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MR POWELL

EUROPEAN COMMUNITY: BUDGET OVERRUNS IN 1984 AND 1985

We spoke about the Community budget overruns. This question was discussed in the Steering Committee on European Questions last week. The Chancellor of the Exchequer is now sending a minute to his colleagues. I understand that a time has also now been earmarked on Friday, 13 July for a meeting between the Prime Minister and the Ministers most directly concerned.

2. The Council of Ministers (Budget) on 18-19 July will be discussing the Commission's proposals for a supplementary budget for 1984 and for the Community's preliminary draft budget for 1985. Both proposals are in excess of the revenue available under the 1 per cent VAT ceiling. It is clear, therefore, that firm corrective action by the Council to respect the Community's legal obligations is necessary. The United Kingdom's tactics are also important, so that we avoid fall-out and gain the maximum advantage from the handling and timing of the corrections.

3. There are three guidelines for the United Kingdom's broad approach to the 1984 and 1985 budget overruns -

(i) we have consistently taken the view that the rules on the Community's own resources must be respected and that the Community cannot legally adopt a budget unless there is the revenue to finance it (article 199 of the Treaty). We have ensured that the 1 per cent VAT ceiling has not been undermined and we need to make sure that nothing is done now which would allow the undermining of the 1.4 per cent VAT ceiling later;

(ii) we believe that savings both on the Community's 1984 budget and on the preliminary draft budget for 1985 are possible and must be made. Realistically we have accepted - although we have not said so publicly - that if there were difficulties about financing some Community expenditure in November/December 1984, the Community financing would have to come out of the 1985 budget;

(iii) the negotiation in the European Council at Fontainebleau has now secured that the lasting system of budget correction will apply to the United Kingdom's refund in respect of 1985 and subsequent years. There will be only one year (1984) to which a fixed refund of 1000 million ecu will apply. It is therefore to our advantage that, if there is a choice, Community expenditure should fall in 1985 or later years rather than in 1984.

4. 1984 budget overrun. The Commission proposed in April to submit a supplementary budget of 2300 million ecu and, in order to legitimise its proposal in the absence of finance, also proposed a regulation under article 235 of the Treaty (unanimity) for a loan from member states repayable with interest when own resources had been increased. Germany and the United Kingdom opposed this loan proposal and it will not be adopted. The Commission is expected to withdraw it and to replace it with a proposal for financing by repayable advances from member states.

5. There are two key questions for the Council of Ministers (Budget) on 18-19 July: first, how far the Council can reach agreement on reducing the Commission's estimated overrun; and, secondly, what should be done about the financing when the overrun has been cut back to the irreducible minimum. The Commission has recently looked again at its figures and is revising the overrun downwards slightly to about 2000 million ecu. The Council may be able to reach agreement on a figure below, but not much below, this level (we are, of course, arguing for bigger savings).

6. Thereafter we expect that there will be a disagreement on the action to take -

either (i) member states should make available temporary advances to the Community in order to pay the bills in November/December 1984. These advances would be in accordance with the VAT key, so that the United Kingdom would be liable for 20-21 per cent. The Commission would propose a regulation under article 235 of the Treaty (unanimity), by-passing the 1 per cent VAT ceiling on the Community's own resources but justifying this on the ground that they were also proposing that the ceiling should be increased on 1 October 1985. We do not like this approach because of the undermining effect of an article 235 regulation on the own resources ceiling and because the United Kingdom would be paying straightaway at the VAT rate. It would be difficult to get any repayment of the advances in 1985 within the budget correction/United Kingdom refund system, because all other member states would oppose this. The Germans also do not like an article 235 regulation and have been thinking about payment of advances under a gentlemen's agreement

("advances": solution of nine member states - Germany equivocal);

or (ii) any legitimate expenditure for which Community finance was not available in the last weeks of 1984 would be met nationally, with reimbursement from the Community budget at the beginning of 1985. Under this arrangement the United Kingdom would be paying out only about 13 per cent or less of Community expenditure in the last weeks of 1984 (ie payments to our own farmers and traders) and we would be certain that, when all member states were reimbursed in 1985, the new budget correction/UK refund system would be in effect ("temporary funding with reimbursement": solution of the United Kingdom).

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7. The chances of agreement on (ii) above would be increased if we could break up the incipient nine to one situation. We need, if we can, to keep the Germans in favour of our solution or at least opposed to an article 235 regulation. The other member states will be more amenable to our solution if they think that the difficulties are temporary and will be unravelled by new own resources becoming available in 1985.

8. 1985 preliminary draft budget. The Commission's proposal is about 1900 million ecu over the level of finance available with the 1 per cent VAT ceiling in place. The Budget Committee has already agreed to take about 600 million ecu off the Commission's proposal. It is possible that the Council of Ministers (Budget) on 18-19 July will reach agreement on a 1985 preliminary draft budget within the 1 per cent VAT ceiling. If so, there will be strong pressure from other member states on Germany to agree to the Commission's proposal that the revised Decision on Own Resources should enter into force on 1 October 1985, thus providing the safety-valve of a potential supplementary budget after the Decision had come into force. A similar argument will be advanced to the United Kingdom if (as we propose in para 6 (ii) above) we argue in favour of pushing some 1984 expenditure into 1985. Entry into force of the revised Own Resources Decision on 1 October 1985 has advantages as well as disadvantages for the United Kingdom: it would ensure that we obtained our 1984 refund of 1000 million ecu in 1985 (otherwise we might have to wait until 1986) but for technical reasons it would give the European Parliament a higher baseline for non-agricultural expenditure.

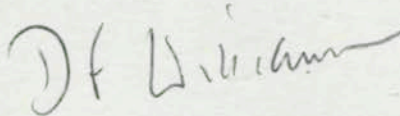
9. The July Budget Council normally reaches a common position on the preliminary draft budget for the following year, so that the procedures with the European Parliament can be launched. Although the 1984 and 1985 budget overruns are not directly linked with the budget correction/United Kingdom refund system

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negotiated at Fontainebleau, any serious disagreement or delay might be presented as a setback to the Fontainebleau package. It is all the more important, therefore, that the United Kingdom should seek, in a deal on 18-19 July on the budget overruns -

- (i) to achieve the maximum negotiable savings;
- (ii) to push any remaining 1984 overrun into 1985 ("temporary funding with reimbursement");
- (iii) to keep the 1985 preliminary draft budget within the 1 per cent VAT ceiling;
- (iv) if the revised Own Resources Decision is to enter into force on 1 October 1985, to circumscribe to the maximum extent possible the European Parliament's baseline for non-agricultural expenditure.

10. I am sending a copy to Sir Robert Armstrong.



D F WILLIAMSON

10 July 1984