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CONFIDENTIAL

AJC

(2)

Prime Minister

To be aware of the line we are taking (para 3 below).

A.J.C. 2/5.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

MA

FOREIGN AND COMMONWEALTH SECRETARY

COMMUNITY BUDGET 1984: COMMISSION PROPOSALS FOR ADDITIONAL FINANCE IN EXCESS OF THE 1 PER CENT VAT CEILING

As you know, the Commission put forward a proposal just before Easter inviting member States to contribute a loan of 2.33 billion ecu to bridge the gap between what they argue is needed to finance CAP expenditure in 1984 and the 16.5 billion ecu available within the Community Budget and the 1 per cent VAT limit. This proposal (which would require unanimous agreement of all member States) is now under discussion in the relevant Working Groups in Brussels. I understand that it will be further discussed by COREPER (Deputies) on Friday this week and then go forward for a first discussion at the Foreign Affairs Council on 14-15 May.

2. I am attaching below a note by my officials which analyses the Commission's proposal and recommends what line we should take in response to it. I understand that this note has been discussed with, and its conclusions agreed by, officials in other interested Departments.

3. The conclusions to the note are in paragraph 21, but you may also like to look particularly at paragraphs 13-16, which set out our objectives and tactics for the forthcoming discussions in Brussels. To summarise briefly, our objective is to ensure that:-

(i) no conclusions are reached on the Commission's supplementary financing proposals until there is full agreement on both the substance and implementation of acceptable solutions to the problems of budgetary imbalances and budgetary discipline, and on the payment of our 1983 refunds;

(ii) as far as possible the 1984 and, if necessary, the 1985 "financing gaps" are bridged by genuine savings and deferment of agricultural expenditure;

(iii) if in the last resort, and always provided we have secured the full agreement referred to in (i) above, the need for some element of supplementary financing in 1984 is conceded, this should impose the least possible cost on the UK.

4. Our tactics therefore must be to protract the discussions for as long as possible and to insist on a stringent examination of both the Commission's figures and underlying assumptions and the scope for economies and deferment of agricultural spending. The present signs are that we may get some support for this approach - at least for a little while - from some other member States, notably Germany and the Netherlands.

5. The note also suggests that further work is needed in two areas. First officials should examine in more detail what can be done to achieve agricultural savings. Second, there is the possibility that, if there is deadlock on the Commission's loan proposal, other member States may be tempted to go for agreement on alternative methods of bridging the financing gap (eg by deferment of the 10 per cent "own resources" refunds), by qualified majority voting. At present it looks doubtful whether any such attempt would succeed, but we need to consider how best we could protect our position if it were made.

6. If you are content with these conclusions they can form the basis for the line to be taken in COREPER this week and at the Foreign Affairs Council on 14-15 May. In view of the discussions which have already taken place at official level I suspect that there is no need for a meeting to take the paper. Perhaps, however, other colleagues

could let you know if they wish to have a discussion, or if they have any other comments on the recommendations in the note. It would be helpful to have such comments in the course of the next two days in advance of the COREPER discussion on Friday this week.

7. Copies of this minute go to members of OD(E), the Lord President the Lord Privy Seal and to Mr Coles (No 10) and Mr Williamson (Cabinet Office).

David Peretz

N.L.
1 May 1984
(Approved by the Chancellor and signed in his absence)

CONFIDENTIAL

COMMUNITY BUDGET 1984: COMMISSION PROPOSALS FOR ADDITIONAL FINANCE IN EXCESS OF 1% VAT CEILING

Note by HM Treasury

INTRODUCTION

1. The EC Commission estimate that potential expenditure on the CAP this year will exceed provision in the 1984 EC Budget by 2.13 billion ecu and that in addition there will be a need for other expenditure of 100 mecu and a shortfall of revenue from agricultural levies of 0.5 billion ecu. They estimate that in the absence of either economy measures or of the provision of additional financing, budget appropriations to pay for the CAP will be exhausted in mid-November. To meet this position the Commission have now proposed that Member States should agree to provide supplementary finance of 2.333 becu by a loan in 1984 which will be interest bearing and will be repaid on or after June 1986. The figure takes account of savings of 350 mecu in other expenditure already identified. The draft Regulation which the Commission have circulated with a paper justifying the proposal is at Annex A. This is already scheduled for discussion by the Budget and AGRIFIN Committees in Brussels on 27 and 30 April respectively. The outcome of the former will be reported orally to EQS.

2. The Government's present position, as stated by the Minister of Agriculture at the price fixing, is that CAP expenditure in 1984 must be accommodated within the existing budgetary provision and that, if budgetary problems arise in 1984 (or 1985) the Commission should take the necessary steps to reduce expenditure to the permitted level. The Government now needs to decide in detail what its objectives and tactics should be in further discussions of the Commission proposal in these Committees and

in COREPER and in the Foreign Affairs Council on 14/15 May.

ANALYSIS OF COMMISSION PROPOSALS

3. The 1984 budgetary situation and the Commission's proposal together with other options which might arise in discussion are analysed in the more detailed note by officials at Annex B. The main conclusions flowing from this analysis are set out in paragraphs 5 to 15 below.

(a) The Budgetary Situation

4. We accept (paragraphs 2 to 10 of Annex B) that in the absence of genuine economy measures or of additional financing the Commission would be left with a potential "financing gap" of more than 2.7 becu this year. The savings in non-agricultural expenditure proposed by the Commission are only 350 mecu, not even enough to offset the shortfall in levies and duties. So by mid-November Community money for agricultural will run out as budgetary appropriations are exhausted.

5. If by that time no agreement has been reached on either savings or on supplementary finance there will probably be strong pressure from other members to continue payments to farmers under the common agricultural policy and to finance these nationally where they fall. They are likely at the same time to demand a firm undertaking that expenditure will be reimbursed from future Community budgets when own resources have been increased.

6. A demand for national financing and subsequent reimbursement would raise a number of complex legal issues. These are dealt with in some detail in paragraphs 24-26 of Annex B and in EQS(84)11. Our assessment, however, is that if pressed, the Commission would probably authorise national financing towards the end of the year to avoid difficulties for farmers and traders. The questions of reimbursement and the impact on the UK's net contribution are dealt with in paragraph 12 below.

7. In the absence of national financing and genuine savings the Commission would have to find ways of deferring obligations into

1985 (when they would add to the already considerable difficulties of drawing up a budget within the 1% VAT ceiling), or Supplementary Community finance would have to be found. It is not clear to what extent the expenditure can be deferred. In principle there is considerable scope for deferment of Community expenditure, although in part this would be by building up intervention stocks, at Member States' expense. However, a proportion of the outstanding CAP expenditure may consist of pre-fixed export refunds or MCA subsidies which under Community regulations have to be paid within fixed time-limits. The options available without an increase in own resources are distinctly limited.

(b) Commission's financing proposals

8. The Commission's decision to opt for a regulation under Article 235 of the Treaty of Rome is in our view open to legal challenge, (paragraphs 27 and 28 of Annex B) as well as being objectionable in terms of under UK objectives. The Commission have provided a background paper setting out the reasons for their conclusion that savings in the budget are only small and that expenditure on agriculture cannot be constrained to 16.5 becu in 1984. They seek authority to call on member states to provide advances upto a maximum of 2.333 becu in 1984. Member states shares in these advances would be the same as their VAT shares, 20.040% for the UK. The advances would be subject to interest and would be repaid in 8 six-monthly instalments starting in June 1986. It is clear that repayment would be made from future budgets within the ceiling of own resources at the time. This must assume that unless the growth in agricultural guarantee expenditure has been drastically curtailed there has been agreement on an increase in own resources.

9. As stated in paragraph 28 of Annex B the legal basis of the Commission's proposal is Article 235 of the Treaty. Since a regulation under this article requires unanimity, the UK could block its acceptance even if it were supported, as is likely, by all other member states. As in the case of the 1% VAT ceiling itself, our ability to veto the Commission's proposal is an important lever in our hands in the continuing negotiations on the future financing of the Community.

10. There is some risk that, faced with a UK veto on the Commission proposal, other member states may try to bring forward other proposals for raising additional finance, which they may claim can be adopted by qualified majority voting. Possibilities include:-

- deferment into 1985 or later of the 10% own resources rebates paid in respect of the costs of collecting customs duties and levies;
- increased coresponsibility levies;
- the oils and fats tax.

11. These possibilities are examined in detail in paragraphs 22(i), 33-37 and 38 and 39 of Annex B. The conclusion drawn at this stage is that either unanimity is required or that for other reasons these are unlikely to be passed or accepted by other Member States as solutions. But the possibility cannot be excluded that, if the Commission proposal is blocked, other Member States may argue that some form of financing, in particular through deferment of the 10% own resources supplementary rebate, can be voted through by qualified majority in the budgetary procedure. Accordingly, further work is needed on how we should respond if any such attempt is made and how best we could resist it.

(c) Effect on the UK's Net Contribution

12. The Commission's proposal for a loan if adopted would add to UK's public expenditure as described in paragraph 30 of Annex B. The net addition could be of the order of 245 mecu (£160 million) in 1984. The refund on offer to us in respect of 1984 is, however, a lump sum of 1000 mecu. Unless, therefore, we could get a specific agreement that the 245 mecu was eligible for budgetary relief under the corrective mechanism in 1985 or 1986, the budgetary burden of our contributions to the Community Budget would be increased by the full amount with no compensation for this additional burden in the 1985 budget by way of budgetary refund for 1984. It therefore compares unfavourably with the alternatives of deferment of expenditure into 1985 or national financing of expenditure where it arises. In the case of deferment the expenditure would enter into the calculation of our refunds in the first year of the

budgetary corrective mechanism or if this was not in place again be caught by the own resources ceiling. National financing would be the least costly solution to this UK, provided there was no subsequent reimbursement of member states from the Community Budget in a later year. It is, however, not clear that we could prevent the Commission from declaring nationally financed expenditure as eligible for subsequent reimbursement. This point needs further legal scrutiny. National financing with reimbursement should, however, still be less costly than the Commission's proposal, since, our contributions to the reimbursement expenditure in later years would automatically enter into the calculations under the budgetary corrective mechanism.

UK OBJECTIVES

13. The Commission proposal is a way of evading the 1% VAT ceiling. To agree it would be inconsistent with the Government's position, that it is not prepared to agree to any increase in the VAT ceiling without satisfactory agreements on budgetary imbalances and budgetary discipline, and would remove from our hands an important bargaining lever in the negotiations. It would also be inconsistent both with the Minister of Agriculture's declaration at the end of the price fixing (that we expect the Community to live within the existing 1984 budgetary provision of 16.5 becu for agriculture, if necessary, by further savings and economies) and with the Government's general policy that the level of agricultural support in the Community should be constrained and agricultural spending controlled within a strict financial guideline.

14. Our objectives are accordingly to ensure that:-

(a) no conclusions are reached on the Commission's supplementary financing proposals until there is full agreement both on acceptable solutions to the budgetary imbalances and budgetary discipline questions (including the detailed texts implementing these solutions) and on the payment of our 1983 refunds.

(b) to the greatest possible extent the 1984 and 1985 "financing gap" is bridged by genuine savings in agricultural expenditure or to the extent that these are insufficient by deferring such expenditure. Agricultural spending for later years must be consistent with the strict financial guideline. Annex B (paragraphs 17 to 19) sets out some possible methods of making agricultural savings, but these need to be supplemented by a more detailed study by the Ministry of Agriculture.

(c) Provided satisfactory agreements are reached on budgetary imbalances and budgetary discipline, it may be necessary, as part of the deal, to consider conceding some element of supplementary financing. Any resulting additional budget burden for the United Kingdom would have to be taken into account under the corrective mechanism in 1986 or later years, and we should also seek to insist on a firm agreement to claw back any 1984 addition in later years under the financial guideline. One way of providing supplementary finance for the CAP wuld be a period of "national financing" of Guarantee expenditure without reimbursement from the Community Budget. In principle this approach could be to our budgetary advantage: we would only finance expenditure arising within the UK. On the other hand other Member States would be likely to resist the idea of a period of national financing and further study is necessary of the practical problems in this approach (for example the risk of trade diversion)l.

TACTICS

15. We should leave our partners under no illusion that there can be any question of our agreeing to provide additional finance in the absence of full solutions to the budgetary imbalances and budgetary dicipline issues. This has already been made clear by the Prime Minister to the House of Commons in answer to questions on 26 April.

16. But it is tactically in our interest to prolong the discussions on the Commission's proposal for as long as possible. We should therefore take the line that the detailed examination of the

Commission's proposal by the appropriate expert group (the Budget and AGRIFIN Committees) should not be skimped and rushed. They needed to probe:

- the Commission's forecasts of its revenue availability and expenditure requirements for the rest of 1984 (and possibly 1985).
- the scope for bridging the gap by fresh CAP savings and economies (for example those listed in Annex B) and for deferring expenditure into 1985.
- the implications for the operation of the financial guideline for agricultural spending.
- the technical difficulties and objections of the Commission's proposal, without prejudice to member states' conclusions.

We should seek support from any potential allies (the Germans and Dutch) for this approach.

17. In these preliminary examinations we should, as appropriate, draw attention to our doubts about the legality of the proposal and to its consequences for the UK's budgetary burden. We will have to insist on the need for unanimity on any provision for additional financing and keep the Commission up to the mark on this (see paragraphs 8 and 9 above).

POSSIBLE REQUESTS FOR CASH ADVANCES OR USE OF OVERDRAFT

18. Quite apart from their proposal for raising extra money above the 1% VAT ceiling, the Commission may find that, within the total already provided within the 1984 Budget, they may run into a cash shortfall and so be obliged to request either advances of customs duties and levies, (as they nearly did in March) and/or an overdraft facility under Articles 10(2) and 12(2) respectively of the Own Resources Regulation 2891/77. At present the Commission view is that they can get through to July without such recourse, but that thereafter either or both may be needed.

19. Advances under Article 10(2) would require the approval of a Supplementary Estimate by the House of Commons. A request for

an overdraft would be an obligation which could be met from the Consolidated Fund without specific Parliamentary approval. Legal advice is that the request would constitute an obligation in Community law.

20. A decision on whether to comply with any such request could only be taken in the particular circumstances at the time. Either form of request could clearly be politically embarrassing in the absence of any overall agreements on the EC's future financing arrangements.

CONCLUSIONS

21. The Committee is recommended:

(a) to endorse the negotiating objectives set out in paragraph 14 and to agree that we should respond to the Commission's proposals for raising extra finance along the lines set out in paragraphs 15-17.

(b) to agree that the Treasury and MAFF should consider and put forward to Ministers a list of ways in which agricultural expenditure could be reduced or deferred, to be drawn on as appropriate in discussion of the Commission's proposals.

(c) to note the legal advice that the Commission's proposal requires unanimity in the Council of Ministers, but to invite officials to study urgently the risk that deferment of the 10% own resources rebate or other alternatives could be implemented by qualified majority (paragraph 11 above);

(d) to note the possibiity that the Commission may anyway need to request advances of own resources or an overdraft facility (paragraphs 18-20 above).

Annex A.

Proposal for a

Council Regulation (EEC, EAEC) introducing supplementary measures to cover budgetary requirements in 1984

Whereas, having regard to the ultimate destination of the funds required, the Community should approach the Member States direct;

HAS ADOPTED THE PRESENT REGULATION:

Article 1

The Member States shall make a sum of 2 333 million ECU available to the Commission on the terms indicated below. These funds shall be used exclusively to provide supplementary cover for budgetary expenditure in 1984.

Article 2

The Commission shall apply to all Member States, who shall contribute to the proposed operation in accordance with their share of the Community's uniform VAT base for 1984, viz:

Germany	28.75
Belgium	3.45
Denmark	1.99
France	22.78
Greece	1.58
Ireland	0.86
Italy	15.32
Luxembourg	0.25
Netherlands	4.98
United Kingdom	20.04

Article 3

The Commission shall call on these funds as budgetary requirements arise and before 31 December 1984.

Article 4

The funds shall be made available to the Member States on the date indicated by the Commission. Interest shall be payable from that date at the market rate for a comparable loan of the same duration.

Article 5

The funds shall be repaid in eight equal six-monthly instalments beginning on 30 June 1986.

Article 6

The Council, acting by a qualified majority on a proposal from the Commission, shall lay down detailed rules for implementing this Regulation.

Article 7

This Regulation shall enter into force on the day following its publication in the Official Journal of the European Communities.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Council
The President

ANNEX B

EUROPEAN COMMUNITY BUDGET FORECAST 1984: EXHAUSTION OF OWN RESOURCES

This paper is an assessment of the budget crisis facing the Community because expenditure is outstripping revenue and of the measure proposed by the Commission in COM (84) 250 final to deal with the emerging deficit. The paper also covers other measures which might be put forward.

Size of 1984 deficit

2. The table at Annex B shows the order of magnitude of the problem as it is likely to emerge month by month. As the commentary attached to the table makes clear the assessment is derived from figures provided by the Commission. In summary the shortfall described by the Commission is:

	mecu
FEOGA guarantee	2,131
Other expenditure	100
Reduction in levies and duties	550
Offset by lower 10% refunds for cost of collection	- 55
	2,726

FEOGA guarantee expenditure is the most significant component of the budget and the Commission have described why the budget provision of 16.5 becu will prove to be substantially short of what would normally be needed to cover existing policies. We shall need to probe this.

The nature of the problem

3. The rules governing the Community budget have Treaty status and the problem arises because of the terms of Article 199 of the Treaty of Rome:

"All items of revenue and expenditure for the Community, including those relating to the European Social Fund, shall be included in estimates to be drawn up for each financial year and shall be shown in the budget.

The revenue and expenditure shown in the budget shall be in balance."

4. The expenditure side of the budget is broken down into payment appropriations which may be spent for a specified purpose. When the designated limit for particular elements is reached no further payments can be made even if there is spare cash available. Appropriations can only be increased by formal transfers from other parts of the budget or by a supplementary and amending budget to which the rules of budgetary balance also apply.

5. FEOGA guarantee advances are normally made to member

states on about the 20th of each month so that intervention agencies can pay farmers during the following four weeks. In recent months at least 50% of these advances has been postponed to the beginning of the following month. On the basis of the figures in Annex C the total requirements for advances would be 16.781 becu by 20 October, 281 mecu more than the budget provision.

6. Once the appropriations limit of 16.5 becu has been reached no further advances can be paid, even if there is cash available. The forecast advance of 1532 mecu in October (or the beginning of November if phased) would therefore have to be reduced accordingly, making it necessary for the intervention agencies to stop payment to farmers towards the middle of November.

7. A further constraint on expenditure is the availability of cash. Even if the appropriations provision is not exceeded there may from time to time be imbalances between the flow of funds and the timing of expenditure. So far this year the Commission have dealt with the cash problem by phasing agricultural guarantee advances. Instead of paying a full month's advance around the 20th of each month a substantial proportion has been postponed until the beginning of the following month when VAT own resources are paid by member states. This expedient may serve for a further month or two.

8. The Commission might also, as they have done in the past, make use of advances of own resources under Article 10(2) of the Own Resources Regulation. But since these do not in our view constitute an obligation it is necessary for the government to seek Parliamentary authority through the supply procedure. The Treasury Committee and individual Members have expressed strong opposition to such advances and passage of any future Supplementary Estimate is likely to be a stormy one. The Commission could also ask member states to provide temporary overdrafts under Article 12(2) of the same regulation. We are advised by our lawyers that payments under this Article constitute an obligation and therefore be made direct from the Consolidated Fund. But the circumstances giving rise to an overdraft would make a Ministerial announcement to the House essential and the Commission's decision to ask for an overdraft would need to be made in good time to allow this.

9. The current problem is <u>not</u> however simply one of a temporary cash imbalance. Unless measures are taken to reduce the entitlements of farmers and traders in 1984 the liabilities will either have to be carried forward to the 1985 budget or ways found of increasing <u>appropriations</u> in the 1984 budget as well as the cash to finance them.

10. There are two main ways of coping with the FEOGA guarantee problem. First, expenditure in 1984 could be contained by savings or economies, or expenditure could be deferred beyond 1984. Second, steps could be taken to increase the funds available for agriculture. The Commission have decided on the latter and on 17 April put forward a proposal for a Council Regulation. This would make it obligatory for member states to put at the disposal of the Commission a total amount of 2,333 becu for the 1984 budget. Member states individual shares would be equal to VAT shares. Advances would be subject to market rates of interest and would be repaid in 8 equal half-yearly instalments on or after 30 June 1986. The Commission propose that the detailed implementing regulations would be agreed by qualified majority voting.

Government objectives

11. The Community's need for supplementary finance for agriculture at a time when the ceiling of own resources revenue has been reached gives the Government a lever for attaining UK objectives in the main negotiation. Our main aims are to achieve a satisfactory outcome on budgetary discipline, particularly in relation to the agricultural guideline; to secure an agreement for reducing budgetary imbalances and satisfactory arrangements for 1983 and 1984 refunds; and to ensure that any interim arrangement for agriculture does not lead to an increase in the calculation of our future

net contribution.

12. If we are to make the maximum use of this lever it will be essential to:

(i) only agree to consider the proposals when satisfaction has been achieved in the negotiations;

(ii) put emphasis on minimising agricultural expenditure, in accordance with statements made by UK Ministers in Brussels. (See para 15 below).

(iii) ensure that the solution with the least cost to the UK is adopted. National financing would be more favourable than the Commission proposal. In any solution involving the Community budget we should need to ensure eligibility for refunds in respect of subsequent years.

AGRICULTURE

The problem as seen by the Commission

13. The provision for FEOGA guarantee expenditure in the 1984 budget is 16.5 becu. The Commission estimate that on present trends this could be some 2 becu less than is needed to finance the levels of price support recently agreed by the Agriculture Council. Against this background the Commission have stated their intention of seeking supplementary financing from the Member States to fund the 'hump' in agricultural

expenditure in 1984.

14. The Commission have presented the problem as in part a temporary one - financing a 'hump' of expenditure while the CAP 'reforms' take effect. But it is far from clear that we are dealing with a temporary problem rather than the latest manifestation of the pressure for increased agricultural spending within the Community. Over half of the 2 becu excess expenditure which the Commission predict appears to flow from production (and thus expenditure) having increased more rapidly in sectors such as wine, olive oil, milk, beef and fruit and vegetables. Except in the case of milk the decisions recently taken by the Agriculture Council will not in themselves serve to turn round expenditure on the CAP.

The Government's Objectives

15. The Government's position in respect of the immediate pressures on agricultural spending remains as stated by the Minister of Agriculture at the price-fixing Council on 30-31 March: viz that CAP expenditure in 1984 must be accommodated within the existing budgetary provision and that, if budgetary problems arise in 1984 (or 1985), the Commission should take the necessary steps to reduce expenditure to the permitted level.

16. The rest of this section of the paper concentrates on how that objective is to be achieved in respect of 1984. But it is necessary also to bear in mind the Government's continuing objective of constraining the level of agricultural support in the Community and keeping the rate of growth of agricultural spending as far as possible below the rate of growth of the Own Resources base. That objective implies:

(a) a series of tough price fixing settlements over a number of years with significant price reductions in real terms, to build on the limited progress achieved in 1984.

(b) the need to ensure that FEOGA Guarantee expenditure is consistent with the financial guideline over the period 1984 to 1986.

<u>Scope for containing expenditure to 16.5 becu in 1984</u>

17. The Commission have scope for achieving economies on their own initiative through the CAP Management Committee system. The second sentence of paragraph 17 should be replaced by: "An illustrative list of the sort of options available to them is as follow."

(i) <u>defer payments into 1985</u>

Given that traders are likely to anticipate such action this year, MAFF estimate that direct action on deferments is unlikely to yield more than 500 mecu.

(ii) Level of intervention stocks

The Commission appear to envisage a programme to reduce the level of intervention stocks, particularly of milk products and beef, lasting over a number of years and beginning in 1984 at a cost of 150 mecu. It is not clear why such a disposal programme should be initiated this year when the budgetary situation is so critical; and there may in addition be scope for some increase in intervention stocks and thus significant reductions in expenditure on other forms of market support.

(iii) introduce tendering in all sectors for export refunds

The Commission have proposed the extension of the tendering system to a number of sectors where refunds are at present paid on a flat rate basis fixed some time in advance. The detailed implications for each sector need to be considered, but this approach may yield some modest genuine savings (as opposed to postponed expenditure) by ensuring the most cost effective use of refunds and by giving the Commission more control over the rate of expenditure. This action would have to be accompanied by restrictions on prefixation of the existing fixed rate refunds.

(iv) reduce rates of export refunds and disposal aids

A more drastic option than (iii) would be to reduce the rates of refunds and disposal aids to make them less attractive or, in the extreme case, to stop them altogether.

(v) <u>suspending discretionary market management measures</u>

Some management measures such as certain wine distillations, and some intervention measures for cereals and beef, are introduced at the discretion of the Commission.

(vi) <u>increase delay in payments for intervention purchases</u>

There is probably little scope for increasing these delays following the action taken earlier this year the delay is now about 4 - 5 months. The savings to the Community budget would in any case be fairly small since the initial costs of intervention fall on Member States' budgets.

(vii) <u>reduce payments to the Member States in respect of intervention costs</u>

There is probably some scope for reducing compensation for financing and technical costs.

18. Three of these measures (ii, iii and iv) involve reducing the attractiveness or availability to producers and traders of immediate subsidised export or other

subsidised disposal as compared with intervention. Their effect is thus:

(a) to build up intervention stocks;

(b) in so doing to shift, for a period, the burden of financing the CAP from the Community Budget to Member States' budgets (vii also has this effect);

(c) to postpone Community Budget expenditure until intervention stocks are run down. (There are of course certain payments from FEOGA to Member States in respect of the storage and interest costs of intervention).

Measures of this sort are therefore ways of postponing the cost of the CAP to the Community Budget. They are inferior to 'savings' resulting from reductions in support levels (eg explicit price reductions or implicit price reductions such as those which measures i, v and vi would produce).

19. On the other hand for the United Kingdom saving the Community Budget money by increasing intervention stocks could be less unattractive than for most other Member States. With the possible exception of barley,

the UK share of intervention stocks in all commodities is likely to be substantially less than our current marginal share of additional Community expenditure. Postponing any given amount of expenditure on the CAP until such time as we have been able to negotiate an effective system for limiting the UK's marginal share of additional EC expenditure is thus to our advantage.

20. Hardly any of these measures would help towards our objective of reducing the rate of growth of the CAP expenditure in later years and thus of keeping within the strict financial guideline for 1985 and 1986.

21. Urgent further work is required on the scope for economy measures to keep expenditure within 16.5 becu this year. MAFF should be asked to undertake this.

<u>Other Measures open to the Commission</u>

22. Should such actions not produce sufficient savings, it is open to the Commission to propose additional measures within the agricultural sector for Council decision by Qualified Majority. The main options would appear to be:-

(i) <u>new or increased co-responsibility levies</u>

Further action in the milk sector seems unlikely following the recent decisions on the superlevy. Levies in other sectors would take time to set up and might not yield much revenue in 1984. At a rough calcualtion and as an example a 1% levy on cereals might yield 300 mecu in a full year.

(ii) <u>reduction or suspension of production aids</u> (2.5 becu in 1984 budget).

This would effectively unravel the price fixing compromise.

(iii) <u>virement from the FEOGA guidance section</u>

MAFF estimate that the maximum saving from this course might be about 200 mecu.

<u>ASSESSMENT</u>

23. It is unlikely that other member states will be willing to agree to any courses of action which would seriously reduce the level of support for their farm producers. If that is the case, there will most likely have to be recourse to increased intervention and deferment of payments into 1985. It is not clear whether these by themselves will suffice to cover the whole of the 1984 overhang. Part of the 2 billion ecu may consist of legally contracted commitments to traders

eg pre-fixed export refunds and MCAs) which member states cannot or will not defer. But if no alternative sources of finance can be made available, the Commission would not be able to advance money to the intervention agencies in the member states for the purpose of meeting these commitments.

24. This is effectively what happened for a short period at the end of 1983. If advances were suspended for longer than a few days, member states would be faced with the difficult choice of whether to allow the CAP to break down for lack of funds or to make national finance available in some form to allow the intervention agencies to continue making the payments.

25. Member states are likely in this situation to give way to strong pressures from their farmers for such payments to be made and to insist on reimbursement from subsequent budgets to preserve the principle of 100% Community financing of the CAP. As pointed out in EQS(84)11, there are divided views among the Community's experts as to whether national financing in these circumstances is permitted at all or, contrarywise, is an obligation which Member States have to meet.

26. If there were an agreement that there should be a period of explicit national financing of the CAP, this would be in the United Kingdom's interest provided that there were no reimbursement of the expenditure concerned from the Community Budget, since on the assumption we could prevent trade diversion we would only have to finance the expenditure from which our own farmers benefitted. This latter conditon would, however, be difficult to negotiate, since it is not clear that the Commission could be stopped from declaring the expenditure eligible for reimbursement. Even if there had to be reimbursement from the Community Budget in 1985 or in later years, this could be financially more attractive from the UK's point of view than the Commission's proposal or other financing options discussed below, since the Community reimbursements would count as part of the allocated budget in the year in which they were made and should therefore in principle be included in the calculation of the compensation due to us under any corrective mechanism set up.

Options for additional budgetary finance

27. The Commission's proposal for increasing revenue to allow higher agriculture expenditure, which is discussed with other options below, is unacceptable

in that it represents evasion of the 1% VAT own resources ceiling. We consider that all options would entail new regulations, which would have to be agreed unanimously. The Articles of the Treaty concerned with member states' contributions to the budget do not in our view provide authority for additional finance. We also think that use of Article 235 of the Treaty could be challenged as the basis of regulations covering new sources of funds. That Article says:

"If action by the Community should prove necessary to attain in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the Assembly take the appropriate measures."

The Commission's proposals

28. The Commission's proposed regulation would be made under Article 235 of the Treaty. [Our lawyers advise that the Commission's use of this Article could be challenged on the grounds that there is existing provision elsewhere in the Treaty for financing the budget. The Commission might argue that the words "other revenue" in Article 4(1) of the Own Resources

Decision of 21 April 1970 justifies their case:

"From 1 January 1975 the budget of the Communities shall, irrespective of other revenue, be financed entirely from the Communities' own resources."

However, in our view this refers to existing other revenue and is not a back-handed way of allowing new resources to be created.

29. If we are to maintain credibility in meeting our major objectives as mentioned earlier we must:

(a) question the legality of the action proposed;

(b) stress the need to contain agricultural expenditure;

(c) investigate the scope for restricting legal liabilities by avoiding all new commitments and by postponing payments arising from existing commitments.

30. The financial implications of the proposal for the UK's net contribution are shown in tabular form below and compared with alternative ways of dealing with the financing problem.

ADDITIONAL UK UNADJUSTED NET CONTRIBUTION

Measure	Effect on UK unadjusted net contribution
1. Commission proposal (loan of 2.33 becu from member states) (UK share 20.04%)	Net increase in programme 2.7 of £143 million in 1984 since payment of loan (£275 million) offset by increased receipts from FEOGA (£132 million). When repayment starts, the UK will be refunded its share (which was based on the 1984 VAT) but this would be financed in later year's budgets when our VAT share will be higher giving a further addition to programme 2.7. The draft amount will depend on the interest rates to be applied between the date of the loan and the repayment the last of which will be 31 December 1989. The additional expenditure in 1984 will not score for refund in 1985 since a flat rate refund of 1,000 mecu has been proposed and practically accepted. For future years we would need to ensure that the repayment of the loan was included in the allocated budget otherwise it would not necessarily score for as part of our net contribution under the corrective mechanism as proposed.
2. Defer FEOGA expenditure to 1985	The effect on public expenditure depends on the measures taken to defer expenditure. The position in 1985 will depend on whether FEOGA takes a greater share of the budget than otherwise since the 1% VAT ceiling will still apply in 1985. On programme 2.7 there would only be an addition to our net contribution if the increased FEOGA expenditure in 1985 displaced other expenditure from which the UK derives a higher rate of return. If deferment took the method of increased intervention buying then domestic public expenditure (programme 3) in 1984 would be increased.

3. National financing with reimbursement	In 1984, programme 2.7 would be unaffected but domestic public expenditure (programme 3) would be increased by £132 million. The effect in 1985 on programme 2.7 would depend upon whether the increased FEOGA expenditure displaced other expenditure from which the UK derives a higher rate of return or whether there was further deferment into 1986. If monies were available to repay member states due to Commission savings within the 1% ceiling then one could argue that the net effect on 1985 would be to increase public expenditure by £143 million (£275 million minus repayment of £132 million). Since all this expenditure occurs on FEOGA, the amounts in in 1985 would fall as part of our net contribution to be adjusted by the corrective mechanism as proposed.
4. National financing without reimbursement	There would be no effect on programme 2.7 but domestic public expenditure (programme 3) would increase by about £132 million.
5. Borrowing on the market	Programme 2.7 would show a reduction of £132 million in respect of increased FEOGA receipts. The repayments of the loan would not count as UK public expenditure until they were repaid during the period 1986-89 near the EC budgets for those years. We would need to ensure that the repayments of these loans were included as part of the allocated budget and this might be difficult since the repayments would not be to member states but to third parties. There is therefore a risk that this extra expenditure would not be included as part of the allocated budget to which the corrective mechanism as proposed would apply. The exact amount of the additional public expenditure in UK terms would depend upon the UK VAT share in each of the relevant years together with the interest rate charged on the loan by the market.

31. We are advised that if lending by member states is made obligatory under a regulation the UK's share of loans can be made under S.2(3) of the European Communities Act 1972 direct from the Consolidated Fund or the National Loans Fund. Unlike an increase in the VAT own resources ceiling it would not need ratification by member states governments. The increase in our net contribution for 1984 would be wholly uncompensated, if other member states stick to their present offer - which we have said we are prepared to accept - of a lump-sum refund of 1000 mecu in respect of 1984. If, we could, however, get it agreed exceptionally that these contributions (less our assumed share of the 1984 expenditure) should be included in the allocated budget for the purpose of the budgetary corrective mechanism there would be an increase in UK refunds.

National contributions

32. At an earlier stage the Commission seemed to envisage increasing national contributions through a Regulation under Article 235, perhaps also citing Article 200. The latter covered financial contributions by six member states before they were replaced by own resources under Article 201. In our view the provisions of Article 200 are spent. We are advised by our lawyers

that a Regulation could not be made under Article 235 in view of the prior provisions of Article 201. The effect on the UK's net contribution for 1984 would be similar to that described in the previous paragraph.

Own resources refunds

33. The Commission had also contemplated postponing payment of own resources refunds to member states. They are unlikely to propose a regulation for this, but the implications are rehearsed below.

34. The Council Decision of 21 April 1970 made under Article 201 of the Treaty set out arrangements for replacing financial contributions from Member Sates (under Article 200 of the Treaty) by the Communities' own resources. Article 3 of the Council Decision says:

"The Communities shall refund to each Member State 10% of the amounts paid in accordance with the preceding subparagraphs in order to cover expense incurred in collection".

35. Regulation 2891/77 was made under Article 209 of the Treaty to "determine the methods and procedure whereby the budget revenue provided under the arrangements relating to the Communities own resources shall be made available to the Commissions and determine the measures to be applied, if need be, to meet cash requirements."

36. Article 9(2) of Regulation 2891/77 says:

"Each amount [of own resources] shall be entered gross. In the 30 days following notification of any entry, the Commission shall issue a transfer order in favour of the member state for the amounts corresponding to the standard refund for the expenses incurred in collection as referred to in the fifth sub-paragraph of Article 3(1) of the Decision of 21 April 1970."

The Commission may propose an amendment to this Regulation deferring repayment of amounts due for the remainder of 1984 and for the whole of 1985 until 1986. Adoption would require unanimity. The sum available (about 1 becu in a full year) would then allow FEOGA appropriations to be increased through a supplementary budget or perhaps by a budgetary transfer proposal. Even if the Commission do not themselves propose a regulation to defer own resources refunds there is a risk that a member state would take the opportunity of a preliminary draft supplementary budget to reduce or remove the provision in the 1984 budget and transfer it to agriculture. If this were done by qualified majority under the budgetary voting rules we could be outvoted. But we could challenge the legality of such action.

37. In 1984 the UK's share of own resource refunds is expected to be about 24%, higher than our VAT share. If all the refunds due for the remainder of the year were postponed our net contribution and public expenditure in 1984 would rise by 95 mecu (£55 million). When this is eventually repaid in 1986 it would be financed by extra VAT call-up. The net benefit (about 20 mecu) to the UK would artificially reduce our compensation in the year in question under any corrective mechanism. The amount available under this option would not be enough on its own to meet the Commission's revenue requirement.

Oils and fats tax

38. The Commission have proposed that the oils and fats tax should be instituted by means of a Regulation adopted by qualified majority under Article 43. We have argued that Article 43 is not an appropriate legal base for a protective and revenue raising device but have little support for that view. Whether we can continue to block the oils and fats tax therefore depends crucially on the attitude of the Germans who, with us, constitute a blocking minority. Their attitude is likely to be heavily influenced by their assessment of the effect that imposing the oils and fats tax would have on relations with the United States.

39. The oils and fats tax proposed by the Commission

(75 ecu per tonne) would raise 560 mecu in a full year. MAFF regard it as not beyond the bounds of possibility that the Commission could propose a much higher rate of levy: say 200 ecu per tonne, raising 1.5 becu annually. The Commission have so far envisaged that there would be a gap of about 7 months between Council's adopting a Regulation to impose the oils and fats tax and revenue reaching the Community budget.

Savings in other expenditure

40. Expenditure other than agricultural guarantee expenditure totals about 9 becu. The Commission have repeated their declaration to the European Parliament that they are not disposed to sacrifice non-agricultural expenditure to cover overshoots in agricultural guarantee expenditure. They have nevertheless proposed savings of 350 mecu following a "rigorous" examination of budget needs. Without better information from the Commission it is difficult to judge the scope for doing more. We need to know what proportion of the expenditure is to meet legal commitments already entered into. But even expenditure already committed can be deferred beyond 1984 and some other member states may propose transfers to agriculture if a preliminary draft supplementary and amending budget is put forward. We know that 1300 mecu from the structural funds and food aid were probably deferred from 1983 to 1984. It should

be possible to arrange a similar deferment into 1985, although this would exacerbate an already tight situation in that year.

41. Legal commitments arising from existing commitments are likely to call for increases of 20% in non-obligatory expenditure, against a maximum rate of 8.5%. It is, moreover, not in the UK interest for the Community to sacrifice expenditure on regional and social measures to increase provision for agriculture. For every £1 the UK contributes to agriculture it gets only 55p back, whereas we still get back rather more than our full contribution to the ERDF and the Social Fund. There would doubtless be opposition from other member states who benefit similarly (Greece, Italy and Ireland); and the European Parliament has said it is not prepared to see non-obligatory expenditure raided.

42. There is, however, provision for UK and German refunds of 1200 mecu in Chapter 100 (provisional appropriations) of the budget. These refunds cannot be paid until the Council have agreed the necessary Regulations and a transfer to the main part of the budget agreed by both the Council and the European Parliament. For simplicity it is assumed for the purposes of Annex C that refunds would be made in December. If, as we expect, the bulk is paid earlier the relevant end month cash deficit would have to be

increased accordingly. The cash requirement would have to be covered by advances of own resources or temporary overdrafts under Regulation 2891/77 (see paragraph 8 above). It is unlikely that the Commission would propose a transfer of unused refunds to increase agricultural payments. If they were to do so this would obviously require a strong reaction from the UK.

Other member states reactions

43. Individual reactions are likely to be mixed. On the one hand the majority of member states will not be happy to see the discipline of the own resources ceiling being side-stepped; on the other there will be domestic pressures to maintain payments to farmers by increasing expenditure.

ANNEX C

COMMISSION VIEW OF
EC CASH POSITION 1984

MECU

	EXPENDITURE					REVENUE				BALANCE	
	FEOGA Advances	Food Aid	Other Commission	Expenditure Institutions	Total	VAT	Other OR	Other Revenue	Revenue Total	Difference between Forecast Revenue and Expenditure	Cumulative-Cash Position
											+1500.0
JANUARY	3412.5	72.2	227.4	29.3	3741.4	1171.0	792.3	20.4	1983.7	-1757.7	-257.7
FEBRUARY	1722.9	37.7	558.2	33.0	2351.8	1255.9	992.2	8.5	2256.6	-95.2	-352.9
MARCH	1436.9	49.2	400.0	57.0	1943.1	1212.9	839.6	8.5	2061.0	+117.9	-235.0
APRIL	1392.0	42.0	626.4	35.0	2095.4	1213.0	840.0	8.5	2061.5	-33.9	-268.9
MAY	1485.0	40.0	600.0	33.0	2158.0	1213.0	840.0	8.5	2061.5	-96.5	-365.4
JUNE	1475.0	40.0	600.0	55.0	2170.0	1213.0	840.0	50.0	2103.0	-67.0	-432.4
JULY	1414.0	30.0	600.0	33.0	2077.0	1213.0	840.0	20.0	2073.0	-4.0	-436.4
AUGUST	1414.0	30.0	600.0	35.0	2079.0	1213.0	840.0	9.0	2062.0	-17.0	-453.4
SEPTEMBER	1506.0	30.0	600.0	33.0	2169.0	1213.0	840.0	9.0	2062.0	-107.0	-560.4
OCTOBER	1523.0	70.0	600.0	33.0	2226.0	1213.0	840.0	9.0	2062.0	-164.0	-720.4
NOVEMBER	1672.0	100.0	750.0	33.0	2555.0	1213.0	840.0	9.0	2062.0	-493.0	-1217.4
DECEMBER	-	130.0	2150.0	33.3	2313.3	1213.0	840.0	50.0	2103.3	-210.3	-1427.7
TOTAL	18453.3	671.1	8312.0	442.6	27879.0	14556.8	10184.1	210.4	24951.3	-2927.7	
1984 BUDGET	16500.0	502.1	7933.8	425.6	25361.5	14565.9	10573.4	222.1	25361.5		
c/f from 1983	+17.0	+202.6	+1128.3	+27.0	+1374.9						
					26736.4						

NOTES ON ANNEX C

The table in Annex A shows the Commission estimates of expenditure in 1984 together with the resulting shortfall each month. The total expenditure and revenue forecast by the Commission is compared with the 1984 budget appropriations together with the appropriations carried forward from 1983.

2. The format of the table follows the Commission's layout in the tables given to member states in Budget Committee. The profiles have been constructed as follows:

(i) for January to March the figures used are taken from the Commission's tables, given to Budget Committee, when the Commission withdrew the request for an advance of April's traditional own resources.

Expenditure

(ii) FEOGA advances: the profile is based on information given to MAFF by DG.VI.

(iii) Food aid: the profile is based on previous years' expenditure patterns taking account of the actual spending of the carry forward from 1983 in the first three months of 1984. Food aid expenditure rises substantially in the final quarter of each year.

(iv) Other commission: this is the balance of the Commission section of the budget, including the UK and FRG refunds. It has been assumed for illustrative purposes that the refunds are not paid until December. If an earlier date for payment is agreed, the amount can be switched between December and the month of payment. This will increase the expenditure in the month of payment and the deficit between revenue and expenditure for that month, with a corresponding decrease in December. The cumulative cash position will be reduced by the amount of payment in each of the months from the month of payment to November (inclusive). The cumulative cash position at end December will remain unchanged at -1427.7 mecus.

(v) the other expenditure is assumed to be broadly even throughout the year, with the exception of the ERDF and ESF which are normally end year loaded.

(vi) Other Institutions: this column covers the expenditure of the European Parliament, the Council,ECOSOC, the Court of Auditors and the Court of Justice. It is assumed that expenditure, mainly salaries, is broadly even througout tha year with the exception of rent payments and the costs of the European Parliament Elections.

Revenue

(vii) VAT: the profile assumes equal payments each month since VAT is paid in equal tranches throughout the year. In January the VAT payment is based on the previous year's VAT base with the appropriate adjustment in February. The difference between total received and total budgeted, results from exchange rate movements as the payments of VAT on the 1st of the month are calculated using the exchange rate applicable on 15th of the month previous. It has been assumed that the VAT adjustment in August is neutral in Community terms.

(viii) Other own resources (OR): the latest information available is that traditional own resources (customs duties, agricultural levies and sugar and isoglucose levies) will remain fairly constant at their present level for the rest of the year. The March figure has therefore been repeated, slightly rounded. This gives a total revenue of 10,184.1 compared with a budget figure of 10,573.4 mecus.

(ix) Other revenue: almost 50% of this total is represented by the proceeds of the tax on salaries and contributions to the pension scheme of Community officials etc. The balance is miscellaneous contributions to other Community programmes, etc. Most of which are paid twice yearly.

April 1984

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CC NO

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9 May 1984

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D Nigel.

COMMUNITY BUDGET 1984 : COMMISSION PROPOSALS FOR ADDITIONAL FINANCE IN EXCESS OF THE 1 PER CENT VAT CEILING

(with AJC)

Thank you for sending me a copy of your letter of 1 May to Geoffrey Howe. I agree with the line set out in the paper you attached and that, provided other colleagues concur, there is no need for a meeting to discuss the paper.

2 I am copying this letter to the recipients of yours.

Yours
Norman

NORMAN TEBBIT