cc PC.

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A.J.C. 9/4

f.a.

J B Unwin
Deputy Secretary

12 April 1984

D F Williamson Esq
Cabinet Office
70 Whitehall
LONDON SW1

Dear David,

FORECAST OF UK NET CONTRIBUTION TO COMMUNITY BUDGET: EXCESS CUSTOMS DUTIES AND LEVIES

The purpose of this letter is to suggest that there would be merit in an early discussion about the forecasts of our excess customs duties and levies for the period up to 1988 in order to resolve the disagreement which has arisen between Departments over the last week or so.

2. We in the Treasury were concerned to see that - without any prior warning - the briefing provided for the Prime Minister's meeting on 5 April gave two sets of forecasts of the excess customs duties and levies, one designated "Treasury" and one "Cabinet Office". We were still more concerned - after the discussion of these figures at the Prime Minister's meeting - to see that the FCO's briefing for this week's Foreign Affairs Council evaluated the different variants of the Davignon scheme solely in terms of the "Cabinet Office" figures. I did not myself see this briefing until Monday after it had been completed and circulated.

3. I think this is most unsatisfactory. All the projections are necessarily subject to margins of error. But Ministers must be able to assess any budgetary imbalances scheme under discussion by reference to a <u>single</u> central figure for our unadjusted net contribution (including the excess customs duties and levies), in the confidence that this has been accepted by all the Departments concerned as the best and most up to date professional forecast available. The Treasury are responsible for making these forecasts and advising Ministers on them. But, in making these forecasts - as other economic forecasts - we are entirely willing to draw on any expertise and information that may be available in other Departments and to have the forecasts and the assumptions underlying them tested in inter-departmental discussion before they go to Ministers.

4. There are in fact two reasons why the forecasts need to be brought up to date again now. First, a fresh forecast of our programme 2.7 net contributions is required for the Public Expenditure Survey (PES) Report by mid-May. As you may know, Geoffrey Fitchew held a first meeting of the new PESC(EC) Committee this week. The Treasury will circulate a new forecast to this Committee early in May. The net contribution figures which go into the PES Report will form the starting point for the later forecast which will go into next year's Public Expenditure White Paper.

5. Second, if and when we reach a satisfactory settlement on budgetary imbalances, we shall need very rapidly to advise Ministers what estimates can prudently be given to the House of Commons of the net contribution figures likely to result from the application of the corrective mechanism. Such figures will undoubtedly command great attention and be subject to close scrutiny and it will not be possible to provide them unless we have a single agreed central estimate available. This central estimate will need to be as up to date as possible and compatible with what is subsequently put forward to Ministers in the PES Report and in the Public Expenditure White Paper.

6. I therefore propose that we should proceed as follows. The Treasury is now preparing a new forecast of our customs duties and levy payments for the period up to 1988. We will circulate this as soon as we can - if possible before Easter. If other Departments think there are any problems with the figures, or wish to examine the assumptions underlying them in more detail, Geoffrey Fitchew or Jamie Mortimer will organise a meeting with the MAFF and FCO technical experts, with the aim of arriving at an agreed central forecast. This will then form part of the input into the PESC(EC) work. If, however, there is any need to provide briefing for Ministers (eg for any further discussion with President Mitterrand or other bilaterals with the French) <u>before</u> this updated forecast is available, I must ask that figures to be used should be the Treasury estimates set out in Jamie Mortimer's letter of 29 March to David Durie, in your note to the Prime Minister of 4 April and in the Treasury ready reckoner supplied for this week's Foreign Affairs Council.

7. Copies of this letter go to Crispin Tickell, Michael Butler, Derek Andrews and for information to John Coles at No 10.

Yours Ever,
Brian Unwin.

J B UNWIN

Mr Coles

cc PK

CABINET OFFICE

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Qz.03688

17 April 1984

J B Unwin Esq
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Mr Coles
- to see o/r

DMB
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Dear Brian,

FORECAST OF UNITED KINGDOM NET CONTRIBUTION TO COMMUNITY BUDGET: EXCESS CUSTOMS DUTIES AND LEVIES

Thank you for your letter of 12 April. We welcome your suggestion that there should be an early discussion about the forecasts of excess customs duties and levies up to 1988. We shall be pleased to participate and we note that the Treasury is preparing a new forecast of these payments.

2. I agree with you that it is desirable that Ministers should have a single central figure for our unadjusted net contribution, both for assessing the negotiating position and for presentation in the event of a settlement. I should add that, if there is a settlement, I consider that we should not offer any more information than is strictly necessary about forecast refunds and unadjusted net contributions beyond 1986. If we succeed in establishing a system, we should concentrate our announcement on this.

3. As the Treasury is now preparing a new forecast of customs duties and levy payments, I do not wish to prolong the recent disagreement. I should like, however, to record these points -

(i) we were genuinely surprised here to discover, after the Treasury's figures had been distributed with Mr Peretz' letter of 30 March, that the excess customs duties and levies had been forecast to rise from an estimated 291 million ecu in 1983 to 436 million ecu in 1988, an increase of 145 million ecu or 50 per cent (the alternative assumption - the so-called Cabinet Office figures - was that the excess duties and levies gap throughout the period to 1988 would be 13 per cent higher than in 1983). By comparison with the average figure for the three year period 1981-83, you are forecasting an increase of 47 per cent.

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(ii) there has never been any dispute that the work of Mr Timmins and Mr Marshall, circulated under cover of Mr Mortimer's letter of 28 February to Mr Durie, provides the essential raw material for an assessment. We remain of the view, however, that the figures for excess customs duties and levies incorporated in the forecasts of net contributions (Mr Peretz' letter of 30 March to Mr Bone) are not consistent with the conclusions which may reasonably be drawn from the work of Mr Timmins and Mr Marshall. You will recall that Mr Timmins' conclusion on customs duties on manufactured goods was that "the most central projection would probably be somewhere between cases 2a and 2b". These cases showed

case 2a	1983	1984	1985	1986	1987	1988
Customs duties/GDP gap (as % of GDP)	0.091	0.093	0.090	0.081	0.075	not forecast
Customs duties/GDP gap: increase or decrease in million ecu	-	+59	unchanged	-35	-27	not forecast

(In 1987 the gap would be 3 million ecu lower than in 1983)

case 2b						
Customs duties/GDP gap (as % of GDP)	0.100	0.105	0.109	0.106	0.105	not forecast
Customs duties/GDP gap: increase or decrease in million ecu	-	+80	+45	+4	+7	not forecast

(In 1987 the gap would be 136 million ecu higher than in 1983)

Mr Marshall's work on the agricultural element does not greatly alter the conclusion on the total gap but is more provisional and slightly on the down side (on agricultural levies "there is no particular reason to suggest that a strong rise in the UK's share from the 22% expected in 1983 is likely, and some plausible indications that the medium term trend may be downwards" and on sugar levies ". . . it is likely that the total value of sugar levies may fall in the future . . . and the UK share may fall as well").

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In short, we think that you have gone too far away from case 2a and have adopted a position which is very close to case 2b. As you know, Mr Timmins' paper examines at length four cases (1, 1a, 2, 2b) and concluded that "the discussion above would suggest that case 2a is the most central projection of those considered so far since it more realistically takes into account the effect of reducing tariff rates than either case 1 or case 1a and allows for a more likely future path of the ratio of manufactured imports in total imports for the UK than case 2". Cases 1b and 2b were introduced because of the question whether it is appropriate to model the proportion of extra-EC imports of manufactures in total imports of manufactures as a function of past trends alone. It is in our view right that there should be some assessment of this point but it is certainly a disputed and difficult point;

(iii) I have referred above to cases 2a and 2b since in the view of Treasury economists "a scenario bracketed by cases 2a and 2b would seem to be the most probable outcome". Mr Mortimer correctly recorded, however, in his letter of 28 February to Mr Durie that, while Treasury economists believe that projections 2a and 2b represent the most likely outcome, FCO tend to favour projection 2. The reasons for the difference of view between the Treasury and the Foreign and Commonwealth Office are set out in that letter, which was agreed with FCO economists. Case 2 is as follows -

	1983	1984	1985	1986	1987	1988
Customs duties/GDP gap (as % of GDP)	0.090	0.087	0.081	0.071	0.062	not forecast
Customs duties/GDP gap: increase or decrease in million ecu	-	+33	-17	-45	-46	not forecast

(the customs duties/GDP gap would be 75 million ecu lower in 1987 than in 1983)

4. These points do seem to need further clarification in the meeting which you have suggested.

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5. I am sending copies to the recipients of your letter.

David Williamson

D F WILLIAMSON

cc: Sir Crispin Tickell, FCO
Sir Michael Butler, UKREP, Brussels
Mr Andrews, MAFF
Mr Coles, No 10

Euro Bl.

Budget Pt 24