Prime Minister.

This is very useful.

A.J.C. 2/12.

Qz.03473

MR COLES

EUROPEAN COMMUNITY: EUROPEAN COUNCIL OF 4 - 6 DECEMBER

You thought that it would be helpful for the Prime Minister to have a short glossary of the main terms which may be used in the discussion on the budget inequity at the European Council on 4 - 6 December. I attach a note covering the main terms and illustrating it with the figures.

I am sending a copy to Sir Robert Armstrong and Brian Fall (FCO).

D F Williamson

D F WILLIAMSON

2 December 1983

EUROPEAN COMMUNITY NEGOTIATIONS ON THE BUDGET INEQUITY

Glossary of terms, with illustrative figures

1. Gross contribution. The gross contribution is the total amount of customs duties, agricultural levies and VAT on a standard basis within a ceiling of 1% ("own resources") which a member state passes over to the Community.

	million ecu	
	1981	1982
UK gross contribution	3880	5080

2. Net contribution. The net contribution is the gross contribution less receipts from the Community budget. The United Kingdom's net contribution is too high for two reasons:

   (i) because we receive too little from the Community budget (our share is only about 13%). This is usually known in the Community as the payments gap or the expenditure gap (see below);

   (ii) because we pay in too much money from customs duties and agricultural levies (our share is about 26%). This is usually known in the Community as the excess contribution.

   In money, point (i) is much more important than point (ii)

	million ecu	
	1981	1982
UK net contribution	1419	2036

3. The safety net. The United Kingdom's proposal works by applying relief to the whole of the net contribution. It works on the fair principle of relative prosperity. If a member state's GDP per head is 90% or less of the Community average, its net contribution is zero (ie relief is total). Above this the limit rises gradually with relative prosperity. The limit is always expressed as a percentage of a member state's total GDP. In 1982 the United Kingdom's limit would have been about 0.1% of its GDP and Germany's limit would have been 0.32% of its GDP.

	million ecu	
	1981	1982
UK adjusted net contribution under the safety net	219	437

/4.

4. A safety net could of course operate in two parts - one part setting relief because we receive too little from the Community budget (point 2(i): the payments or expenditure gap) and the other part setting relief because we pay in too much money from customs duties and levies (point 2(ii): the excess contribution). Other member states have moved a considerable way towards us on the first point. They are opposing us on the second point.

5. The payments (or expenditure) gap. In a two part solution, this is the bigger part. We should be able to get good relief on this. Other member states will not want us to have 100% relief above the limit. There are three ways of measuring this gap but the differences, when averaged over a period of years, are not very great:

(i) the payments share/VAT share gap. This is the difference between our share of payments from the Community budget (about 13%) and our share of all the VAT paid to the Community (normally 20-21%). We think that on balance this is the best measurement (the VAT share is, after all, our marginal contribution). This gap was

	million ecu	
	1981	1982
	1070	1785

If we got relief for all of it (which other member states will oppose) and applying our own limits formula:

	1981	1982
UK adjusted net contribution from payments share/VAT share gap relief	568	688

or (ii) the payments share/GDP share gap. This is the difference between our share of payments from the Community budget (about 13%) and our share of the Community's total GDP (about 20%). This gap was

	million ecu	
	1981	1982
	1188	1263

If we got relief for all of it (which other member states will oppose) and applying our own limits formula:

	1981	1982
UK adjusted net contribution from payments share/GDP share gap relief	450	1210

This type of relief is in the proposals of Germany, France and Denmark.

/or (iii)

or (iii) the payments share/population share gap. This is the difference between our share of payments from the Community budget (about 13%) and our share of the Community's population (about 20.5%). This gap was

	million ecu	
	1981	1982
	1246	1369

If we get relief for all of it (which other member states will oppose) and applying our own limits formula

UK adjusted net contribution from payments share/ population share gap relief	392	1104

This type of relief is in the Commission's proposal.

6. The excess contribution. In a two part solution, this is the smaller part. In recent years the excess contribution of customs duties and levies has provided about 350 million ecu towards our total net contribution. Other member states are opposing any second mechanism at all. The simplest way would be to have relief related to the GDP share/own resources share. When added to 5(ii) this would cover the whole gap between our low share of payments from the Community budget (the payments share) and our high share of contributions to the Community budget (the own resources share) ie it would cover the whole net contribution. If this new scheme could not be obtained, there are three possibilities:

(i) a cleaned-up Dublin relief mechanism. The Dublin mechanism did not work because it was littered with restrictive conditions. It was, however, a GDP share/own resources share relief scheme, which might be brought out of mothballs without the restrictive conditions.

(ii) Commission's proposal for modulated VAT. The proposal is that, subject to certain other criteria and definitions, any Community expenditure on agriculture which is above 33% of the budget would be paid for by member states on a different VAT key which would be more favourable to the United Kingdom. This does not respond directly to the excess contribution problem but it would give the United Kingdom a considerable amount of extra money

/modulated VAT:

	million ecu	
	1981	1982
modulated VAT: relief for UK additional, for example, to that in para 5(ii)	318	537

It is opposed by some member states, particularly France, partly because it "discriminates against" agricultural expenditure.

(iii) possible Commission proposal for modulated VAT on a different basis.

7. In all these areas we base ourselves on the figures in the allocated budget. We do not accept any attempt (such as that recently made by the Commission) to reduce the real figures by excluding some expenditure. The correct definition of the allocated budget is in a Commission note of 1980 (reference XIX/480/80).

8. If the United Kingdom obtains sufficient relief, there are two further points about the implementation of relief:

(i) it should be implemented, in the Community phrase, "on the revenue side" ie by reducing the VAT contribution of the benefitting member state in the following year. This leaves the Community budget free for proper expenditure instead of cluttering it up with pseudo-schemes.

(ii) it will be necessary to agree how the relief is financed. We maintain that member states benefitting from reliefs should not contribute to their own or other benefitting member states' reliefs. The cost of relief should be shared among the other member states either according to the normal VAT key or according to a special financing key. The two methods do have different effects: France, for example, wants a special financing key in order to keep down its own net contribution which would otherwise rise quite steeply in order to pay for our reliefs.

9. Timing. We need the solution to apply in respect of 1984 and later years. (This would still allow the system to come in effect in 1985 because the VAT relief is given in the year following the excessive net contribution).

D F Williamson

D F WILLIAMSON

2 December 1983