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10 DOWNING STREET

From the Private Secretary

13 May 1985

The Enlarged Community

The Prime Minister was grateful for the paper on the Enlarged Community enclosed with your letter of 9 May. She found it interesting and to the point. The main conclusions which she draws from it are as follows:-

i) we must intensify our efforts to bring the CAP under control in the enlarged community. We should not resist a shift towards more national financing.

ii) we must steer Community Research and Development work firmly towards co-operation between companies and away from Community-funded programmes.

iii) while decision-taking may well become more difficult in the enlarged Community, the importance of being able to insist on unanimity on matters of vital national interest will increase (because there are more likely to be costly initiatives which we shall have to oppose). Nothing must be done to weaken the Luxembourg compromise.

iv) we should exploit the sort of divisions between France and Germany seen at the recent Bonn Economic Summit and be ready to work with each of them as suits the issue.

v) we should de-dramatise the concept of "variable geometry" within the Community, because it will probably suit our interests in the enlarged Community for there to be smaller groupings. There are several reasons for this: we shall probably not want to participate in everything: it may sometimes be the most effective way to get things done: and it will counter movement towards "union". What we must avoid, though, is the appearance of a two-tier community with us in the second division. The Prime Minister likes the concentric circles analogy.

/CB

vi) finally the Prime Minister agrees that we should do more to encourage British exporters to exploit the larger market which will be offered by a Community of Twelve.

I am copying this letter to the Private Secretaries to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Minister of Agriculture, the Home Secretary and Sir Robert Armstrong.

Charles Powell

Colin Budd Esq
Foreign and Commonwealth Office.

PRIME MINISTER

The Enlarged Community

I attach the further paper on the Enlarged Community which you requested. It is not a bad effort.

It would give a bit of impetus to the work of departments if you were to comment. I attach a draft letter setting out some possible conclusions.

Agree to letter?

CDP.

Yes – thank you
M

10 May 1985

R7.30

CONFIDENTIAL

cc PC

(2)

Prime Minister

CDP 5/6

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

4 June 1985

L V Appleyard Esq
Private Secretary to the Secretary of
State for Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London SW1A 2AL

Dear Len,

THE ENLARGED COMMUNITY

The Chancellor has seen a copy of your letter of 9 May, enclosing the FCO paper on the enlarged Community, and Charles Powell's reply of 13 May, recording the Prime Minister's comments. While he agrees with the broad conclsuions of the FCO paper and with the description of our objectives in paragraph 3 of the summary, he has a number of comments on the paper.

The Chancellor agrees with the Foreign Secretary that the Fontainbleau mechanism will, to a considerable extent, cushion us against the additional costs arising from enlargement. But there are three caveats which he has asked me to record.

First, our underlying budgetary position seems almost certain to deteriorate over the years immediately ahead, both because of enlargement itself and because of IMPs and the strengthening of the Mediterranean interest in the Community. Our shares in Regional Fund and Social Fund expenditure seem bound to fall and we may for the first time become a net contributor to the Regional Fund. Moreover, our latest projections suggest that we are doing little better than break even on Community R&D expenditure. So it is not easy to see how progress can be made towards reducing the UK's budgetary imbalance by "the development of expenditure policy", as suggested in the Fontainbleau conclusions.

Second, the Chancellor's view is that, when the 1.4 per cent VAT ceiling is reached, we may face a rather more difficult negotiation on the renewal of the Fontainbleau mechanism than the FCO paper implies. France and Germany will certainly want some limit set on their own contributions. But this will as certainly be resisted by the smaller rich countries. There could well be a temptation for all these countries to seek to resolve their differences at the expense of our abatement. Moreover, Spain and Portgual are likely to press to be exempted from contributing to the UK's abatement at all. Our objective must be to improve on the Fontainbleau deal, if at

[But they won't get the extra own resources if they do insist] CDP all possible, but certainly to accept nothing less favourable. But even this could involve a considerable battle.

Third, the crucial issue facing us in the next three years will be to keep Community expenditure within the 1.4 per cent VAT ceiling. This will not be at all easy. Our latest internal projections suggest that the Community can live within the 1.4 per cent ceiling up to and including 1988-89, but only provided that budgetary discipline is strictly applied to both agricultural and non-agricultural spending. Even if this is done, room for manoeuvre will be very narrow - no more than 2 billion ecu for the 1986 Budget, declining to around 0.6 becu by 1988 and 1989. This headroom could easily be used up in a single year by a modest fall in dollar prices for CAP products which could substantially increase the cost of disposing of Community surpluses overnight. In addition there will be strong upward pressures on non-agricultural expenditure mainly arising from commitments already entered into by the Community in recent years.

The Chancellor draws the following conclusions from this analysis. First, one of our main priorities over the next three years will be to ensure the budget discipline arrangements are firmly applied. This means, as the Prime Minister says, that we must intensify our efforts to bring the CAP under control and should not resist moves towards national financing. For the same reason, all forms of non-agricultural expenditure will also need to be curbed. This certainly means steering Community R&D policy towards co-operation and away from Community-funded schemes. But it may well also mean cutting back on the rate of growth of both spending and commitments from the structural funds (with the possible exception of the Social Fund). More generally, we should resist all new expenditure commitments in Community Councils unless they can be contained within the maximum rate.

Although the new Commission is more conscious of the need for budgetary discipline than the old, they are still likely to push for a faster rate of growth in the Community Budget than we would want. The latest information from Brussels is that the current draft of the 1986 Budget gives a VAT rate of 1.34 per cent. This will no doubt be cut back in the budgetary procedure. But there is a substantial risk the Commission will begin its review of the Fontainbleau agreement and put forward proposals for an increase in the 1.4 per cent ceiling during the course of 1987 and perhaps no later than the second half of 1986. The Chancellor suggests that, in the light of the 1986 Budget, it may be necessary to turn our attention to these issues not much later than the turn of the year.

I am sending copies of this letter to Charles Powell (No.10) Hugh Taylor (Home Office), John Mogg (DTI), Colin Williams (MAFF), Richard Hatfield (Cabinet Office).

Yours ever
Rachel

RACHEL LOMAX

Euro Pol: Enlargement Pt 2