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PRIME MINISTER

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Cabinet: Community Affairs

You will wish to inform Cabinet of the results of the European Council at Fontainebleau on 25-26 June which at last reached agreement about the reform of the Community's financing system and the United Kingdom refunds. You may wish to stress the key points that:

- i. the new system, which is linked with the increase in own resources, will be durable: unless the United Kingdom itself agrees to change it, the new system will continue to our benefit;
  - ii. the combined effect of the new system of refunds and the increase of 1.4 per cent in the VAT ceiling is that the United Kingdom will be contributing less than 1 per cent of VAT. In the absence of an agreement we would have been contributing 1 per cent.
2. In particular:
- i. the agreement on budgetary imbalances provides a lump sum payment to the United Kingdom of 1,000 million ecu net for 1984 (about £600 million) with the system thereafter giving refunds for the United Kingdom at a rate of 66 per cent of the VAT share/expenditure share gap, calculated, as we would wish, on the payments basis. The refunds in 1985 and later years will be substantially higher than in 1983 and 1984. By comparison with the 750 million ecu refund for 1983 and the disagreed position on 1,000 - 1,250 million ecu at the Brussels European Council, the new arrangement would give a refund for the United Kingdom of nearly 1,080 million ecu on 1983 figures, and significantly higher figures in 1985 and later years. The system will last as long as the decision to enlarge

the Community's own resources by increasing the VAT ceiling from its present 1 per cent to 1.4 per cent from 1 January 1986, and can only be changed by unanimity. The Germans will pay two-thirds of their normal share of United Kingdom reliefs;

ii. in securing this agreement, you successfully resisted pressure from other member states for two ad hoc years and for a less satisfactory system which would have given the United Kingdom only a partial relief of the VAT/expenditure gap added to a fixed sum. You also pushed other member states up substantially from their original refund figures of 55 or 60 per cent and eliminated proposals which would have had the effect of making us contribute to any German refunds or to transitional "own resources" relief for Spain and Portugal at our full rate;

iii. it was also agreed that measures should be taken at the next Budget Council to balance the 1984 Budget and to complete the implementation of the provisional agreement on budgetary discipline;

iv. the Foreign Affairs Council has now adopted the three regulations necessary to unblock our 1983 refunds of 750 million ecu (£440 million). It is now for the European Parliament to transfer the money from the reserve chapter of the budget;

v. the United Kingdom achieved its main objectives on the budget inequity, securing a satisfactory relief on our unadjusted net contribution, a durable system with effect from the refund for 1985 (with only one more year of arbitrary relief) and the release of our 1983 refund. Subject to the satisfactory completion of the work on budgetary discipline and the 1984 budget overrun, we have also achieved our objectives in these areas;

vi. the Germans, while obviously unclear about their main objectives, achieved a modification of the application to them of the system and an increase in VAT relief for

German farmers from 3 per cent to 5 per cent from 1 July so that they can pay from their national budget more compensation for dismantling the monetary compensatory amounts;

vii. President Mitterrand will have the satisfaction of having presided over a successful European Council. He will no doubt emphasise also the other matters discussed there, in particular the establishment of an ad hoc group of representatives of Heads of State and Government to examine a list of topics designed to benefit the "citizens of Europe", including the introduction of the common passport from 1 January 1985, and the introduction by 1 April 1985 of a single customs document for the transport of goods, the abolition of frontier controls for individual travellers and a system of equivalence of university awards. A further ad hoc group will consider institutional questions to improve the operation of the Community;

viii. the European Council confirmed the objective of completing the enlargement negotiations with Spain and Portugal by 30 September 1984;

ix. much detailed work has now to be done, not just by the Budget Council, but by officials to ensure that the European Council's decisions are turned into texts, including the amendment of the Own Resources Decision.

3. The Environment Council meets on 28 June and the Research Council on 29 June.



ROBERT ARMSTRONG

27 June 1984

BUDGET SETTLEMENT : BULL POINTS

- I) This agreement means that since 1979 this Government will have secured £3,000 million in refunds from the Community. That means we have contributed £3,000 million less than if Labour's arrangements had still been in effect.
- II) Despite the increase in the general VAT ceiling to 1.4% the new system will mean that our net contributions to the Community will be less in real terms than they would be under the existing 1% VAT ceiling.
- III) We confidently expect our contribution to fall in real terms under the new arrangement.
- IV) Under the new system Britain will be contributing not 21% of new Community expenditure but 7%.
- V) The increase in the VAT ceiling to 1.4% is necessary to allow others to pay more so that we can have our refunds and pay less.
- VI) The new arrangement is far better than any deal previously on offer to this country.
- VII) The new system is durable. It can be changed only by unanimous decision by the member Governments and national Parliaments.

BUDGET DEAL GIVES US LESS THAN WE COULD HAVE GOT AT BRUSSELS

This is a much better deal than anything available in Brussels. We have secured a lasting system which can only be changed by unanimous agreement of Member States. We have secured only one more ad hoc year: at Brussels we were offered between two and five more ad hoc years. We have also secured a rate of compensation which is better than anything which was on offer in March.

RELIEFS NOT AS GOOD AS AVAILABLE UNDER PREVIOUS REFUNDS

Previous refunds had to be negotiated each year. This was becoming increasingly difficult as we saw over our 1983 refunds. Moreover, the level of ad hoc payments had been degressive (£783 million in 1981; £491 million in 1982; £440 million in 1983). Under this agreement we secure release of our 1983 refunds (£440 million); a guaranteed refund for 1984 (£600 million) and an automatic system of reliefs for 1985 onwards. This new system can only be changed with our agreement. It will give us automatic payment of reliefs on the revenue side and on the payments basis which is of great importance to this country. It gives us a firm assurance of reliefs at a constant rate for the future.

WHY HAVE YOU GIVEN UP THE SYSTEM?

No question of our giving up the system. We have secured all the essential elements which we sought, namely, a lasting system embodied in the own resources, that can only be changed with our agreement; payment of reliefs on the revenue side of the budget; a fair sharing of budget burdens based on our ability to pay.

WILL THE OTHER MEMBER STATES BENEFIT?

The agreed text provides that any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time. The system will apply to the United Kingdom only at this stage. The FRG will contribute to our reliefs at two thirds of her normal financing share. The UK will of course not contribute to this abatement of the German contribution.

INCREASE IN OWN RESOURCES TOO HIGH A PRICE FOR REFUNDS?

We have agreed to increase in own resources in order to enable the Community to develop new policies of benefit to Britain; to allow for an increase in real terms in the Regional and Social funds from which we benefit; and so as to complete the negotiations for Spanish and Portuguese membership which are in the vital interests of the NATO alliance and of Western democracy. At the same time, the UK will be paying about half, even with an increase in own resources, what it would have paid with no increase and no agreement. We shall go on paying at less than 1% of VAT while other Member States pay more. Over the period 1983-88 our adjusted net contribution will fall in real terms.

UK NONETHELESS REMAINS LARGE NET CONTRIBUTOR

The Federal Republic of Germany will remain the largest net contributor and will be bearing a greater share of the burden through its contribution to our reliefs. As a result of enlargement and increase in own resources, France will also become a substantial net contributor. Britain will remain a net contributor but at a much lower rate than if there had been no agreement. The UK's contribution to new Community expenditure will now be less than 7%, compared with our normal VAT share of about 21%. Other Member States, who will be contributing to our reliefs, will be getting lower receipts from the Community budget than in the past.

[\* UK adjusted net contribution in 1983 = £683m  
1984 = £631m  
1985 = £588m]

ARE NOT LEVIES AND DUTIES ON IMPORTS FROM OUTSIDE  
THE COMMUNITY EXCLUDED?

Not at all. The basis of correction which has been agreed covers the great bulk of our payments to the Community since what the VAT share/expenditure share gap means is that our levies and duties are counted as if they were paid at the VAT rate, ie just over 21% of the Community budget. On 1983 figures, our "excess" levies and duties on this definition amounted to 291 mecu on a total gap of 1913 mecu. Over the last few years the figure has fallen in real terms.

WHY NOT MAKE SAVINGS INSTEAD?

Savings are being made, as this year's agricultural price settlement showed. In addition, the Community has now agreed on the need to set annually a total favourable expenditure. This will apply to all Community spending and will ensure that agriculture takes a diminishing, not a growing share of the Community budget.

WHY 1.4%?

A 1.4% VAT ceiling is consistent with the necessary cost of enlargement, modest real growth of the structural funds and limited growth of new policies.

WHEN WILL NEW CEILING BE REACHED?

With effective budget discipline we expect the new ceiling to be sufficient for the Community's foreseeable needs.



FURTHER INCREASE AGREED TO 1.6%

A number of Member States wanted a further increase in 1988, to 1.6%. Under the agreement reached, there can be no further increase without the unanimous agreement of Member States and the approval of national parliaments.

WHEN WILL PARLIAMENT DEBATE INCREASE IN OWN RESOURCES?

The next step is for detailed legal texts implementing the agreement reached at Fontainebleau to be drawn up. The procedure will be:

- (a) the Commission will submit a proposal for a decision to the Council of Ministers which, in the UK, will be subject to Parliamentary Scrutiny in the usual way;
- (b) that decision can only be adopted by unanimity in the Council of Ministers. It would then be recommended for adoption by the Member States in accordance with their respective constitutional requirements;
- (c) in the case of the UK, the Government would lay a draft Order in Council under Section 1(3) of the European Communities Act 1972. This would require the approval of both Houses of Parliament;
- (d) if approved by Parliament, the Section 1(3) Order would be submitted to the Privy Council;
- (e) following Privy Council enactment, the Secretary General of the Council of Ministers would be informed of the completion of the UK constitutional procedures.

#### WHAT ABOUT 1983 REFUNDS?

They were blocked by two Member States pending resolution of the budget negotiations. These two countries have now lifted their reserve as we anticipated and contrary to the dismal predictions of the opposition, doubtless based on their lamentable performance when in government.

#### EUROPEAN PARLIAMENT COULD STILL BLOCK

The Parliament has to approve the transfer of the refunds. The Commission will not institute the necessary request so that the refunds can be paid.

#### WHAT ABOUT 1982 REFUNDS

This disagreement was of a quite different order than the 1983 refunds. There was no dispute about our basic refund, all of which has been paid but, about a small element of the so called risk sharing payment. The disagreement arose over the calculation of the amount due. We have now secured, for the future, the payments basis as the method of calculation. This is of great value to us since it will enable the full amount of our refund to be deducted forthwith under the system. In the light of this agreement, we have decided not to pursue the argument with the Budget Council about the residual risk sharing element from 1982.

## BUDGET DISCIPLINE

### NOW YOU HAVE AGREED NEW OWN RESOURCES WON'T THE COMMUNITY CARRY ON OVERSPENDING?

We shall continue to press for savings and deferment of expenditure instead of raising new funds as proposed by the Commission.

For the future, under the new arrangement for budget discipline, agriculture is to take a diminishing share of the Community budget while all Community spending is subject to an annually agreed maximum. The agreement on own resources will only be ratified when the measures necessary to guarantee the effective application of the principles agreed have been adopted. Finance Ministers have been asked to complete this work.

### BUT THE 1985 PDB PROVIDES FOR AGRICULTURE TO TAKE AN EVEN LARGER SHARE OF THE CAKE

So far, we only have the Commission's proposals. The budget must conform to the own resources ceiling. The Commission's proposals for the 1985 budget year must therefore be revised so as to comply with the legal provisions of the Treaty of Rome.

### IF SAVINGS CANNOT BE FOUND, WILL THE GOVERNMENT AGREE TO A LOAN OR TO ADVANCES?

No adequate case can be made for a loan just half way into the budget year. The immediate need is to identify and make savings, and to defer expenditure. This issue will be considered by the Budget Council in July. Heads of Government agreed that steps should be taken to ensure that the 1984 budget was in balance. We have already put forward proposals for savings to achieve this goal.

## NEW COMMUNITY POLICIES

### WHAT DID EC HEADS OF GOVERNMENT AGREE AT FONTAINEBLEAU?

Heads of Government reaffirmed their commitment to a number of objectives including:

- development of Europe's scientific and technological potential
- strengthening of the internal market

To achieve these objectives there is a need for:

- a framework programme for telecommunications and biotechnology
- increased effort in research and development
- measures to simplify trade and customs formalities
- harmonisation of standards and products
- liberalisation of trade in services, notably transport and insurance

### UK PAPER ON FUTURE OF EUROPE

I have today placed in the library of the House the paper on the future development of the Community which I sent to Heads of Government before the European Council. It sets out practical ideas for a more effective Community - through completion of the common market for goods and services; collaborative action where this can achieve better results than national action alone; through a more prominent international role for the Community and through a number of ideas for institutional and organisational changes.

### WILL THE UK AGREE TO A NEW TREATY ON EUROPEAN UNION?

The Community should concentrate on implementing the existing Treaties before we start drafting new ones. We all agreed at Fontainebleau to consider practical steps towards improving European cooperation.

COMMUNITY HAS AGREED TO GIMMICKS SUCH AS FLAG,  
FOOTBALL TEAM, ETC.

A number of ideas have been put forward and will be discussed by representatives of Heads of Government. Our aim is to make the Community more relevant to the lives of its citizens and to work towards greater unity by practical means. If honourable Gentlemen would take the trouble to read the paper which I have placed in the library of the House they will see that all the suggestions in it are sensible, practical and of real value to this country and to the Community as a whole.

COMMON FORMAT PASSPORT

UK PLANS FOR THE COMMON FORMAT PASSPORT?

My right honourable Friend the Home Secretary expects to make a statement about the Government's intentions shortly.

RECOMMENDATION ON WORKING TIME

WHY HAS THE UK REJECTED THE PROPOSED RECOMMENDATION ON WORKING TIME?

A reduction in working time is not the way to create more jobs. The biggest cause of lost jobs has been falling competitiveness in the Community in relation to the rest of the world. Our top priority must be to improve competitiveness. This recommendation works against that aim, and by risking damage to competitiveness could make the employment situation worse.