SUBJECT

10 DOWNING STREET

THE PRIME MINISTER

9 March 1984

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T38/84

Dear Mr. President,

When we met on Monday, I promised to let you have a paper about the problem of the imbalance in the Community Budget. The paper would be designed to describe a lasting and systematic solution to this problem and explain how a net transfer of resources of 400-500 million ecu by the United Kingdom in a 12 Member Community could be achieved on a sustainable basis.

I now enclose this paper and hope it will be of use to you as you prepare the March meeting of the European Council.

I much valued the opportunity we had at Chequers to discuss the whole range of European Community problems that confront us. Like you, I hope that we shall be able to make decisive progress at our meeting later this month. I am sure that it will be important for Geoffrey Howe and Roland Dumas to keep in close touch over the next two weeks.

Yours sincerely

Margaret Thatcher

His Excellency Monsieur Francois Mitterrand

FUTURE FINANCING OF THE COMMUNITY

The EC Treaty established in Article 200 a first system for financing the Community which was replaced in 1970 by the Own Resources Decision. That Decision was based on two main principles

- the Community's Own Resources were to consist of the customs duties, agricultural levies and a proportion of VAT revenue on a standard basis

- there was to be an upper limit on Own Resources, in the form of the 1% VAT ceiling.

2. Before the United Kingdom joined the Community, a solemn assurance was given to us that "should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the institutions find equitable solutions". Events have shown that the Own Resources Decision does produce an unacceptable situation for the United Kingdom. It is ill-adapted to a Community of 10 and will be even more unsatisfactory for a Community of 12. It will increasingly jeopardise the Community's development unless it is corrected. The Community is now at a critical stage in its history, at which it will either demonstrate the capacity to adapt its priorities and enlarge its objectives, including its ability to meet the social, industrial and technological challenges it faces or it will cling on to old decisions.

3. In recent years ad hoc solutions to the budget problem have been found. The Stuttgart Declaration set the objective of avoiding "the constantly recurrent problems between the Member States over the financial consequences of the Community's budget and its financing" and to this end "ensuring equitable financial situations for all Member States". The underlying problem remains. In the period 1980-82 the United Kingdom whose gross domestic product per head was only 95% of the Community average

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during this period would have contributed about 50% of the resources transferred to other member states through the Community budget if there had not been corrective adjustments on an ad hoc basis. The United Kingdom's net budgetary burden, without taking account of ad hoc refunds negotiated from 1980, rose as follows -

million ecu

1978	1979	1980	1981	1982
228	849	1512	1419	2036

If the Own Resources ceiling were raised and no corrective system were in place, this burden would rise substantially.

4. The United Kingdom has made clear that it is only prepared to consider an increase in the VAT ceiling if there is effective control of agricultural and other spending ("budget discipline") and if the financing system is put on to an equitable basis ("budget imbalance").

5. There is now an emerging consensus that a reformed system must -

(i) be lasting and be included in a revised Own Resources Decision;

(ii) involve a correction on the revenue side by reducing a member state's VAT contribution in the following year;

(iii) be based on a member state's relative prosperity, limits being expressed as a percentage of a member state's gross domestic product;

(iv) come into effect in 1985, so that it can operate in respect of 1984 and subsequent years.

6. The reformed system should be so designed as to leave the United Kingdom at the outset with a net transfer of resources through the Community budget to other member states in a 12 member Community of 400-500 million ecu per year.

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7. The United Kingdom has proposed a system based on measuring the actual net transfers of resources through the Community budget. This is the best way of dealing with the problem. In the illustrative example put forward by the United Kingdom a member state whose relative prosperity was at or below 90% of the Community average would not make any net contribution. Above this level, there would be a limit expressed as a percentage of a member state's gross domestic product. It would rise by 0.007% of the member state's gross domestic product for each percentage point increase in its relative prosperity. The member state would receive relief for the excess of its net contribution above its limit. No member state would be expected to contribute to its own relief or to the relief of another member state if by so doing it would increase its net contribution above its limit. Applying this system to the 1982 figures and using a relative prosperity index for a Community of 12, the United Kingdom's adjusted net contribution would be 437 million ecu.

8. A number of other delegations have supported a system based on the VAT share/expenditure share gap. This formula treats the customs duties and levies as though they were VAT. For some member states, including France and Germany, this would be an advantage, because it overstates their contribution. But for the United Kingdom it would produce a measured gap which would have been 350 million ecu a year lower than the actual transfer of resources through the budget. In order to keep the United Kingdom's transfer of resources through the Community budget after adjustment within 400-500 million ecu, the limit would have to be very low. This result could be achieved by technical adjustments in the system. If, for example, it were decided that a member state whose gross domestic product per head was below the Community average made no net contribution and the limit rose by 0.01% of the member state's

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gross domestic product for each percentage point increase in its relative prosperity, the United Kingdom's actual net contribution after adjustment would have been about 400 million ecu (1982 figures, using a relative prosperity index for a Community of 12). Alternatively, a member state whose gross domestic product per head was at or below 97½% of the Community average could make no net contribution, with the limit rising by 0.008% of the member state's gross domestic product for each percentage point increase in its relative prosperity. This would have given on the same assumptions a United Kingdom actual net contribution after adjustment of about 460 million ecu.

9. Each of the systems described above is based on a single method of correcting the budget imbalance. However, if this result were achieved by the VAT share/expenditure share gap, it would not provide the necessary assurance against the risk of arbitrary fluctuations in the size of the gap. One way of providing this protection would be by allowing any member state benefitting from the system described in paragraph 8 and whose share of levies and duties was larger than its VAT share to have a correction to the latter gap as well.

10. The United Kingdom accepts that, if its relative prosperity were to improve, its net contribution to the Community budget would rise.

Margaret Thatcher

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cc: D.S.

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10 DOWNING STREET

From the Private Secretary

9 March, 1984

FUTURE FINANCING OF THE COMMUNITY

Would you please refer to David Williamson's minute of 8 March with which he forwarded a revised draft letter and paper for the Prime Minister to send to President Mitterrand.

The Prime Minister has approved the paper as drafted and has signed the letter to the President. I enclose the signed version with this letter and would be grateful if you would arrange for its immediate despatch, together with the paper, to the Elysee.

We agreed that you would telegraph the texts in advance.

I am copying this letter to John Kerr (H.M. Treasury) and to Richard Hatfield (Cabinet Office).

A. J. COLES

Roger Bone, Esq.,
Foreign and Commonwealth Office

CONFIDENTIAL

Qz.03625

MR COLES Now see my letter to F/C.O. [initials] 9/3.

FUTURE FINANCING OF THE COMMUNITY

I attach a revised draft letter and paper for the Prime Minister to send to President Mitterrand, on the lines discussed at the Prime Minister's meeting this evening.

I am sending copies to Roger Bone (FCO), John Kerr (Treasury) and Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

8 March 1984

Draft letter from the Prime Minister to President Mitterrand

When we met on Monday, I promised to let you have a paper about the problem of the imbalance in the Community Budget. The paper would be designed to describe a lasting and systematic solution to this problem and explain how a net transfer of resources of 400-500 million ecu by the United Kingdom in a 12 Member Community could be achieved on a sustainable basis.

I now enclose this paper and hope it will be of use to you as you prepare the March meeting of the European Council.

I much valued the opportunity we had at Chequers to discuss the whole range of European Community problems that confront us. Like you, I hope that we shall be able to make decisive progress at our meeting later this month. I am sure that it will be important for Geoffrey Howe and Roland Dumas to keep in close touch over the next two weeks.

Draft letter from the Prime Minister to
President Mitterrand

When we met on Monday, I promised to let you have a paper which set out briefly and succinctly the case for the Community agreeing on a lasting and systematic basis a corrective arrangement to deal with the problem of the imbalance in the Community budget and which would also explain how the figure of 400-500 million ecu which I mentioned at Athens as a reasonable net transfer of resources through the Community budget for the United Kingdom to make in a twelve member Community could be achieved on a sustainable basis under such a corrective system. I enclose this paper. I hope that it will be of use to you as you prepare the March meeting of the European Council.

I much valued the opportunity we had at Chequers to discuss the whole range of European Community problems that confront us. Like you, I hope that we shall be able to make decisive progress at our meeting later this month. I am sure that it will be important for Geoffrey Howe and Roland Dumas to keep in close touch over the next two weeks.

FUTURE FINANCING OF THE COMMUNITY

The EC Treaty established in Article 200 a first system for financing the Community which was replaced in 1970 by the Own Resources Decision. That Decision was based on two main principles

- the Community's Own Resources were to consist of the customs duties, agricultural levies and a proportion of VAT revenue on a standard basis

- there was to be an upper limit on Own Resources, in the form of the 1% VAT ceiling.

2. In the view of the United Kingdom events have shown that the Own Resources Decision, which served the Community adequately in the early 1970s, is ill-adapted to a Community of 10 and will be even more unsatisfactory for a Community of 12. It will increasingly jeopardise the Community's development unless it is corrected. The Community is now at a critical stage in its history, at which it will either demonstrate the capacity to adapt its priorities and enlarge its objectives, including its ability to meet the social, industrial and technological challenges it faces or it will cling on to old decisions.

3. There is now pressure to change the Own Resources Decision in two important respects -

(i) the common purpose in the further development of the Community can only be sustained if there is also a common acceptance that the financing of the Community is justifiable and fair. In fact, the operation of the Own Resources Decision and the pattern of Community budget expenditure have turned out to be quite different from what was expected ten or more years ago. When the Own Resources system was discussed with the United Kingdom in the accession negotiations it was argued by the original six member states that the development of non-agricultural

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policies would correct the budgetary disadvantage for the United Kingdom resulting mainly from the large proportion of the Community budget spent on agriculture. It was on this basis that the United Kingdom was given in these negotiations the assurance that "should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the institutions find equitable solutions".

The Community has acknowledged this in recent years, and ad hoc solutions have been found. Nonetheless, the underlying problem remains. In the period 1980-82 the United Kingdom whose gross domestic product per head was only 95% of the Community average during this period would have contributed about 50% of the resources transferred to other member states through the Community budget if there had not been corrective adjustments on an ad hoc basis. The United Kingdom's net budgetary burden, without taking account of ad hoc refunds negotiated from 1980, rose as follows -

million ecu

1978	1979	1980	1981	1982
228	849	1512	1419	2036

If the Own Resources ceiling were raised and no corrective system were in place, this burden would rise substantially;

(ii) there is a strong demand within the Community to increase the present 1% VAT ceiling. The operation of this ceiling, if it remains unchanged, will present the Community with a serious political dilemma: either obligatory expenditure will have to be severely

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constrained or finance will have to be increasingly diverted from other existing policies to meet the Community's agricultural obligations. There will be no available resources for the development of desirable Community policies such as the ESPRIT programme.

4. The United Kingdom has made clear that it is prepared to consider an increase in the VAT ceiling, provided that there is effective control of agricultural and other spending ("budget discipline") and that there is a correction of the present inequitable financing system ("budget imbalance").

5. There seems to be an emerging consensus that a ~~corrected~~ reformed system must -

(i) be lasting and be included in a revised Own Resources Decision;

(ii) involve a correction on the revenue side by reducing a member state's VAT contribution in the following year;

(iii) be based on a member state's relative prosperity, limits being expressed as a percentage of a member state's gross domestic product;

(iv) come into effect in 1985, so that it can operate ~~provide correction~~ in respect of 1984 and subsequent years.

6. The United Kingdom considers that ~~any corrective~~ the reformed system should be so designed as to leave the United Kingdom at the outset with a net transfer of resources through the Community budget to other member states in a 12 member Community of 400-500 million ecu per year.

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7. The United Kingdom has proposed a system based on measuring the ~~total~~ actual net transfers of resources through the Community budget and believes this is the best way of dealing with the problem. ~~Under this proposal a member state's full net transfer of resources through the Community's allocated budget would be taken into account in setting a threshold limit on that contribution.~~ In the illustrative example put forward by the United Kingdom a member state whose relative prosperity was at or below 90% of the Community average would not make any net contribution. Above this level, the threshold, expressed as a percentage of a member state's gross domestic product, would rise by 0.007% of the member state's gross domestic product for each percentage point increase in its relative prosperity. The member state would receive relief for the excess of its net contribution above its threshold. No member state would be expected to contribute to its own relief or to the relief of another member state if by so doing it would increase its net contribution above its threshold. Applying this system to the 1982 figures and using a relative prosperity index for a Community of 12, the United Kingdom's adjusted net contribution would be 437 million ecu.

8. A number of other delegations have supported a system based on the VAT share/expenditure share gap. This formula treats the tariffs and levies as though they were VAT. For some member states, therefore, it would take into account only a part of the net transfer of resources through the Community budget, leaving aside any difference between the member state's VAT share and its share of own resources. In the case of the United Kingdom on average in 1979-82 this would produce a measured gap which would be 350 million ecu a year lower than the actual transfer of resources through the budget. For the United Kingdom's transfer of resources through the Community budget after adjustment to be within 400-500 million ecu, the remaining margin of manoeuvre in setting the threshold under the new system would need to be narrow.

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The result referred to above could, however, be achieved at the outset by technical adjustments of the threshold in the system. If, for example, it were decided that a member state whose gross domestic product per head was below the Community average made no net contribution and the threshold rose by 0.01% of the member state's gross domestic product for each percentage point increase in its relative prosperity, the United Kingdom's actual net contribution after adjustment would have been about 400 million ecu on 1982 figures, using a relative prosperity index for a Community of 12. Alternatively, a member state whose gross domestic product per head was at or below 97½% of the Community average could make no net contribution, with the threshold rising by 0.008% of the member state's gross domestic product for each percentage point increase in its relative prosperity. This would have given on the same assumptions a United Kingdom actual net contribution after adjustment of about 460 million ecu.

The choice between the threshold arrangements could be made, taking account of the position of the other major contributor.

9. Each of the systems described above is based on a single method of correcting the budget imbalance. However, since in the system in paragraph 8 this result would have been achieved by the use of the VAT share/expenditure share gap, it would not provide the full assurance the United Kingdom considers necessary against the risks of this system. One way of providing this protection would be by allowing any member state benefitting from the system described in paragraph 8 above and whose share of levies and duties was larger than its VAT share to have a correction to the latter gap as well.

10. ~~Whichever solution is adopted~~, The United Kingdom accepts that, if its relative prosperity improves, its net contribution to the Community budget would rise.

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PRIME MINISTER

PAPER FOR PRESIDENT MITTERRAND

I attach a letter for you to sign and a paper for you to send to President Mitterrand, as agreed with him at Chequers yesterday.

I should draw your attention to one point about the paper. It describes, in paragraph 6, two formulae which could produce the result which we want. The first is our own safety net formula. The second is based on the French scheme which involves the VAT/expenditure gap.

At a Ministerial meeting on Thursday you and your colleagues will be asked to decide whether, provided we get the figures we want, a system based on the VAT/expenditure gap is acceptable. You may therefore think it rather odd that in advance of taking that decision you should send such a paper to President Mitterrand. The justification for doing so is that Mitterrand came close to saying to you that he could contemplate solving our problem by a system based on the VAT/expenditure gap. The paper does not actually advocate this solution but simply describe~~s~~ it as one of the two systems under discussion in the Community which could produce the results which the United Kingdom wants. That is perfectly true.

The paper has been agreed by the Treasury and the FCO (at official level). David Williamson believes that it would be safe for you to send it in its present form.

If you agree, perhaps you would sign the attached letter to President Mitterrand.

A. J. COLES

6 March, 1984

cc France: Visits of Pres. Mitterand: Pt 4

CONFIDENTIAL

Qz.03618

MR COLES

POST-STUTTGART NEGOTIATIONS ON THE FINANCING OF THE COMMUNITY

As requested in your letter of 5 March to Mr Bone, I attach a draft letter from the Prime Minister to President Mitterrand, together with the paper which she promised to send to him. TPM

I am sending copies to Roger Bone (FCO), John Kerr (Treasury) and to Sir Robert Armstrong.

D.F Williamson

D F WILLIAMSON

6 March 1984

cc France: Visits of Pres. Mitterand: Pt 4

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Draft letter from the Prime Minister to President Mitterrand

When we met on Monday, I promised to let you have a paper which set out ~~briefly and succinctly~~ the case for the Community agreeing on a lasting and systematic basis to a corrective arrangement to deal with the problem of the imbalance in the Community budget and which would also explain how the figure of 400-500 million ecu which I mentioned at Athens as a reasonable net transfer of resources through the Community budget for the United Kingdom to make in a twelve member Community could be achieved on a sustainable basis under such a corrective system. I enclose this paper. I hope that it will be of use to you as you prepare the March meeting of the European Council.

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10 DOWNING STREET

From the Private Secretary

5 March 1984

Dear Roger,

VISIT OF PRESIDENT MITTERRAND

I enclose a record of the conversation which took place at Chequers today when President Mitterrand called on the Prime Minister.

After the meeting, the Prime Minister asked that Mr. Williamson should prepare urgently the paper which she promised to send to the President and which is referred to towards the end of the record. I should be grateful if this could reach me by, at the latest, close of play on 6 March.

I am sending copies of this letter and its enclosure to John Kerr (HM Treasury), Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food) and Richard Hatfield (Cabinet Office).

Yours ever

John Coles.

cc France: Visits of Pres. Mitterrand : Pt 4

CST.

Roger Bone, Esq.,
Foreign and Commonwealth Office.

SECRET