744/80 of 27 October 1980[2] was adopted by the Council to provide a legal base for the Supplementary Measures expenditure, for which provision is made in Chapter 53 of the Budget. By the end of 1981, the UK had been granted Supplementary Measures support totalling 1437.6m ecus, the gross equivalent, on the Commission's calculation, of our net refunds entitlement of 1175 mecus for the 1980 Budget. Of the amounts granted, 1422.6 mecus (£790.6m) had been paid. Within these amounts, the UK was granted a total of 193.5m ecus as advance payments from the 1980 Budget. When the Regulation was adopted, it was agreed that the UK would receive at least 80 per cent of its estimated entitlement to Supplementary Measures support before the end of the corresponding UK financial year. Since no advance payments were agreed for 1981, this means that we should receive about 1450 mecus (ie. some £800m) before the end of March 1982. The balance of our estimated gross entitlement for 1981 (some 350 mecus) should be paid during the remainder of 1982.

14. As mentioned above, the 30 May Agreement, as well as providing for a limit on the UK's net contributions to the 1980 and 1981 Budgets, contained an undertaking that the Community would resolve the problem of the UK's contribution for 1982 by means of structural changes; the Commission was given a mandate to make proposals and it accordingly presented its report on restructuring the EC Budget on 24 June 1981. The Commission's report argues that the Community must adopt a joint strategy to cope with the present problems facing it. Noting that the Community has mainly developed through a common market and a common agricultural policy, it argues that the Community must look forward and make a contribution to the development of new technology and industry. There should also be more progress towards economic and monetary union through greater co-ordination between Member States and development of the European Monetary System, once all Member States participate. (The UK and Greece are not members). However, the Commission also argue that with increased emphasis on these priorities, the Community will need more own resources, and hence will need to raise the 1 per cent ceiling on VAT Own Resources.

15. The Report was discussed by the European Council in November last year. The European Council identified four key issues - mediterranean products, the CAP, milk, and

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[2] OJ L284 of 29 October 1980.

the Budget - for Foreign Ministers to consider further. This they have done at meetings in December and January. Progress has been made on the first two items but guidelines have not been agreed on milk and the Budget. Foreign Ministers are likely to consider the issues again in March, on the basis of proposals from the Presidents of the Council and Commission.

PROCEDURE FOR CONSIDERATION AND ADOPTION OF THE COMMUNITY BUDGET

16. Article 203 of the Treaty of Rome, as amended by the Treaty of 22 July 1975, sets out the procedure for the consideration and adoption of the Budget. However, since 1976 the timetable laid down in the Treaty has been advanced, by mutual agreement of the Institutions, in order to provide more time for consideration at each of the various stages. The general sequence of events under this "pragmatic" timetable is as follows:-

i) Each Institution is required to forward to the Commission by 15 May estimates of its expenditure in the following year. The Commision then consolidates these along with its own estimates of expenditure in the Commission Section of the Budget and forwards the consolidated Preliminary Draft Budget (PDB) to the Council by 15 June. The Commission forwarded the 1982 PDB to the Council and the European Parliament on 15 June 1981.

ii) In advance of the consolidated PDB the Commission has on some past occasions (but not since 1979) presented an "Orientation" paper to a Joint Foreign Affairs/Finance Council. The Commission also discusses its estimates for the agricultural parts of its Budget, before these are finalised, with representatives of member states meeting in an Advisory Committee of the Commission. In addition the Council receives the estimates of the other Institutions so it is able to commence its examination of these parts of the Budget in advance of the Commission Section. This examination is undertaken initially by the Budget Committee (appointed by the Committee of Permanent Representatives (COREPER) under Article 104 of the Financial Regulation and comprising officials of the Member States and the Commission). Unresolved matters are then discussed by more senior officials in COREPER.

iii) This stage culminates in the First Budget Council which usually takes place towards the end of July. This Council, which is normally attended by Finance Department Ministers, formally endorses the decisions taken at official level and decides on those matters which still remain outstanding. It then 'establishes' (ie approves) the Draft Budget as a whole, which is then forwarded to the Parliament.

iv) In the early autumn the Commission usually presents a Preliminary Draft Amending (or Rectifying) Letter proposing certain adjustments to expenditure to take account of recent developments, predominantly on the agricultural front. After discussion the Council establishes a Draft Amending Letter, which is then forwarded to the Parliament. (See also paragraph 24 below on Amending Letters).

v) The Parliament then considers the Draft Budget, as amended by the Draft Amending (or Rectifying) Letter. It has the right to amend budget entries relating to non-obligatory expenditure acting by a majority of its members. It may also propose modifications to budget entries relating to obligatory expenditure acting by a simple majority of the votes casts. The Parliament notifies the Council of its decisions by the end of October.

vi) Following preparation at official level, the Second Budget Council meets towards the end of November and either accepts, rejects or alters the Parliament's proposed modifications and amendments. The Council's decisions on modifications is final and any amendments not altered by the Council are incorporated in the Budget.

vii) The Draft Budget is then returned once more to the Parliament, which has to decide before 19 December, by a majority of its members and 3-5ths of the votes cast, whether to amend or reject the Council's proposed modifications to the Parliament's amendments. Thus the Parliament has the final word on the level of non-obligatory appropriations, subject only to the overall limit imposed by the maximum rate provision (see paragraph 21), whereas the Council has the last word on obligatory appropriations. The Council and the European Parliament may meet in mid-December to discuss the Council's modifications.

viii) When this procedure is completed, the President of the Parliament declares the Budget finally adopted. However, the Parliament may, if there are important reasons, reject the Draft Budget en bloc and ask for a new Draft to be submitted to it. (This power was used for the first time in 1979 in relation to the 1980 Budget).

In order to comply with the Treaty the budget documents are also transmitted formally between the Council and the European Parliament at the times laid down in Article 203.

17. Under the Treaty, if an item of expenditure is not re-opened, the amount is settled, eg if the Parliament do not make an amendment to an item in the Draft Budget, there can be no more discussion on that item.

18. The Commission is required, by a Council Decision of 21 April 1970 to prepare each year financial forecasts for the three subsequent financial years. These are sent to the Council with the PDB. The figures in the PDB are used for the first year. These forecasts are discussed by the Economic Policy Committee (EPC) in the early autumn.

QUALIFIED MAJORITY VOTING

19. The Council's decisions in relation to all stages of the Budget are reached on the basis of qualified majority voting. Under Article 148 of the Treaty, as amended, Member States have the following votes:-

Belgium	5
Denmark	3
Germany	10
Greece	5
France	10
Ireland	3
Italy	10
Luxembourg	2
Netherlands	5
United Kingdom	10
Total	63

Forty-five votes constitute a qualified majority where the Treaty requires acts of the Council following a proposal from the Commission eg adoption or rejection of budgetary proposals or appropriations. Under this system there is no national veto. The system also encourages tactical voting, since it is sometimes necessary to vote for unattractive proposals in order to avoid a qualified majority moving towards something even less attractive.

20. There must be a qualified majority in favour of any amount entered in the draft budget, whether the figure proposed by the Commission or a different amount. Consequently, if there is no qualified majority, then a token entry or "pm" (pour memoire) is entered against the item of expenditure. However, after the Parliament makes amendments to non-obligatory items or proposes modifications to obligatory items the following rules apply:-

(a) Where an amendment is made, the Council may alter (modify) it by qualified majority. Unless modified by the Council, an amendment automatically goes into the adopted Budget. Parliament still have the final say and may reject, or further alter, by a majority of its members and three-fifths of the votes cast, the Council's suggestions.

(b) Where a modification would increase overall expenditure it is not included in the Budget unless the Council approves it, acting by a qualified majority.

(c) Where a modification would not increase overall expenditure (ie, it proposes an offsetting reduction or a total reduction) it is included in the Budget unless the Council votes, by qualified majority, to reject it.

MAXIMUM RATE

21. Article 203, as amended, also contains the provisions relating to the 'maximum rate', which sets a limit on the increase, compared to the previous year's Budget, in the total appropriations for non-obligatory expenditure. Although there is no reference in the Treaties to separate commitment and payment appropriations, the Council and the Parliament have agreed that the maximum rate should be applied separately to each total. The first stage in this procedure involves the calculation of the maximum rate by the Commission on the basis of trends in the preceding year of Member States' real GNP, public expenditure and cost of living indices. In accordance with this procedure, the Commission declared a maximum rate of 14.5 per cent for the 1982 Budget. In general terms the effect of Article 203.9 is:-

(i) If the rate of increase in non-obligatory expenditure in the Draft Budget (ie that established by the Council of Ministers and sent to the Parliament) is less than half of the maximum rate, than the Parliament may increase the total of non-obligatory expenditure up to the maximum rate.

(ii) If the rate of increase of non-obligatory expenditure in the Draft Budget is more than half the maximum rate, the Parliament can further increase the total of non-obligatory expenditure by an amount not exceeding half the maximum rate, (eg if the Commission declared a maximum rate of increase of 10%, and the Council's Draft Budget provided for an increase in non-obligatory expenditure of 6% compared to last year, the Parliament could approve amendments adding a further increase of 5%, making an increase of 11% in all).

(iii) If at any stage of the budgetary procedure the Parliament, Council or Commission considers that non-obligatory expenditure should be increased beyond the limit allowed by the maximum rate calculated by the Commission, a higher rate may be fixed by agreement between the Council, acting by a qualified majority, and the Parliament, acting by a majority of its members and 3-5ths of the votes cast.

(iv) It has become accepted practice that, if a new maximum rate has to be fixed, a margin is provided within it for the European Parliament to allocate.

22. At the Budget Council on 22 March 1979, all member States except the Netherlands agreed to an arrangement intended to avoid a situation where a Budget Council approves increases exceeding the maximum rate but is unable to obtain a qualified majority in favour of a proposal to increase the maximum rate. This had happened during consideration of the 1979 Budget and in consequence some member states contested the legality of the Budget initially adopted. The arrangement contains the following elements:-

1. Agreement that, if the Draft Budget as established by the Council at its first

reading exceeds the maximum rate, the Council will vote on the new maximum rate thereby produced before forwarding the Draft to Parliament.

2. Agreement that the following procedure should apply when the Council votes on the Parliament's amendments at its second reading:-

a. if, after a preliminary examination of the Parliament's amendments, the total remaining would require an increase in the maximum rate in excess of that which can be agreed, these amendments will be considered again with a view to agreeing further modifications which would bring the total within the ceiling imposed by the maximum rate on which agreement can be reached;

b. if this procedure fails to achieve consistency between the two positions, then, as a last resort, proportional reductions will be applied to the amendments remaining to bring the total into line with the Council's view on the maximum rate.

This procedure is an internal Council working arrangement only and does not affect the balance of powers as defined in the Treaties in any way.

SUPPLEMENTARY PROVISIONS

23. Once the Budget has been adopted, the amounts provided for each item in commitments and payments can only be exceeded by the use of the following procedures:-

(i) Transfers involve drawing surplus appropriations from elsewhere in the Budget or from the reserve section in the Budget (Chapter 100), when it is anticipated that a need for further provision will arise. Transfers are subject to the approval of the budgetary authority, ie the Council or the Parliament or both, as provided for within the Financial Regulation, according to the nature of the appropriations involved. There are certain exceptions to this ground rule: transfers within chapters can be made on the responsibility of the institution concerned; the Council and the European Parliament can make transfers between chapters in their own budgets on their own responsibility; lastly, the Commission may make transfers between the two titles of its Budget relating to staff and administration on its own responsibility.

(ii) Carry-forwards (or Carry-overs) are appropriations, either for commitments or payments, which because of timing or for other reasons are not used in one year's Budget but are still needed and therefore carried-forward to the next year but remain part of the Budget in which they were entered. Some can be carried-forward automatically, eg payment appropriations outstanding in respect of commitments entered into between 1 January and 31 December, or commitment appropriations not committed at the end of the financial year in which they were entered. An example of a non-automatic carry-forward is payments outstanding as at 31 December for commitments entered into after 15 December for purchase of equipment. Non-automatic carry-forwards are approved unless the Council, acting by qualified majority, after consulting the Parliament, decides otherwise within six weeks. In the UK's view, money which has been carried-forward cannot be transferred. Article 21(2) of the Financial Regulation, which contains the rules for transfers, says that the Commission may only make proposals to transfer appropriations between chapters of the Budget, ie of the current financial year. Carry-forwards are not part of the Budget of the current financial year.

(iii) Supplementary and Amending Budgets: if there is no specific provision in the Budget or where appropriations available are insufficient to cover additional expenditure, a Supplementary Budget or Amending Budget is required. A Supplementary Budget is needed to increase the overall Budget total, for example Supplementary Budget No.2 for 1980 included provision for new commitments and payments for emergency earthquake relief to Italy. Amending Budgets provide for changes in Budget nomenclature; for expenditure which cannot be charged to existing items, or for alterations to revenue estimates, but do not increase the overall Budget size. The procedure for establishing and adopting Supplementary and Amending Budgets is broadly the same as for the Budget, but is usually compressed within a shorter timescale.

AMENDING LETTERS

24. The Financial Regulation provides that the Commission may present amending letters to the PDB. These are quite common; there were three to the 1981 Budget. These Amending Letters must be forwarded at least 30 days before the first reading of the Draft Budget and the Council must put them to the Parliament at least 15 days before this. There is one technical point which leads to artificiality and confusion: the Commission amend the PDB but the Council, when considering the proposed revision, amend the Draft Budget. Thus, there were three letters of amendment to the 1981 Draft, whereas there were only two to the 1981 PDB, since the first letter of amendment to the Draft Budget concerned an item which had been included in the PDB. (See also paragraph 16(iv).)

OUTSTANDING DIFFERENCES BETWEEN THE COUNCIL AND THE PARLIAMENT ON THE BUDGET

25. Responsibility for the implementation of the Budget is vested in the Commission by the Treaty. However, under Article 18.2 of the Financial Regulation the Commission is required to delegate authority to the other Institutions and the Court of Auditors for the implementation of their own sections of the Budget. The Parliament, which, as stated

earlier, has the final word on provisions for non-obligatory expenditure subject only to its margin of manoeuvre under the maximum rate arrangements, takes the view that inclusion of appropriations in the Budget provides, of itself, a sufficient legal base for the Commission to incur expenditure in all cases. The Council, on the other hand, maintains that, in general, formal Council agreement enacted in Community legislation is also needed before expenditure can be incurred. It accepts that the Commission has a certain discretion, ill-defined but mainly in respect of administrative expenditure, to incur expenditure without specific Council approval. The Commission's approach to this problem was outlined in a statement by Commissioner Tugendhat to the Parliament on 11 October 1977 (set out on pages 104-5 of Volume 7a of the 1979 Preliminary Draft Budget see Annex II). This explains that the Commission considered that budgetary provision constituted an adequate legal basis for expenditure only where it related to a Community policy which could be precisely defined and specified; in other cases a separate decision defining the policy needed to be enacted before appropriations authorised could be used.

26. Another important problem occurs on the interpretation of the maximum rate provisions. Until December 1977 the Treaty provisions had been interpreted as meaning that the increase in non-obligatory expenditure proposed by the Council was the amount included in the Draft Budget when it was established by the Council, and that the Parliament's margin applied to both the amendments proposed at its first reading of the Draft Budget and subsequently accepted at the Second Budget Council, and to any further amendments which it adopted when adopting the Budget in December. The Parliament's margin was therefore applied in two stages. At a meeting between the Budget Council and a delegation of the Parliament's Budgets Committee on 7 December 1977, a new interpretation was advanced. This was that the Parliament's amendments accepted by the Second Budget Council should be treated as increases approved by the Council and that the Parliament's margin should be taken as applying only to the further amendments which it adopted in December. This would effectively increase the margin available to the European Parliament; it could be countered by the Council rejecting all the Parliament's amendments. The origin of this proposal lay in difficulties that arose between the Council and the Parliament, in relation to the margin, on the sum to be included in the 1978 Budget for the Regional Development Fund.

27. The question of whether amendments accepted at the second Budget Council should or should not be attributed to the Parliament's margin has not yet been resolved but has not subsequently been pressed. As respects the 1982 Budget dispute the Parliament did not use this as justification for their action on 17 December 1981 in adopting amendments resulting in increases in commitment and payment appropriations in excess of the maximum rate.

REJECTION OF THE 1980 BUDGET AND THE TWELFTHS REGIME

28. On 13 December 1979 the European Parliament rejected the Draft Budget for 1980. It

called upon the Commission to present a new Preliminary Draft Budget for 1980 on the basis of which the Council would present a new Draft Budget to the Parliament. The reasons given by the Parliament for its rejection of the draft Budget were the level of appropriations for agriculture, the non-budgetisation of loans and the Council's refusal to agree to a major increase in the maximum rate of increase in non-obligatory expenditure.

29. In the absence of an agreed Budget for 1980, certain provisions of Article 204 of the Treaty of Rome as amended, of the Financial Regulation of 21 December 1977 and of Regulation 2891/77 came into operation. These provisions are known as the "Twelfths Regime", and limit monthly Community expenditure to one twelfth of the lower of the provisions of the 1979 Budget or the 1980 Draft Budget, and limit VAT Own Resources to the amount entered in the 1980 Draft Budget. The 1980 Budget was finally adopted on 9th July 1980.

DISPUTE OVER THE 1982 BUDGET

30. On 17 December 1981 the Parliament adopted a second set of amendments to the Draft Budget (see paragraph 16(viii)) which resulted in increases in non-obligatory expenditure of 220.5 mecu in commitment appropriations and 192.7 mecu in payment appropriations. In the Council's view, the margin of manoeuvre available to the Parliament for additional non-obligatory provision in fact amounted to 72 mecu available for commitment appropriations and nothing for payment appropriations.

31. In addition, the Parliament adopted amendments increasing both commitment and payment appropriations for Food Aid by 31.4 mecu. But the Council classifies Food Aid as obligatory expenditure and considered that it had already decided the amounts to be entered in the annual budget for 1982.

32. An additional Budget Council was convened on 21 December 1981 with the objective of further negotiation between the Council and the Parliament before the adoption of the 1982 Budget. The Council requested Mme Veil to delay adoption of the Budget until agreement had been reached on new maximum rates. The President, however, declared the Budget adopted on 21 December. Although there was thus an adopted budget which the Commission had undertaken to implement, it was necessary for the Council to consider what steps it needed to take pending resolution of the differences of opinion between it and the Parliament.

33. On 26 January the Council decided to begin without delay appropriate consultations with the Parliament and the Commission mainly on the classification of expenditure with the object of improving for the future the operation of the Community's budgetary procedure.

As a precautionary measure the Council also decided to initiate proceedings against the Parliament and the Commission before the European Court of Justice against the Budget as adopted by the Parliament. At the same time Member States agreed to pay in full the sums required by the 1982 Budget as adopted.

34. All Member States paid the full amounts resulting from the Budget as adopted in February 1982.

UK PARLIAMENTARY INTEREST IN THE COMMUNITY BUDGET

35. Under the terms of reference of the House of Lords and House of Commons Select Committees on European Legislation, (the "Scrutiny Committees"), all draft proposals for legislation and certain other documents relating to Community matters have to be deposited with both Houses of Parliament. In addition, the Department principally responsible for the subject matter of the document has normally to forward, within two weeks of deposit, an 'Explanatory Memorandum' signed by a Minister. The Select Committees then recommend which proposals should be further considered by their respective Chambers.

36. Most documents concerning the Community Budget are subject to this procedure, (except that Explanatory Memoranda about transfers and other routine budgetary matters are not signed). In the annual Budget round, the first budget documents to be deposited are those relating to the Preliminary Draft Budget. Once the Explanatory Memorandum has been provided and considered by the Scrutiny Committee together with the documents, the Treasury Minister responsible for Community matters may be called to give evidence to the House of Commons Scrutiny Committee, and officials called to the House of Lords Scrutiny Committee. It has been usual for both Houses to recommend debates on the Community Budget before the First Budget Council. In 1980 the House of Commons recommended an additional debate after the Second Budget Council.

37. After the First Budget Council, the resulting Draft Budget documents are also deposited with an Explanatory Memorandum, as are any Rectifying Letters.

38. The next document to be deposited is the Parliament's amendments and proposed modifications to the Draft Budget; these appear towards the end of October. Up to and including the 1978 Budget, this was the final document to be deposited. However, following a request from the House of Commons Scrutiny Committee, it was agreed that, for the 1979 and subsequent Budgets, the decisions taken at the Second Budget Council in November on the Parliament's amendments and proposed modifications should also be deposited together with an Explanatory Memorandum.

39. It is possible that either Scrutiny Committee could recommend a debate during the later stages of the budgetary procedure, though this has only happened so far on the 1981 Budget. The most appropriate stage for such a debate would be prior to the Second Budget Council in November, although the House of Commons Scrutiny Committee itself envisaged a debate after this in order to influence the actions of UK Members of the European Parliament before the Budget was adopted.

40. See Annex III for a list of debates.

EC2 Division

March 1982

ANNEX 1

FINANCING OF THE 1982 COMMUNITY BUDGET ON A FULL OWN RESOURCES BASIS

million ecu

	Sugar and Isoglucose levies	Agricutural levies	Customs duties	VAT/GNP Contributions	Total
Belgium	56.0	190.0	415.0	471.6	1,132.6
Denmark	25.0	10.0	140.0	245.0	420.0
Germany	200.0	255.0	1,890.0	3,338.5	5,683.5
Greece	17.0	70.0	110.0	197.5	394.5
France	258.0	140.0	1,150.0	2,913.1	4,461.1
Ireland	11.0	4.0	90.0	92.5	197.5
Italy	95.0	435.0	725.0	1,595.3	2,850.3
Luxembourg	-	0.1	4.0	22.2	26.3
Netherlands	57.0	245.0	615.0	638.1	1,555.1
United Kingdom	67.0	555.0	1,800.0	2,681.9	5,098.9
TOTAL	786.0	1,899.1	6,939.0	12,185.7	21,819.9

TOTAL BUDGET EXPENDITURE	21,984.4
Less Miscellaneous and other revenue	164.5
Amount to be financed by own resources	21,819.9

LEGAL BASIS FOR EXPENDITURE

The Council notes the following by Mr Tugendhat to the European Parliament on 11 October 1977 in connection with the discussion of Oral Question No.0 - 54/77 (to the Commission):

"This last case is a fitting introduction, Mr President, to the third part of the question as to whether the Commission considers that the Budget, as approved, provides the legal basis for the use and expenditure of the appropriations. As Mr Cheysson did last year, I can confirm that we do consider that the Budget, as approved, provides a requisite legal basis for the use and expenditure of appropriations. In the absence of such a basis no expenditure or receipts can be incurred. However, this basis is not sufficient in every circumstances to allow the expenditure. The Community can only work within the defined powers of each institution or the framework of regulations and decisions on each Community policy. The Commission, which is responsible according to Article 205 of the EEC Treaty for the implementation of the Budget, confers on each institution - in accordance with Article 18 of the Financial Regulation 'the powers needed for the implementation of the budget sections' which concern them, without for all that renouncing the overall responsibility conferred by the Treaty.

Each institution exercises these powers as is provided for in Article 4 of the EEC Treaty, 'within the limits of the powers conferred upon it by the Treaty'. One can say that, where they are not specifically mentioned in the Treaties, the powers conferred upon the institutions by the Treaties arise from the Treaties in the building of the Community. For institutions other than the Commission, the power to implement their own expenditure in practice covers virtually all the appropriations in the sections of the Budget devoted to these institutions. The provisions of the Financial Regulation, the staff regulations and the implementing texts govern the expenditure in question and lay down the limits of the respective administrative powers. The Commission of course enjoys the same scope in respect of its own operating appropriations. But these form only a small part of the total of Section 3, for the implementation of which the Commission is more especially responsible. The other, more numerous appropriations, relate either to Community policy or to individual actions clearly defined as specified measures. The Commission recognises that a problem can arise if for some budget heading the expenditure cannot be covered directly or indirectly by one of the existing legal or regulatory frameworks.

There are two possible outcomes. In the first case, the budget heading concerned authorises appropriations for measures which constitute a Community policy but which cannot be precisely defined and specified in the Budget, thus having to be left to separate decision. These authorisations cannot then be used until the legal basis required by the Treaties has been enacted. The Commission and Council must clearly make all possible speed to create this basis in time to allow the use of the appropriations. In the second outcome, the appropriations are for the implementation of clearly defined and specified measures. Every time appropriations are entered in the Budget for such measures, the Commission uses the appropriations and incurs the expenditure in accordance with budgetary rules alone.

To turn to the further question: why have we not implemented all the actions listed? I think, Mr President - I hope so at any rate - that the answer is already clear from my factual comments and from the answer I have just given on the point of principle. The Commission is able to go ahead with many specific actions where the budget provision itself constitutes the legal basis or where the separate legal basis already exists. But where this is not so, the Commission has to wait for the Council to act before implementing the Budget. When presenting the Preliminary Draft Budget the Commission always indicates the legal basis for each heading, mentioning whether this exists or will have to be created. Thus, when the Budgetary Authority enters the appropriations in the Budget it is fully appraised of any legal preliminary to the use of the appropriations concerned".

ANNEX III

Debates from May 1974

19-12-74 Commons debate on 1975 EEC Budget

(Lords ERDF 24-2-75
Commons 27-2-75)

27-2-75 Commons debate on EEC Budget Contributions

4-7-75 Further Commons debate on the 1975 EEC Budget

6-11-75 Commons Debate on 1976 EEC Budget

7-11-75 Lords Debate on 1976 EEC Budget

19-7-76 Commons debate on 1977 EEC Budget

19-7-76 Lords debate on 1977 EEC Budget

18-7-77 Commons debate on 1978 EEC Budget

18-7-77 Lords debate on 1978 EEC Budget

10-7-78 Commons debate on 1979 PDB

21-2-79 Commons debate on Documents of EEC Budget:-

1. Own Resources
2. Budget Contributions
3. Financial Mechanism
4. Resource Transfer Policy
5. CAP
6. EMS
7. Council/Assembly dispute on the 1979 Budget.

9-7-79 Lords Debate on:-

1. Financing the Community
2. Global Appraisal of Budgetary problems of the Community
3. Annual Report of the Court of Auditors 1977.

16-7-79 Commons debate on the 1980 PDB

22-11-79 Commons debate on the EEC Budget Contribution

2-7-80 Commons debate on the EEC Budget 1980

2-7-80 Lords debate on the EEC Budget 1980

28-11-80 Commons debate on the Community Budget.

1. 1981 Draft Budget
2. Letter of Amendment
3. Amendments and modifications adopted by the European Parliament
4. Annual Report of the Court of Auditors 1978
5. Council Recommendation to the European Parliament on the discharge to the Commission in respect of 1978.

20-7-81 Commons debate on the Community Budget.

1. 1982 Preliminary Draft Budget
2. The Council's Decisions on the European Parliament's amendments and modifications to the 1981 Draft Budget
3. The Preliminary Draft Supplementary Budget No. 2 for 1980
4. The Draft Supplementary Budget No. 2 for 1980
5. The European Parliament's amendments to the Draft Supplementary Budget No. 2 for 1980.

4-3-82 Commons debate on Court of Auditor's Annual Report for 1980.

COMMISSION FIGURES FOR 1982 NET BALANCES.

1. On 28 January the Commission published estimates of Member States' unadjusted net budget balances for 1982. The figures (which exclude the effect of the UK refunds) are expressed as ranges, as follows:

	MILLION ECU		
BELGIUM	232	TO	292
DENMARK	276	''	312
GERMANY	-2177	''	-1993
GREECE	673	''	723
FRANCE	- 51	''	79
IRELAND	682	''	760
ITALY	1497	''	1675
LUXEMBOURG	233	''	263
NETHERLANDS	252	''	352
UK	-2108	''	-1972

CONCLUSIONS OF THE FOREIGN AFFAIRS MINISTERS ON COMPENSATION TO THE UNITED KINGDOM FOR 1982

1. On the basis of the Commission's estimate (*), compensation for the United Kingdom for 1982 is fixed at 850 million ECU (net).

2. Corrections to be made for 1980 and 1981 in the light of the actual figures, will be taken into account when negotiating the subsequent solution.

3. At that time, adjustments will be made in the event that the actual figure proves to be higher or lower than the 1982 base referred to in paragraph 1.

If the actual figure is higher than 1 530 million ECU but lower than 1 580 million ECU, the net compensation to the United Kingdom is unchanged. If the actual figure is higher than 1 580 million ECU but lower than 1 730 million ECU the net compensation is increased by 50% of the difference between the actual figure and 1 580 million ECU. If the actual figure is higher than 1 730 million ECU, the net compensation is increased by 75 million ECU plus 75% of the difference between the actual figure and 1 730 million ECU.

If the actual figure is lower than 1 530 million ECU, but higher than 1 480 million ECU, the net compensation to the United Kingdom is unchanged. If the actual figure is lower than 1 480 million ECU, the net compensation to the United Kingdom is reduced by an amount equal to 75% of the difference between the actual figure and 1 480 million ECU.

(*) 1 530 million ECU

.../...

4. The budgetary effect of the present agreement on compensation to the United Kingdom for 1982 on the Community budget for 1982 will be limited to the amount corresponding to the net compensation mentioned in paragraph 1.

5. Compensation to the United Kingdom will amount to 1 092 million ECU (gross)(*). It will take the form of additional measures within the meaning of Regulation n° 2744/80 which will be extended and adapted accordingly. Appropriations to this end will be entered in the Community budget for 1982. The total amount will be advanced to the United Kingdom before the end of December 1982. Surpluses which exist from the 1981 and 1982 budget years will serve to finance this compensation.

If the financial mechanism yields any payment to the United Kingdom for 1982, the amount of such payment will be deducted from payments to the United Kingdom under the additional measures.

(*) The adjustment of the gross figures in paragraph 5 to take account of the possible corrections foreseen in paragraph 3 as well as the adjustment of the gross figure in paragraph 6, according to the commitment taken by Ministers on 25 May 1982 in favour of Germany, will be entered in the Budget for 1983.

The gross amounts have been calculated on the basis of the VAT shares contained in the Budget of the relevant budgetary year. They will be adjusted so as to reflect the actual VAT figures of the years in question.

.../...

6. Community resources will be allocated to projects or measures of Community interest in Germany, to take account of the need to improve the budgetary impact of common policies in that country. These Community resources will amount to 152 million ECU (net) or 210 million ECU (gross)(*). The projects and measures will be carried out in 1983. The payments will be made no later than 1983. The resources needed for this will be entered in the 1982 budget. Surpluses which exist from the 1981 and 1982 budget years will serve to finance these projects and measures. Payments will be made on the basis of a Regulation based on Article 235 to be proposed by the Commission. The total amount will be committed before the end of December 1982. Advance payments in 1982 are possible.

7. The Ministers undertake to take a decision before the end of November 1982 on the subsequent solution.

(*) See footnote (*) page 2