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PRIME MINISTER

Cabinet: Community Affairs: Commission Paper on Budgetary Imbalances

You may like to have this further note on the paper on budgetary imbalances tabled by the Commission at the current meeting of the Special Council, which proposes a new method allocating expenditure in the Community budget. This would be combined with their existing proposal for modulated VAT.

2. For the last four years the Commission has used a method of calculating net contributions which has been accepted as the basis for the budget refunds to the United Kingdom and Germany. This has essentially represented the difference between what a member state pays into the Community budget and what it receives. The Commission now propose:

(i) To allocate most of the European Agriculture Guidance and Guarantee Fund (FEOGA) guarantee expenditure in accordance with production shares. They justify this by arguing that payments are not necessarily made in the country of origin and that all member states benefit from the stability which the payments create. In fact, production shares are not relevant to the measurement of transfers throughout the budget from one member state to another across the balance of payments.

(ii) To exclude from the Common Agricultural Policy (CAP) expenditure on food aid restitutions and that arising from the import of African, Caribbean and Pacific sugar. In fact, both proposals have previously been rejected more than once. The costs arise from the difference between world and Community prices and are therefore attributable to the operation of the CAP.

(iii) To allocate a proportion of administrative expenditure to the host countries of the Community institutions and to exclude the remainder. In fact, Belgium and



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Luxembourg receive financial benefits for the siting of Community institutions in their countries many times greater than the direct expenditure.

3. These proposals would have reduced the United Kingdom's "expenditure gap" in 1982 from 1350 MECU (£770 million) to under 1000 MECU (£570 million), representing an apparent share of Community farm spending of 16 per cent, as compared to the actual 11 per cent and our contribution rate of 21 per cent. The proposals would also have effects on other member states: Belgium, the Netherlands and Italy could become net contributors with Britain and Germany, while other member states except France would become smaller net beneficiaries. The reduction in the United Kingdom's contribution would come from a combination of these proposals and their modulated VAT proposal which would yield some 500 MECU (£275 million). Under the new proposals member states would receive an abatement if their expenditure gap exceeded some unspecified percentage of Gross Domestic Product (GDP). This percentage would rise according to relative prosperity. Since the percentages are not specified it is not possible to say what abatement the United Kingdom would receive, but if it was accepted that the United Kingdom percentage should be 0.1 per cent of GDP (as in our safety net proposal) the United Kingdom's abatement would be at most some 500 MECU (£275 million), making up to about 1000 MECU (about £570 million) in total.

4. The proposals are reportedly the result of an initiative by Mr Thorn, who believes that other member states will not be prepared to reach a permanent settlement on the basis of the present scale of the United Kingdom's net contribution. Only Commissioner Tugendhat opposed them, Commissioner Richard being unavoidably absent at a meeting of Social Security Ministers. Because the proposals reduce the apparent size of the burden borne by net contributors, they are likely to attract other member states as offering a cheaper solution to the British budget problem. The United Kingdom has already made it clear that we reject this attempt to manipulate the figures, which cannot provide the basis for a solution.

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