CONFIDENTIAL

Qz.03649

MR COLES

FAIR SHARING OF THE COMMUNITY BUDGET BURDEN

The Council of Ministers (Foreign Affairs) did not reach agreement on the correction of the Community's budget burden on the United Kingdom. The Foreign and Commonwealth Secretary made no concessions whatever. Despite the difficult atmosphere in which the meeting ended, it is very probable that we shall keep two concessions made by other member states -

(1) the ad hoc rebate of 1000 million ecu will now be for one year (1984) only and the revised system will come into effect thereafter. This is the position taken by the Prime Minister in the European Council and is a clear financial advantage for the United Kingdom by comparison with the offers made by other member states last week;

(2) all member states, including Italy, explicitly accepted that there must be a reformed system of financing to be included in the revised own resources decision.

2. Between now and the next meeting of the Council of Ministers (Foreign Affairs) on 9-10 April, the Commission will almost certainly come up with some proposal on the starting figure (the X in the Presidency paper) for the new system. They have promised to be in touch with us before they make any ideas public.

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

D F Williamson

D F WILLIAMSON

28 March 1984

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PERSONAL

A Message from
[redacted]VID WILLIAMSON

MR C[redacted]ES A.S.C. 28/3

p.a.

The attached would be in line with the comments of the Chancellor of the Exchequer and the Secretary of State for Trade and Industry at this morning's OD meeting, which I think that the Prime Minister supported.

David Williamson
28/3/84

28 March 1984

CABINET OFFICE
70 Whitehall, London SW1A 2AS Telephone 01-233 7256

Qz.03650 28 March 1984

Stephen Wall Esq MVO
Foreign and Commonwealth Office
London SW1

Dear Stephen,

FOREIGN AFFAIRS COUNCIL: STATEMENT IN THE HOUSE

Thank you for your letter of today. In the light of the discussion in OD this morning I suggest that you might wish to include at the beginning of paragraph 3 sentences on these lines:-

"I would remind the House that the main question at issue is the demand of other member states to change the Community's basic financing Decision by increasing the ceiling on the VAT resources of the Community. Their demand is equivalent to a change in the Treaty and requires the unanimous agreement of member states and their Parliaments. The United Kingdom Government has indicated that it is ready to consider their demand for a fundamental change if there is effective control of Community expenditure and a fair sharing of the budget burden."

Yours sincerely,

David Williamson

D F WILLIAMSON

cc: Sir Crispin Tickell) FCO
Mr Hannay)

Mr Unwin, H M Treasury

Sir Robert Armstrong
Mr Stapleton
Mr Durie

520

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A brief for the debate on the current negotiations within the European Community to be held on Tuesday, 3rd April 1984.

CONTENTS

Conservative Research Department,
32 Smith Square,
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Enquiries on this brief to:
Andrew Tyrie Ext. 2519

A) <u>General characteristics of the Budget</u>

The 1984 Community Budget amounts to about 25 billion ecu (£15 billion). These revenues are derived from the Community's 'own resources'. Certain revenues, although collected by national authorities, belong to the Community from the time of their collection. About 60% of the Community's revenues are derived from VAT (calculated on a harmonised base), and the remaining 40% comes from customs duties and levies on agricultural imports. The Community is very close indeed to the 1 per cent VAT ceiling which limits any extension of Community expenditure. On the expenditure side, the Guarantee section of the CAP takes up two thirds of the budget. The rest is composed of regional and social funds (c13%), refunds to the UK and West Germany (c5%), aid (c4%) and on research projects, energy projects, administration, and the agricultural Guidance section.

B) <u>Cause of the Budget problem</u>

i) <u>Revenue</u>. Our percentage contribution to 'own resources' exceeds our percentage share of Community GDP. This is because our economy is relatively more open than those of the other Member States, and a higher proportion of these imports still come from outside the Community than is the case with other Member States.

ii) <u>Expenditure</u>. The relative smallness of the UK's agricultural sector and the fact that surplus production is largely concentrated in other Member States means that the UK obtains only about 11 per cent of the Guarantee section of the CAP, which in turn accounts for two thirds of the budget.

Under the existing budgetary system there is no likelihood that there will be any change in this large net contribution to the Community budget that results. (See table appended). The existing budgetary system pays little regard to the distributive impact of its policies on Member States, whereas individual countries ensure that their fiscal systems achieve a redistribution of resources from prosperous areas to disadvantaged ones. It could be contended that any <u>truly</u> Community budgetary system should accommodate a similar principle.

C) <u>The Conservative Government and the May 30th Agreement</u>

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 indefensibly ... 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 negotiatios which culminated in the May 30th 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 amounted 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 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. 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 arrangments 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 1982-83. 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) The May 25th 1982 Agreement

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 West Germany'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

At the Stuttgart Summit agreement was reached on the diagnosis - what the problems were, but not the solutions to those problems. The impending exhaustion of the Community's 'own resources' was becoming an important factor in concentrating the minds of those Member States who under the existing budgetary system were net beneficiaries (all countries except West Germany and the UK). At Stuttgart the Community agreed a programme for firm decisions on its future financing, including, and this is vital for us, a fairer distribution of the burden.

The Stuttgart communique stated:

> '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.'

These problems were discussed in a series of Special Council meetings in the Autumn of 1983. There was a wide measure of agreement that discussions would take place with a view to long term solutions and not with a view to finding ad hoc arrangements and short term expedients such as had, up to then, been used to deal with the UK budget problem. To these Special Council sessions the United Kingdom delegation tabled three papers which form the basis of the Government's position. They would constitute a comprehensive reform of the Community based on the principles of equity and cost efficiency. These were: a safety net proposal; proposals to control agricultural expenditure; and suggestions for the development of new policies for the European Community.

The safety net proposal proposed a mechanism which would put an end to constantly recurring problems of certain Member States by ensuring a more equitable sharing of the burden of financing the Community budget. It provided that Member States whose relative prosperity in the enlarged Community was below a given level should be net beneficiaries from the Budget and not in any circumstances net contributors. Above this level there would be a limit on Member States' net budgetary burden related to its GDP and relative prosperity in the enlarged Community. (Long term proposals on the budget must take account of the likely enlargement of the Community to include Spain and Portugal.) On agriculture the British Government put forward the proposal for a strict financial guideline to achieve the objectives for agriculture put forward in the Stuttgart communique.

The strict financial guideline would ensure that the rate of increase in agricultural guarantee expenditure in any year should be less than the increase in the Community's own resources and would be embodied in the Community's budgetary procedures.

The United Kingdom's third submission to the Special Councils was addressed to the future development of the Community. In these the Government drew attention to a number of key areas in which Member States could benefit by concerted action at the Community level. These would include work to complete a truly common market for goods and services, and the need to develop more effective Community action in the fields of research, innovation and new technologies.

F) The Athens Summit

Although a great deal of detailed work was undertaken in seven Special Council sessions before the Athens Summit, agreement was not reached on a large number of critical issues. As a result, many issues of detail were left to the Summit and the Heads of State and Government were faced with a Herculean task of reconciling divergent positions on a large number of detailed matters. They did not succeed. After the Summit the Prime Minister said:

> 'Perhaps it is not surprising that we have had to have this meeting, at which we have not reached agreement, as a prelude to one that I hope will eventually reach agreement. (The British Government was) prepared to tackle the issues in a long term way. We believe in the relaunching of the Community, but we believe that is only going to be done by facing the fundamental issues and facing them realistically ... I am not prepared to stagger from compromise to compromise' (Athens, 6th December 1983).

G) The Brussels Summit

At the Brussels Summit on 19th-20th March progress was made towards securing control of spending by setting a maximum limit for growth of overall expenditure and by a financial guideline on agricultural expenditure. The French Presidency also proposed a lasting system for a fair sharing of the budgetary burden. In her statement to the House of Commons on 21st March 1984, the Prime Minister said:

> 'We would have been able to accept this system but some other Member States despite the long discussions over the last nine months, were still unable to do so.'

At the end of discussions, during which the United Kingdom made sustained efforts to reach a satisfactory compromise, the United Kingdom was invited to accept the following package:

- an ad hoc five year arrangement which would have left the United Kingdom receiving about half her net contributions, compared with the two-thirds obtained since 1980 and agreed by other Member States as reasonable. But in relative terms this would have declined as expenditure increased.

- a milk deal which affected the farmers of some Member States less than others in terms of cutting back milk production.

- an increase in own resources from 1 per cent to 1.4 per cent in 1986 with the prospect of a further increase in 1988 to 1.6 per cent.

Yet another ad hoc arrangement would certainly not be acceptable. On this the Prime Minister stated in the House of Commons:

> 'I made it plain that neither I nor the British Parliament could accept such a package. Therefore, I did not agree to any increase in the Community's resources. The 1 per cent VAT ceiling remains.'

H) Further Developments

A Special Foreign Affairs Council and Agricultural Council was called to tackle the budget and agriculture problems respectively and took place on March 27th. Neither Council reached agreement. In the Foreign Affairs Council discussions took place on the basis that one more year of ad hoc refunds to cover 1984 would be agreed, this to be followed by a durable and equitable arrangement for sharing budgetary burdens entering into force in 1985. The system would be based on the ability to pay measured by GDP per capita. The system would contain two main elements, a threshhold and a 'ticket moderateur' (our rate of contribution to any amount above the threshhold). The operation of the threshhold and the 'ticket moderateur' is still for negotiation. The initial agreed threshhold figure would form the basis for future years. Agreement did not prove possible on that figure. Hence the gap between 1,000 mecu (£590m) which has been proposed by some other Member States and 1,250 mecu (£737m) which the Government was prepared to accept is larger and more important than would appear at first sight. Negotiations are continuing. The Finance Ministers, on 2nd April and the Foreign Ministers on 9th/10th April will take the issue further.

Advance Payments

The Commission requested Member States to make an advance payment of own resources for the month of April principally to pay for the UK and German refunds by the end of March. The refunds remain blocked; it is not intended that this advance payment be made as the main need for them has been removed. The Commission has now accepted that early payments are no longer required.

Own Resources

Since the Stuttgart Summit the Government has made it clear that it would be prepared to consider an increase in own resources provided that there is effective control of Community spending and a fair sharing of the budgetary burden. It has been argued that an increase in the own resources ceiling would be needed, first, because the customs levies and duties element is diminishing in real terms and secondly because some funds will required to finance such new policies as may be agreed, which could include an increase in regional and social funds and enlargement. The Government is committed to firm control of agricultural expenditure. However, immediate reductions in expenditure (to provide room under the own resources ceiling for other foreseeable costs) cannot be made without causing immense hardship to farmers. At the Foreign Affairs Council there was further discussion of a possible increase in own resources. The possibility of an increase of the VAT ceiling to 1.4 per cent in 1986 with a possibility of a further increase in 1988 to 1.6 was discussed. These would represent an increase in today's revenues of about 25% and 40% respectively (not 40% and 60% because VAT is only one component of own resources). On own resources Sir Geoffrey Howe said in his statement on 28th March:

> 'That proposal (to increase the VAT ceiling) requires unanimous consent of Member States and National Parliaments. The Government have indicated their willingness to entertain this proposal, but only if there is effective control of Community spending and a fair sharing of the budgetary burden. Both these conditions remain crucial.'

I) Labour Party attitudes contrasted

The Labour Party's approach to these negotiations and to Europe is divided, contradictory and insincere:

- The Labour Party has now changed its attitude towards membership five times

- Labour's latest volte-face is dressed up with opportunistic imprecision. Mr Kinnock has called for a new Messina but he is completely vacuous about what this means. He proposes new policies which would require additional expenditure without explaining where the cuts or the money are going to come from - strikingly similar to their demands for more expenditure domestically.

- Mr Kinnock says in his 'new Messina' that we should involve Eastern Europe. Does this mean that we should form a Community with communist countries? Or is he really talking about a non-aligned Europe?

- What is Labour really proposing to do with the agricultural sector?

- Mr Kinnock proposes reflation on a Europe-wide scale. Reflation means inflation. Has Mr Kinnock not learnt the lessons of the French experience under President Mitterand, who did a U-turn on just such a reflationary package?

- Labour's track record is appalling. They failed to obtain any refunds at all during their period in office. (The Conservative Government has obtained two thirds of Britain's net contributions since 1980 - in excess of £2.5 billion).

- Labour's only attempt at serious negotiation with our Community partners, in 1975, was a complete failure. On the central question of budgetary imbalances, the Labour Party myopically agreed to a mechanism which would only come into effect in the event of a balance of payments crisis. This would hardly be likely in the late 1970s and early 1980s in view of the balance of payments benefits of North Sea Oil, major discoveries of which had already been made. Moreover, payments under this so-called 'corrective mechanism' would be related to the gross contribution rather than the net contribution. This would neglect the UK's relatively small receipts from the budget, the major source of the budgetary imbalances.

- Nor is Mr Owen less culpable. As Foreign Secretary in 1979 he permitted our net budgetary contributions to get out of all control, reaching £1.2 billion for that year (worth nearly £2 billion in today's money).