



Treasury Chambers, Parliament Street, SW1P 3AG
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FOREIGN SECRETARY

EC BUDGET NEGOTIATIONS

Although the Community Budget negotiations are currently in a lull, they are likely to be resumed quickly after the European elections. We need therefore to consider again what our attitude should be during the next few weeks.

2. The central issue at Fontainebleau will be budget imbalances. But we shall need to deal also with three other issues which will inevitably be linked with the main negotiations. There are the 1984 overrun (for which the Commission has proposed that there should be a 2.3 billion ecu loan from member states), the financing of our 1984 refunds and the 1985 budget. I minuted to you on the first of these on 1 May and Ian Stewart's office wrote to John Coles on the third on 23 May. We need to consider these issues in advance in the context of a satisfactory budget imbalances settlement. Of course, if no such settlement can be achieved, there will be no question of our agreeing to additional financing for the Community either through an increase in own resources or through any other devices.

3. The attached paper, prepared by my officials in consultation with the Foreign Office and the Cabinet Office, considers in paragraphs 17-21 four broad options for tackling this problem. They can be summarised as:

(i) bringing forward the proposed increase in own resources to 1.4 per cent from 1986 into late 1985. The 1984 overrun would then be financed nationally and reimbursed out of the 1985 budget, which would also provide for our 1984 refunds; but the earlier increase in own resources would also enable there to be additional expenditure in the 1985 budget;

(ii) leaving the own resources increase to come into effect in 1986 as in the provisional March European Council conclusions, but conceding supplementary finance for the 1984 overrun by means of an article 235

Prime Minister.

You will wish to consider this -
but, I suggest, after the Economic
Summit. Meanwhile, await Foreign
Secretary's view? A.D.C. 4/6.

cc. No
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regulation and, similarly, providing for payment of the 1984 refunds through an article 235 regulation;

(iii) leaving the own resources increase to come into effect in 1986 but refusing any supplementary finance for agriculture in 1984 or 1985 over the 1 per cent VAT ceiling. As in (i) any overrun expenditure in 1984 (and 1985) would have to be financed nationally though in this case with reimbursement deferred until 1986. This option would almost certainly mean that we should not get our 1984 refunds until 1986, though we should of course expect to get the 1983 refunds before the end of this year;

(iv) simply deferring decisions on the three issues in the hope that the rest of the Fontainebleau package can be settled first.

4. The fourth of these options seems unrealistic. Our partners will expect a firm commitment from us to contribute to supplementary financing to meet the 1984 overrun as part of the overall package.

5. Of the other options, option (iii) seems to me the least unattractive. It should enable us to maintain a tighter squeeze on the 1985 budget (which will be first discussed at the July Budget Council); and it would be more consistent with our position hitherto on increasing the Community's own resources. This is therefore my preferred option.

6. It is however possible that other member states will press instead for option (i). There are disadvantages in this course: most notably, it could weaken our position in the 1985 budget discussions. However, if it enabled us to get a better overall settlement, I accept that we should be prepared to fall back on this option, but in doing so I would suggest that we seek two further provisos. First, it should be an essential part of the arrangement that the 1984 overrun should be nationally financed in the first instance. Second, we should want to do all we could to ensure that, despite the bringing forward of the own resources increase, strict discipline was applied to the 1985 budget, in particular to CAP expenditure. We may indeed need to insist that the initial 1985 budget is adopted within the 1 per cent VAT ceiling and that the call-up of additional own



resources is limited to covering exceptional and unforeseen needs from Autumn 1985 onwards.

7. The least attractive of the options is option (ii); in particular because, as explained in paragraph 19 of the paper, any supplementary finance we contributed during 1984 would almost certainly be ineligible for refunds under the corrective mechanism and would thus mean a substantial addition to our budgetary burden this year. I would only therefore think this worth entertaining as a last resort if it were the only way of getting a good imbalances settlement. But we would need to fight very hard to secure some compensation for our additional contribution in 1984.

8. For the above reasons, my preference is for option (iii), and I suggest that we should approach the negotiations on this basis. The Prime Minister, will, however, want to have the maximum negotiating flexibility at Fontainebleau to get the best deal possible on Budget imbalances and I would therefore be prepared to accept option (i) as a fall-back. There must, however, be no question of advocating this course in advance; if we did resort to it, it should be as a concession to get a better overall settlement than would otherwise be possible.

9. I should be grateful for your reactions. I am sending copies to members of OD(E), the Prime Minister, and Sir Robert Armstrong.

David Pertz

pp

(N.L.)

4 June 1984

(approved by the Chancellor and
signed in his absence)

cc.
NIO
CO
DTI
LOD
LPS
MAFF
FCO

bc PC.

CONFIDENTIAL



10 DOWNING STREET

From the Private Secretary

Mr. Peretz

EC BUDGET NEGOTIATIONS

The Prime Minister has seen the Chancellor of the Exchequer's minute of 4 June. She will wish to consider the proposals in it after the Economic Summit, and in the light of the views of other members of OD(E).

I am sending copies of this minute to the Private Secretaries to the other members of OD(E) and to Richard Hatfield (Cabinet Office).

A. J. COLES

6 June, 1984.

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BUDGET: 1984 OVERRUN, 1984 REFUNDS AND THE CURRENT NEGOTIATIONS

There are three short-term Community budgetary issues which are beginning to impact in various ways on the main negotiations on the future financing of the Community. These are:

- (i) the Commission's proposal for a loan to finance the 1984 overrun;
- (ii) the implementation of the provisional agreement on 1984 refunds; and
- (iii) the problem of how to approach the 1985 Community Budget.

This paper considers the links which exist or which are likely to be made between these issues and the main negotiations; and the implications of these links for the UK's objectives and our tactical approach to those negotiations.

Background

2. The Commission's proposal on the 1984 budget overrun was analysed in the paper attached to the Chancellor of the Exchequer's minute to the Foreign Secretary of 1 May. The Government's basic position was stated by the Minister of Agriculture at the price fixing: CAP expenditure in 1984 must be accommodated within the existing budgetary provision and, if budgetary problems arise in 1984 (or 1985), the Commission should take the necessary steps to reduce expenditure to the permitted level.

3. At the May Foreign Affairs Council, further work was set in hand to examine the size of the financing gap, the scope for savings and the options for financing the remaining gap. The Germans and French opposed the Commission's loan proposal. Several delegations stressed the need for decisions before the summer, and President Thorn drew an explicit link with the package of issues to be settled at the June European Council. We have had separate reports that several member states are likely to refuse to agree to a solution on the budget imbalances aspects of the main negotiations without a simultaneous agreement on financing the 1984 overrun. Meanwhile, the Germans (or at least their Finance Ministry) have told us they

would prefer national financing (probably with reimbursement) to a loan; and the European Parliament has expressed opposition to the Commission proposal (but without rendering a formal opinion), although they favour some form of supplementary financing.

4. On 1984 refunds, the March European and Foreign Affairs Councils provisionally agreed to an ad hoc figure of 1000 mecu net. The draft Presidency conclusions went on to state that:

"It [ie. the 1984 refund] will be paid in 1985 in accordance with procedures to be determined, which will not affect the level of Community expenditure."

There have been no discussions of how these conclusions should be put into effect. The Commission has not proposed anything in its 1985 preliminary draft Budget, although the introduction says that they are willing to put forward appropriate proposals when final decisions are reached. As it stands, the text on 1984 refunds is open to different interpretations; there is accordingly scope for other member states to make considerable difficulties over its implementation.

5. On the 1985 Budget the Commission has proposed a preliminary draft Budget (PDB) providing for an increase of 17 per cent in FEOGA guarantee compared with the original 1984 budget provision; an increase of nearly 13 per cent in non-obligatory expenditure compared with a "maximum rate" of 8½ per cent; and a resultant excess over currently available own resources of just under 2 billion ecu. The Commission proposes to meet this excess by inviting member states to ratify the new own resources decision in time for new own resources to become available by 1 October 1985. However, they recognise that this may not be possible, and they suggest as a fallback a further loan under Article 235, on the pattern of their proposal for 1984.

6. A separate note on our approach to the 1985 Budget is being prepared. For the present paper, it is sufficient to note that the July Budget Council, which will establish the Draft 1984 Budget, will be extremely difficult. We may find it hard to secure the

necessary support to bring the draft back below the 1 per cent ceiling; there may be deadlock; or, at worst, we might be outvoted by qualified majority (although it must be doubtful whether other member states would be prepared to acquiesce in a budget of doubtful legality).

7. Although our public position has been that the Commission's loan proposal for 1984 is a separate issue to be treated on its merits and not one which is connected with the great negotiations, in practice it and the other issues above are and will be related to each other. Indeed, the paper attached to the Chancellor of the Exchequer's minute recognised this:

"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".

The Prime Minister has also told the House that "we could not agree [to the loan proposal] until other things are settled". Moreover, even if the others do not explicitly link the 1984 overrun with the budget imbalances problem, they are bound to link the implementation of the 1984 refunds (which will require a separate agreement) with the Commission's loan proposal. And, if the 1984 overrun has not been settled, this will add to pressures on the 1985 Budget and make the task of the July Budget Council even harder.

8. Linkage is thus inevitable. But, although other member states seem to consider that it will operate in their favour, the balance of advantage could operate in both directions. We are looking for a satisfactory agreement on the budget imbalances mechanism and for definite arrangements for the payment of 1984 refunds. The others are looking for new own resources and an agreement on the financing of the 1984 overrun. It seems quite likely that the "two-way" linkage on these issues will operate as much in our favour as in theirs.

UK and others' objectives

9. Our objectives are:

- (i) a satisfactory settlement on budgetary imbalances incorporating a corrective mechanism to apply with effect from 1985;
- (ii) effective arrangements for budgetary discipline including a strict financial guideline for agricultural expenditure;
- (iii) early agreement on the payment of the 1984 ad hoc refunds, ensuring that there is no scope for difficulties similar to those we have had with 1983 refunds;
- (iv) on the 1984 overrun, to minimise supplementary financing and to ensure that if there has to be any we are properly compensated for our share in it; and
- (v) on the 1985 Budget, to safeguard our interests, and in particular to ensure that agricultural expenditure is reined back.

10. For the most part, the other Nine have interests operating in the opposite direction to ours, although we have some allies on budgetary discipline. In particular, they will not wish to agree a settlement of (i), (ii) and (iii) above without action to meet (iv). And on (v), they will wish to protect the CAP both from the effects of the 1 per cent ceiling and from the demands of nonobligatory expenditure. It is worth also noting that most other member states realise the potential advantage to the UK of financing the overrun in a year (1985) when we get compensation under the budget imbalances mechanism. They may well try to use this in some way as a bargaining counter.

Timing

11. All these issues will come to a head at the Fontainebleau European Council (25/26 June). (The 1985 Budget itself will follow the usual slower procedure, but it will be affected by decisions at Fontainebleau). Preparations for Fontainebleau will be made at the 18/19 June Foreign Affairs Council, which will also be

separately considering the 1984 overrun. We will wish to ensure that 1984 refunds are also dealt with promptly. We accordingly need to decide our line quickly, especially since it may affect bilateral contacts, in particular with the Commission, the Presidency and the Germans.

Line to take

12. On the 1984 overrun, we should be able to continue to argue for agricultural savings to reduce the gap as much as possible. This should get support from the Dutch and Germans. But at the same time, we will have to accept that there is a substantial gap which cannot be met by savings (as opposed to deferment) during 1984.

13. As explained in the Chancellor's earlier paper, the best way to meet this gap would be to defer agricultural support expenditure or its common financing beyond 1984, provided our position in 1985 and future years is protected through the operation of the imbalances mechanism. Deferment would mean rejecting the Commission's loan proposal and any supplementary budget they come forward with. It could take a number of practical forms, all of which would probably imply national financing in November/December, either of expenditure such as export refunds normally prefunded from the Community Budget or of increased intervention, in both cases with reimbursement to the member states to be charged to the 1985 budget (it is clear that others will reject national financing without subsequent reimbursement). The problem of financing the 1985 budget would thus be aggravated.

14. So far as 1984 refunds are concerned, we have accepted that these should be financed "in a way which does not affect other EC expenditure". This phrase could be interpreted to mean, as we would like, that the refunds will be paid on the revenue rather than the expenditure side of the Community Budget - though there are significant legal problems about achieving this result. But whatever the interpretation, it will not be possible to finance the 1984 refunds on either side of the budget within the 1 per cent VAT ceiling. Accordingly, unless the increase in own resources is brought forward into 1985, there appear to be only two ways

of paying the 1984 refunds in that year:

- (i) they could be paid outside the Community Budget altogether; or
- (ii) they could be paid inside the Budget under a special article 235 regulation involving additional ad hoc contributions from member states.

15. There are difficulties about both of these possibilities. On the first, it would be dangerous to rely on separate national legislation in the other Nine member state Parliaments; accordingly a Community legal base would be the preferable option. But there are major legal and political problems over payment outside the Community Budget for an item which is covered by Community legislation. On the second option, there is no realistic alternative to an article 235 regulation, but there are legal difficulties over suggesting such a regulation for a revenue side correction. It might be possible with political will to sidestep these difficulties, but it is unlikely that the others will agree to bend the rules and accept an article 235 regulation for the payment of our 1984 refunds without demanding that we agree in return to finance the overrun under a separate article 235 regulation. There are not, therefore, any easy solutions for the payment of the 1984 refunds.

16. On the 1985 budget, we will aim to bring the draft back within the 1 per cent ceiling, either by inviting the Commission to submit a revised PDB or by insisting on cuts at the July Budget Council - preferably in agricultural expenditure. At the same time, we will wish to protect the Regional and Social Funds from which we are net beneficiaries. Even with these actions, however, it will be extremely difficult to accommodate agricultural guarantee expenditure within the 1 per cent ceiling in 1985. This will be especially true if whatever measures are taken in response to the probable 1984 overrun effectively add to the Community's financing burden during 1985.

Financing implications for 1985

17. The analysis thus far shows that the 1984 overrun, the 1984

refunds and the 1985 budget will between them place great pressure the 1 per cent VAT ceiling during 1985. Indeed, it seems likely that constraining the Community's budget within the 1 per cent VAT ceiling in both 1984 and 1985 without any form of supplementary financing may prevent us achieving all of the objectives set out in paragraph 9. Ministers will accordingly wish to consider the best strategy for us to adopt, both in terms of its general political effect and in terms of its implications for our negotiating objectives. We have identified four possible options.

18. The first is to resolve the 1985 financing problem by bringing forward increased own resources from 1986 into the latter part of 1985, as now proposed by the Commission. It should be possible for the necessary legislation to be ratified quickly following an agreement at Fontainebleau, since most member states (other than the Germans - see below) are anxious to see new own resources come into effect as soon as possible. Points worth noting on this strategy are:

- (i) it would be the surest way of getting our 1984 refunds in 1985, since they could be paid on the revenue side in accordance with the mechanism contained in the new own resources decision;
- (ii) it would enable us to finance the 1984 overrun out of the 1985 budget and thus protect the UK's position provided that the imbalances mechanism applies in respect of 1985. This would also enable us to scotch once and for all the pressure for special loans or other financing expedients; and it would mean we could stick to our view that Article 235 Regulations cannot properly be used to raise additional revenue;
- (iii) against these advantages, the bringing forward of additional own resources would make it more difficult to stick to a firm line on the 1985 budget. We could try to limit additional own resources to the amounts required for our 1984 refunds and the 1984 overrun, but it would be difficult to prevent the Commission, some other member states and the European Parliament using additional own resources to finance higher

agricultural and other expenditure than would otherwise have been possible in 1985, particularly since a number of them (notably Italy), regard an increase to 1.4 per cent as inadequate;

- (iv) there are also major tactical and presentational disadvantages in the UK advocating the early introduction of new own resources. Not only would this sit ill with our general attitude towards budget discipline; it would also make for serious difficulties with the Germans who have publicly and emphatically refused to contemplate the introduction of new own resources before 1986. It might, though, be possible to leave the Commission and/or Presidency to take the lead both in advocating the early introduction of own resources and in persuading the Germans to change their position, in which case we could consider reluctantly acquiescing rather than fervently advocating it, desirably in return for a better budget imbalances settlement;
- (v) finally, although in theory ratification ought to be possible before late 1985, there might be slip-ups in the process somewhere along the line. It could be slightly dangerous to rely on prompt ratification.

19. The second strategy would be to leave the introduction of own resources until 1986, as presently envisaged, but to concede at least some supplementary financing of the 1984 overrun under an article 235 regulation (not necessarily in the same form as the Commission's proposal). At the same time, we would insist on a separate article 235 regulation to pay our 1984 refunds, preferably on the revenue side of the budget. This approach has the following characteristics:

- (i) it would solve the difficulty of getting our 1984 refunds, though less certainly than the first approach;
- (ii) although it would mean additional finance for the 1984 overrun, the aim would be to restrict the provision of funds to this purpose and to payment

of the 1984 refunds. We would argue that there should be no question of additional sums for other activities, including higher agricultural expenditure in 1985;

- (iii) against these points, supplementary finance in 1984 might cost us more than the alternative of increased own resources in 1985, since the budgetary imbalances mechanism does not cover our 1984 net contribution for which we have accepted a flat rate refund. We might argue that we should be compensated in some way for this, but there is no guarantee that we would be successful in pressing our case;
- (iv) although we would avoid the tactical difficulty of advocating the early introduction of own resources, there could still be some criticism of the Government for conceding additional financing over and above the 1 per cent ceiling this year; and we would have conceded the very important principle that an Article 235 Regulation could be used to raise revenue.

be to

20. The third strategy would leave the introduction of new own resources until 1986; but at the same time to refuse to provide any extra finance during 1984 or 1985 above the 1 per cent VAT ceiling. Agricultural obligations above this would have to be met by national financing with reimbursement in 1986. We would also almost certainly have to accept that we would not receive our 1984 refunds during 1985, but we could press for them to be paid as soon as possible in 1986. This strategy has the following features:

- (i) it would be consistent with our general approach to tighter budgetary discipline and also with the Germans' desire not to introduce new own resources until 1986;
- (ii) in accordance with this, it would keep up the pressure on the 1985 budget and enable us to squeeze agricultural expenditure. At the same time, our willingness to accept deferral of the 1984 refunds until 1986 would remove the possibility that others might exert pressure over us in relation to the

financing of the 1984 overrun by refusing to accept a special regulation for payment of the 1984 refunds (they could be covered instead by the new own resources decision itself);

- (iii) against these points, there would be a significant interest cost in deferring our 1984 refunds until 1986. It is not clear that it would be possible to receive the 1984 refunds in the first quarter of 1986 (and thus in our 1985-86 financial year) because we may not be paying enough VAT in that quarter for it to be possible to abate our contributions by a sufficiently large sum;
- (iv) pushing the agricultural overrun and 1984 refunds into 1986, when both the 1985 corrective payment to the UK and the first year of enlargement will also be financed, will put considerable pressure on the new 1.4 per cent VAT ceiling. If there is to be enough money to pay us all our refunds, very firm budgetary discipline will need to be applied to other expenditure, particularly on agriculture;
- (v) there could be some criticism of the Government for failing to secure payment of the 1984 refunds during 1985.

21. The fourth strategy would be to acknowledge that there are problems with both the 1984 overrun and the 1984 refunds, and that the 1985 budgetary procedure will be especially tricky; but to avoid reaching definite conclusions on any of these subjects as early as Fontainebleau. The others will be looking for some commitment on the financing of the 1984 overrun, but we might be able to engineer a rather vague form of words about our willingness to ensure that all the Community's agricultural obligations are satisfactorily met without committing ourselves to a specific method of bringing this about. So far as 1984 refunds are concerned, we in our turn would probably have to be content with the present wording of the Presidency conclusions, which promises that they are to be paid in 1985 but in a way which does not affect the level of Community expenditure. These uncertainties need not affect the main Fontainebleau package which could be settled; and, in

Subsequent discussion of the detailed implementation of the package, of the arrangements for meeting the Community's 1984 obligations and of the 1984 refunds, we could act to ensure that they all proceed in parallel, in practice on the basis of one of the three strategies described above. It must, however, be doubtful whether this strategy could run given the pressures for an early settlement of the 1984 overrun, so we may well be pushed towards one of the other three approaches at Fontainebleau.

HM TREASURY

30 MAY 1984

✓ CC PC
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MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH



From the Minister

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs

Downing Street
London SW1A 2AL

// June 1984

EC BUDGET NEGOTIATIONS

I have noted the options and preferences set out in Nigel Lawson's minute to you of 4 June.

My only general comment is that, if and when an acceptable outcome on budget imbalances is available, we must clearly be ready to consider carefully any other option which emerges and gathers support as a way of tackling the 1984 and 1985 problems. This could, however, be considered at the time.

I can see the attractions of bringing an element of national financing into the chosen solution, as envisaged by Nigel. If this is to be adopted, the legal framework will need to be carefully constructed since there will be a number of difficulties to resolve. And it will be important to ensure that the mechanisms established will maintain the cash flow required by the Intervention Board without any cross effects on the other programmes of the Agricultural Departments.

I am copying this to the Prime Minister, members of OD(E) and Sir Robert Armstrong.

MICHAEL JOPLING

Euro Pot Budget Pt 25

28 JUN 1994

