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SECRETARY OF STATE FOR DEFENCE

Customs Relief on Imports of Defence Equipment

1. There have been disturbing developments in our long-standing dispute with the Commission over our practice of granting a waiver of import duty on certain imports of defence equipment.

2. As you know, Article 223(1)(b) of the Treaty of Rome allows any Member State to take "such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material". For many years there has been disagreement within the Community about whether this Article entitles Member States unilaterally to waive import duties on articles of defence equipment imported from third countries and falling within categories defined in a list drawn up by the Council in 1958. The Commission have long argued that this practice is not justified, and have sought to establish a distinction between those imports of an inherently military nature and those which, though intended for military use, are capable of other applications.

3. Earlier initiatives on this issue by Davignon in 1977-80 were successfully resisted. Francis Pym, then Secretary of State for Defence, agreed (in his letter to Ian Gilmour of 2 October 1979) that our interests would be best served by continuing to resist, and by stiffening the resistance of other Member States likely to be affected. Although we managed

persuade the Commission to shelve the issue on that occasion, they have now returned to the charge. In October 1984, the UK and six other Member States (FRG, Italy, Denmark and the Benelux countries) received Article 169 mise en demeure letters alleging that all were in breach of Treaty obligations for operating a waiver. We contested the Commission's claim vigorously in our letter of 3 December 1984 on the grounds that

- the United Kingdom procedures were consistent with Article 223 of the Treaty;

- the Treaty leaves to the explicit discretion of Member States the determination of what constitutes their security interests: the Commission has no locus;

- the transfer of resources involved in paying duty would correspondingly diminish the amount available for the defence of the United Kingdom;

- individual procurement decisions would be distorted by considerations other than those of national security;

- to supply information about the costs and quantities of material imported (which would have to include information about the uses to which it would be put, and why alternatives were not suitable) would be contrary to essential security interests; and

- the distinction that the Commission had tried to draw between items of an intrinsically military nature and those which could also be used for civilian purposes was false.

4. We lobbied the other Member States involved in the hope that they would take an equally firm line, but they have so far been insufficiently active to persuade the Commission that opposition from Member States is such as to justify suspending further proceedings against them. The Commission consequently have decided to take at least the next step towards action before the Court. At their meeting on 27 March they endorsed a recommendation that Reasoned Opinions should be issued against all the Member States involved. Lord Cockfield has been sympathetic to our concerns, but he has received virtually no support from his colleagues, and is in a difficult position on an issue falling within his portfolio, on which his functions are semi-judicial, which he inherited from the last Commission, and on which he cannot appear to be arguing a case of concern only to the British. The Reasoned Opinions must issue within three months and are likely to be submitted to Lord Cockfield before the end of April.

5. This is a potentially serious development. We have a good legal case. But if, in the event of the Commission bringing the case before the European Court of Justice, the Court were to decide against us and other Member States we could find ourselves faced with having to pay duty on a coniserable proportion of our imports of defence equipment. I have seen no authoritative estimate of the additional costs that this would entail, but given the level of our imports of defence equipment from non-EC countries I imagine that the sum could well be substantial. As customs duties form part of Own Resources the sums in question would not simply be transferred to the Exchequer: an equivalent amount would be paid into the European Community budget. There would be further serious implications for those Member States whose international commitments in

Memoranda of Understanding on bilateral defence collaborative projects involve reciprocal waivers of customs duty.

6. How serious the diversion of resources would be is for you to say. But I am sure that you would agree that we must continue to object strongly to the element of Community preference that would thereby be introduced into procurement decisions, as Malcolm Rifkind did when the question arose recently in the Dooge Committee. Such a development would be inconsistent with our strongly held views of the respective functions of the Alliance and the Community. It would also be inappropriate at a time when we are concentrating on reaffirming the transatlantic link (in the face of Congressional pressure to cut back US commitments in Europe), and when we are encouraging the Americans to remove some of the obstacles on their side to a more balanced two-way street in defence equipment trade. It might, I suppose, be objected that the impetus which you and your colleagues have given to European defence procurement collaboration in the IEPG represents a form of European preference. But the IEPG is closely linked with the Alliance, and the clear objective is to strengthen the European defence industries and technological base as a contribution to the common defence.

7. I am concerned too about the underlying issue of principle. An adverse judgement in the European Court would insert a wedge into our hitherto successful policy of excluding the Community from competence in all matters relating to defence, and the Commission could be expected to do all it could subsequently to enlarge the breach. While we believe that our case in law is, as I have said, a good one, the Court tends to interpret exceptions to the Treaty restrictively, and I should much prefer not to have to submit our case to the test.

8. Our lobbying so far in capitals has revealed that the Danes and the Dutch have some sympathy for our view. The Italians were also initially constructive. But we must now mobilise support at a political level among those directly concerned. It would therefore be very helpful if you were to write to your colleagues in the other six countries affected by the Commission's proposal (FRG, Italy, Denmark and the Benelux countries), drawing their attention to this problem and seeking their assistance. Woerner should be particularly important in this. I understand that the Germans, Dutch and Italians at least buy a greater proportion of their defence equipment from the Americans than we do: they should be very concerned by the implications of the Commission's action. I would not have thought that it would be necessary to write to Member States other than those immediately affected: while the Commission's line reflects French interests, especially their attachment to 'Community preference' in this area, it is the Commission, not the French, that we are attempting to outflank. To write also to them and others not in the Commission's line of fire might even risk provoking a counter lobbying campaign.

9. It would be worth pointing out to your colleagues that it will be harder to persuade the Commission not to proceed with the case once they have issued the Reasoned Opinions. The time to lobby is now, before the papers have been prepared for signature. We would therefore hope that Defence Ministers in the six other Member States concerned might encourage their colleagues in Foreign Ministries to exert sufficient pressure not only on their Commissioners but also directly on Lord Cockfield, as Commissioner responsible, to dissuade the Commission from issuing the Reasoned Opinions at all.

Even if, in spite of such lobbying, Reasoned Opinions were issued, it would be reassuring to know that your Defence Minister colleagues would seek then to ensure that their governments would reply to the Reasoned Opinion in robust terms.

10. It would also be worth pointing out to your colleagues the link between this case and the separate decision which the Commission took on 27 March to issue a Reasoned Opinion against the United Kingdom on the Commission's claim to customs duty on five Tristar aircraft which were imported duty free by British Airways in 1980 and 1981, used initially for civil purposes but subsequently sold to the Ministry of Defence for military use. We have contested the Commission's claim, primarily on the commercial policy grounds that the customs union provisions of the Treaty do not require the raising of a customs duty on the end use of the Tristars. But we have also reserved our right to argue that even if they did, Article 223 would allow exemption from customs duty. Although the legal basis of the Commission's action on Tristars rests solely on end use, if it were to succeed, the wider issue of Member States' rights under Article 223 would necessarily also be prejudiced. This too, therefore, should be a matter of concern to other member states and not just to us. We hope that they will join in urging the Commission not to proceed on Tristars - and would, if necessary, intervene in any eventual court case to support our position.

11. I think it would also be helpful if Nigel Lawson were to alert his German, Italian and Dutch opposite numbers (and possibly other colleagues) to the disturbing implications of the Commission's action on Article 223 for the allocation of finite resources in national budgets, since it will increase

the pressure on defence budgets. I imagine that Finance Ministries in some, if not all, Member States affected would share their Defence colleagues' wish to resist this Commission initiative.

12. I have no doubt that we need to do everything in our power to muster support on this. It would be absurd of the Commission to pursue action of this kind at a time when all European countries are struggling to accommodate within their defence budgets escalating costs of projects and programmes. The end result could only be to reduce the resources available for the European Allies to devote to defence.

13. I am copying this to other members of OD and Sir Robert Armstrong.

GEOFFREY HOWE

Foreign and Commonwealth Office
4 April, 1985