



Foreign and Commonwealth Office

London SW1A 2AH

9 May, 1985

Dear Charles,

The Enlarged Community

In my letter of 4 February (not to all) I undertook to let you have a fuller note on the enlarged Community. The attached paper has been approved by Sir Geoffrey Howe. It confirms his view that:

- Prime Minister
This is the further paper
for which you asked
on the Enlarged
Community. It is an
interesting
paper.*
- (a) enlargement offers opportunities as well as risks;
 - (b) the Community cannot hope to prosper on the basis simply of carrying forward existing policies. We have already succeeded in achieving major changes; we must use the opportunities that will arise to achieve more;
 - (c) we must expect smaller and more cohesive groupings to emerge;
 - (d) our own position in relation to those groupings will depend on the policy choices we make; to the extent that there is an inner core within the Community we shall want to be sure that the UK exerts effective influence on what is decided within it;
 - (e) the French and Germans will try to assert a position of leadership. There is no reason why we should permit that to happen. Their own relationship, though much advertised, is subject to various strains. They will take various initiatives of their own. But Fontainebleau has created a better basis for cooperation with them, jointly where possible, and separately where not. This will be the key to our ability to ensure that the enlarged Community functions in a way compatible with our interests.

*That would
be very
damaging
to our interests*

The Foreign Secretary notes that, thanks largely to the policies pursued since 1979, there has been a significant convergence of our economic performance with that of other leading Member States in this period. Whereas in the 1970s we were bottom of the league for economic growth amongst EC countries, in 1983 we were top. Despite the coal strike we were in line with the EC average in 1984, and for 1985 the OECD forecasts that we will again achieve the fastest growth of any major EC country.



The Foreign Secretary considers that the FRG's remarkable trading performance (\$19.5 billion surplus in 1984 on trade in manufactures with the rest of the Community) shows that the remaining barriers to trade in merchandise can be surmounted. This confirms his impression that British commerce and industry have still not been able fully to exploit the opportunities which the EC market already offers. He is aware that the Department of Trade and Industry are keen to encourage British exporters to take a fresh look at the European market and impress on them the opportunities that already exist. He strongly supports efforts in this direction. We need also to focus industry's attention on the large new market in Spain and Portugal which will open up in the next decade. The recent CBI seminar on the Iberian market (which took place after prompting from Whitehall) is, in his view, an example of what can and should be done.

4. I am sending copies of this letter and its enclosure to the Private Secretaries to the Chancellor of the Exchequer, the Minister of Agriculture, the Secretary of State for Trade and Industry, the Home Secretary and the Cabinet Secretary.

Yours ever,

Colin Budd

(C R Budd)
Private Secretary

C D Powell Esq
10 Downing Street

THE ENLARGED COMMUNITY : SUMMARY OF CONCLUSIONS

1. The justification for enlargement has been mainly political. The economic and commercial opportunities must be set against inevitable costs, including increased pressure on the Community budget. The enlarged Community will have its own North/South divide (paragraphs 1-6).

2. The UK achieved its objectives in the enlargement negotiations. We will have to bear some of the costs, but these will be much reduced by the Fontainebleau mechanism, giving us better protection than Germany or France (paragraphs 7-8).

3. Our objectives will be to:

(a) maximise our potential economic benefits through completion of a genuine common market. This will only happen if our own industrial structure and performance are geared to taking advantage of the Community market as a whole. The German example (\$19.5 billion surplus with the rest of the Community in manufactures) shows that strong industrial performance can surmount existing obstacles to trade. In services the obstacles remain more formidable: we must work to get them removed. UK industry must not get left behind in the race to exploit the new opportunities in the Iberian market (paragraphs 9-14);

(b) contain resource transfers to the Mediterranean. Some transfers through the structural funds will remain necessary to help the weakest member states to adapt. But convergence cannot be achieved through resource transfers. It can only be achieved through adoption of the appropriate economic policies and structural reforms (paragraphs 15-17);

(c) maintain pressure to reform the CAP and limit its cost. Containing support for Mediterranean agriculture will depend on a continuing effort to get expenditure on northern products under control. Small farmers, who are particularly vulnerable to price

discipline, may need other forms of support. There could over time be a shift towards more national financing (paragraphs 18-21);

(d) steer R&D activity towards promoting direct cooperation between the companies and research institutes, limiting public funding, but ensuring that we do not miss opportunities to benefit from practical cooperation, particularly in the application of research (paragraphs 22-24);

(e) strengthen political cooperation so as to give the Community an influence commensurate with its potential (paragraphs 25-27).

4. There will be an increasing tendency towards cooperation on a variable geometry basis, involving some but not all member states. We shall need to:

(a) encourage practical improvements in decision taking, both to counter increased difficulties in obtaining consensus and bring about key reforms (paragraphs 28-29);

(b) ensure that we form part of the core groupings that are likely to develop in areas of particular interest to us. Otherwise we could see a Community dominated by a substantially unreformed CAP and structural funds with much of the real action - progress towards completion of the internal market, industrial collaboration etc - taking place in smaller groups (paragraphs 30-32).

(c) take advantage of the movement of France into the same camp as the Germans and ourselves as net contributors to the budget. Our ability to get things done in the enlarged Community, contain its costs and establish a new equilibrium within it will depend on the effectiveness of our collaboration with the French and Germans (paragraphs 33-35).

THE ENLARGED COMMUNITY

Introduction

1. The existing Member States supported the accession of Spain and Portugal for political, not economic reasons: they wished to anchor both countries firmly into the West European democratic system. The Spanish and Portuguese governments are convinced that membership will help maintain domestic political stability. The successful completion of the negotiations should have a positive effect on the Spanish referendum on NATO. The prospect of accession provided us with a lever to get the Gibraltar border reopened.

2. Opening up the highly protected Spanish market will be of advantage and could not have been achieved without EC membership. Spain should eventually reach Italy's level of economic development. Portugal is a semi-developed country which will look to the Community for special assistance. Spain and Portugal together will add one third to the number of farmers in the Community. There will be strong pressures for more spending on Mediterranean agricultural products. The Fontainebleau mechanism will protect the UK against rising expenditure better than France or Germany. But the CAP in its present form will not be able to operate at acceptable cost in the enlarged Community unless there is firm action to deal with surpluses and prevent the escalation of Mediterranean spending. If existing procedures are not improved, decision-taking will also become more difficult and cumbersome.

The New Members

3. Spain (population 38m, GNP per capita 57% of the Community average)** has the highest unemployment in Western Europe (21%). She is already a favoured target for US and Japanese investment

** A table comparing the population, relative prosperity and net budgetary benefits of the 12 Member States is at Annex B.

and accession will further encourage this. To remain competitive, Spain is likely to devalue the peseta and is unlikely to want to join the ERM. Towards the end of the transitional period her very competitive agricultural sectors will pose an increasing challenge to the French and Italians (wine, fruit and vegetables for both; olive oil for the Italians) as well as the Dutch and ourselves (out of season vegetables). Weaker sectors - peasant holdings - will expect to benefit from FEOGA guidance. Spanish industry will have to emerge from behind its protectionist wall. Many sectors will face a difficult period of adjustment, though in some areas - steel, cars, shipbuilding - Spain is already very competitive. Community membership in the long run probably will act as a stimulus to the Spanish economy and provide the framework for industrial restructuring.

4. Spain has had to accept a tough accession bargain. The Commission do not expect her to derive significant net financial benefits from accession until the latter part of the transitional period. There will be friction over the accession terms on fisheries and agriculture. There will not be much scope or tolerance for any formal re-negotiation. To improve these terms, Spain will try to use such opportunities as arise, eg the review of the transitional arrangements for fisheries (1993) and the end of the first stage for agriculture (1990), though in practice she is more likely to improve her position by trying to maximise her benefits on the expenditure side. Politically Gonzalez continues to have strong support and is unlikely to want to emulate Papandreou's maverick performance.

5. Portugal (population 9.9m, GNP per capita only 26% of the Community average) will be by far the poorest Member State, with weak and vulnerable agricultural and industrial sectors. Despite improvement she is still running a balance of payments deficit: \$880m last year, down from \$3bn in 1981-82. Portugal is no threat to the rest of the Community except in textiles. Though her leverage is small, there is general recognition that she will

require extended help and special treatment. This has been reflected in the transitional arrangements, which should ensure that Portugal is a substantial net beneficiary from the outset.

Other Member States

6. The effects of enlargement on other Member States are summarised at Annex A. The main points are:

(a) France will become a net contributor and has already become much more restrictive about agricultural spending. The French, however, will continue to attach great importance to the Community as a way of locking their economy into that of the Federal Republic and maximising their political influence;

(b) The FRG, which has strongly supported enlargement, will bear the brunt of the budgetary costs but can expect to benefit from the wider market. German policy will remain contradictory on the budget and agricultural prices. But they and the Dutch will remain our closest allies on some key issues.

UK Objectives in the Enlarged Community

7. We achieved our objectives in the enlargement negotiations. We have secured the opening up of the Spanish market, effective protection for our fisheries and our other specific objectives in the negotiations, including a better relationship with Spain over Gibraltar. We are however likely to receive less from the structural funds and have to pay more for Mediterranean agriculture and (for the next few years) for IMPs. But the Fontainebleau mechanism will protect us against much of the budgetary cost of enlargement. In that respect the UK is better placed than France (which expects to overtake us as a net contributor to the Community budget in 1987) or Germany (which will eventually want to limit its own contribution, but will not be able to escape paying the lion's share).

8. The key to securing our objectives in the enlarged Community will be to work with France and Germany to ensure that expenditure is kept within bounds and made more cost effective. This means

giving priority to our objective of opening up the internal market; combining with others to resist Mediterranean efforts to maximise north/south resource transfers; progressive reform of the CAP; and getting more value for money from other expenditure.

9. The UK's balance of visible trade with the Community (1984 net deficit \$4.8bn; deficit in manufactures \$11.2bn) is similar to that of France (visible deficit \$6.5bn; deficit in manufactures \$10.2bn). Both compare unfavourably with Germany (visible surplus \$8.5bn; surplus in manufactures \$19.5bn). But the adverse trend in our balance of trade in manufactures with the Community is identical to the trend in our trade with the rest of the world. Our exports to the Community have grown since accession much faster than to the rest of the world: the EC took 44.8% of UK exports last year, compared to 30% in 1972. On invisibles the picture is different. The Germans run a substantial deficit with the rest of the EC (\$10.6 billion in 1983). Despite the fourfold growth of our invisible exports in sterling terms since 1972 (fivefold for financial services), the EC share of total UK invisible exports remains at 25%, the same as in 1972, and we continue to run a deficit with our EC partners (£2.1 billion in 1983, compared to a surplus of £5.7 billion with the rest of the world).

10. In terms of prosperity as measured by GDP per head, the UK is now at 98% of the EC average. After enlargement we will be above the new average (at about 108%). But the UK's industrial performance and economic strength are still well behind those of our two largest partners.

11. A fundamental question is how far UK industry will take advantage of the opening up of the Spanish market, and of the Community's internal market generally. The FRG's example (1984 surplus on trade in manufactures with EC partners: \$19½ billion) is a clear demonstration that strong industrial performance can easily surmount many of the remaining barriers to trade in merchandise in the Community. Improving the UK's own industrial

performance and making a determined attempt to increase our share of the whole EC market will remain crucial if we are to maximise our own benefits from EC membership. Despite the improvements that we have secured, Britain's industrial performance remains her Achilles heel.

Convergence and the Common Market

12. The Community's founders believed that the creation of a common market, combined with coordinated economic policies in Member States, would bring about a gradual convergence of economic performance and wealth. There has been some convergence of economic policies, but the common market remains to be completed - and convergence of performance and wealth has similarly lagged behind. The spread of economic performance will be greater still with the entry of Spain and Portugal. The common market offers significant opportunities, but these have not been maximised; nor have they been evenly distributed. Greek manufacturing industry, for instance, has found it hard to compete or adjust (one factor in the Greek demands for IMPs); so too with parts of British industry and commerce.

13. Completion of a genuine common market will remain the highest of priorities for us. We have won the intellectual argument: all Member States now acknowledge the need for progress and that this will be crucial to maximise the Community's ability to help create wealth and employment. But progress is likely to remain painfully slow unless some direct impulsion is given by the heads of government themselves. There are very different concepts of the objectives and hence the actions required to open up the common market and - from the Germans as well as the French and others - straightforward resistance in some areas to opening up their markets at all (especially in relation to financial services, transport and public procurement). Some of our own policies are seen by other member states as inconsistent with our commitment to opening up the internal market, e.g. our derogation on lorry weights and our attitude towards frontier controls.

14. Delors is committed to achieving progress (and indeed to a programme aimed towards completion of the common market by 1992). But we shall need to convince the Commission that progress is not going to be made by the hardest route, ie tax approximation which will be opposed by us and other member states. We should also look for ways of advancing matters more rapidly with those who are willing to move, as with the Dutch over air services. The Commission is also laying stress on freedom of movement for individuals and the achievement of a "Europe without frontiers". Our concerns about immigration and terrorism, though they are shared to some extent by other Member States, may not permit us to go as far as the French, Germans and Benelux. We shall continue to point out the important differences between land and other frontiers. The measures the French and Germans so far have taken relate to the movement of people, not goods.

15. As to convergence, part of the bargain between richer and poorer Member States has consisted of limited transfer payments to the poorer regions - though by far the most significant transfers through the Community budget in fact have been to the agricultural sector generally, including the rich northern agricultural regions. These transfers are substantial in relation to the balance of payments and public expenditure of the net contributors, and are important to the economies of the smallest Member States such as Ireland. Total spending on agriculture and the structural funds still represents less than 0.75% of Community GDP, or about 2% of total public expenditure in the Community. Except in agriculture these transfers have little overall impact in promoting future sources of economic growth.

16. The net contributors are increasingly likely to insist that their liabilities cannot be open-ended. At the same time they will need to ensure that there is no erosion of the joint commitment to the common market, which for them is the Community's most important economic asset. Provided British industry and commerce have the ability and will to take advantage of it, the enlarged Community will offer increased markets. The UK must

therefore:

(a) continue to attach central importance to implementation of the Treaty obligations concerning the internal market;

(b) aim to limit the flow of help to the poorer countries without attacking the principle of such help;

(c) argue that convergence will only be brought about by the adoption of the appropriate economic policies and modernisation of the economies of the poorer Member States;

(d) continue to give the highest possible priority to improving our own industrial performance, and to securing much greater awareness of the opportunities for exporting. A particular effort needs to be made to increase our share of EC markets.

17. The UK has benefited substantially from the structural funds. Last year we did exceptionally well, receiving 27% of the Regional Fund and 32% of the Social Fund, with a financing share of 21%. After enlargement our share of receipts is liable to decline. We are unlikely over time to remain a net beneficiary from the Regional Fund. We will remain a net beneficiary from the Social Fund, though our share is likely to fall. We must aim to limit these effects by continuing to put forward programmes well calculated to attract Community support.

CAP

18. Recent decisions have brought real cuts in support prices and the introduction of guarantee thresholds. The Commission has again put forward restrictive price proposals for 1985/86: but, as we know, the outcome for this round is still uncertain.

19. But what has been achieved so far represents only the beginnings of reform. What is seen as the need for common support prices to be set at levels which produce acceptable incomes for

small producers has combined with continued improvements in yields and investment by large and efficient producers to generate increasing surpluses. If support prices are to be held down over a prolonged period by mechanisms such as improved guarantee thresholds, there may be a need for more direct assistance to smaller producers. This could work to the disadvantage of British farmers and affect our share of FEOGA receipts. Our aim must be to ensure that so far as possible such assistance is nationally funded.

20. The accession of Spain will increase expenditure on Mediterranean products. The cost of support of those regimes has already increased by 250% over the past five years, though the total cost of support for Mediterranean agriculture is still less than expenditure on milk alone, which continues to account for 20% of the total Community budget. The strength of the dollar has held down the cost of export restitutions and Community aids, particularly on cereals and oil seeds. A substantial fall in the dollar, coupled with changes in US farm policy, could cause a further escalation of CAP costs. But it remains to be seen whether Congress will permit the US Administration really to cut farm support.

21. Both the French and the Germans have been prepared already to devote substantial resources to national support for agriculture, and a wider shift towards more national financing of agriculture may come about over the next few years, either through being accommodated within the overall framework of the CAP or as direct national aids - though such developments will continue to be strongly resisted by the main CAP beneficiaries and significant distortions of competition would have to be avoided.

Community Research and Development

22. There is a general recognition of the need for more effective cooperation and pooling of effort between European companies operating in specific high technology sectors and there will be continuing pressures to do more to stimulate this. Other

governments see this and industrial collaboration, as well as completion of the common market, as among the keys to competing with the United States and Japan. But they are coming to accept our view that the emphasis should be on stimulating and coordinating action by industry and the research institutes themselves. Some Community expenditure on R and D has not been as well directed as it could be. We must insist on a continuing review of its cost effectiveness.

23. Properly defined Community programmes can be worthwhile when they are specifically tailored to stimulate cooperation between leading companies. Good examples of this joint approach include ESPRIT and could include a re-defined version of RACE (Research into Advanced Communications in Europe), which is strongly supported by industry and would have more attraction if industry itself were to assume the main financial burden. Our objective should be to steer Community funding towards projects of this type and, quite apart from Community funding, to promote closer industrial cooperation. The European Council has agreed that a higher proportion of the Community's resources should be devoted to R&D though, at our insistence (with some support from the FRG), it rejected the Commission's proposal to raise R&D expenditure from 3% to 6% of the Community budget by 1989. We should continue to point out that the scope for increased expenditure in this area will depend on what can be done about limiting the proportion of the budget devoted to the CAP.

24. The French proposal for a European Research Coordination Agency (EUREKA) is not likely to prosper in the form initially advanced, i.e. envisaging large-scale public funding. But some further effort to coordinate the application of research activities is likely to be the first variable geometry project in the enlarged Community, with the Germans, Dutch and Italians expressing interest in a better defined scheme, involving genuine coordination and very limited public funding outside the Community framework.

External Policy

25. Spain is independent-minded, but on most issues has been moving closer to the majority view in the Community. Portugal is already a well schooled member of NATO. Both Spain and Portugal voted with us at the last UN General Assembly on every occasion when the Ten were united. Spanish and Portuguese membership of ~~the~~ Community will be a net plus for the Alliance, and participation in political cooperation is likely to draw Spain further towards the mainstream of Western and Alliance thinking. Gonzalez will want to play a more responsible role than Papandreou, but Spain may still create problems over the Middle East and Central America. On the Falklands, Community support - already fragile - will become more difficult to sustain (though Spain will want to continue to avoid taking a very advanced position on this). A formal agreement on political cooperation should be so devised as to make it harder for EC countries to take positions in the UN or elsewhere which could affect key national interests of other member states.

26. The United States attached great importance to the success of the enlargement negotiations; they were concerned about the consequences in Spain and Portugal if they failed, as well as the effects on Spanish membership of the Alliance. But they will lose agricultural exports to Spain and Portugal and, once in the Community, Spain is likely to join France in the protectionist camp. The avoidance of serious trade friction with the United States will depend on the development of US and EC farm policies and the handling of the new GATT round.

27. The Mediterranean countries will be directly affected, particularly Tunisia and Morocco. We and others will resist pressures to compensate them for loss of markets with increased financial aid. We shall argue for continued trade access for the more significant agricultural exports of the Mediterranean countries, which are bound to be affected anyway by Spanish production and agricultural efficiency. Negotiations on this subject will continue in the Community throughout the latter part

of this year.

Achieving our objectives

28. The Community's prospects will depend on its ability to deal with the practical problems it faces now, and which enlargement is likely to compound. It is easier to divert attention to institutional reform than to take the difficult policy decisions necessary to complete the common market or reform the CAP.

29. Concern at the consequences of enlargement lies behind much of the current debate on the development of the Community, in particular on decision taking. There will have to be increased use of majority voting on non-vital issues if decisions are to be arrived at on a reasonable timescale. The UK has an interest in encouraging practical improvements in decision taking, both to counter increased difficulties in obtaining consensus and to bring about key reforms. Our aim must be to get agreement on measures which will have some practical effect, including the avoidance of the referring upwards of problems from the Council of Ministers to the European Council; and insistence by the Council of Ministers that decisions on matters of lesser importance should be taken in COREPER. We share the French and German concern to apply some additional pressure to systematic dissidents like the Greeks. This must be done by political and procedural means. The reality will remain that no member state is prepared to be voted down on issues of major importance. We should present this to others less in terms of the Luxembourg compromise - to which some of them still feel bound formally to object - than of the basic understanding on which the Community rests and which they all know actually to govern decision-taking in the Council. To vote a country down on a matter which genuinely is of very important national interest would be more damaging to the cohesion of the Community than a delay in decision-taking.

30. Enlargement will bring some increased nostalgia for the supposedly more cohesive and economically compatible Community of the Six. The Six claim that they could agree to further

institutional development and increased cooperation in other areas. There has been some evolution in French attitudes e.g. on majority voting - though not as far as they would have others believe. The Six are no more prepared to see their national interests disregarded than we are, but there is a difference in domestic political attitudes, as well as the accompanying rhetoric. If the enlarged Community were to prove unmanageable or unreasonably costly, there could be a reversion to cooperation among the Six - though that would depend on our own policy at the time. The core grouping the Six themselves would most like to see encouraged in the enlarged Community is that of the WEU Seven. We have the same objective, as the Seven are potentially the most homogeneous major grouping, comprising countries whose economic structures and levels of development are most similar, and who are close together in their views on key defence and security issues.

31. Some measure of variable geometry will be desirable and indeed inevitable. This certainly will continue to be the rule in relation to major collaborative projects such as Airbus. More generally, where progress within the enlarged Community is held up, we shall see groups of member states taking action on their own. In areas where some member states wish to intensify their cooperation in one area or another, the option for others to join later must be left open. Most business will still need to be conducted on a Community basis, but a new balance will have to be struck between common action by the Twelve and cooperation in smaller groupings. Membership of the enlarged Community could have limited value unless we form part of the inner groupings that are likely to develop in areas of key interest to us. Otherwise we could see a Community dominated by a substantially unreformed CAP and structural funds in which the northern member states have declining real interest, with much of the real action - completion of the internal market, industrial collaboration etc - taking place in ad hoc groups.

32. A series of concentric circles is more likely than a single exclusive group. In some areas - particularly the progressive

abolition of frontier formalities - there is already increased cooperation among the Five (France, Germany and the Benelux). They face practical difficulties and progress will be laborious, but they are trying to make progress towards a common travel area. It will take a long time for them to achieve the virtual elimination of frontier formalities between them, but that is the direction in which they are headed. The French and Germans also have done a good deal of work on standards. Here too progress has been slow and there is increasing acceptance in the Community of our view that what is required is the mutual recognition of existing standards with common standards for new products and technology.

33. Over the past year, what threatened to be a partially exclusive alliance between France and Germany has come under considerable pressure. The French and Germans will try to establish a position of leadership and have developed a particularly close pattern of consultation. But they will have their work cut out to adjust their existing policies to the new situation. Despite the political theatre surrounding it, the Franco-German relationship is by no means easy. A special feature of French policy is the great importance they attach to tying the Germans ever more securely into the Western European system. They are worried by trends in German opinion. Successive German Chancellors also have been tying the FRG into the European framework as the best safeguard against the development of more nationalist or neutralist attitudes. We share these concerns and should be less inhibited in private discussions about acknowledging this. It is a factor which needs to be given due weight in the formulation of our own policy.

34. Both France and Germany have found it easier on some key issues to cooperate with us than with each other. We have found it easier to work with the French than the Germans on the main budgetary issues. The French are mid-way between us and the Germans in their attitude to the institutional development of the Community. The Germans see us as their natural allies on trade

policy. Enlargement will accentuate that.

35. Despite the inevitable clashes of interest, permanent French egocentricity, and the no less permanent and damaging confusion in German policy, our ability to get things done in the enlarged Community and to establish a new equilibrium in it will depend crucially on the effectiveness of our cooperation with the French and Germans, separately as well as jointly. A determined effort must be made to work out with them a strategy for the management and development of the enlarged Community. In the main this cooperation will have to continue to be organised bilaterally to avoid friction with others. But we shall need to enlist the support of the northern Member States generally in containing Mediterranean pressures, and to work closely with the Dutch on completion of the common market. We shall have allies on all of these issues, the most important change of all being the movement of France into the same camp as us and the Germans as net contributors to the Community budget. The enlarged Community will account for 20% of world trade. But the economic and political influence it can bring to bear will depend primarily on the leadership we, the French and Germans can provide. Our own influence with other countries, including the United States, will be affected by the extent to which we are seen to be playing a central role in the Community.

Effects of Enlargement on Other Member States

1. The French no longer even pretend to express much enthusiasm for the Mediterranean dimension of the Community. French wine, fruit and vegetable producers will be vulnerable by the end of transition - hence M. Chirac's opposition to Spanish accession. But France is already a major industrial investor in Spain. She will exploit the new market opportunities, while enlisting Spanish protectionist instincts both in external trade and the internal market.

2. The French expect to overtake us as net contributors to the Community budget in 1987. They have already adopted a much more restrictive attitude towards CAP expenditure. They will have to look after their own Mediterranean regions (they were obliged to support IMPs even though they will be major net contributors) and will continue to oppose nationalisation of the CAP. But they do now see a greater convergence of interests with us. The French will continue to attach great importance to the Community as a way of locking their economy into that of the Federal Republic and maximising their political influence. But the original bargain whereby the French opened up their market in industrial goods in return for German under-writing of the CAP has been overtaken. They will want in due course to "correct" their own financing burden and expose Benelux and Denmark to their real share, while ensuring that the Germans remain the main paymasters.

3. Germany gave very strong political support to enlargement, but is worried about the budgetary consequences. Increased French questioning of CAP expenditure on northern products is exposing the contradiction between German protestations of devotion to budgetary control and their insistence on fixing high prices for northern products. The German Government still shows no readiness to grasp this nettle and German policies on central issues, especially the CAP, will continue to be indecisive, confused and short-sighted.

4. The Germans will be restrictive about most forms of Community expenditure other than the northern CAP regimes. They will claim that they cannot be expected to carry so large a share of transfer payments to poorer (ie Mediterranean) Member States, and will want to limit the growth of the structural funds. Despite the budgetary burden, the Community brings them major benefits. They will be well placed to exploit the opening up of the Spanish market for industrial goods. They are running a very large visible trade surplus vis à vis the other member states - over \$8.5 billion in 1984 (with a \$5.4 billion surplus with France and \$2.6 billion with the UK). Nevertheless as soon as the 1.4% VAT ceiling is reached the FRG will try to make up for having been out-manoeuvred at Fontainebleau by insisting on some correction of its own budgetary contribution before agreeing to any further increase in the VAT rate. In view, however, of their attitude on agricultural prices and large trade surplus, they will encounter considerable resistance.

5. Benelux. The Dutch are the most important here. They accept that it is necessary to control costs of northern as well as southern CAP products. They are liable to be caught by longer term changes in the Community's financial system, but in most areas they will continue to see their interests in much the same way as the UK and will be a useful ally. The Benelux countries generally will give high priority to abolishing frontier controls, particularly with France and Germany.

6. Italy remains a substantial beneficiary from the budget. But while enlargement may strengthen her negotiating hand on Mediterranean issues (eg southern CAP products) it poses a clear threat to her interests. Her prosperity will still be below the Community average, but she can no longer expect to get large net benefits: these will have to be shared out among more Mediterranean claimants. Italy can see this coming: hence her determination to qualify for IMPs, and chagrin that we have been able to limit this so much that Italy could end up as a net

contributor. Italy will continue to try to have the best of both worlds - to claim a place at the top table while leading Mediterranean attempts to maximise their benefits.

7. Greece, Ireland and Denmark, for different reasons, all occupy a more marginal position in the existing and will do so in the enlarged Community. Greek benefits, thanks to the agreement on IMPs, will not be diminished for some years after enlargement. Under Papandreou Greece no doubt will continue a policy of blackmail, but will much have less leverage. There is increasing resentment of the Greek role in political cooperation. Greece is likely progressively to be brought to book over Treaty infringements. Ireland is worried that the Mediterranean tilt will lead to a loss of benefits. Irish non-participation in the Alliance leads them to occupy an uneasy position in political cooperation. Denmark, second only to Germany in the prosperity league, remains a significant net beneficiary from the budget through the CAP, demonstrating the perversity of existing transfers. The Danes have put themselves into a peripheral position through over-use of the Luxembourg compromise and what is seen as a general lack of interest in the Community except for the CAP.

8. Overall there will be a fundamental change from the days of the Nine when there was only one poor country, which was also small (Ireland). With four or five relatively poor countries, the enlarged Community will have its own North/South divide.

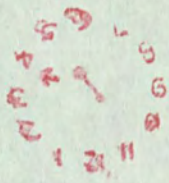
POPULATION, RELATIVE PROSPERITY AND NET BENEFITS

	Population (millions) (1984)	GNP per head as % of EC-12 average (1983)	1983 Net Benefits from EC Budget (mecu)
Luxembourg	0.4	145	-38
Denmark	5	137	+276
FRG	61	136	-2647
France	55	124	-251
Netherlands	14	118	+295
Belgium	10	109	-452
UK	55	108	-1000 (after correction)
Italy	56	75	+776
Ireland	3.5	57	+756
Greece	10	47	+973
Spain	38	57	**
Portugal	10	26	**

** On the basis of Commission estimates, which are subject to wide margins of error, Spanish net benefits are expected to be close to zero throughout much of the transitional period (between -25 and +100 mecu pa). On a similar basis the Portuguese net benefits are estimated at 56 mecu in the first year of transition, 200-300 mecu in each of the four following years. Spanish benefits should become significant in the latter part of the transitional period and will be substantial thereafter.

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