cc PC
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Qz 05369

MR POWELL (10 DOWNING STREET)

Prime Minister's meeting with President Mitterand

Briefing will be submitted shortly by the Foreign and Commonwealth Office. It seems to us that on European Community affairs there are three points which the Prime Minister may wish to keep in mind.

1) relations with France. On Community issues these are good and close, although we always have to be wary in our own interest. It has become more and more apparent, since the enlargement to twelve member states, that a UK/French/German understanding is now often the best way to hold back unjustified delays and demands from the south of the Community, particularly for extra spending. Effective examples of such understandings in recent months have been the Council's agreement on a draft 1987 budget which respects both the agricultural guideline and the maximum rate for non-obligatory expenditure (structural funds etc); a close position on the research and development framework programme; and combined opposition to various Spanish demands on the Mediterranean agreements.

2) the London European Council, 5-6 December. We would expect President Mitterand to be content with the approach which the Foreign and Commonwealth Secretary has recommended to the Prime Minister, that - apart from political cooperation issues - the main themes should be Business and Jobs (creating the conditions for employment growth; opportunities for small and medium businesses; lifting the regulatory burden on business; and the consumer interest) and Terrorism/Drugs/Immigration. We have not yet discussed the approach with Elysee officials but they will know from Community discussions and will have briefed President Mitterand what our main concerns are.

3) future financing of the Community. It was agreed at Fontainebleau that, one year before the 1.4 per cent VAT ceiling was reached, the Commission would present a report to the Council on future financing (the "ex-novo review"). The Commission has done little serious work on this but will present at the end of the year a report covering future financing, the coordination of the structural funds and possible further action on agricultural policy and expenditure. It is obvious, since we hold the top card (no change on the Fontainebleau abatement mechanism except by unanimity), that we shall say that we shall not accept any change in long term financing which is not at least as favourable as Fontainebleau. For the short term we stand by the Fontainebleau statement that "the maximum rate may be increased to 1.6 per cent on 1 January 1988 by unanimous decision of the Council and after agreement has been given in accordance with national procedures" - no more and no less than this text. Behind the scenes we have been

(i) seeking to ensure that the Commission report is not available before the London European Council, since we have nothing to gain from opening up prematurely a discussion which will lead many other member states to demand a higher level of Community resources;

and (ii) stressing to the Commission that the report must have some substance on stopping the agricultural budget haemorrhage if it is to be at all credible here.

We believe that the debate on long term future financing will begin next year and will go on a long time. There will, however, be a difficult issue to handle in 1987 on short term financing: when the draft 1988 budget comes forward for decision during the autumn of 1988 it will be apparent that a quart will not go into a pint pot, ie that the combined effect of agricultural expenditure (fully respecting the agricultural guideline), expenditure on structural funds etc (even with a reduction) and the expected very high United Kingdom abatement would exceed the available resources within the 1.4 per cent VAT ceiling. The Treasury is currently estimating our abatement in 1988 at 2750 million ecu (at current exchange rates above £1925 million) and our net contribution to the Community's allocated budget in 1988 at nil (the total net contribution for the budget year 1988/89 in terms of the public expenditure white paper is estimated to be about £350 million). Since all other member states will want to go to 1.6 per cent in 1988 or failing this, to target our abatement, we strongly recommend that the Prime Minister should continue to take the line, if asked, that

- we shall study with interest the ex novo review when it is received at about the end of the year. We shall look with particular interest at the Commission's proposals for cutting down the misuse of resources on, for example, the storage and disposal of abnormal agricultural surpluses

- for the financing of the Community in the immediate future we stand by the exact text of the Fontainebleau declaration on a possible move to 1.6 per cent VAT. It is neither agreed nor ruled out at this stage.

I am sending a copy to Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

13 October 1986