John Coles
(top copy in PM's box)

Qz.03451

MR BARCLAY

EUROPEAN COMMUNITY: POST-STUTTGART NEGOTIATIONS

I attach, for the Prime Minister's meeting at 5pm on 1 December:-

(1) a memorandum on the main questions for the European Council; and

(2) a memorandum on contingency plans.

I am sending copies to Mr Fall (FCO), Mr Kerr (H M Treasury), Mr McCarthy (DTI), Mr Llewelyn (MAFF) and to Sir Robert Armstrong.

Guy Stapleton
for
D F WILLIAMSON

28 November 1983

EUROPEAN COMMUNITY: THE MAIN QUESTIONS FOR THE EUROPEAN COUNCIL

Memorandum by the European Secretariat, Cabinet Office

Introduction

1. There will be one more meeting of the Special Council on 28 November before the European Council in Athens on 4-6 December. In addition, on 29 November the Foreign Ministers, probably in a very restricted session, will discuss the preparations for the European Council. The Presidency has already circulated its conclusions on some aspects of the negotiation and we have proposed amendments. The conclusions are almost certain to be revised again.

2. Most member states want to come to a result (or, at the least, make significant progress towards a result) at Athens. It remains to be seen, however, whether a real basis for agreement will be found and whether the decisions sought will be specific or of a more general kind. It is also important to stress that even in a successful outcome there will not be a single set of decisions at Athens. An agreement on the main points may be possible. If so, the United Kingdom will continue to hold an important card, because the details and the implementing texts will need to be thrashed out over the following months and we shall not agree that a revised text should be submitted to our Parliament until we were entirely satisfied on the whole package.

3. In the light of the Prime Minister's meeting of 4 November and the results of the Special Council of 9-11 November, this memorandum sets out the decisions which will need to be taken before the European Council.

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The budget inequity

4. Our objectives, which are fully met by our safety net solution, are clear. The revised budget arrangement must be durable; must be implemented on the contributions side; must properly measure the ability to pay; must properly measure the imbalance itself (ie give relief representing a large percentage of the net contribution); and must give the United Kingdom enough money. Provided that these objectives are met, a solution could also be reached by putting together the various "building blocks", some of which are already under discussion separately in the negotiation so far. This is explained more fully below.

5. The proposals made by the Commission and the Presidency at the last Special Council on the correction of the budget inequity were unacceptable. The Commission's proposal purported to reduce the United Kingdom's net contribution by removing or adjusting some elements of the calculation. The Presidency's proposal did not take account of the contributions side, ie that the United Kingdom contributes a disproportionate share of the Community's own resources as well as receiving too little from the Community budget. While we rejected these proposals, there was for the first time a wide measure of agreement that the solution must

- be implemented by adjustment of a member state's VAT contribution;

- be durable, forming part of the revised Own Resources Decision;

- properly measure a member state's ability to pay, as the United Kingdom has proposed. The limit should be expressed as a percentage of a member state's GDP (about 0.1% for the United Kingdom under our proposal).

It is helpful that the amount of money which could be available to the United Kingdom under these successive proposals of the Commission, Presidency and other member states has been steadily increasing. We have made progress in convincing member states that the relief must adequately cover that part

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of the budget problem which results from the fact that the United Kingdom receives too little from the Community budget (the so-called "payments gap"). We have made much less progress in seeking to cover the other part of the problem, ie the disproportionate contribution of customs duties and levies to the Community budget. We are working now to maximise the chances of the inclusion in their revised proposals of as many as possible of our requirements. This will make it difficult for them to go back at Athens on these elements and on the amount of money on offer.

6. The main points which need to be examined by Ministers immediately before the European Council are likely to be:

(i) <u>the safety net</u>. It is possible that we shall come to the European Council with more than one form of safety net on the table, in particular, the version set out in our own document of 25 July and an improved version of the Presidency proposal. It is recalled that the main figures relating to our proposal, if applied to 1982 and using the GDP per head of an enlarged Community, are -

	million ecu
UK's uncorrected net contribution	2036
UK's actual corrected net contribution after refunds	910
UK's corrected net contribution if we received a relief equivalent to two-thirds of our uncorrected net contribution	679
UK's corrected net contribution under the safety net scheme	437

Faced with our opposition the Presidency and other member states may adapt their proposals in two ways which would move towards the United Kingdom's position. First, they may propose that there should be relief representing the major part of the difference between a member state's share of payments from the Community budget (UK, about 13%) and its share of the VAT

/contribution

contribution (UK, about 20 - 21%). This form of measurement of the so-called "payments gap" is gaining ground within the Community. It does deal directly with the insufficient amount which we receive from the Community budget. Even if we get a good form of measurement, there will still be an argument about the extent of the correction. In order to illustrate the order of magnitude, however, if the whole of this gap were compensated according to the safety net limits formula, the United Kingdom would have received relief on average in 1981 and 1982 of about 1100 million ecu and the United Kingdom's average corrected net contribution in these two years would have been about 628 million ecu. The relief would have been equivalent to about 63.6% of our uncorrected net contribution in those years. Other ways of measuring the "payments gap" (eg the difference between the share of payments and the share of the Community's GDP and the difference between the share of payments and the share of the Community's population) are still being discussed.

Secondly, they may include the Commission's original proposal of 6 May or some other form of modulated VAT. Since there is strong opposition from some member states to the basis on which the Commission constructed its original proposal, they may put forward another version. This approach does not deal directly with the disproportionate amount of own resources which we pay into the Community budget but its financial effect could be significant (the original proposal would have given the United Kingdom average relief in 1981 and 1982 of about 428 million ecu).

Thus, on the same basis as the figures in paragraph 5(i) and on the conditions set out above, a Presidency proposal amended in one or more of these ways would give the following results:-

UK's corrected net contribution under Presidency proposal amended so that it relates to	million ecu, average of 1981 and 1982 (the figure in brackets is the % of the UK's uncorrected net contribution)	
(a) the gap between payments share and VAT share (the payments share/VAT share formula with full compensation)	628	(36.4%)
(b) the Commission's original proposal for modulated VAT <u>and</u> the relief at point (a) (modulated VAT and the payments share/VAT share formula with full compensation)	200	(11.6%)
(note: for 1982 this is more favourable than our safety net proposal)		

It will be necessary to decide in principle before the European Council whether and with what amendments solutions based on these elements would be acceptable if all other conditions were met. The schemes are capable of adaptation so that at the outset the UK and French contributions are broadly the same.

(ii) <u>own resources</u>. The question of the Community's requirements in terms of own resources does not arise unless the United Kingdom is satisfied on the conditions laid down by the Prime Minister at Stuttgart. If we were satisfied, we would need to be able to take a position on the size of the Community's own resources. The elements of this judgement are the effect on the VAT ceiling of the financing by other member states of the budget relief for the United Kingdom; the costs of enlargement; some possible growth in new policies; and the potential savings, particularly from agriculture. An increase in the ceiling requires ratification by the Parliaments of all member states of amendment of the 1970 Own Resources Decision - the same Decision which will need to be amended in order to include the arrangements for the budget relief.

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The financing of reliefs can be done in three ways and the effects on the own resources ceiling would be slightly different -

(a) outside the VAT ceiling.

(b) financed net within the VAT ceiling (ie the total payments made to finance the reliefs equals the cost of the reliefs). This would require a VAT ceiling of about 1.1%.

(c) financed gross within the VAT ceiling (ie as under the current refund arrangements - member states contribute towards the costs of their own reliefs). This would require a VAT ceiling of about 1.2%.

Any increase in the ceiling requiring ratification by national Parliaments should not be a short term decision. The technical judgement of officials is that, allowing for enlargement, a diminishing proportion of Community expenditure on agriculture and growth in real terms of other Community expenditure, an increase in the VAT ceiling to 1.2% should be sufficient to finance the Community budget at least into the 1990s. This does not take account of the possible 0.1% or 0.2% which might be needed to permit the financing of the United Kingdom's budget relief by other member states.

Within the Community some member states are thinking in terms of unrealistic figures such as a 2% VAT limit (Commission proposal 1.8% by two new slices of 0.4%). The Germans - and probably most member states in the end - are likely to opt for a single increase of 0.4%. This would be a once-for-all increase in the total own resources of the enlarged Community of about 23%. There has been some suggestion that, within any new maximum approved by Parliaments, any increase in the

 /VAT

VAT ceiling should be released in tranches. This would have advantages for expenditure control. It would be difficult to obtain agreement to this within a ceiling of 1.2% but it might be possible within a ceiling of 1.4%.

The United Kingdom's corrected net contribution will of course be equivalent to a VAT rate substantially below the Community maximum. If we assume, first, that the correction of the budget inequity would be made by reducing the VAT contribution of those member states receiving relief and passing the cost on to other member states according to a normal VAT key and, secondly, that the United Kingdom receives the amount of relief under our own safety net proposal, the situation on the same basis as the figures in paragraph 5(i) would be that the UK's corrected net contribution would be equivalent to a VAT rate for the United Kingdom of about 0.4%. Even if the increase in the ceiling were to 1.4% the United Kingdom's VAT contribution after reliefs would be equivalent to less than 1% provided that the relief gave more than about 950 million ecu net.

The timing of any increase in the limit on own resources is very important for the United Kingdom. In a final package we must ensure that the new system comes into effect (after ratification) in 1985, so that the relief for the budget inequity in 1984 can be included in an amended 1985 budget. Failing this, we must have a cast iron undertaking that relief equivalent to that available to us under the revised system will be given in respect of 1984 and later years.

(iii) control of agricultural and other expenditure. The French have now floated ideas for a more rigorous control of all expenditure, which could be helpful to us. It is doubtful whether they will be fully developed by Athens but we would like to see some reference to these ideas in the communique, as a basis on which we could build in the period immediately following the European Council. They are additional to, and not a substitute for, obtaining at Athens the best possible result on control of agricultural spending.

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The negotiations on the strict financial guideline for agricultural expenditure have not disclosed any willingness among eight member states to support the British/Dutch demand for a legally binding arrangement. Two conclusions can be drawn: first, we must carry our proposal unchanged into the European Council since the issue will in any event be a major component of the discussions there. Secondly, a strict and legally binding guideline does not appear to be negotiable at Athens; the only arrangement on which agreement could be obtained is a guideline embodied in political commitments by the European Council and the Commission and based broadly on the Commission's ideas (though perhaps strengthened by suggestions from the Germans and Dutch). We shall have to judge whether our requirement of effective control of agricultural and other expenditure can be met by the European Council's endorsement of the French ideas for a guideline for all Community expenditure; by specific adoption of the Commission's revised proposal (as strengthened by the Germans and Dutch) for the guideline on agricultural spending; and a commitment by the Commission that it will not make proposals in breach of the guideline.

(iv) agriculture. The revised Presidency text takes partial account of the amendments which we have been pressing. On a cautious and, where necessary, restrictive price policy and on the application to more products of limits on the guarantees ("guarantee thresholds") the text is broadly on the right lines but needs to be tightened up. There remain a number of lesser questions which we are trying, probably successfully, to keep out of the discussion in the European Council and three principal points - milk, cereals (including cereal substitutes) and monetary compensatory amounts.

On milk, we need to set out more clearly the amount of milk which would receive the full guarantee in the Community and the methods to be taken to bring production back within those limits. Our favoured solution is to do this through price alone or, failing this, through price combined with a quota/super levy system. In the second case we should accept

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the quota/super levy proposal, provided that the reference year is satisfactory (it should not be based on 1981 but on 1983 production less an agreed percentage) and that we are satisfied that the scheme will be effective, non-discriminatory and capable of satisfactory administration. We should aim for a price freeze, since it would be absurd to offset the effects of a quota/super levy system by a lax price policy. It would not be appropriate for decisions to be taken at Athens on other specific milk proposals in the Presidency paper, in particular the application of a tax on so-called intensive holdings (which we oppose); the suspension of intervention for skimmed milk powder (which needs further consideration); and the suspension of the butter subsidy (which is of benefit to the United Kingdom and is an aid to consumption which it would be quite wrong to abolish while the Community has excessive stocks of butter).

On cereals we need the strongest possible reference to our intention to bring Community support prices more nearly in line with those in other major producing countries, principally the United States. On imports of cereal substitutes there will be disagreement: we should not accept any commitment to deconsolidate the tariffs but should aim for further discussions between the Commission and the United States at which the Commission should seek to make the most of the Community's restrictive intentions on its own support prices for cereals.

Monetary compensatory amounts are a Franco/German battleground. We must be satisfied on the arrangements applicable to variable mcas such as we have in the United Kingdom. We should continue to oppose the German suggestion that in future currency realignments agricultural prices should be set in terms of the strongest currency. If at Athens in an otherwise satisfactory package it were thought right to accept this suggestion, we would need strict arrangements restraining the phasing out of the negative mcas.

The oils and fats tax must be rejected.

/(v)

(v) <u>other policies</u>. Our principal objectives are to direct attention to, and to obtain progress on, those areas of policy which will be beneficial to the United Kingdom and do not add significantly to expenditure. For this reason we are pressing for progress on the completion of the common market both in good and services (single administrative document, lorry quotas, air services, insurance, standards) and other action of particular benefit to us (solid fuels policy, lead in petrol). It is clear that, for a balanced package as seen by other member states, the Athens communique will need also to refer to improving the environment for cooperation between industrial enterprises in the Community (insofar as this relates to the removal of obstructions to such cooperation while leaving the commercial decisions to the enterprises themselves, we can support it); to new technologies in areas such as telecommunications; and to certain specific decisions on proposals already made.

We should oppose the proposed doubling of finance for the structural funds (Regional Fund, Social Fund etc) and will be supported on this. We should refuse to take decisions on the very costly integrated Mediterranean programmes. We should be able to avoid a decision on the financing of the research and development programme. There will be a need to decide what financing we can accept for the information technology programme ESPRIT.

The Presidency's revised text includes most of the points on our short list, although we have proposed further strengthening and correction. The French are unlikely to be satisfied with the references to industrial cooperation and will have to fight for any text which they may put forward. There will probably, however, be common ground which will make it possible for us to establish sensible references to improving the environment for cooperation between industrial enterprises.

/7.

Contingency plans for a deadlock at Athens

7. Before the Athens European Council we need to be clear what line the Prime Minister should take at the conclusion of the Council if there is a deadlock and, in particular, whether we should move straightaway to block the transfer of the Community's own resources. An updated separate paper on the options and contingency plans is being circulated.

8. On the basis of the Special Council discussions we believe that, although an agreement may not be reached in the European Council, it is unlikely that the discussion will break down through a complete failure of other member states to comprehend our requirements. It is probable that their proposals will be substantial, although it remains to be seen whether they are sufficient. It is unlikely that an inconclusive or disagreed result of the European Council will lead other member states to try to block the United Kingdom's 1983 refunds agreed at Stuttgart.

9. In these circumstances it is more likely that a problem will arise with the European Parliament later in December. The European Parliament might put the United Kingdom's 1983 refunds in the reserve chapter with specific conditions restraining transfer to budget lines.

10. It is recommended that our line should be -

(i) in the event of a successful conclusion at Athens, we would expect that our 1983 refunds in the 1984 draft budget will run through and that the new agreement itself covers the situation in relation to 1984 and later years;

(ii) if, contrary to our expectations, other member states were to make clear that they intended to block on a continuing basis the regulations necessary for the payment of our 1983 refunds, the United Kingdom Cabinet would be invited to agree that we should block the transfer of the Community's own resources;

/(iii)

(iii) if the European Parliament were to block the payment of our 1983 refunds, we should demand that the Commission and the Council of Ministers should honour the Stuttgart declaration by taking the necessary budgetary action in time to enable the bulk of the refunds to be paid by 31 March 1984. We would set a deadline, eg the end of the United Kingdom's financial year, with a more or less explicit threat to block the transfer of Community funds if the deadline were not met.

Conclusions

11. Before the European Council of 4-6 December it will be necessary for Ministers to decide:-

(i) whether and under what conditions the possible approaches to the solution of the problem of budget inequity set out in paragraph 5(i) could meet our requirements;

(ii) to take stock of the latest situation on the strict financial guideline for agriculture (and other) spending; and to decide whether the combined elements could represent the effective control of spending which is required (para 5(iii)

(iii) to endorse the main negotiating objectives for agriculture set out in para 5(iv)

(iv) to endorse the United Kingdom's existing approach on other policies, as set out in para 5(v);

(v) their approach to the question of own resources, if all other conditions were met (para 5(ii));

(vi) to decide in principle whether the response to an unsuccessful conclusion at Athens should be as in para 10.

Cabinet Office

25 November 1983

EUROPEAN COMMUNITY BUDGET NEGOTIATIONS: CONTINGENCY PLANS

Memorandum by the European Secretariat

Cabinet Office

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1. It is not possible now to know whether the European Council in Athens on 4-6 December will come to a successful conclusion, a partial success or a deadlock. It is necessary, therefore, not only to conduct our strategy with a view to a success at Athens but also to be prepared for a worse result and in that event to be prepared to protect our position on our 1983 refund (750 million ecu net) and on the amount which we insist that we are owed under the 1982 risk sharing arrangement (75 million ecu net).

The 1983 Refund

2. The conclusions of the European Council at Stuttgart provide that a refund of 750 million ecu net should be incorporated in the 1984 draft budget. The Budget Council in July respected this decision: it made full provision in the 1984 draft budget and allocated the amount to budget lines, not to the reserve chapter. Implicitly, therefore, the Council rejected, as we do, any argument that these refunds were conditional on decisions on future financing.

3. The Stuttgart conclusions do not specify when during 1984 the refunds are to be paid. As in the case of previous refunds, we want the payment to be made before 31 March 1984. Before the refunds can be paid, two further stages are required:

(i) the European Parliament must adopt the 1984 budget, including provision for these payments. If provision is made on budget lines, there is no problem. If provision is made in the reserve Chapter 100, a further step is required to transfer the provision to budget lines;

(ii) the Council must adopt the necessary implementing regulations which provide the legal basis for making payments out of the Community budget.

Budgetary Provision

4. At its plenary session on 24-28 October the European Parliament put the United Kingdom's 1983 refunds (and 825 million ecu of agricultural guarantee money) into the reserve Chapter 100 of the draft budget, adding that payment of

/the refunds

refunds was conditional on "the opinion it forms of the outcome of the European Council in Athens". On 22 November the Budget Council decided to reject the proposals made by the European Parliament and reinserted the original provision on budget lines. The Council has the last word on the part of our refunds classified as obligatory (736 million ecu gross) but the European Parliament at its second plenary session on 12-16 December has the last word on the part classified as non-obligatory (255 million ecu gross). If the Parliament respects the Council's classification between obligatory and non-obligatory expenditure, they would only legally be able to place the non-obligatory expenditure in Chapter 100. The Parliament, however, may dispute the classification and declare the budget adopted with all our refunds in Chapter 100. If all or some of the refunds remain in Chapter 100, a further decision by the Council and the European Parliament will be required before the money can be paid.

5. The European Parliament also has the right at its December plenary session to reject the draft budget in its entirety. This would create, however, an entirely new situation going well beyond the payment of our 1983 refund.

Regulations

6. The regulations have to be adopted unanimously by the Council of Ministers. An Opinion from the European Parliament is also required. If the European Parliament's Opinion differs from the Council's, it may demand conciliation with the Council before the regulations are adopted. The Commission is about to table the regulations. They have yet to be considered either by the Council or by the European Parliament.

Cash Flow Problems

7. Even if the regulations have been passed and the necessary provision has been made within the 1984 Budget, there will still be an additional obstacle to be cleared to ensure that the bulk of our refunds reach us, as in previous years, by 31 March. In previous years the Commission has been able to meet this deadline without any difficulty, because it has had surplus cash in its bank accounts carried over from the previous year. At the beginning of 1984, however, it will be very short of cash. One way round this difficulty would be for the Commission to have recourse to advances of own resources and, if necessary, their overdraft facility. There will, however, be pressure from both the Commission and other member states that our refunds should be paid over a longer period of 1984.

/The Political

Political Obstacles

8. Despite the results of the European Council in Stuttgart and the decisions of the Budget Council in July, there is a risk that, if there is little or no progress at the Athens European Council, France or some other member states would block the implementing regulations under which the 1983 refunds would be paid to us in 1984. The conclusions of the Stuttgart European Council bear out our interpretation that no conditions were attached to the 1983 refund. The Prime Minister has since set out our understanding in a letter to Chancellor Kohl, copied to President Mitterrand, on which there has been no come-back. Chancellor Kohl's statement to the European Parliament on the outcome of the Stuttgart European Council made no mention of any conditionality. Nonetheless, the question of our 1983 refunds is a lever which some member states may yet try to use in the present negotiations.

9. Thus if in the opinion either of the European Parliament or of one or more member state there is insufficient progress at the Athens European Council in resolving the main issues including new own resources raised in the post-Stuttgart negotiation, the payment of our 1983 refunds could be blocked. The situation would almost certainly not be clearcut. We could find that provision for our refund was incorporated in the 1984 budget but that all or part of it had been transferred to Chapter 100. Equally, there could be delay over the adoption of implementing regulations caused either by other member states' desire to continue to exercise leverage over us in the context of the wider negotiations or by the need for conciliation with the Parliament. The situation might be sufficiently confused to make it difficult for us to point clearly to a single, politically motivated cause for delay.

10. If payment of both our 1983 refunds and the outstanding risk-sharing element of 1982 refunds were made in line with the timetable followed in recent years, we would expect the bulk (£510 million gross) to be paid by the end of our 1983/84 financial year, with the balance (£115 million gross) paid in the Summer of 1984. In 1984 our net contributions to the Community are estimated to be about £100 million a month. If, therefore, we were to begin blocking from 1 January 1984 the transfer across the exchanges of the Community's own resources, we could expect by 31 March to have withheld about three fifths of the amounts which we should have been paid by then.

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'tions on the 1983 Refunds

11. It is not very probable that a direct threat to our 1983 refunds will appear at the conclusion of the European Council on 4-6 December. It is more likely that there will be difficulties when the European Parliament decides on the 1984 budget on or about 16 December. If following the European Council in Athens and the December plenary session of the European Parliament the obstacles to the payment of our 1983 refunds have not been overcome, the following are the principal options:-

Option 1. In the event of an overt challenge by member states (eg a deliberate and continuing refusal to agree to the implementing regulations) we could block the transfer of an equivalent amount of the Community's own resources. Contingency plans have been updated. This would require a formal decision of United Kingdom Ministers. Ministers would also need to decide a number of important issues, as set out in OD(83)9, such as the form and extent of the blocking of Community funds, whether legislation were required and, if so, its timing and content, and whether to publish a White Paper (the draft circulated as OD(83)8 is being updated). Action would create a new crisis in the Community and would have a major impact on the course of the post-Stuttgart negotiations.

Option 2. If the European Parliament, and not a member state, was the cause of the difficulty, we could seek a unanimous declaration by the Council of Ministers of its determination to honour the Stuttgart agreement on 1983 refunds. We would follow this up by demanding that the Commission and the Council honour this declaration by taking the necessary budgetary action in time to enable refunds to be paid by 31 March 1984. The European Parliament's agreement to this - their March Plenary Session 12/16 March - would depend on progress in the post-Stuttgart negotiation up to and at the March European Council (19/20 March). We could set a deadline for payment of the refund, eg the end of the United Kingdom's financial year which would be after the March European Council. We could couple this with a more or less explicit threat to block the transfer of Community funds if the deadline was not met.

Options on the Risk-Sharing element of the 1982 Refunds

12. Although the United Kingdom has drawn attention to the failure of the Community to honour its obligations under the risk-sharing arrangements at successive meetings of the Foreign Affairs Council and the Special Council and has asked for action to put the matter right, we have received no support from

/other

her member states who have refused to admit any further liability. It is necessary to decide how to handle the issue at Athens. If we do not waive or trade off our claim in the course of the discussions at Athens, the following appear to be the principal options:-

Option 1: We might seek to make the early payment of the 75 million ecu net an extra condition to our final agreement to an otherwise satisfactory package on the Community's future financing arrangements.

Option 2: We could continue to press our claim, if necessary by taking our case to the European Court. The advice of the Law Officers will be available by 1 December. Departmental legal advisers consider that the prospects of success are slight. Nevertheless, we should probably be following a fully defensible line of action and could try this course if other ways were blocked.

Option 3: If, as a result of failure either at Athens or later, we were blocking transfers of own resources to the Community in order to secure our 1983 refunds, the 75 million ecu net could be added to the amounts withheld.

Conclusion

13. Our strategy is to achieve a successful result at the Athens European Council. Contingency plans in the event of a deadlock are prepared. The options in relation to the 1983 refunds are set out in paragraph 11 and those in relation to the risk-sharing element of the 1982 refunds in paragraph 12.

European Secretariat
Cabinet Office
25 November 1983

A.T.C. 2/12

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DEBATE ON EUROPEAN COMMUNITY BUDGET

A brief for the debate on the European Community Budget to be held on Thursday, 1st December 1983.

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(see over)

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DEBATE ON COMMUNITY BUDGET DOCUMENTS

a. Future Financing of the Community

In this document the Community puts forward a draft decision on 'own resources' to replace the original 'own resources' decision of 21st April 1970. This would require Treaty amendment and constitutes a very major change in Community funding.

The main features of the proposals are:

i) an increase in the VAT ceiling from 1% to 1.4%. This would be worth about 6 billion ecus.

ii) the introduction of a corrective VAT mechanism for part of the revenue derived from VAT. Part of VAT would be raised according to a special key reflecting shares in the Community's agricultural production and 'net operating surplus', modified to take account of relative prosperity. See paragraphs 8 and 14 of Commission document for detailed explanation. It is estimated by the Treasury that this would reduce the UK's net contribution by about 25%.

iii) other:
- the Commission would retain any surplus of revenue over expenditure at the end of each year rather than return it to member states.
- the Commission proposes that the Council (acting unanimously) and Parliament (by three fifths majority) should have the power to reduce the reimbursement of the cost of collection of 'own resources'. This is at present 10% of total levies and duties. This proposal would be worth about 1 billion ecus.
- the Commission proposes to include customs duties on products under the ECSC Treaty as part of general budget revenues. This would be worth about 60 million ecus.
- the Commission is considering the introduction of a tax on non-industrial consumption of energy as part of 'own resources'.

iv) the Commission also reiterate a controversial proposal outlined in their February paper. They urge consideration of a proposal which they tabled in 1973. Under this the Community institutions would be empowered to create additional sources of revenue without having to obtain ratification by national parliaments. Following consultation with the Parliament the Council would consider whether, and in what manner, new revenue should be introduced by the Community. The European Parliament could then, acting on a Commission proposal, and after the Council had given its unanimous assent, amend the upper limit of the VAT ceiling if the proposal obtained a sixty per cent majority.

The overall impact of these proposals would be to increase 'own resources' for the Community by about 25-30%.

b. <u>Report by the Court of Auditors on Financial Management of Community activities</u>

These detailed reports have been effective in uncovering waste of financial resources and are useful as an independent source of support for the Government in its demands for more stringent scrutiny of Community finances.

The Court is critical in this report of:

- EAGGF Guarantee Expenditure and recommends that producers assume responsibility for costs incurred as a result of over-production. The Court also recommends that MCAs (Monetary Compensatory Amounts) be reformed so as to limit their budgetary effect and to encourage a return to economic balance by means of competition. The Court would undoubtedly prefer to see the abolition of MCAs.

- the absence of clearly defined objectives for the Structural Funds and the Commission's failure to evaluate systematically policies according to objectives. Here the Court recommends that 'the Commission should work in conjunction with Member States from the decision-making stage to that of on the spot monitoring.'

The Court of Auditors' report, valuable as usual in highlighting inadequacies of aspects of the Community's financial affairs, is unfortunately unlikely to have much impact.

c. & d. <u>The Fourth and Fifth Reports from the Commission on the Supplementary Measures Scheme</u>

These half-yearly reports serve to verify the implementation of the Special Programmes which form the UK refunds. Together with any refunds paid under the amended financial mechanism, these receipts make up the United Kingdom's entitlement to refunds under the Budget Agreement of 30th May 1980. The Commission appears to be satisfied with their implementation.

e. & <u>Preliminary Draft Supplementary and Amending Budget No. 2 for 1983</u>
f. <u>The Draft Supplementary and Amending Budget No. 2 for 1983</u>
g. <u>Letter of Amendment to the Draft Supplementary and Amending Budget No. 2 for 1983</u>

The Supplementary and Amending Budget No. 2 for 1983 was adopted by agreement between Council and the European Parliament in October. The main elements of the adopted Supplementary budget were:

i) extra EAGGF spending of 16.5 thousand million ecus.

ii) rebates to the UK of 307.5 million ecus and to West Germany of 62.5 million ecus for 1982.

The difficulties encountered in passing this Supplementary budget reflect the urgent need for a long term solution to the budget problem as a whole. Several Groups in the European Parliament attempted to put pressure on Council to produce a long term solution by suggesting that the Supplementary budget be blocked (by placing it in chapter 100). The European Democratic Group, after considerable lobbying, was successful in preventing these Groups from mustering the required 218 votes.

h. Community Structural Funds

The Stuttgart Council emphasized the need to make the Structural Funds subject to greater budgetary discipline and the Commission was asked to produce a report with proposals.

The Commission advocates that the Funds make a more affective contribution to economic convergence and suggests that the Commission should have more influence over the allocation of funds to ensure this. The Commission also advocates that these funds should be more distinct from national funding programmes and that they be geographically targeted to ensure a higher proportion of Community finance in approved projects than at present.

The report concentrates on the Regional Fund. The priority for Community funding should be the development of structural adjustments for less developed regions and declining industrial areas, the intention being to direct funds more towards those areas where problems have been created by Community policies (for example rationalisation of the steel industry). Although initially programmes would be agreed jointly between the Commission and Member States the Commission feels that ERDF operations should eventually satisfy 'specifically Community objectives'. The Commission also anticipates abolishing the distinction between 'quota' and 'non quota' sections of the Fund, after a transitional phase. The Commission points to the problems of co-ordination of Funds, their complementarity, and the danger of overlapping assistance. The Commission also points to the benefits to be derived from improvements in monitoring and assessing projects as they proceed.

The Government is generally sympathetic to many of the suggestions in this paper, agreeing about the need to concentrate effort geographically and favouring emphasis on problems of industrial decline. However handing over further control to the Commission at this stage may not reap clear benefits and may be more costly to administer.

2. The British Government's Position

There have been numerous clear statements on the Government's position over the past few years. Sir Geoffrey Howe's speech in The Hague, 'the positive approach', submissions by the UK delegation to Special Council after the Stuttgart Summit this year, and other recent statements are summarized below.

a) The Hague Speech

Shortly before the Commission produced its Mandate Report in June 1981 the Chancellor of the Exchequer, Sir Geoffrey Howe, outlined the British Government's philosophical approach to the Budget problem in a speech at The Hague. The central tenet of the Chancellor's speech was that the Community should be more rational and deliberate in its distribution of resources. While stressing that he was not advocating a system of juste retour, Sir Geoffrey said:

> 'Within nation states, it is an established and overriding principle that resources should tend to flow from more to less prosperous regions, and not vice versa. But there is no comparable principle governing resource flows between Member States. The net effect on individual Member States is largely fortuitous. It emerges accidentally from a multitude of separate, unco-ordinated decisions by the Commission and the Community's specialist Councils ... The conclusion which seems to me to emerge, is that the Community will need in future to take conscious decisions on how the budget should affect individual Member States. We cannot allow the budget to go on producing redistributive effects which are entirely perverse' (3rd June 1981).

Among the Chancellor's more detailed proposals were that:

- the 1 per cent VAT ceiling should remain intact for at least as long as the Community's expenditure priorities remain unreformed. He expressed considerable scepticism about whether, even then, Member States would feel able to release proportionately larger funds to the Community at a time of great financial stringency at national level;

- the non-budgetary costs and benefits of Community membership (e.g. Italy's net receipts from the budget which are broadly offset by adverse resource transfers outside the budget on trade in agricultural produce) should be taken into account;

- expenditure on agriculture should rise annually by less than the rate of growth in 'own resources' and should thereby be reduced as a proportion of the budget;

- increases in expenditure on regional and social projects would not be sufficient to offset the budgetary effects of the CAP. A resource-transfer mechanism was therefore required.

- the cost of the CAP should be reduced through the elimination of structural surpluses and by subjecting agricultural spending to the same financial disciplines as apply to national public expenditure programmes.

b) 'The Positive Approach'

During the Autumn of 1982 British Ministers launched a series of speeches on the development of new Community policies designed to show that the United Kingdom's interest in Community affairs is not restricted to the problem of the British net contribution to the Budget. These proposals for increased European co-operation (quotations from which have been collected in a pamphlet called 'The Positive Approach') included the following suggestions:

- increased Community support for the devlopement of coal and greater energy pricing transparency between Member States;
- an expansion of the European Regional Development Fund and a concentration of Community aid on unemployment blackspots;
- liberalisation of the Community market in services, particularly air transport, road transport and insurance;
- increased exchange of information about, and co-operation to overcome, the problems of urban decay;
- improvements to the Common Agricultural Policy to reduce and ultimately eliminate structural surpluses, and action to achieve a better balance between livestock and cereal prices;
- in relation to the new technology industries the British Government would like to see a liberalisation of the market (particularly in relation to public procurement) in order to secure the full advantages of the Community's 'home' market of 270 million consumers;
- an expansion of the resources available to the Social Fund and greater concentration on combating unemployment amongst the young.

c) <u>Submissions to Special Council</u>

The Government's position in Stuttgart and negotiating stance for Athens remains that any increase in 'own resources' can only be considered if a lasting and equitable solution to the sharing of the budgetary burdens between Member States and the strict budgetary control of agricultural other expenditure is found.

The UK delegation have suggested the creation of 'a safety net' whereby:

- the Community would agree that Member States whose relative prosperity (after enlargement) was below a given level would be net beneficiaries of the budget and not in any circumstances net contributors;
- above that level a Member State's net budgetary burden would be expressed as a small percentage of a Member State's GDP and a limit would be placed on the extent of that burden;
- any Member State bearing a net budgetary burden of more than this agreed limit would have VAT payments reduced by that amount in the following year.

On agricultural spending, the British Government has consistently taken the view that the rate of growth of CAP expenditure should be markedly lower than the rate of growth of the Community's 'own resources'. To ensure this a strict financial guideline for the CAP is proposed. The Treasury document 'Future Financing and the Development of the Community: British Government ideas' published in October 1983 suggests that 'the rate of increase in Guarantee expenditure by the European Agricultural Guarantee and Guidance Fund (FEOGA) in any year, as compared with the corresponding provision in the original budget adopted for the preceeding year, cannot exceed a proportion (the given fraction) of the rate of increase in the Community's 'own resources' base between those two years. The size of the 'given fraction' would be for negotiation. Complementary to the 'safety net' proposal and the suggestion for a strict financial guideline for CAP expenditure, is a paper on the Future Development of the Community. This proposes other areas where the Community may develop and ia an elaboration to some extent of the ideas outlined in 'The Positive Approach' described above.

On the question of raising the 'own resources' threshold the Foreign Secretary stated in the House on 14th November 1983:

> 'we would be prepared to consider this (an increase in own resources) provided that two very important conditions were met: first, that agreement was reached on an effective control of the rate of increase of agricultural and other expenditure; and secondly, that it was accompanied by an arrangement to ensure a fair sharing of the financial burden.' (Hansard, col. 611).

3. The Positions of Other Governments

It is probable that all the other Member States favour an increase in the 1% VAT ceiling. However for some time West Germany has agreed with the United Kingdom that greater financial discipline in Community spending is required and was critical of the Commission's proposal to raise the VAT ceiling from 1 to 1.4%, tabled at Stuttgart. On 28th November at the penultimate Special Council session of Foreign and Finance Ministers, France agreed with the need for tighter control of spending. Ireland has maintained its opposition to the proposed super levy on surplus milk production, a substantial element of the Commission's proposals to control surpluses and farm spending. Denmark and possibly Italy would probably prefer an increase in the VAT ceiling to up to 2%.

4. History and Background

(a) General Characteristics of the Budget

The European Budget amounts to about 0.9% of the Community's Gross Domestic Product, or 2.6% of total public expenditure in the EEC. Its revenues are derived from the Community's 'own resources' whereby certain revenues, although collected by national authorities, belong to the Community from the time of their collection. The main components of 'own resources', and their approximate contribution to total revenue, are: customs duties (31%), levies on agricultural imports and sugar levies (10%) and revenue from notional rate of VAT calculated on a harmonised base up to a ceiling of 1% (59%). The Budget is determined each year through a lengthy process of negotiations between the Council of Ministers (who have the final word on 'obligatory' expenditure - chiefly agriculture) and the European Parliament (which within an overall ceiling has the final say on most non-agricultural spending).

(b) The Cause of the Budget Problem

Britain's budgetary problems arise first because of the United Kingdom's low level of receipts from the Community Budget. Britain only receives about 11% of the disbursements made under the Common Agricultural Policy Guarantee Fund (which accounts for almost two-thirds of total Community spending), while funding about 20% of the gross expenditure.

Secondly, Britain's contribution to the 'own resources' system is higher than our share of Community GDP because our level of trade with non-Community countries is proportionately higher than for other Member States, making Britain liable to pay more in customs duties. Also, due to our consumption patterns and low level of self-sufficiency, Britain has to pay 27% of the total levies collected on agricultural imports into the Community. A root cause of the problem is, however, that whereas nations ensure that their fiscal systems achieve a redistribution of resources from prosperous areas to disadvantaged ones the Community pays little regard to the distributive impact of its policies.

(c) The Conservative Government and the May 30th Agreement

In October 1979, the Prime Minister gave notice of her determination to achieve a substantial reduction in Britain's net contribution. Delivering the Winston Churchill Memorial Lecture she declared:

> 'Britain cannot accept the present situation. It is demonstrably unjust. It is politically indefensible ... the imbalance is not compatible with the spirit of the Community. Its continuation would undermine the sense of solidarity and common obligation which lies at the base of Community endeavour' (Luxembourg, 18th October 1979).

There followed seven months of concentrated negotiations which culminated in the May 30th 1980 Agreement under which our partners agreed to pay compensation for Britain's excessive contribution in respect of 1980 and 1981, with a possible extension for a third year should a long term solution not have been devised by then.

The 'refunds' paid for the first two years amonted to £1.7 billion and were used to help finance infrastructure projects primarily, although not exclusively, in the United Kingdom's Assisted Areas. The second element of the May 30th Agreement was to give the Commission a 'Mandate' to produce proposals on the restructuring of the Community's expenditure priorities without calling into question the basic principles of the 'own resources' system or the Common Agricultural Policy but with the objective of preventing the recurrence of an 'unacceptable situation' for any Member State.

The Commission produced its Mandate Report in June 1981 which contained proposals on containing agricultural expenditure, reducing the production of surpluses, the development of new Community policies and the completion of the internal market. In addition the Commission conceded that their gradualist approach to CAP reform together with the development of new expenditure policies would be unlikely to solve the UK Budget problem immediately. For example if all other factors were to remain as at present the European Regional Development Fund would need, with present quota allocations, to be increased by 50 billion ecus (approx. £28 billion) or over twice the size of the present Community Budget, to give Britain net receipts equivalent to our basic refund of 850m ecus for 1982. Accordingly, as the Mandate Report recognised that the root of the 'British problem' lay with the operation of the CAP, it suggested the initiation of a new mechanism to compare the United Kingdom's share of Community GNP with its share of agricultural receipts, with funds being made available to finance new projects of Community interest in Britain to make up part of any discrepancy.

Concentrated negotiations took place during the second half of the British Presidency on the basis of the Mandate Report. A breakthrough was made at the London meeting of the European Council when disagreement was narrowed to four heads: control of production in the milk sector; improved support arrangements for Mediterranean agriculture; the target for the growth of agricultural expenditure within the total resources available to the Community; and the initiation of a mechanism to prevent any Member State from having to make an inequitably large net contribution to the Budget. Unfortunately, however, the momentum of the negotiations was lost during the early months of the Belgian Presidency. In an effort to break the deadlock which was beginning to develop the Presidents of the Council and Commission, Mr. Leo Tindemans and M. Gaston Thorn, tabled various proposals which would have ensured that Britain received budgetary compensation over a 3-5 year period. However, the negotiations inevitably became entangled with the Annual Farm Price Review for 1982-3. An interim settlement for 1982, in accordance with the optional extension provided for by the May 30th Agreement, was promoted by the Presidency. Discussions on this were continuing when the Community was thrown into turmoil following the setting aside of the British veto on the Farm Price package. This repudiated the fundamental link between agricultural spending and the budget problem which had been unanimously recognised by Heads of Government at the European Council meeting in London.

(d) <u>The May 25th 1982 Agreement</u>

The crisis was temporarily defused the following week (May 24th - 25th) by an agreement on 'refunds' for the United Kingdom: a basic refund in respect of 1982 of £490 million, with provision for sharing the burden should the Commission's estimates of the UK net contribution either prove too conservative or too pessimistic. At the same time the Council expressed its intention to devise a long-term settlement to the Budget problem by the end of November 1982. The May 25th 1982 Agreement was, however, exceptional in releasing the Federal Republic of Germany, as a fellow net contributor, from the obligation of financing more than half her normal share of the British 'refunds'.

Unfortunately because of the difficulties (encouraged and amplified by the French delegation) over devising exactly how to finance the German relief (i.e. should the United Kingdom contribute to the FRG's compensation for having to pay 'refunds' to Britain for its excessive net contribution) and over whether Britain should have to compensate the Community for alleged over-payment of 'refunds' for 1980 and 1981, it was not possible for the UK 'refunds' to be entered in the 1983 draft Budget. An agreement on these practicalities was reached in Council on 26th October 1982 but this entailed the production of a special draft Supplementary Budget to give effect to the Agreement.

(e) Stuttgart Summit and beyond

At the Stuttgart Summit on 18th June 1983 it was agreed that 'in the course of the coming six months a major negotiation will take place to tackle the most pressing problems facing the Community so as to provide a solid basis for the further dynamic development of the Community over the remainder of the present decade.' Negotiations in seven special foreign and finance councils have been preparing the ground for the Athens Summit (4-6 December) mainly on the Budget problem.

Net Contributions to (−) and Receipts from (+) the allocated Budget, by Member States

million ecu

	1978	1979	1980	1981	1982 (provisional)
I. Net positions before UK refunds					
Belgium/Luxembourg	+337	+610	+439	+515	+510
Denmark	+381	+380	+327	+279	+294
Germany	−597	−1,430	−1,526	−1,684	−2,085
France	−371	−78	+431	+576	+14
Ireland	+326	+545	+650	+582	+721
Italy	−334	+534	+737	+788	+1,586
Netherlands	+41	+288	+454	+239	+302
United Kingdom	−228	−849	−1,512	−1,419	−2,040
II. Net positions before UK refunds per head					
Belgium/Luxembourg	+33	+60	+43	+50	+50
Denmark	+75	+74	+64	+55	+57
Germany	−10	−23	−25	−27	−34
Greece	—	—	—	+18	+71
France	−7	−2	+8	+11	+0·3
Ireland	+98	+162	+191	+169	+207
Italy	−6	+9	+13	+14	+28
Netherlands	+3	+21	+32	+17	+21
United Kingdom	−4	−15	−27	−25	−36
III. Net positions after UK refunds					
Belgium/Luxembourg	N/A	N/A	+377	+441	+447
Denmark	N/A	N/A	+294	+242	+262
Germany	N/A	N/A	−1,957	−2,185	−2,442
Greece	N/A	N/A	—	+161	+682
France	N/A	N/A	+81	+139	−366
Ireland	N/A	N/A	+639	+568	+708
Italy	N/A	N/A	+527	+549	+1,373
Netherlands	N/A	N/A	+376	+94	+245
United Kingdom	N/A	N/A	−337	−9	−883

Source: House of Commons Sixth Report from the Select Committee on European Legislation, Session 1983-84. Future Financing of the European Community

Summary Table of Principal Components in UK Payments & Receipts from EEC 1978–82

	1978	1979	1980	1981	1982
Community VAT Rate	—	·7889	·7322	·8667	·9248
PAYMENTS					
			(£m)		
VAT own resources/GNP-based financial contributions*	596	544	741	1,095	1,554
Sugar and isoglucose levies†	15	17	19	26	40
Agricultural levies†	227	229	241	192·2	267
Customs duties†	714	868	861	861	1,002
Article 131 compensation‡	−204	−352	−95	—	—
Total Gross payments	1,348	1,606	1,767	2,174	2,863
RECEIPTS					
EAGGF...	329	371	550	683	791
Regional Development Fund	35	71	173	145	111
Social Fund	62	87	95	107	152
Other receipts	100	130	145	149	184
Total receipts	526	659	963	1,084	1,238
Net payments before United Kingdom refunds§	822	947	804	1,090	1,625
Refunds§	—	—	98	693	1,019
Net payments after refunds§	822	947	706	397	606

*VAT own resources were first paid by the United Kingdom in 1979. In 1978 the United Kingdom made a GNP-based financial contribution.

†United Kingdom made payments on the basis of pre-determined financing shares during 1973–77. Therefore no accurate breakdown between categories of own resources is available.

‡Compensation to United Kingdom for contributing on basis of full resources system under Article 131 of Accession Treaty.

EAGGF = European Agriculture Guidance and Guarantee Fund.

§Refunds to United Kingdom payable under agreements of 30 May 1980, 25 May and 26 October 1982.

Sources: Official Report, 11 July 1983, cols 255–6 and 29 July 1983, cols 687–8.

Source: House of Commons Sixth Report from the Select Committee on European Legislation, Session 1983-84. Future Financing of the European Community.