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

Prime Minister
See also Mr. Williamson's minute attached.

PRIME MINISTER

EC BUDGET: PAPER ON 'SAFETY-NET'

It was agreed at the meeting of the Foreign Affairs Council after Stuttgart that all member states should be encouraged to contribute papers before the end of July setting out their views on the future financing of the Community and related matters. Officials have recommended that the United Kingdom should contribute two papers - one on our 'safety-net' idea for solving the budgetary imbalances problem on a lasting basis and another on a strict guideline for agricultural expenditure. I support this recommendation, and my officials have produced accordingly, in consultation with the Cabinet Office, FCO and UKREP Brussels, the attached draft of the 'safety-net' paper.

Pf 20

2. As you will recall from Geoffrey Howe's minute of 17 March, the safety-net approach, if implemented, would have enormous advantages for the United Kingdom and (I believe) the Community. It would provide a lasting solution to the budgetary imbalances problem for all member states by limiting the net contribution which any member state would be expected to bear in the enlarged Community to some small percentage of its GDP, defined by reference to its relative prosperity, the necessary adjustments being made by deduction from VAT contributions. Such an arrangement would tackle the imbalances problem head-on, and be guaranteed to solve it, while causing minimum disturbance to the Community's existing arrangements. It would remove the need for appalling annual haggles over refunds. In contrast with a system under which refunds are expressed as a percentage of our uncorrected net contribution and paid from the budget, ~~and~~ it would protect us against (a) increases in our uncorrected net contribution, (b) 'crowding out' of our refunds by other expenditure within the present or any future own resources ceiling, and (c) rejection of refund payments by the European Parliament. We would continue to have a close interest, on public expenditure and general grounds, in controlling Community expenditure; but the safety-net would protect us from having to make excessive net transfers across the balance of payments to other member states.

3. The draft paper sets out our ideas in simple terms, with the help of diagrams, and stresses their 'communautaire' nature without actually using that word. The draft emphasises that the diagrams and the threshold percentages mentioned in the text, are for purposes of illustration only. In fact the parameters illustrated would have limited the United Kingdom's net contribution for 1982 to a little over 0.1 per cent of our GDP, the precise percentage depending on the formula and on whether the GDP and relative prosperity figures are calculated 'in-year' or on a three-year moving average. The accompanying table shows what limits the two formulae illustrated would have set for France and Germany, as well as the UK, for 1982, and compares these with actual net contributions after UK refunds.

4. As the table indicates, the limits on net contributions which we have in mind would be unlikely to benefit the French in the near future, though they might do so in the longer term. One of France's main concerns will therefore be to obtain agreement to a method of financing any reliefs for net contributor countries which bears less hard on France than 'normal' VAT: if Germany and the UK were both receiving relief as a result of the safety-net limits, France could find itself under normal VAT bearing rather more than half the cost of financing these reliefs. The last sentence of paragraph 6 allows accordingly for the possibility of a different financing arrangement under which France would contribute less.

5. The limits shown in the table have been calculated using market exchange rates to convert national currency figures for GDP and GDP per head into ecus. They would consequently be liable to vary somewhat from year to year, in line with market exchange rates; but such variations would be much less troublesome than the likely variations in our uncorrected net contribution and could anyway be smoothed by use of three-year moving averages. We would expect the United Kingdom's own relative prosperity in the enlarged Community to be within five per cent either side of the Community weighted average.

6. Between now and the end of the month, officials will be continuing their discussions with French and German officials about these and related ideas, with the object of finding as much common ground as possible. We may want to

revise the draft paper somewhat in the light of these exchanges and other developments.

Prime Minister

Agree?

A.J.C. 7/7.

7. I hope you will feel, as I do, that this is the right way to follow up our ideas for obtaining a lasting solution to the budget problem - and in particular that we should plan to circulate in Brussels later in the month a paper on the lines of the attached draft.

8. I am copying this minute, and the draft paper, to Geoffrey Howe, Michael Jopling and Sir Robert Armstrong.

NL

(N.L.)

6 July 1983

ANNEX

COMMUNITY OF TWELVE : MEMORANDUM ITEMS

	1980	1981	1982	Average
GDP per head				
(Index numbers, weighted for Twelve = 100)				
Belgium	124	116	106	115
Denmark	135	136	137	136
France	127	127	125	126
Germany	138	133	134	135
Greece	43	45	48	45
Ireland	55	58	63	59
Italy	73	73	76	74
Luxembourg	133	126	117	125
Netherlands	125	118	121	121
UK	98	106	105	103
Spain	59	59	60	59
Portugal	27	30	29	29
GDP in billions of ecu				
(converted at market exchange rates)				
Belgium	84.1	85.5	84.6	84.7
Denmark	47.7	52.3	57.0	52.3
France	470.0	512.3	549.2	510.5
Germany	586.7	614.2	669.3	623.4
Greece	28.8	33.0	38.3	33.4
Ireland	12.9	15.0	17.9	15.3
Italy	285.1	315.2	354.4	318.2
Luxembourg	3.3	3.5	3.5	3.4
Netherlands	121.7	126.3	140.8	129.6
UK	376.8	447.9	477.7	434.1
Spain	152.0	167.3	184.0	167.8
Portugal	17.7	21.4	23.4	20.8
EC12	2356.7	2393.8	2600.2	2450.2

COMMUNITY FINANCING : A 'SAFETY-NET'

NOTE BY THE UK DELEGATION

1. The European Council Declaration at Stuttgart defines as one of the Community's objectives "to agree measures which, taken as a whole, will avoid the constantly recurrent problems between the member states over the financial consequences of the Community's budget and its financing". It states that "all appropriate ways and means will be examined to this end, in particular the proposals made by the Commission and the suggestions of certain member states with a view to ensuring equitable financial situations for all member states". The Council on 21 June invited all member states to put forward their suggestions. The present note outlines accordingly the United Kingdom's suggestions for solving the problem of financial imbalances, and in particular our ideas for a 'safety-net' arrangement.

General approach

2. The United Kingdom shares the view that the Community should develop its expenditure policies in the longer term so as to achieve a more appropriate financial balance between member states. In practice, however, it will not be possible to solve the imbalances problem totally by this means in the foreseeable future. In the United Kingdom's view, therefore, some kind of 'safety-net' arrangement will be needed in addition to ensure that no member state bears an unreasonable burden. Such an arrangement should be designed to disturb the Community's existing arrangements as little as possible. It should respect the principles of the own resources system, and it should be designed to be applicable to the enlarged Community. A further objective should be to enable those member states bearing the heaviest budgetary burdens to look at proposals for new Community policies on their merits rather than having to oppose them if they would aggravate an already inequitable budgetary situation.

A possible arrangement

3. In the United Kingdom's view, it should be possible to devise an arrangement which would meet the above requirements and provide a Community solution. A suggested arrangement on these lines is outlined below. It reflects the philosophy set out in Sir Geoffrey Howe's Hague speech of June 1981; but it is much more modest in scope and concentrates on correcting any inequitable burdens which may fall on net contributor countries. The main elements would be:

- The Community would agree that there should be some limit on the net budgetary burden which any member state should be expected to bear.

- These limits would be expressed as a small percentage of the GDP of the member state concerned, the percentage being related to relative prosperity in the enlarged Community.

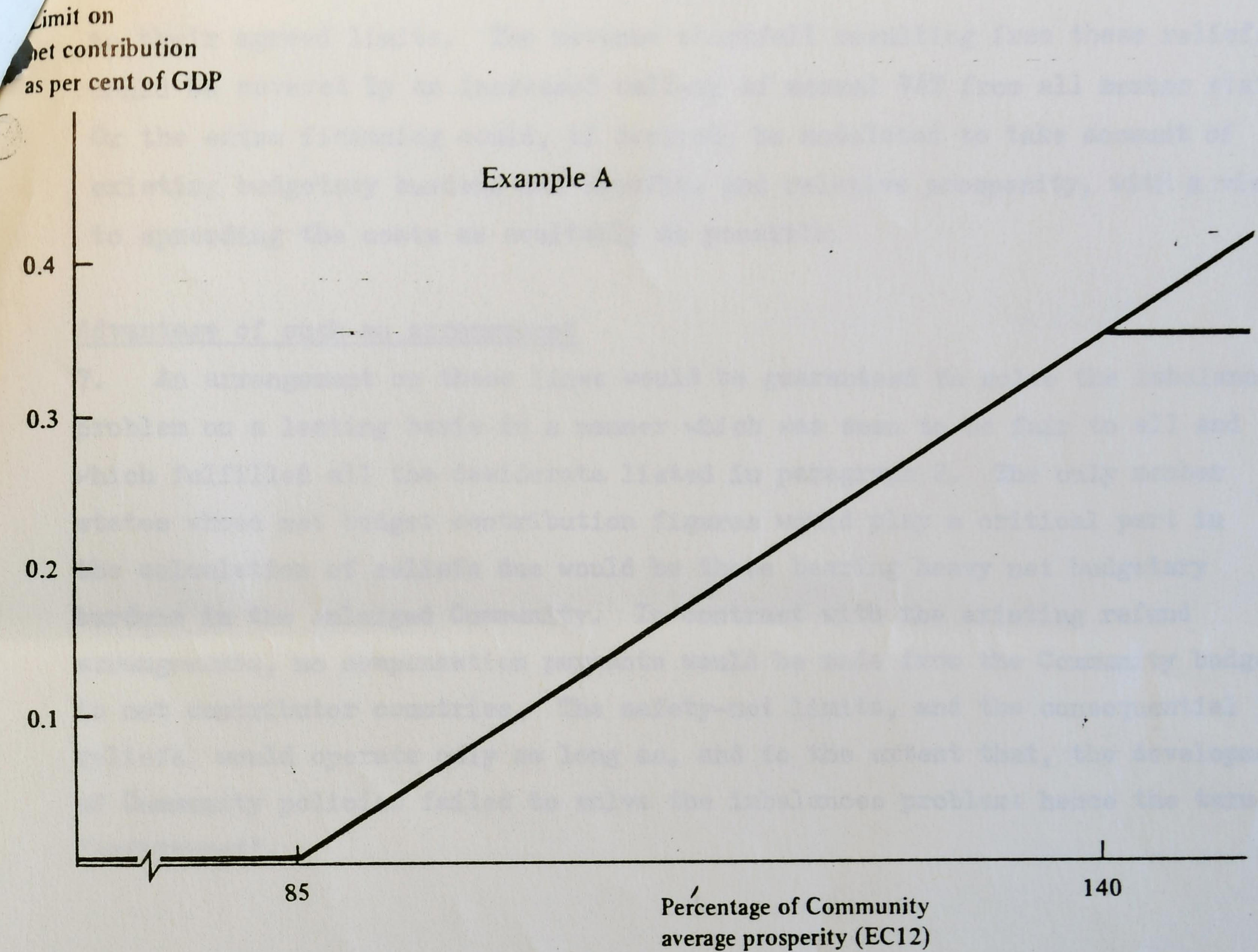
- Any member state bearing a net budgetary burden of more than its agreed limit would have its VAT payments in the following year modulated and reduced, accordingly, by the amount of the excess.

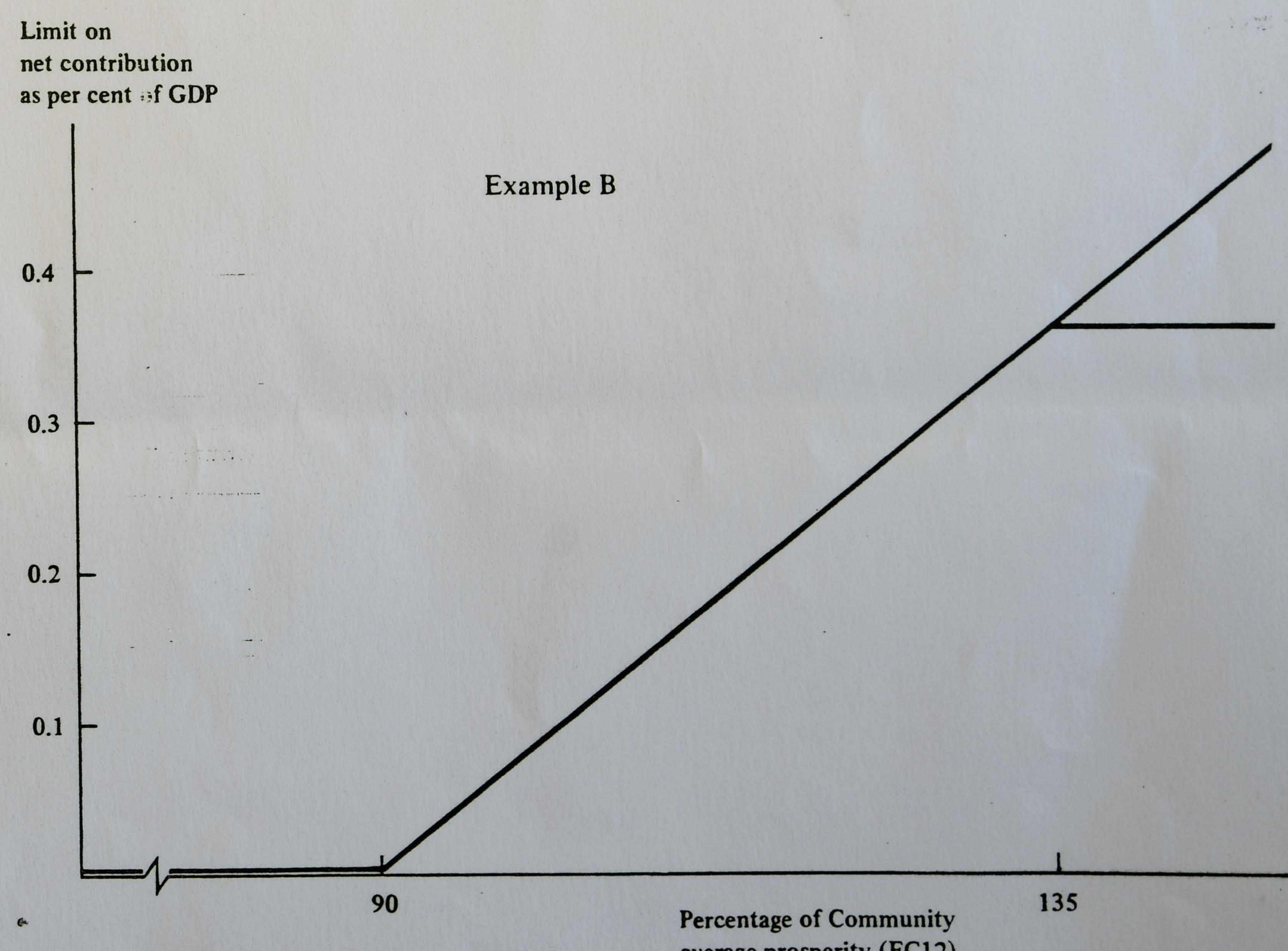
4. It would be for the Community to decide what the limits on the net budgetary burdens of member states with any particular level of relative prosperity should be. The Community might agree, for example, that member states with less than (say) 85 or 90 per cent of Community average prosperity in the enlarged Community should not be net contributors in any circumstances. At the other end of the scale, the Community might think it reasonable that the most prosperous countries (perhaps those with 135 or 140 per cent of Community average prosperity after enlargement) should be prepared if necessary to bear a quite substantial net budgetary burden, provided that it did not exceed some specified percentage, say 0.3 per cent or 0.4 per cent, of their GDP. Between these two points, the limits on net budgetary burdens as a percentage of GDP could rise in accordance with relative prosperity.

5. The accompanying diagrams, based on the illustrative figures mentioned above, may help to clarify the idea. Their purpose is purely illustrative. They do not represent UK proposals as to what would constitute acceptable levels of compensation. The Community would need to decide both the level of relative prosperity below which member states would not be expected to make any net contri bution at all, and the rate at which the limits on member states' net budgetary burdens should increase with relative prosperity. It would likewise be for decision whether there should or should not be some absolute upper limit, in terms of the percentage of GDP, on the net contribution which any member state would be expected to bear, regardless of its relative prosperity - and at what level of relative prosperity any such absolute upper limit (illustrated in the diagrams by the horizontal sections towards the righthand side) should begin.

6. The precise method of implementation would likewise be for decision. But there would seem advantage in retaining a common rate of VAT for all member states and expressing as deductions from VAT the reliefs needed to bring the net contributions of member states with excessive net budgetary burdens down

SAFETY – NET LIMITS IN THE ENLARGED COMMUNITY :
SOME ILLUSTRATIVE EXAMPLES





to their agreed limits. The revenue shortfall resulting from these reliefs could be covered by an increased call-up of normal VAT from all member states. Or the extra financing could, if desired, be modulated to take account of existing budgetary burdens and benefits and relative prosperity, with a view to spreading the costs as equitably as possible.

Advantage of such an arrangement

7. An arrangement on these lines would be guaranteed to solve the imbalances problem on a lasting basis in a manner which was seen to be fair to all and which fulfilled all the desiderata listed in paragraph 2. The only member states whose net budget contribution figures would play a critical part in the calculation of reliefs due would be those bearing heavy net budgetary burdens in the enlarged Community. In contrast with the existing refund arrangements, no compensation payments would be made from the Community budget to net contributor countries. The safety-net limits, and the consequential reliefs, would operate only so long as, and to the extent that, the development of Community policies failed to solve the imbalances problem: hence the term 'safety-net'.

LIMITS ON NET CONTRIBUTIONS FOR 1982

Million ecus : per cent of GDP in brackets

	Formula A	Formula B	1982 Actual (after UK refunds)
In-year basis			
UK	610 (0.13)	570 (0.12)	911
Germany	2100 (0.31)	2360 (0.35)	2305
France	1400 (0.26)	1540 (0.28)	407
3-year moving average			
UK	500 (0.12)	450 (0.10)	911
Germany	2000 (0.32)	2240 (0.36)	2305
France	1340 (0.26)	1470 (0.29)	407

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10 DOWNING STREET

From the Private Secretary

12 July, 1983

EC Budget: Paper on 'Safety Net'

The Prime Minister has read the minute of 6 July by the Chancellor of the Exchequer on this subject.

She agreed with Mr. Lawson's proposals for handling this matter and, in particular, that we should plan to circulate in Brussels later in the month the paper on the lines of the draft annexed to his minute.

I am copying this letter to Brian Fall (Foreign and Commonwealth Office), Robert Lowson (Ministry of Agriculture, Fisheries and Food) and Richard Hatfield (Cabinet Office).

A. J. COLES

John Kerr, Esq.,
H.M. Treasury

10 DOWNING STREET

Prime Minister

Do you agree with the last paragraph of the Chancellor's minute?

A. J. C. 11/7.

Yes [illegible]

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