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(2) cc PC

Prime Minister
To note particularly the warning in ~~paragraph 4~~
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CDP 21/9.

MINISTER OF STATE TREASURY

RESTRICTED

PRIME MINISTER

BUDGET COUNCIL, 17-18 September 1985

The Budget Council at Luxembourg went about as well as could be expected from the UK's point of view. I fear, however, that difficult times still lie ahead.

2. In close collaboration with the German, French and Dutch delegations, we were able to block a Presidency proposal to establish a draft budget providing for increases of over 12% in payment appropriations and nearly 16% in commitment appropriations, for non-obligatory expenditure. The Council finally established by qualified majority, despite strong objections from the big-budget proponents, Italy, Greece and Ireland, a draft budget which respects the Budget Discipline Conclusions and the reference framework agreed by ECOFIN in July, with only limited additions for enlargement. The main features of the draft budget are:

- an increase of 5.3% in agricultural guarantee expenditure (within the financial guideline) for the existing ten member states, with a further 567 mecu for Spain and Portugal: there was no opposition to our suggestion that there should be early discussion in ECOFIN on extending the financial guideline to cover a Community of Twelve;

- an increase of just under the full maximum rate of 7.1% in commitment and payment appropriations for non-obligatory expenditure (which the European Parliament will have the right under the Treaty to raise to 10.65%). Our starting position was to argue for an increase of half the maximum rate (3.55% or some 217 mecu), as envisaged in the December 1984 budget discipline conclusions, with Spain and Portugal as well as the Ten being accommodated within the resulting total; but there was no prospect of reaching agreement on this, and the second half-maximum-rate increase of some 217 mecu added by the Council is much smaller than the total non-obligatory expenditure of some 600 mecu proposed by the Commission for Spain and Portugal next year. To a considerable extent, therefore, non-obligatory expenditure in Spain and Portugal would, on these proposals, be accommodated by reining back expenditure in existing member states. By keeping the total increase in non-obligatory expenditure below the full maximum rate, the Council avoided the necessity for setting a new (and much higher) maximum rate by co-decision between the Council and the Parliament;

- no special increase to deal with the so-called "cost of the past" (overhang of past commitments) problem but a remit to the Presidency to review the problem in conjunction with the Commission and bearing in mind the views of the Parliament. We argued strongly for a lower increase in commitment appropriations than payment appropriations but there was no prospect of a qualified majority for this given the number of new commitments needed for Spain and Portugal;

- a token entry rather than substantive provision for a food aid reserve, following the Milan European Council conclusions. Several member states noted that the rains in Africa had been more plentiful than expected at the time of Milan, and the Council undertook to review the disposition of aid allocations in the light of circumstances;

- compatibility with the reference framework. Even allowing for the Parliament's right, within the Treaty, to add a further half-maximum-rate increase of some 217 mecu to the total of non-obligatory expenditure, the excess of budgetary provision over the reference framework limits is less than the extra own resources (net of transitional refunds) which Spain and Portugal will be contributing.

3. Reasonably satisfactory as this outcome was, there will be further battles at the Council's second reading of the budget in November or December. Our objective then will be to find a qualified majority for a budget limited to the existing draft budget total plus the European Parliament's statutory margin of some 217 mecu; but this will be extremely difficult to achieve.

4. Looking ahead to next year, the prospects are even gloomier. The Spaniards and Portuguese, who attended this week's Council as observers, criticised the draft budget with some vehemence. It is a sobering thought that if they had been voting members this week there would have been no qualified majority for the draft budget as established (or indeed for the Presidency's more prodigal initial proposals). In next year's budgetary process, when the UK has the Presidency, Spain and Portugal will almost certainly join Italy and Greece in arguing for big budgets with a heavy Mediterranean/less prosperous country emphasis, and the four countries between them will have a blocking minority (as indeed would Italy, Spain and Portugal or Greece). In these circumstances it will, I fear, be extremely difficult to find a qualified majority for a draft budget which is even moderately satisfactory from the UK's point of view. We shall need to consider this problem carefully with German, French and Dutch colleagues early next year.

5. I am copying this minute to Geoffrey Howe, Leon Brittan, George Younger, Nicholas Edwards, Tom King, Michael Jopling, David Young, Kenneth Baker and Sir Robert Armstrong.

MWN

for **IAN GOW**
approved by the Minister of State and signed in his absence

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ccPS

Foreign and Commonwealth Office

London SW1A 2AH

From The Minister of State

25 September 1985

Ian Gow Esq MP
Minister of State
HM Treasury
Parliament Street
SW1P 3AG

CDP 27/9.

Dear Minister

BUDGET COUNCIL, 17/18 SEPTEMBER 1985

File on O/UP.

Thank you for sending the Foreign Secretary a copy of your minute to the Prime Minister about the outcome of the First Budget Council. In Geoffrey Howe's absence this week, perhaps I can comment on one or two points.

I think you did very well to secure such a satisfactory outcome to the Council. In particular, the financial guideline for agriculture has been made to stick, and we have avoided exceeding the agreed reference framework figure for the Ten. Our 1400 mecu abatement in respect of 1985 has been secured in the budget, in accordance with the Fontainebleau agreement.

As you point out, the Parliament will now reinstate most of the proposed non-obligatory expenditure deleted by the Council. It will be difficult to secure the necessary qualified majority in the Council in November to bring the budget back within the maximum rate. Our ability to achieve a satisfactory outcome will depend again on concerting our position with the French, Germans and Dutch, as you did so effectively before this Council. We shall be hard put, however, to achieve a final outcome on non-obligatory expenditure better than the maximum rate for the EC10 plus 540 mecu for enlargement. This would be consistent with budget discipline, since the additional 540 mecu would be covered by the Spanish and Portuguese contributions to own resources.

/For

For the longer term, your point about the Spanish and Portuguese attitudes is well taken. Enlargement will increase the pressures for additional spending from the Mediterranean countries, and it will be difficult to establish a qualified majority against them. The other side of that medal, however, is that Germany and France will be contributing substantially more to the costs of enlargement than we shall. French officials estimate that as a result of enlargement and the Fontainebleau agreement, France will overtake us as a net contributor next year. After enlargement, we France and Germany, or we, France or Germany plus the Netherlands, will constitute a blocking minority and no budget can be established without our agreement, so prior concertation of our positions will become even more important.

I am copying this letter, as you did yours, to Leon Brittan, George Younger, Nicholas Edwards, Tom King, Michael Jopling, David Young, Kenneth Baker and Sir Robert Armstrong.

Yours sincerely

Anthony Cary

for Malcolm Rifkind
(approved by Mr Rifkind and signed in his absence by his Private Secretary)

EUR. POL: Budget. Pt 30

RESTRICTED

gcPc

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

CDP 7/x.

4 October 1985

Dear Ian,

EUROPEAN COMMUNITY BUDGET FOR 1986: BUDGET COUNCIL 17-18 SEPTEMBER 1985

Thank you for sending me a copy of your minute to the Prime Minister of 12 September outlining the approach you intended to take at the Budget Council. I am sorry time did not allow me to comment before you left for Luxembourg. I was however grateful for a copy of your further minute to the Prime Minister reporting the outcome of the Council.

I share your concern to keep a check on the growth of EC spending in general and to effect proper budget discipline; and your report suggests you had some success in achieving these aims. There are, however, some unfortunate side effects, as I think you know.

The UK's objective of restraining EC non-obligatory expenditure to the maximum rate of increase of 7.1 per cent, if completely successful, would have a noticeable impact upon the availability of aid within the UK from the European Regional Development Fund (ERDF). Local and public authorities in the Assisted Areas have come to rely on it and are likely to be critical of a policy which leads to a sharp reduction in the flow of aid to them. Additionally, if the ERDF payment appropriations approved for 1986 turn out to be insufficient, legitimate UK claims for payment on approved schemes could be delayed at the end of the year. This too would cause consternation as authorities attempt to balance their budgets. I hope that we shall not be faced with this problem but we shall have to keep a close eye on it to see what can be done to minimise the damage, should it arise.

I am copying my letter to the Prime Minister, the Foreign Secretary, the Secretaries of State for Trade and Industry, Employment, Scotland, Wales and Northern Ireland, the Minister of Agriculture and the Cabinet Secretary.

Kenneth

KENNETH BAKER

Ian Gow Esq MP

European Policy Pt 30
Budget