(Part 3)

PREM19

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EUROPEAN POLICY

(future policy towards EEC, including budget)

(Part 3)

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PREM 19/55

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PART 3

~~Confidential filing~~

Future Policy towards the EEC. The Community Budget

EUROPEAN POLICY

PART 1 : MAY 1979

PART 2 : OCTOBER 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~25.10.79~~							
~~29.10.79~~							
~~31.10.79~~							
~~2.11.79~~							
~~16.11.79~~							
~~19.11.79~~							
~~22.11.79~~							
~~26.11.79~~							
30.11.79.							
PART 3 ENDS							

PREM 19/55

PART 3. ends:-

Tsy to MODBA 30-11-79 S

PART 4. begins:-

The Hague Tel 405 to FCO 3/12/79

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(79) 19th Conclusions, Minute 4	01/11/79
CC(79) 22nd Conclusions, Item 3	22/11/79
CC(79) 23rd Conclusions, Item 3	28/11/79

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed CAWayland Date 19 November 2009

PREM Records Team

S E C R E T

Prime Minister

Agree that these other Depts. should now be consulted?

(The Treasury assure me that it is essential if the work is to progress).

TL 30/11

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

30th November, 1979

We should go ahead & consult MT.

Dear Michael,

EEC BUDGET: POST DUBLIN CONTINGENCY PLANNING

A certain difficulty has arisen in following up the contingency work on which Martin Hall sent you an interim report on 28th November.

If we withhold all or part of our contribution to the EEC Budget, one of the risks that arises is of an action being brought against HMG in a British Court. The way to guard against this would be to amend the European Communities Act 1972.

Contingency work is in hand. The Chancellor recognises that his colleagues will wish to consider the implications of this, though he is of the view that it would be totally right - and politically acceptable - to do so. But in order to identify precisely where the risks of action lie, and frame the amendment accordingly, it is necessary to consult Departments who have not so far been brought into the contingency work. They are:

The Home Office
Northern Ireland Office
Energy
Transport
Environment
DHSS
Scottish Office
Welsh Office

/As the work

M. Alexander, Esq.,
Private Secretary,
10, Downing Street

S E C R E T

As the work develops, it may become necessary to consult other Departments, but this is the initial list, so far as we can see at the moment.

Consultations would of course be carried out with the utmost security. But so far we have not thought it right even to permit such consultations to be held. However, we have now reached the stage where this part of the contingency work cannot be taken further unless that authority is given.

At the time of writing this, we do not know the outcome at Dublin. But I am writing to you now so that, if by the end of today the matter is urgent, the Prime Minister can have an opportunity to consider it immediately.

I am copying this to George Walden in the Foreign and Commonwealth Office and to Martin Vile in the Cabinet Office.

Yours ever,

Tony Battishill

(A.M.W. BATTISHILL)

CONFIDENTIAL

MODBA O/R.

Foreign and Commonwealth Office

London SW1A 2AH

30 November 1979

Dear Michael

After Dublin: Checklist of Community Business

We sent you late on 26 November a 'checklist' which the Prime Minister had requested, of forthcoming Community meetings in the context of possible obstruction of Community business in the event that we do not get an acceptable solution on the budget at Dublin.

This 'checklist' has been revised and expanded over the last few days by Cabinet Office, MAFF and the FCO. I enclose the revised version.

I am sending a copy of this letter to Tony Battishill (Treasury) and Martin Vile (Cabinet Office).

Yours ever

pp (P Lever)
Private Secretary

M O'D B Alexander Esq
10 Downing Street

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AGRICULTURE

MAJOR DECISIONS * (TIMING WHERE KNOWN SHOWN AGAINST EACH DECISION)	EFFECT OF DELAY ON OTHER MEMBER STATES	EFFECT ON UK INTEREST
Devaluation of green pound (December Council) - subject to Cabinet agreement.	They benefit from absence of devaluation for UK.	Serious effects on UK farmers' incomes.
New Zealand butter (post 1980 access)	None of the other member states have any interest in continued access for New Zealand butter.	Very serious effect on New Zealand's economy if no decision is taken to permit continued access for butter after the end of 1980. Absence of decision would negate our pledges to New Zealand. Decision cannot reasonably be postponed beyond June at the latest.
Agricultural prices for 1980/81 (March or June Councils).	We could insist on price freeze of 1980/81 or on the validity of 1979/80 prices being extended temporarily while negotiations continued, which would seriously affect farm incomes in other member states.	Serious effect on UK farmers' incomes, in absence of green pound devaluation. Loss of Budget receipts and higher consumer prices, due to ending of butter subsidy.
Sugar (at latest by June Council).	The production quota prov isions would lapse unless extended (with or without changes). This would benefit most member states, assuming support prices continued unchanged, since full support price level would apply to whole production instead of only part.	Big increase in UK Budget contribution.
Commission's other proposals of cutting cost of CAP.	Net beneficiaries from CAP would welcome non-application of these measures.	Increased Budget contribution.
Agriculture structures proposals.	Would annoy some other member states, particularly Italy and Ireland.	Beneficial (saving on Budget contribution).
Potatoes.	Italians will lose potential benefits of regime.	Problems over imports from Cyprus (damage to UK consumers as well as to Cyprus). Possibility of high Exchequer cost if we have to continue with national guarantees for further year.

..OR DECISIONS* (TIMING WHERE KNOWN SHOWN AGAINST EACH DECISION)	EFFECT OF DELAY ON OTHER MEMBER STATES	EFFECT ON UK INTEREST
Sheepmeat.	French would continue their ban on imports.	Loss of potential revenue on exports to France. Possibility of Exchequer cost if UK price depressed in consequence.
Wine Package.	France and Italy would lose some potential financial benefits, but would not be compelled to reduce surpluses.	Increased Budget contribution if surpluses not controlled.
Alcohol.	Little effect.	Little overall impact on UK, but whisky distillers would lose potential Budget receipts

* In addition to the above major points for Council decision, the routine operation on the CAP involves numerous decisions either at Council or Commission level. The day-to-day operation of the CAP is largely conducted by the Commission under the Management Committee procedure (subject to majority voting); if these decisions systematically went against us the additional cost, even in the short run, could amount to hundreds of millions of EUAs.

COUNCILS OTHER THAN AGRICULTURE

[illegible]	Major Decisions to be taken	Effect of delay on other Member States	Effect on UK Interests
4 December ISH COUNCIL	(a) 1980 allowable catches ("tacs")	Annoyance, but no serious economic damage.	Could underline UK credibility on fish settlement.
	(b) Conservation regime	Would undermine their confidence in UK serious intention to settle CFP.	Risks spoiling improved atmosphere on fisheries, and weakening UK powers to influence Conservation regime in face of European Court rulings against us.
	(c) Third Country agreements	Will annoy Germans and French in particular.	We would lose some fishing rights if we blocked Norway and Faroes arrangements.
December NERGY OUNCIL	(a) EEC position for IEA Ministerial Meeting	Very little	A negative attitude by the UK at this meeting would risk (a) retaliation by Commission on UK landing requirement (b) ending of our chances of securing a co.. scheme to suit UK.
	(b) Coking coal decision	Would upset Germans.	
	(c) 1980 targets if not fixed by then	Would annoy all Member States and US.	
December OREPER	Midwives Directive (on which UK isolated)	Irritation but no great surprise.	Not significant.
December RANSPORT OUNCIL	(a) Air Transport Air Services Memorandum	-	We stand to benefi[t] but no harm from delay.
	(b) Aircraft noise	-	Little harm from delay
	(c) Road transport quotas	Very little	We want quota extension.
	(d) Commission statement on infrastructure	-	We stand to gain i[n] longer term; no harm from delay.

/10-11 December

7 December ENVIRONMENTAL COUNCIL	(a) Health protection standards (sulphur and lead in the air).	Not significant.	Not significant. (We already have a reserve).
	(b) Protection of whales	Not significant.	Disappointing. I is a UK initiative.
	(c) Chlorofluro-carbons	Not significant.	Not significant.

/17 December

Meeting	Major Decisions to be taken	Effect of delay on other Member States	Effect on UK Interests
17 December FINANCE COUNCIL	1980 Budget: Could be matters arising from Parliament's 2nd reading and adoption of budget (e.g. application of maximum rate) which would have bearing on whether Council considered 1980 budget to be legally adopted.	Delay difficult – budgetary matters usually decided by qualified majority. Effect not great, and same for all. If budget declared illegally adopted, Community would operate on "twelfths rule". Use of Luxembourg Compromise contrary to practice, accepted even by French.	–
18 December FOREIGN AFFAIRS COUNCIL	(a) Staffing and pay	Other Member States would probably secretly welcome tough UK line on substance. But UK block could cause a strike which would not be welcome.	Community staff would resent UK block.
	(b) Renewal of steel anti-crisis measures (which expire 31.12.79).	Would be popular with Germans, would be disliked by others, especially Italians and Commission.	Could cause damage to UK industry during critical phase of restructuring.
	(c) Shipbuilding Scrap and build	Italians alone would be concerned. Little prospect anyway of agreement.	
	(d) US synthetic textiles	Small	UK initiative would prevent action being taken to protect UK industry.
20 December RESEARCH COUNCIL	(a) "Super-Sara" nuclear safety project.	Italians would be upset. JRC would continue. Other Member States little concerned.	Minimal
	(b) Inertial confinement fusion	"	"
	[illegible]	"	"

Timing	Major Decisions to be taken	[illegible] other Member States	Effect on UK Interests
14-15 January FOREIGN AFFAIRS COUNCIL	(a) Supplementary coal and steel revenue?	All steel and coal producing Member States want agreement.	-
	(b) Extension of social security regulations to self- and non-employed?	Minimal. Danes already blocking.	UK initiative. But minimal effec of delay.
	(c) Pre-accession aid to Portugal	Slight	Delay would suit us.
March EUROPEAN COUNCIL	(a) 3 Wise Men Report	Irritation.	Not significant but possible loss of influence on subsequent decisions.
	(b) New Commission President	Would probably not cause concern until May.	In absence of agreement, Mr Jenkins might stay on into 1981.
5 May TRANSPORT COUNCIL	Harmonisation of summer time dates?	Minimal	Could weaken our chances of getting other Member States to come towards our dates.
3 June SOCIAL AFFAIRS COUNCIL	[Depending on outcome of Dublin summit and ETUC reaction] Further measures to alleviate unemployment (worksharing etc)	Belgium, and to a lesser extent other Member States will be anxious to reach satisfactory conclusion: Germans will be least concerned (sceptical about costs to industry	We do not wish to cause a split with unions, but do wish to avoid binding commitments in this area.

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July BUDGET COUNCIL	Establishment of 1981 draft budget	If others accepted that Luxembourg compromise could be used to block establishment this would prevent adoption of any budget for 1981. "Twelfths Rule" would operate from February 1981. Major irritant to partners, but about equal misery to all: theoretically those with greater receipts from CAP would be wors hit but would take time for this stage to be reached.

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OPTIONS (References are to Commission solutions papers 31 October (A) and 21 November (B)

All figures are on importer benefits MCAs basis

Mechanisms	Net refund in 1980 meua	£m*	Comments
Objective			
Broad balance (as long as below EEC average GDP per head)	1550	1000	Simple mechanism on net contribution would be cast-iron. But will be resisted as departure from Community principles ("juste retour") and because insulates UK from effects of budgetary expansion.

MECHANISMS DISCUSSED IN COMMISSION PAPERS

Mechanisms	meua	£m*	Comments
Gross contributions mechanisms			Excessive contributions less than half the problem. Nc robust in face of increased expenditure from which UK make no net gain.
Existing mechanism (A, 11-15, B, 12-14)			
1. balance of payments surplus	-	-	Produced nothing so far. BOP criterion irrelevant. "Community instrument" so good starting point.
2. balance of payments deficit	250	170	
Amended financial mechanism			
1. remove tranche system	405	270	Recommended by Commission in both papers.
2. and remove 3 per cent ceiling	520	350	Not completely robust.

Payments still subject to conditions:

: GDP per head less than 85% average

: growth rate less than 120% average

: total contribution must exceed 110% of what contribution would be if proportional to GNP.

and limitations: refund not to exceed VAT payments and unabated net contribution [sets effective ceiling of about 1500 meua in 1980.] Could be combined with other mechanisms/measures.

* Assuming £1=1.50 eua

A new mechanism to compensate for increases in contributions (A 18-19. B, 11)			
No increase in UK's share of gross contributions between 1979 and 1980	390	260	Extension of current Article 131 arrangements which expire this year. Dismissed as inadequate in second Commission paper (B). Temporary and ad hoc though could be extended. Corrects same problems as financial mechanism; as long as refund under one does not reduce entitlement under the other, two could be combined to yield 910 meua (£610m) at risk of some absurdity.
A weighted financial mechanism (A, 21-23)			
GNP share weighted by ratio of GNP per head to EEC average			Use of GNP per head smacks of "progressivity"; wider application could be expensive after enlargement. Dismissed in A and dropped in B. Effective but unpopular.
1. GNP per head at market exchange rate, ie 76% weight	1100	730	Size of weight would be affected by sharp movements in market exchange rates. 3-year averaging for GDP per head would be desirable (cf for qualifying criterion).
2. GNP per head at purchasing power parities ie 90% weight	750	500	Essential to confine use of PPP to weighting or remove 85% qualifying criterion from existing mechanism.
Gross receipts mechanisms			Deficient receipts are half the UK's problem. Receipts mechanisms criticised inA, not mentioned in B. Radical,open to charge of "juste retour". Lump sum receipts, not resulting from mechanism more acceptable, if tied to specific Community policies (B,15). Robust, if combined with amended mechnaisms on gross contributions side.

Refund to bring:			
1. UK share of receipts in line with GNP share	720	480	In combination with amended financial mechanism would yield: -1240 meua (£830m) or
2. UK receipts per head in line with EEC average receipts per head	1400	930	1920 meua (£1280m): above our forecast VAT payments in 1980.
OR			
Refund could defray some proportion of shortfall in UK receipts,			Not mentioned by Commission
eg make good two-thirds gap between receipts share and GNP share.	470	310	In combination with amended financial mechanism would yield: - 990 meua (£660m)
Net mechanisms (A, 26)			Criticised in A, dropped in B. Likely to prove quite unnegotiable alone: might be used as failsafe in combination with other mechanisms.
1. net contribution not to exceed a fixed proportion of gross 2. gross contributions not to exceed fixed percentage of UK's share in receipts 3. net deficit to be limited to certain proportion of GNP			Depending on how fixed proportions defined, could be made to yield almost anything. Refund could prove very sensitive to minor changes in forecasts and whether or not MCAs are included.
4. net contribution as % GNP not to exceed that of any more prosperous country.			Not mentioned by Commission. Only relative.

OTHER OPTIONS IN COMMISSION PAPERS

Structure of the Budget (B,6)

Expenditure on structures and investment should take rising proportion of budget	Italian proposal, recommended by Commission. Inadequate on its own.

<u>Increased payments for UK under specific</u>

<u>Community policies</u> (B,15)

	(existing UK programmes) meua	£m	
1. Assistance for coal exploitation	840	(560)	Recommended by Commission. In combination with amended financial mechanism, most promising line of approach.
2. Transport infra structure	1450	(966)	
3. Agricultural improvement	210	(140)	
4. Interest rebates - if UK joins EMS	200 meua maximum	n.a	Value depends on financing existing programmes on sufficient scale, over required time period. Commission proposals "temporary and ad hoc".

OPTIONS : Figures on exporter-benefits MCAs basis

Mechanism	Net refund in 1980 meua	£m
Objective		
Broad balance	1814	1210

Gross contributions mechanisms

as in main table

Gross receipts mechanisms

Refund to bring	meua	£m
1. UK share of receipts in line with GNP share	940	630
2. UK receipts per head in line with EEC average receipts per head	1620	1080

OR

	meua	£m
Refund could defray some proportion of shortfall in UK receipts		
eg make good two-thirds gap between receipts and GNP share	610	410
OR make good 80 per cent gap between receipts per head and EEC average	1300	860

GRPS 1900 AMENDED DISTRIBUTION: 5/12/79

UNCLASSIFIED

FM DUBLIN 301620Z NOVEMBER 79

TO IMMEDIATE FCO

TELEGRAM NUMBER 480 OF 30 NOVEMBER 79

INFO IMMEDIATE UKREP BRUSSELS

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THE HAGUE LUXEMBOURG

INFO ROUTINE WASHINGTON

UKDEL NATO UKDEL OECD

EUROPEAN COUNCIL DUBLIN 29/30 NOVEMBER

1. FOLLOWING IS TEXT OF PRESIDENCY CONCLUSIONS :

ECONOMIC AND SOCIAL SITUATION

PROSPECTS FOR THE COMMUNITY ECONOMY

THE HEADS OF STATE OR GOVERNMENT DISCUSSED DEVELOPMENTS IN THE COMMUNITY ECONOMY AND PROSPECTS FOR 1980, PARTICULARLY IN THE LIGHT OF THE DEFLATIONARY EFFECTS OF THE OIL PRICE INCREASES. THEY RECOGNIZED THAT DESPITE THE PROGRESS ACHIEVED BY THE CO-ORDINATED ECONOMIC APPROACH AGREED AT THE EUROPEAN COUNCIL IN BREMEN, THE OBJECTIVES SOUGHT, PARTICULARLY MAINTAINING GROWTH AND COMBATTING INFLATION HAD NOT BEEN ACHIEVED IN FULL.

IN AN EFFORT TO OVERCOME THE CURRENT ECONOMIC DIFFICULTIES A COMMON APPROACH CONTINUES TO BE ESSENTIAL. PRIORITY MUST BE GIVEN TO COMBATTING INFLATION. THIS IS, IN THE MEDIUM AND LONG TERM, A CONDITION FOR SOLVING THE PROBLEMS OF GROWTH, STRUCTURAL CHANGE AND HENCE EMPLOYMENT. THE EXISTENCE OF THE EUROPEAN MONETARY SYSTEM ALSO UNDERLINES THE NECESSITY FOR A CO-ORDINATED APPROACH IN TACKLING THE BALANCE OF PAYMENTS EFFECTS OF THE NEW OIL PRICE RISES. THE FIGHT AGAINST INFLATION AND UNEMPLOYMENT SHOULD NOT BE MADE MORE DIFFICULT THROUGH ATTEMPTING TO COMPENSATE BY INCREASES IN MONEY INCOMES FOR THE REAL TRANSFER OF PURCHASING POWER WHICH

/HAS

HAS TAKEN PLACE TO THE OIL PRODUCING COUNTRIES. MOREOVER, MONETARY POLICY SHOULD CONTINUE FOR THE TIME BEING TO SUPPORT EFFORTS TO COUNTER INLFATION. MODERNIZATION OF AND INVESTMENTS IN COMMUNITY INDUSTRY MUST CONTINUE TO ENABLE IT TO ADAPT MORE QUICKLY TO NEW PATTERNS OF DEMAND.

THE PRESENT DIFFICULTIES REQUIRE AN IMPROVED CO-ORDINATION OF THE ECONOMIC AND MONETARY POLICIES OF MEMBER STATES. WITH THIS, IN MIND, THE EUROPEAN COUNCIL CONFIRMS ITS INTENTION TO SET UP THE EUROPEAN MONETARY FUND IN ACCORDANCE WITH THE TIMETABLE ENVISAGED. TO THIS END, THE EUROPEAN COUNCIL INVITES THE COMMISSION TO SUBMIT, FIR ITS NEXT MEETING IN MARCH, 1980, A REPORT SETTING OUT THE PROGRESS MADE IN THIS FIELD AND THE DIFFICULTIES ENCOUNTERED. FURTHERMORE, THE PRESENT DIFFICULTIES REQUIRE THAT THE COMMUNITY CONTINUE TO PURSUE A COMMON APPROACH IN CONJUNCTION WITH OTHER INDUSTRIALISED COUNTRIES. THE EUROPEAN COUNCIL RE-AFFIRMED ITS DETERMINATION TO CONDUCT ECONOMIC POLICIES IN LINE WITH THE PRINCIPLES AND STRATEGY AGREED AT THE EUROPEAN COUNCIL IN STRASBOURG.

EVEN WITH THE DOWN-TURN IN THE INTERNATIONAL ECONOMY THE COMMUNITY IS EXPECTED TO ACHIEVE AT LEAST A MODERATE RATE OF GROWTH NEXT YEAR, AND MAY AVERT ACCELERATION IN THE RATE OF INFLATION.

THE EMPLOYMENT PROBLEM

THE EUROPEAN COUNCIL DISCUSSED THE SERIOUS UNEMPLOYMENT SITUATION IN THE COMMUNITY. THEY AGREED THAT THE CONTINUATION AND INTENSIFICATION OF NATIONAL AND COMMUNITY EFFORTS TO IMPROVE ECONOMIC STRUCTURES, PRIMARILY THROUGH INCREASED INVESTMENT, WAS OF FUNDAMENTAL IMPORTANCE.

A MORE CO-ORDINATED APPROACH TO EMPLOYMENT PROBLEMS SHOULD BE DEFINED. THE EUROPEAN COUNCIL ACCORDINGLY REQUESTS THE COMMISSION TO SUBMIT PROPOSALS ON SPECIFIC MEASURES WHICH COULD BE FRAMED TO PROMOTE MORE INCISIVE COMMUNITY ACTION TO DEAL WITH THE UNEMPLOYMENT PROBLEM.

/THE

THE EUROPEAN COUNCIL NOTED THE RECENT ADOPTION BY THE COUNCIL OF MINISTER S OF A RESOLUTION ON THE RE-ORGANISATION OF WORKING TIME AND ASKED THE COMMISSION TO PURSUE THEIR CONSULTATIONS WITH THE SOCIAL PARTNERS.

TELEMATICS

THE EUROPEAN COUNCIL DISCUSSED THE QUESTIONS RAISED IN A COMMISSION COMMUNICATION DRAWING ATTENTION TO THE IMPORTANCE OF DATA TECHNOLOGIES BOTH FOR EUROPEAN INDUSTRY AND SOCIETY. THE EUROPEAN COUNCIL TOOK NOTE OF THE RECOMMENDATIONS OF THE COMMISSION AND INVITED THE COUNCIL (FOREIGN MINISTERS) TO STUDY A COMMON STRATEGY FOR THE DEVELOPMENT OF THESE TECHNOLOGIES IN EUROPE.

CONVERGENCE AND BUDGETARY QUESTIONS

THE EUROPEAN COUCNIL HELD AN EXCHANGE OF VIEWS ON CONVERGENCE AND BUDGETARY QUESTIONS. THEY RE-AFFIRMED THE CONCLUTIONS REACHED A T THEIR MEETING S IN BRUSSELS AND PARIS THAT ACHIEVEMENT OF THE CONVERGENCE OF ECONOMIC PERFORMANCES REQUIRES MEASURES FOR WHICH THE MEMBER STATES CONCERNED ARE PRIMARILY RESPONSIBLE, THAT COMMUNITY POLICIES CAN AND MUST PLAY A SUPPORTING ROLE WITHIN THE FRAMEWORK OF INCREASED SOLIDARITY AND THAT STEPS MUST BE TAKEN TO STRENGTHEN THE ECONOMIC POTENTIAL OF THE LESS PROSPEROUS COUNTRIES OF THE COMMUNITY.

TO THESE ENDS THE EUROPEAN COUNCIL EXPRESSED ITS DETERMINATION TO PROMOTE THE ADOPTION OF MEASURES TO IMPROVE THE WORKING OF COMMUNITY POLICIES, TO REINFORCE THOSE POLICIES MOST LIKELY TO FAVOUR THE HARMONIOUS GROWTH OF THE ECONOMIES OF THE MEMBER STATES AND TO REDUCE THE DISPARITIES BETWEEN THESE ECONOMIES. THEY FURTHER DECLARED THE NEED, PARTICULARLY WITH A VIEW TO THE ENLARGEMENT OF THE COMMUNITY AND NECESSARY PROVISIONS FOR MEDITERRA-NEAN AGRICULTURE, TO STRENGTHEN COMMUNITY ACTION IN THE STRUCTURAL FIELD.

THE EUROPEAN COUNCIL HAS CARRIED OUT A THOROUGH EXAMINATION OF THE PROBLEM OF THE BRITISH CONTRIBUTION TO THE COMMUNITY BUDGET.

/IT

IT WAS AGREED THAT THE COMMISSION'S PROPOSALS CONCERNING THE ADAPTATION OF THE FINANCIAL MECHANISM COULD CONSTITUTE A USEFUL BASIS FOR A SOLUTION WHICH WOULD RESPECT COMMUNITY ACHIEVEMENT AND SOLIDARITY. THIS SOLUTION SHOULD NOT RESULT IN RAISING THE ONE PERCENT VAT CEILING.

IN ADDITION, THE COMMISSION IS REQUESTED TO PURSUE THE EXAMINATION OF PROPOSALS FOR DEVELOPING SUPPLEMENTARY COMMUNITY MEASURES WITHIN THE UNITED KINGDOM WHICH WILL CONTRIBUTE TO GREATER ECONOMIC CONVERGENCE: AND WHICH WILL ALSO LEAD TO GREATER PARTICIPATION BY THE UNITED KINGDOM IN COMMUNITY EXPENDITURE.

THE COMMISSION IS ASKED TO MAKE PROPOSALS WHICH WILL ENABLE THE COUNCIL OF MINISTERS TO PURSUE THE SEARCH FOR APPROPRIATE SOLUTIONS TO BE REACHED AT THE NEXT MEETING OF THE EUROPEAN COUNCIL. THE PRESIDENT OF THE COUNCIL WILL CONVENE THE EUROPEAN COUNCIL AS SOON AS THE CONDITIONS FOR SUCH A MEETING HAVE BEEN FULFILLED.

THE EUROPAN COUNCIL RECOGNIZED THE NEED TO REACH RAPID COMMUNITY SOLUTIONS TO THE PROBLEMS OF FISHERIES, ENERGY AND ORGANIZATION OF THE MARKET IN SHEEPMEAT WITHIN THE FRAMEWORK OF THE PRINCIPLES LAID DOWN IN THE TREATY.

ENERGY

THE EUROPEAN COUNCIL DISCUSSED THE WORLD ENERGY SITUATION WHICH REMAINS VERY SERIOUS. IN VIEW OF RENEWED PRICE INCREASES, CONTINUING UNCERTAINTIES ABOUT SUPPLY AND PRODUCTION, AND THE CHANGING STRUCTURE OF THW WORLD OIL MARKET, THE EUROPEAN COUNCIL CONSIDERS THAT EFFORTS MUST BE MADE BOTH BY PRODUCING AND CONSUMING COUNTRIES TO CREATE GREATER STABILITY. IN THE LIGHT OF F THESE NEEDS THE COMMUNITY FOR ITS PART MUST NOW DEVELOP A MORE EFFECTIVE ENERGY POLICY.

THE EUROPEAN COUNCIL REQUESTS THE COUNCIL OF ENERGY MINISTERS AT ITS MEETING ON 4 DECEMBER TO TAKE A FINAL DECISION ON NATIONAL IMPORT OBJECTIVES OF 1980.

/THE

THE EUROPEAN COUNCIL CONFIRMED ITS RESOLVE TO DEVELOP INDIGENOUS ENERGY RESOURCES, PARTICULARLY COAL, NUCLEAR AND HYDROCARBONS AND TO PROMOTE THE RESEARCH AND DEVELOPMENT PROGRAMMES IN THE ENERGY FIELD WITH PARTICULAR REGARD TO RENEWABLE ENERGY SOURCES.

THE EUROPEAN COUNCIL CONCLUDED THAT AS ENERGY PROBLEMS AFFECT ALL COUNCTIRES IN THE WORLD NO LASTING SOLUTION OF THESE PROBLEMS CAN BE ACHIEVED WITHOUT CLOSER UNDERSTANDING AND CO-OPERATION BETWEEN THE INDUSTRIALIZED, THE OIL PRODUCING AND THE NON-OIL DEVELOPING COUNTRIES. EFFORTS SHOULD BE MADE TO PROMOTE DISCUSSION WITH OIL PRODUCING COUNTRIES WITH THE OBJECT OF ADOPTING POLICIES IN BOTH CONSUMER AND PRODUCER COUNTRIES WHICH WOULD ALLOW THE TRANSITION TO A BETTER MARKET EQUILIBRIUM WITHOUT SERIOUS DAMAGE TO THE ECONOMY OF THE WORLD AS A WHOLE. THE EUROPEAN COUNCIL CONSIDERS IT MOST DESIRABLE THAT SIGNIFICANT AND RAPID PROGRESS BE MADE IN ALL INTERNATIONAL FORA WHERE ENERGY IS DISCUSSED I.E. THE UNITED NATIONS, OECD/IEA AND THE ECONOMIC COMMISSION FOR EUROPE, WITH A VIEW TO ESTABLISHING A CONSENSUS AND CO-OPERATION ON THE ADJUSTMENTS REQUIRED BY THE CHANGING SITUATION IN THE WORLD.

REPORTS ON EUROPEAN UNION

THE EUROPEAN COUNCIL RECEIVED AND NOTED THE REPORTS BY THE FOREIGN MINISTER AND THE COMMISSION ON THE PROGRESS ACHIEVED TOWARD EUROPEAN UNION IN THE PAST YEAR. THE EUROPEAN COUNCIL NOTED THE IMPORTANCE OF DEVELOPMENTS IN THE PAST YEAR TOWARDS THE ACHIEVEMENT OF EUROPEAN UNION AND IN PARICULAR:

- THE SIGNATURE OF THE INSTRUMENTS OF ACCESSION OF THE HELLECNIC REPUBLIC TO THE EUROPEAN COMMUNITIES

- THE ESTABLISHMENT OF THE EUROPEAN MONETARY SYSTEM

- THE DIRECT ELECTIONS TO THE EUROPEAN PARLIAMENT

THE EUROPEAN COUNCIL AFFIRMED THE IMPORTANCE OF THESE CONCRETE STEPS IN DEMONSTRATING THE COMMUNITIES' COMMITMENT TO PROCEED TOWARDS AND TO CREATE THE CONDITIONS FOR FURTHER PROGRESS TOWARDS AN EVER CLOSER UNION AMONG THE PEOPLES OF EUROPE.

THE EUROPEAN

THE EUROPEAN COUNCIL DECIDED THAT, AS HAS BEEN DONE PREVIOUSLY, THESE REPORTS SHOULD BE PUBLISHED IN AN APPROPRIATE FORM.

REPORT OF THE COMMITTEE OF WISE MEN

THE EUROPEAN COUNCIL WARMLY THANKED THE COMMITTEE OF WISE MEN FOR THE TIMELY PRESENTATION OF ITS VALUABLE REPORT ON ADJUSTMENTS TO THE MACHINERY AND PROCEDURES OF THE COMMUNITY INSTITUTIONS, PREPARED IN DISCHARGE OF THE MANDATE GIVEN BY THE EUROPEAN COUNCIL IN BRUSSELS IN DECEMBER 1978.

THE EUROPEAN COUNCIL ASKED THE FOREIGN MINISTERS IN THE APPROPRIATE FRAMEWORK TO EXAMINE THE REPORT WITH A VIEW TO PREPARING THE DISCUSSION AT THE NEXT MEETING OF THE EUROPEAN COUNCIL.

THE EUROPEAN COUNCIL DECIDED TO PUBLISH THE REPORT AND AGREED THAT THE PRESIDENT OF THE COUNCIL WOULD TRANSMIT A COPY OF THE REPORT TO THE PRESIDENTS OF THE OTHER INSTITUTIONS FOR INFORMATION.

THE EUROPEAN COUNCIL ALSO ADOPTED THE FOLLOWING STATEMENTS ON IRAN AND CAMBODIA:

IRAN

1. THE HEADS OF STATE OR GOVERNMENT AND THE FOREIGN MINISTERS OF THE NINE MEETING IN THE EUROPEAN COUNCIL CONSIDERED THE GRAVE SITUATION CREATED BY THE OCCUPATION OF THE EMBASSY OF THE UNITED STATES IN TEHRAN AND THE HOLDING OF MEMBERS OF ITS STAFF AS HOSTAGES IN FLAGRANT BREACH OF INTERNATIONAL LAW.

2. THE EUROPEAN COUNCIL STRONGLY REAFFIRMED THE STATEMENT WHICH WAS ISSUED BY THE FOREIGN MINISTERS OF THE NINE AT THEIR MEETING OF 20 NOVEMBER IN BRUSSELS. IT IS FUNDAMENTAL THAT DIPLOMATIC MISSIONS SHOULD BE PROTECTED. THE FAILURE TO UPHOLD THIS PRINCIPLE AND THE TAKING OF HOSTAGES TO EXERT PRESSURE ON GOVERNMENTS ARE TOTALLY UNACCEPTABLE. IT IS THE DUTY OF ALL GOVERNMENTS TO OPPOSE ENERGETICALLY SUCH A BREACH OF INTERNATIONAL LAW.

THE NINE MEMBER STATES OF THE EUROPEAN COMMUNITY FULLY RESPECT THE INDEPENDENCE OF IRAN AND THE RIGHT OF THE IRANIAN PEOPLE TO DETERMINE THEIR OWN FUTURE . THEY ARE CONSCIOUS OF THE IMPORTANCE WHICH THE IRANIAN PEOPLE ATTACH TO THE CHANGES WHICH HAVE TAKEN PLACE IN THEIR COUNTRY. BUT IN THE SAME MEASURE AS THEY RESPECT THE RIGHTS OF IRAN THEY CALL ON IRAN TO RESPECT FULLY THE RIGHTS OF OTHERS AND TO OBSERVE THE ESTABLISHED PRINCIPLES THAT GOVERN RELATIONS BETWEEN STATES. RESPECT FOR THESE PRINCIPLES IS ESSENTIAL TO THE EFFORT TO SECURE ORDER AND JUSTICE IN INTERNATIONAL RELATIONS WHICH IS IN THE INTEREST OF ALL STATES INCLUDING IRAN.

4. THE GOVERNMENTS OF THE NINE, SUPPORTED BY PUBLIC OPINION IN THEIR COUNTRIES, EXPRESSED IN PARTICULAR BY THE EUROPEAN PARLIAMENT , SOLEMNLY APPEAL TO IRAN TO RESPECT THESE FUNDAMENTAL RIGHTS AND DUTIES SO LONG ESTABLISHED IN INTERNATIONAL LAW. THEY URGE MOST STRONGLY THAT THE IRANIAN AUTHORITIES TAKE ACTION IMMEDIATELY TO RELEASE THE HOSTAGES IN COMPLETE SAFETY AND ALLOW THEM TO RETURN TO THEIR OWN COUNTRY.

CAMBODIA

1. THE EUROPEAN COUNCIL EXPRESSED ITS DEEP CONCERN AT THE TRAGIC SITUATION IN CAMBODIA.

2. IT RECALLED THAT THE EUROPEAN COMMUNITY AND ITS MEMBER STATES ARE CONTRIBUTING SUBSTANTIALLY TO INTERNATIONAL RELIEF EFFORTS NOW UNDER WAY. IT EMPHASISED THE URGENT NEED TO ENSURE THAT INTERNATIONAL EFFORTS TO BRING HUMANITARIAN RELIEF TO THOSE IN NEED IN CAMBODIA AND TO CAMBODIAN REFUGEES IN THAILAND WILL BE FULLY EFFECTIVE. IT APPEALS TO ALL THOSE IN A POSITION TO HELP AND IN PARTICULAR TO THE PARTIES MOST DIRECTLY CONCERNED TO ENSURE THAT HUMANITARIAN RELIEF WILL REACH THOSE IN NEED.

3. IT EXPRESSES ITS PARTICULAR CONCERN REGARDING THE DANGERS CONFRONTING THE REFUGEE CAMPS ON THE THAI-CAMBODIAN BORDER AS A RESULT OF THE CONTINUING HOSTILITIES.

4. IN THE VIEW OF THE GOVERNMENTS OF THE NINE A SOLUTION OF THE WIDER PROBLEMS WHICH CONFRONT CAMBODIA SHOULD BE BASED ON AN INDEPENDENT AND NEUTRAL CAMBODIA, WITH A GENUINELY REPRESENTATIVE GOVERNMENT, FREE FROM ANY FOREIGN MILITARY PRESENCE AND MAINTAINING FRIENDLY RELATIONS WITH ALL THE COUNTRIES OF THE REGION.

HAYDON

FRAME GENERAL:
EID

COMMUNITY BUDGET/CONVERGENCE

The European Council noted that it had not been possible to reach full agreement on the problem of the British contribution to the Community budget at this meeting. It was agreed that the Commission's suggestions for changes in the financial mechanism, which would have the effect of reducing the United Kingdom's net contribution in 1980 by 520 MUA, could form a useful element in the final solution to the problem. The European Council decided that it would hold a special meeting before the end of January to deal with other aspects of the problem.

30/11/79

TREASURY THURSDAY 29TH NOVEMBER 1979

C - Horsham and Crawley

R

No. 232 MR PETER HORDERN: To ask Mr Chancellor of the Exchequer, whether he will make a statement on the meeting of the EEC Budget Council on 23rd November.

MR NIGEL LAWSON

The EEC Budget Council met on 23 November to consider amendments and modifications, proposed by the European Parliament, to the Draft Budget for 1980 of the European Communities. The Draft Budget, after previous amendments by the Council, provided for commitment appropriations of 16,398 MEUA (about £11,070 million). and payment appropriations of 15,324 MEUA (about £10,345 million). The Parliament proposed the addition of 1589 MEUA (about £1073 million) for commitments and 312 MEUA (about £211 million) for payments, including an extra 350 MEUA commitements and 83.125 MEUA payments for the Regional Fund.

2. The Council first held a general discussion on the 1980 Budget. I emphasised the extreme importance attached by Her Majesty's Government to rectifying the situation as regards the size of the UK's net contribution to the Community Budget. I stressed that a solution must be found that acted on the whole of the problem, not just on our high contribution, but also on our low receipts; that a solution must operate in respect of 1980 and subsequent years; and that an agreed solution must last as long as the problem lasts.

3. The Council held a preliminary discussion with a delegation from the European Parliament led by its President. The views of the delegation on the 1980 Budget were carefully considered by the Council before it took its decision on the Parliament's detailed proposals.

4. The Budget Council also drew to the Parliament's attention the difficulties faced by Member States in relation to claims for FEOGA Guarantee Funds as a result of the non-adoption of the

1979 Supplementary Budget by the Parliament at its previous session.

5. In the initial discussion, the Council was not able to accept many of the Parliaments amendments including a proposed increase of 350 MEUA for the Regional Fund, although the United Kingdom supported this particular proposal. There was no qualified majority in the Council to increase the maximum rate of increase for non-obligatory expenditure in the 1980 Budget; the Council was therefore able to accept amendments proposed by the Parliament only to a total of a little over 255 MEUA (about £172 million) in commitments. The major part (some 84%) of the increase agreed by the Council above the level of the Draft Budget was allocated to the Regional and Social Funds; the distribution included 165 MEUA (about £111 million) for the Regional Fund, 50 MEUA (about £34 million) for the Social Fund - of which 37 MEUA (about £25 million) was for Article 5100 relating to aids for vocational training and geographical mobility - 5 MEUA (about £3 million) in the energy sector, 3.545 MEUA (about £2 million) for research, 21.25 MEUA (about £14 million) for Development expenditure, of which 20 MEUA was for Aid to Non-Associated Territories, and 9.535 MEUA (about £6 million) for other Institutions, including the Parliament's own Budget. The total increase in payment appropriations of 87 MEUA (about £59 million), included 55 MEUA for the Regional Fund, 15 MEUA for the Social Fund, 2.2 MEUA for energy, 1.545 MEUA for research and 3 MEUA for Development Aid.

6. The Council rejected by qualified majority the Parliament's proposed modifications on FEOGA Guarantee expenditure. The rejection was accompanied by a formal declaration, to which seven Member States, including the United Kingdom, subscribed in the following terms:-

> "The Council has noted with sympathy and understanding the reasons which have led the European Parliament, within the framework of budgetary procedure, to propose changes in the Guarantee Section. The Council interprets the adoption by the Parliament of these proposed modifications as the will of the Parliament to indicate its preoccupation faced with the financial consequences of persistent agricultural surpluses.

The Council shares this preoccupation and accepts that, provided that the fundamental principles of the Common Agricultural Policy are not called into question, changes will be necessary.

The Council agrees with the Parliament that early action by the Council is an essential step to secure a better balance within the agricultural section of the Budget and within the Budget as a whole.

The Council draws the attention of the Parliament to the fact that the Commission has recently made a number of suggestions to this end. The Council will examine these suggestions with all the consideration that their importance involves.

The Council believes that, until the decisions have been taken, it would be premature to accept the Parliament's proposals to change the appropriations in the Draft Budget, which represent a reasonable estimate of the costs of the measures currently in force. For this reason it had to reject the proposed modifications, without in any way rejecting the motivation which lay behind them."

Two member States (Italy and the Netherlands) dissociated themselves from this statement.

7. The proposals of the Parliament in relation to its own Budget were accepted by the Council, but the Presidency was asked to discuss further with the Parliament two amendments, relating to the payment of members and the rental of accommodation.

8. The decisions of the Council on the Parliament's proposals will be considered by the Parliament at its next plenary session in December, after which there may be a need for further exchanges between the Parliament and the Council before the 1980 Budget is adopted.

Prime Minister

Relations with Parliament

This is a proposal to raise the "maximum rate" (i.e. the Council of Ministers' financial limit on non-obligatory expenditure in the 1980 Budget) in order to reach agreement with the Parliament.

At the recent Budget Council ~~our~~ Treasury Ministers have opposed an increase in the maximum rate, even though that *might* give us a net gain on receipts, because we are resisting increased expenditure.

We think you might on the whole *agree* to the extra latitude - allow an attempt at agreement with the Parliament. But it will be

Subject to your general reserve.

We need the verbal amendment

on the second para. as shown. We want more than

"interest" in cutting ~~the~~ CAP.

K E Couzens

29/11/79.

Foreign and Commonwealth Office

London SW1A 2AH

28 November 1979

Prime Minister

Dear Michael

1980 Community Budget

UKREP telegram No 6447 (copied to you) reports that the Parliament's Committee on Budgets voted today to recommend rejection of the 1980 Budget. The Parliament itself is required to take a position within 15 days of having received the draft budget back from the Council. The deadline will probably fall on 10 or 11 December, when the Parliament will in any case be meeting in plenary session. We shall not know until then whether the Budget Committee's recommendation is accepted.

Since it is likely that the subject will be raised at Dublin, the Prime Minister may like to be reminded of the provisions of the relevant Treaty article, which reads:

> "The Assembly, acting by a majority of its members and two-thirds of the votes cast may, if there are important reasons, reject the draft budget and ask for a new draft to be submitted to it."

The Parliament has never previously rejected a draft Budget. The Treaty does not make clear whether the Budget procedure would have to be repeated in its entirety or not. What is clear, however, is that the Parliament would be within its rights if it were to reject it.

A number of difficult questions arise, which are being studied urgently. We do not know how the full Parliment will vote: given the need for a two-thirds majority, it could be close. We are considering whether to recommend contact with UK MEPs.

The French may refer to this at Dublin in the context of the item on relations between the Council and the Parliament on the agenda at their request, but there is no need for the European Council to involve itself in this. The next step would normally be for COREPER to consider the situation next week and recommend whether there is anything the Council of Ministers can usefully do. Anything more would be premature since the Parliament had not yet voted.

/I

M O'D B Alexander Esq
10 Downing Street

I am sending copies of this letter to Tony Battishill (Treasury) and Martin Vile (Cabinet Office).

Yours ever

pp (P Lever)
Private Secretary

Foreign and Commonwealth Office

London SW1A 2AH

28 November 1979

M Vile Esq
CABINET OFFICE

Dear Martin,

The Belgian Ambassador called the other day and Sir Michael Palliser explained to him in very clear terms how we saw the budget problem and the line we were taking. The Ambassador has now let us see, on a strictly personal basis, a copy of a reply to his telegram reporting this conversation. I enclose a translation.

This gives briefly and clearly the way in which a number of the smaller countries are likely to be approaching this matter. We think that the Prime Minister might be interested to see the telegram.

I should be grateful if the Ambassador's confidence in letting us see the telegram can be respected.

Yours ever,

Andrew

R A Burns

cc:
M Alexander Esq
No 10

Subject - British budgetary problem

SV 722

Thank you for the information. In any further contact you have with the British authorities you might enlarge upon the following:

1 The major difficulty and danger at Dublin is that Great Britain on the one hand, and its Partners and the Commission on the other, will argue from different points of view. For Great Britain the system is basically unjust, since, for it to be just, it should result in a broad balance between return and expenditure for each country. For us the system is basically just because it is founded on the transfer to the Community by each country of the same type of resources (customs duties, 1 per cent levy on VAT). We can agree to alleviate only the excessive, transitory and, to some extent, unforeseen consequences of the system in a political approach. The problem is that as these two arguments are based on different premisses they cannot by their very nature be reconciled. The paradox is that the Heath and Wilson governments had accepted our point of view, since one signed and the other renegotiated the Accession agreement, whose philosophy on budgetary resources was clearly our own. By changing its approach to such a fundamental issue, the Thatcher government is assuming a heavy responsibility.

2 We agree with Palliser's arguments according to which the Community interest requires that where an unacceptable situation comes to light it should be remedied. For that very reason we are prepared to consider solutions which would entail considerable financial repercussions for us, even though in this respect we are under no legal obligation in the strict sense. But it is not for the British Government to decide alone what is unacceptable in the Community interest; this must be done by consensus.

3 From a tactical point of view, Great Britain should realise that if it persists with demands which have no chance of being satisfied at Dublin, there is a danger that there will be no negotiation at all. We will not be able to give at Dublin an indication of the extent of possible concessions, unless there is a fair chance of a successful outcome. We would otherwise run the risk of finding that our maximum concessions in Dublin had become the starting point for fresh negotiations after the European Council.

4 The British press is all too ready to draw attention to the possibility of British blocking tactics within the Community and refers to the French "empty chair" policy which preceded the 1966 Luxembourg Compromise, which it portrays as a triumph for French diplomacy. It is worth remembering that the Luxembourg Compromise is basically an "agreement to disagree" on the principles linked to the fact that it was in the best interests of the Partners, including France, to carry on with the practical activities of the institutions despite the disagreement. The lesson to be learned from this episode is:

a) that despite France's blocking tactics, its Partners stood firm where the principles were concerned;

b) that, in its own interests, France was driven to return to the negotiating table to seek a compromise in an area where De Gaulle did not want one.

Simonet.

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UK BUDGET CONTRIBUTIONS: COMMISSION PREPARATIONS FOR DUBLIN

FOLLOWING IS COMMISSION BRIEF REFERRED TO IN MIPT:-
THE EXPENDITURE SIDE OF THE BUDGET:
SPECIAL ARRANGEMENTS

1. THE COMMISSION'S COMMUNICATION TO THE COUNCIL SUGGESTS THAT SPECIAL, TEMPORARY AND AD HOC MEASURES WITHIN EXISTING COMMUNITY POLICIES TO INCREASE EXPENDITURE FROM THE COMMUNITY GIVEN. THE QUESTION ARISES WHAT PRECISE MEANS MIGHT BE ADOPTED WITHIN THE COMMUNITY IN ORDER TO GIVE EFFECT TO THIS APPROACH IF OVERALL AMOUNTS WERE AGREED IN PRINCIPLE BY THE EUROPEAN COUNCIL.

2. TWO APPROACHES TO THE METHOD OF PROVIDING SPECIAL EXPENDITURE WITHIN THE UK ARE POSSIBLE. THE FIRST WOULD BE TO LINK EXPENDITURE OPERATIONS DIRECTLY TO EXISTING EXPENDITURE PROGRAMMES FINANCED BY THE COMMUNITY BUDGET. FOR EXAMPLE A PART OF THE AGREED EXTRA RESOURCES COULD BE MADE AVAILABLE FOR EXPENDITURE ON INFRASTRUCTURE WITHIN THE REGIONAL FUND ON THE BASIS OF A SPECIAL SECTION OUTSIDE THE EXISTING QUOTA SYSTEM. OTHER PARTS COULD BE DEVOTED TO A LARGER PROPORTION OF PROJECTS IN THE UK QUALIFYING UNDER THE SOCIAL FUND REGULATIONS, THERE COULD BE FURTHER SUPPORT FOR AGRICULTURAL IMPROVEMENT SCHEMES

COULD BE FURTHER SUPPORT FOR AGRICULTURAL IMPROVEMENT SCHEMES ON THE BASIS OF THE KIND OF PROJECTS NROMALLY FINANCED BY THE FEOGA GUIDANCE SECTION. AS REGARDS THE FIELD OF TRANSPORT INFRASTRUCTURE ALTHOUGH NO REGULATION HAS YET BEEN AGREED BY THE COUNCIL IN THIS AREA, A CERTAIN AMOUNT OF ROAD BUILDING IS FINANCED BY THE GEGIONAL FUND, AND EXTRA RESOURCES COULD POSSIBLY BE DEVOTED TO THIS UNDER REGIONAL FUND RULES.

3. BUT THERE ARE A NUMBER OF PROBLEMS IN RESPECT OF THE ABOVE APPROACH. THE MAIN ONE IS THAT THE DISBURSEMENT OF EXTRA CREDITS WOULD BE SUBJECT TO DIFFERENT COMMUNITY REGULATIONS DEPENDING ON THE COMMUNITY POLICIES UNDER WHICH THEY FELL. PROCEDURES ARE CUMBERSOME AND WOULD HOLD UP THE RAPID USE OF AVAILABLE CREDITS. MOREOVER IF THE EXISTING REGULATIONS WERE INTERPRETED LOOSELY BECAUSE OF THE UK'S SPECIAL SITUATION, E.G. BY AGREEING TO A HIGHER THAN NORMAL RATE OF GRANT, IT WOULD BE DIFFICULT TO EXCLUDE OTHER MEMBER STATES FROM THE SAME TREATMENT.

4. THE SECOND AND MORE USEFUL APPROACH WOULD BE THAT OF A SINGLE COUNCIL REGULATION FOR THE DISBURSEMENT OF THE AGREED CREDITS IN LINE WITH A NUMBER OF OBJECTIVES WHICH WOULD BE DIFINED IN THE REGULATION. IN THIS RESPECT THE INTEREST REBATE SCHEME WITHIN THE EMS PROVIDES A USEFUL EXAMPLE. THE REGULATION MAKES CLEAR THAT THE SOFT LOANS ARE TO BE DEVOTED TO GENERAL INFRASTRUCTURE EXPENDITURE IN THE INTERESTS OF CONVERGENCE, WITH THE COMMISSION DECIDING ON THE ELIGIBILITY OF PROJECTS SUBMITTED BY THE MEMBER STATES CONCERNED ON THE BASIS OF A NUMBER OF GENERAL CRITERIA. THUS ARTICLE 5 OF THE RELEVANT REGULATION READS THAT ''THE COMMISSION SHALL DECIDE ON THE ELIGIBILITY OF PROJECTS IN CONFORMITY WITH THE FOLLOWING GUIDLINES:

- THE INVESTMENT CONFORMS TO COMMUNITY RULES APPLICABLE TO THE AREAS CONCERNED.
- THE LOANS ARE DEVOTED ESSENTIALLY TO FINANCING PROJECTS AND PROGRAMMES IN THE FILED OF INFRASTRUCTURE.
- THE INVESTMENT SHOULD CONTRIBUTE TO THE SOLUTION OF THE PRINCIPAL STRUCTURAL PROBLEMS AFFECTING THE STATE CONCERNED, AND PARTICULARLY THE REDUCTION OF REGIONAL DISPARITIES AND THE IMPROVEMENT OF THE EMPLOYMENT SITUATION.
- THE INVESTMENT SHOULD BE IN CONFORMITY WITH THE PROVISIONS OF THE TREATY. WITH RESPECT TO CONDITIONS OF COMPETITION ANY DIRECT OR INDIRECT DISTORTION OF THE

COMPETITION ANY DIRECT OR INDIRECT DISTORTION OF THE COMPETITIVE POSITION OF INDUSTRIES WITHIN MEMBER STATES MUST BE AVOIDED''.

5. WITHIN AN OVERALL APPROACH OF THIS KIND IT WOULD BE POSSIBLE TO DEVISE A REGULATION BASED ON THE NEED TO IMPROVE THE ECONOMIC STRUCTURE AND LEVEL OF INVESTMENT IN A MEMBER STATE IN A PARTICULAR SITUATION VIS A VIS THE COMMUNITY BUDGET, AND CONTAINING APPROPRIATE MEASURES TO THIS END. THESE MEASURES MIGHT TAKE THE FORM OF A SERIES OF ACTIONS CONCENTRATED PARTICULARLY IN THE INFRASTRUCTURE FIELD. AS A SAFEGUARD FOR OTHER MEMBER STATES, IT COULD BE SPECIFIED THAT THEY SHOULD BE IN RESPECT OF ACTIONS WHERE COMMUNITY OBJECTIVES HAVE ALREADY BEEN AGREED. THEY WOULD THUS BE LINKED TO RECOGNIZABLE AREAS OF COMMUNITY ACTIVITY WITHOUT BEING TIED TO THE DETAILED RULES AND PROCEDURES GOVERNING PARTICULAR POLICIES AS THEY ARE CURRENTLY IMPLEMENTED. EXAMPLES WHICH COME TO MIND IN THE CONTEXT OF THE COMMISSION'S COMMUNICATION OF 21 NOVEMBER ARE:

- SPECIAL INTEGRATED SCHEMES BOTH TO DEVELOP AGRICULTURE IN BACKWARD AREAS AND IMPROVE CONDITIONS IN ORDER TO ATTRACT PARALLEL ACTIVITIES (E.G. TOURISM OR SMALL INDUSTRIES) COULD BE CONSIDERED. IT WOULD ALSO BE POSSIBLE TO GIVE EXTRA HELP TO THE FOOD PROCESSING INDUSTRY (ALTHOUGH COMPETITION PROBLEMS WOULD HAVE TO BE AVOIDED HERE).

- ASSISTANCE FOR THE EXPLOITATION OF COAL. AT PRESENT ONLY ECSC LOANS ARE DEVOTED TO MODERNIZING INVESTMENT IN THE COAL INDUSTRY. A SCHEME OF GRANTS ON THE BASIS OF THE UK'S ANNUAL INVESTMENT IN THIS AREA (RUNNING AT AROUND 84? MEUA) MIGHT BE ENVISAGED.

- TRANSPORT INFRASTRUCTURE IN AREAS OF PARTICULAR REGIONAL DIFFICULTY, WITH PROJECTS GOING RATHER WIDER THAN THOSE WHICH QUALIFY UNDER THE REGIONAL FUND.

6. IF IT WAS DESIRED TO DRAW THE REGULATION MORE WIDELY UNDER THE OVERALL UMBRELLA OF IMPROVING INFRASTRUCTURE, NEW CONCEPTS SUCH AS THE RENEWAL OF INNER URBAN INFRASTRUCTURE, AND CONTRIBUTING TO BASIC PUBLIC SECTOR INVESTMENT IN E.G. HOSPITALS AND SCHEELS COULD BE ADDED. THE VIABILITY OF THIS WOULD DEPEND IN PART ON THE SIZE OF FINANCE TO BE DISBURSED UNDER THE REGULATION, AND IN PART ON THE WILLINGNESS OF MEMBER STATES TO SEE EXPENDITURE IN FIELDS OF THIS KIND ON THE BASIS OF 'SPECIAL, TEMPORARY AND AD HOC MEASURES' IT MIGHT, FOR EXAMPLE, BE POSSIBLE TO TAKE FURTHER THE

IT MIGHT, FOR EXAMPLE, BE POSSIBLE TO TAKE FURTHER THE CONCEPT OF THE INTEGRATED COMMUNITY OPERATIONS FOR BELFAST AND NAPLES AT PRESENT UNDER DISCUSSION (AND WHICH AT PRESENT SIMPLY AMOUNT TO COMBINING THE ACTION OF A NUMBER OF COMMUNITY FUNDS) AND DEVELOP A SPECIAL PROGRAMME OF IMMEDIATE ASSISTANCE COVERING URBAN INFRASTRUCTURE PROBLEMS FOR, SAY, GLASGOW.

7. IN SHORT, A COUNCIL REGULATION WITHIN WHICH THE SUMS TO BE SPENT ANNUALLY OVER A GIVEN PERIOD OF YEARS COULD BE INSCRIBED, MIGHT CONTAIN THE FOLLOWING MAIN ELEMENTS:

(I) THE QUALIFYING CRITERIA FOR A MEMBER STATE TO BENEFIT FROM A SPECIAL LINE OF CREDIT WITHIN THE BUDGET (FOR EXAMPLE A NET DIEFCIT SITUATION, BELOW AVERAGE GDP PER HEAD, RECEIPTS LESS THAN A CERTAIN PERCENTAGE OF THE COMMUNITY AVERAGE PER HEAD).

(II) THE PRINCIPAL AIMS OF IMPROVING THE ECONOMIC STRUCTURE AND LEVEL OF INVESTMENT OF A MEMBER STATE AND THE NEED TO SUPPORT THIS OBJECTIVE BY A SERIES OF ACTIONS WITH PARTICULAR EMPHASIS ON SUPPORT FOR INVESTMENTS IN INFRASTRUCTURE.

(III) THE POLICY OBJECTIVES TO WHICH THE SPECIAL RESOURCES SHOULD BE DEVOTED ON THE BASIS OF PROJECTS TO BE SUBMITTED TO THE COMMISSION (THESE OBJECTIVES POSSIBLY TO BE CONDITIONED BY THE FACT THAT ACTIONS SHOULD BE ON THE BASIS OF OBJECTIVES ALREADY AGREED WITHIN THE COMMUNITY).

(IV) A DEFINITIO N OF THE MAXIMUM RATE OF COMMUNITY PARTI-CIPATION IN PROJECTS.

(V) THE COMMISSION TO JUDGE THE ELIGIBILITY OF PROJECTS IN THE LIGHT OF THE ABOVE CRITERIA.

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UK BUDGET CONTRIBUTIONS : COMMISSION PREPARATION FOR DUBLIN.

1. A COMMISSION CONTACT HAS DISCUSSED WITH COUNSELLOR (ECONOMIC) THE BRIEFING BEING GIVEN TO MR ROY JENKINS IN PREPARATION FOR DUBLIN, ON TWO POINTS:

(A) THE ROME FOR MANOEUVRE AVAILABLE WITHIN THE ONE PER CENT VAT CEILING IN 1980 AND LATER YEARS:

(B) THE TYPE OF ARRANGEMENTS WHICH MIGHT BE USED TO IMPLEMENT SPECIAL ACTION FOR THE UK ON THE EXPENDITURE SIDE OF THE BUDGET.

2. KNOWLEDGE OF WHAT FOLLOWS IN THE REST OF THIS TELEGRAM AND MIFT SHOULD, ON NO ACCOUNT, BE REVEALED AT DUBLIN, BUT IT MAY NEVERTHELESS BE HELPFUL IN SUGGESTING WHAT QUESTIONS SHOULD OR SHOULD NOT BE PUT TO THE COMMISSION.

ROOM FOR MANOEUVRE AVAILABLE WITHIN THE ONE PER VAT CEILING.

3. THE TABLE BELOW REPRODUCES FIGURES CIRCULATED IN THE COMMISSION'S TRIENNIAL FORECAST, SHOWING THE PROPORTION OF THE BUDGET PLANNED TO

TRIENNIAL FORECAST, SHOWING THE PROPORTION OF THE BUDGET PLANNED TO BE SPENT ON STRUCTURAL AND INVESTMENT EXPENDITURE (IE REGIONAL AND SOCIAL FUNDS ETC) IN RELATION TO THE TOTAL BUDGET AND THE OWN RESOURCES AVAILABLE.

STRUCTURAL AND INVESTMENT PROJECTIONS (IE REGIONAL AND SOCIAL FUND ETC)		TOTAL BUDGET MEUA	ONE PER CENT CEILING MEUA
1980	13.9 PER CENT	16,000	17,500
1981	19.9 PER CENT	19,000	18,500
1982	21.9 PER CENT	21,000	19,600

THE TABLE SHOWS A POSSIBLE MARGIN OF 1,500 MEUA AVAILABLE IN 1980 WITHIN THE ONE PER CENT CEILING, BUT A SHORT-FALL IN 1981 AND 1982. MR JENKINS IS, HOWEVER, BEING ADVISED THAT FOLLOWING THE BUDGET COUNCIL ON 23 NOVEMBER THE FIGURES FOR 1980 ARE NOW AS FOLLOWS

1980	11.9 PER CENT	15,400	17,700

THUS THE MARGIN FOR 1980 HAS RISEN FROM 1,500 MEUA TO 2,300 MEUA AS A RESULT OF AN UPWARD REVISION OF THE FORECAST REVENUE AND THE REDUCTIONS IN PARLIAMENT'S AMENDMENTS AGREED BY THE BUDGET COUNCIL. NO NEW FIHURES ARE AVAILABLE FOR 1981 AND 1982, BUT IT LIKELY THAT THE ESTIMATES FOR THE OWN RESOURCES AVAILABLE MAY ALSO BE REVISED UPWARDS LATER.

4. MR JENKINS IS BEING FOREWARNED, NO DOUBT CORRECTLY, THAT THE ITALIANS AT DUBLIN WILL ARGUE THAT THE PROPORTION OF THE 1980 BUDET TO BE DEVOTED TO STRUCTURAL AND INVESTMENT POLICIES SHOULD BE RESTORED TO AT LEAST THE 14 PER CENT PROMISED IN THE TRIENNIAL FORECAST AND IN THE COMMISSION'S COMMUNICATION OF 21 NOVEMBER. THIS WOULD INVOLVE AN INCREASE OF ABOUT 350 MEUA IN THE BUDGET AS IT STANDS AT PRESENT, ON THE ASSUMPTION THAT THE FIGURES FOR AGRICULTURE ARE MAINTAINED. MR JENKINS IS, HOWEVER, BEING RECOMMENDED THAT SUCH A MOVE COULD BE HELPFUL TO BUY IRISH AND ITALIAN SUPPORT FOR HELP TO THE UK. WE HAVE POINTED OUT TO OUR CONTACT THAT SUCH AN INCREASE IN STRUCTURAL EXPENDITURE WOULD NOT REDUCE THE UK'S NET CONTRIBUTION AS SHOWN IN THE SEPTEMBER QUOTE REFERENCE PAPER UNQUOTE, SINCE THE LATTER ITSELF ASSUMED ACCEPTANCE OF THE COMMISSION'S PARLIAMENT'S HIGHER FIGURES FOR STRUCTURAL AND INVESTMENT EXPENDITURE: AND WOULD ASLO BITE INTO THE MARGIN AVAILABLE.

COMMENT.

5. IT MAY NEVERTHELESS BE HELPFUL IF MR JENKINS CAN BE INDUCED TO

5. IT MAY NEVERTHELESS BE HELPFUL IF MR JENKINS CAN BE INDUCED TO REVEAL THE UPWARD REVISION IN THE MARGIN OF UNCOMMITTED REVENUE AVAILABLE, SINCE EVEN IF THE 350 MEUA WERE TO BE CONCEDED TO THE IRISH AND ITALIANS THIS WOULD STILL LEAVE A MARGIN OF 1,950 MEUA WITHIN THE ONE PER CENT LIMIT IN 1980, WHICH FIRM ACTION ON THE CAP COULD FURTHER INCREASE.

SPECIAL ACTION ON THE EXPENDITURE SIDE OF THE BUDET FOR THE UK.
6. MIFT CONTAINS THE TEXT OF A BRIEF BEING PREPARED FOR MR JENKINS ON THE FORM THIS ACTION MIGHT TAKE. THIS IS STILL SUBJECT TO REVISION AND THERE IS NO GUARANTEE THAT IT WILL REMAIN UNSCATHED. AS THE TEXT SHOWS, OUR COMMISSION CONTACTS ARE, WITH OUR ENCOURAGEMENT, ADVISING A FLEXIBLE PROCEDURE, FOLLOWING THE PRECEDENT OF THE EMS INTEREST RATE SUBSIDIES, WITH BROADLY-DRAWN DEFINITIONS OF ELIGIBLE UK EXPENDITURE, (THOUGH WE WOULD HAVE PREFERRED THEM NOT TO HAVE COME OUT SO STRONGLY AGAINST THE POSSIBILITY OF LINKS WITH THE EXISTING REGIONAL AND SOCIAL FUNDS). MORE SPECIFICALLY, WE HAVE SUGGESTED THE FOLLOWING AMENDMENTS TO THE TEXT IN MIFT:

(I) IN PARAGRAPH 5, THIRD INDENT, THE DELETION OF THE WORDS QUOTE IN AREAS OF PARTICULAR REGIONAL DIFFICULTY UNQUOTE:

(II) IN PARAGRAPH 7 (III) THE INSERTION OF QUOTE PROGRAMMES AND UNQUOTE BEFORE QUOTE PROJECTS UNQUOTE.

7. THE REFERENCE IN PARAGRAPH 6 OF MIFT TO QUOTE PUBLIC SECTOR INVESTMENT IN EG HOSPITALS AND SCHOOLS UNQUOTE IS TAKEN FROM THE TREASURY BRIEF. WE HAVE ALSO ENCOURAGED THE THOUGHT THAT THE QUOTE SPECIAL ACTION UNQUOTE WOULD NEED TO ENCOMPASS ONGOING INVESTMENT EXPENDITURE AND NOT JUST QUOTE NEW STARTS UNQUOTE. THERE IS NO REFERENCE IN THE PAPER TO QUOTE ADDITIONALITY UNQUOTE.

8. BOTH THE BRIEFS ARE BEING PROVIDED FOR ROY JENKINS TO USE IN ANSWER TO QUESTIONS. HE WILL NOT NECESSARILY VOLUNTEER THE INFORMATION.

FCO PASS TO ADVANCE COPY ADDRESSEES ONLY:
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TSY - PS/CHANCELLOR SIR K COUZENS JORDAN-MOSS MRS HEDLEY-MILLER J W R SHORE
NO10 - ALEXANDER
CSD - PS/LORD PRESIDENT
BUTLER

SECRET

13

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

28th November, 1979

Dr Michael,

UK CONTRIBUTION ETC.

In reply to your letter of today's date, I enclose the interim assessment on withholding referred to in your third paragraph. This has been agreed with representatives of the FCO, Cabinet Office, Law Officers Department and Treasury Solicitor.

Copies of this letter and enclosure go to the recipients of yours.

Yours ever,

(M.A. HALL)
Private Secretary

M. Alexander, Esq.,
Private Secretary,
10, Downing Street

EEC CONTRIBUTION: WITHHOLDING

This is an interim note which does not attempt to answer all the questions which a decision to withhold part of our EEC contribution would raise. However, it may narrow the options and identify some of the issues.

Mechanics

2. We have examined each link in the chain by which customs duties, agricultural levies and VAT (the 3 components of the Community's "own resources") are collected in the UK and transferred to the Community; and by which the Community then remits out of the UK the equivalent of our net contribution. The main stages are:

i. "establishment" and collection of the duties; "establishment", which includes calculation and notification to the payer is a term of art in Community regulations;

ii. payment of these duties by Customs staff into the departmental bank account which forms part of the Consolidated Fund;

iii. transfer from the Consolidated Fund to the EEC No 1 Account with the Paymaster General (there is a No 2 Account relating to the Coal and Steel Community). These transfers to the EEC Account have to be made by the 20th of each month in the case of Customs duties and agricultural levies. The transfers relate to sums collected 2 months earlier (ie in December we pay in the October collections). In the case of the Community's VAT share we make payments on the first working day of each month which represent 1/12th of an estimate made at the beginning of each year. Then an adjustment is made after the end of the year. Failure to make these transfers on the due dates attracts an interest penalty which is at present 17%, increased in respect of the whole period by ¼% for each month's delay.

From this EEC Account, the Community makes payments in sterling within the UK (eg our Article 131 refunds; payments to us under the Regional Fund; payments to the Intervention Board to finance purchases into intervention from UK farmers);

iv. at intervals the Commission instruct the Treasury to make transfers from the EEC Account with the Paymaster General to their account with the Bank of England. It is from that Bank of England account that the Commission make remittances overseas.

3. If we are to resort to withholding, there seem to be overwhelming advantages in achieving it by stopping remittances from the EEC Account with the Paymaster General to the account at the Bank of England. A stop on collection could only apply to customs duties and agricultural levies, not to VAT where the great bulk of the collection is for our own purposes. But this would be a very drastic course: a dismantling of the external tariff to the Community. It really would look like a permanent breach with the Community. It would also stop the flow of funds into the EEC Account which are used for our own farmers and other EEC beneficiaries. We might well have to make good part or all of that to them out of public expenditure. Moreover we do not want to upset the normal working of customs staff.

4. Stopping payments of duties once "established" into the EEC Account with the Paymaster General would attract the interest rate penalty. It would not of itself stop the flow of money overseas, to the extent that balances remained in the EEC Account. And it would endanger the flow of funds to our own EEC beneficiaries.

5. Interfering with flows out of the EEC Account at the Bank of England would also be unattractive. The Bank might well fear the precedent of interference with a customer account. It would probably be neither a legal nor an appropriate use of the statutory power of direction to the Bank to use that weapon to block the account. And it is much better to have the blocked balances in the EEC Number 1 Account where they are automatically relent to HMG.

6. The Treasury is required by Community regulation to comply "as soon as possible" with instructions to transfer money from the EEC Account with the Paymaster General to the EEC Account at the Bank of England. But there is no prescribed interest rate penalty for delay, though the Court might award such a penalty if it were sought. By stopping transfers at that point we would effectively stop transfers abroad; we would leave untouched the funds out of which UK beneficiaries are paid. And we would ourselves retain the use of the money, since the whole balance of the EEC Account with the Paymaster General is relent without interest charge to the UK Government. The Account is a mere book entry. And any problem of "unscrambling" if a settlement is reached is kept to a minimum.

How Much

7. Perhaps 4 serious possibilities:-

i. a token amount;

ii. withhold up to the amount of our estimated net contribution for 1980, but on an importer benefits basis (1552 meua);

iii. withhold the net contribution on an exporter benefits basis (1814);

iv. withhold up to the amount of our VAT tranche (1330 meua).

8. There seems little point in i. The principle underlying both ii. and iii. is to withhold the amount of the Government's claim. The amount yielded by iv. would be somewhat less. On the other hand, to withhold only the VAT tranche might be less offensive to our partners than withholding the customs duties and levies which are "own resources" par excellence. In practice we would not expect to be in default by more than our VAT tranche for many months.

9. If the Commission stopped payments to UK beneficiaries (which would be a considerable further escalation of the dispute) we would have to make them instead. Urgent payments could be made from the Contingencies Fund pending provision in Supplementary Estimates under the cover of the Appropriation Act. In this emergency situation the "new" public expenditure would be matched by "borrowing" from the EEC No 1 Account; and the intention would be that it would be made good out of the Account at the unscrambling stage.

10. It might be 3 to 6 months or so before our withholding created actual financial stringency for the Community.

Legal Aspects

11. In refusing to comply with a valid instruction from the Commission to transfer money to the EEC Bank of England Account we would be failing to carry out a legal obligation. The Commission could go to the European Court and obtain an order directing us to pay. This could happen in a matter of weeks.

12. Our public posture should however be that our action in withholding pending a settlement of our problem was justified because in our view the institutions of the Community had failed in a duty to redress a situation inconsistent with certain basic provisions of the Treaty. This is not the same as saying that we would win a case against our withholding in the European Court on such an argument. The Attorney General has advised that we would not.

13. The question whether we should ourselves initiate Article 175 proceedings in the Court (arguing as in the preceding paragraph) has been considered. Work is in progress to enable the Law Officers to form a final view. However the Attorney General has so far considered it doubtful whether such an action would succeed, and has added that any chances of success would be reduced by prior withholding.

14. The Commission would be under obligation to take us to the Court on withholding but they have some discretion about the speed at which they would proceed. We for our part need to be clear whether we would intend to comply with a Court ruling against us before we had reached agreement on the budget question. If so, withholding would be shown to be little more than a demonstration.

15. The question of UK legislation arises because the Council Regulation governing our payments to the budget is directly enforceable in the UK under Section 2(1) of the European Communities Act 1972. There is a risk of action in a UK Court to oblige the UK Government to meet its obligations, though it is unlikely that the Commission would resort to that as a first step. To eliminate all risk of action in a UK court it would be necessary to legislate to amend the European Communities Act. This would itself appear to be contrary to the Treaty of Rome. The wider implications would clearly need further study.

Implications

16. We do not in this paper attempt to set out a view on whether withholding would exert quicker and/or more effective pressure on other Member States than widespread destruction of Community business and whether it would make easier in the end to get them to concede more of our case. There are differences of view on this. There would be a risk that our partners would refuse to negotiate in the circumstances. But after the French precedent on lamb, which has not been greeted with s such a refusal, it would be more difficult for them to take this line, especially if we made it clear that our withholding was temporary, pending a settlement of our budget problem. We need more time to make a considered assessment.

Announcement

17. If it were proposed to withhold, this would require a carefully prepared statement addressed first to the House of Commons. The question could arise swiftly if a second early meeting on the budget were refused at Dublin and the Prime Minister wished to make an early statement on Dublin and the Government's response.
There would also be a question whether to give some prior warning, general or specific, to other Heads of Government at Dublin.

EEC BUDGET. "SOLUTIONS". COMMISSION SUGGESTIONS FOR ACTION ON UK RECEIPTS

Comment on the Commission suggestion that UK receipts could be increased by "immediate assistance for exploitation of coal resources, measures to promote transport infrastructure, and some agricultural improvement schemes"was contained in one of the attachments, headed "Solutions 4", the brief to PMVD(79)4A.

2. There will presumably not be time at Dublin for any detailed discussion of the kind of expenditure which would be financed. The UK's own choice will need inter-departmental discussion and decisions by Ministers. The Commission will need to make careful proposals about the form of the Community instrument which would authorise the payments, and the UK will have views on this too.

3. If the Council does agree to finance expenditure on an adequate scale to meet the UK's objectives, approved Departmental expenditure plans should easily throw up enough candidates. Some additional illustrative figures are given below.

4. But there are three points to watch.

5. First, though the Prime Minister may find it prudent not to say so during the discussion, the UK cannot accept proposals involving additional public expenditure here : the Community money must replace approved expenditure which would have taken place anyway.

6. Second, the procedures must be clean and quick acting. It will be no good setting up arrangements which require protracted discussion with the Commission about whether individual items of expenditure do or do not qualify. The money available must be exclusive to the UK, but the criteria, otherwise, broadly drawn.

7. Therefore there should be a clear understanding at Dublin about the total required to be disbursed each year.

8. On candidates, Community assistance with the National Coal Board's investment programme, as recently agreed by Ministers, need not, it is thought, leak into miners' wages. A bid of say £600 million in each of the next two years, and of say £300 million a year after that, could be justified.

9. On transport infrastructure there appears to be ground for seeking at least £100 million a year on a conservative estimate of what the Commission would regard as qualifying, and perhaps multiples of that on a more liberal interpretation. The total planned expenditure on road and rail transport is over £1 billion in 1980-81. The total cost of "EEC orientated" road transport infrastructure projects alone in 1980-84 is about £860 million.

10. Agricultural improvements would probably not produce large additional sums from the Community. In respect of half the £150 million planned expenditure on agricultural capital grants in 1980-81, and of all the £55 million for hill farmers, the Community already finance one quarter. To increase this to a half would bring in an extra £30 million. (We have to be particularly careful in this area of establishing precedents of which others, notably Ireland and Italy, could seek expensive advantage).

11. Other possibilities include Regional Development grants, (£366 million in 1980-81), Nuclear Energy (£132 million), Research and Development (£35 million), urban programmes (£140 million), quite apart from capital expenditure or schools (£385 million) and hospitals (£442 million).

12. Finally, the Community might take over some or all of the expenditure in Northern Ireland on fixed assets for various services : roads, industrial development, water and sewerage, hospitals. In 1980-81 these will cost £240 million.

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10 DOWNING STREET

B/F 29.11.79

From the Private Secretary

28 November 1979

Dear Tony,

UK Contribution to the Community Budget

As you will recall, OD discussed at its meeting on 24 October the question of withholding our contribution to the EEC budget in certain circumstances. OD concluded at the time that further contingency work was not necessary. However, in the light of ministerial discussion in the last 24 hours, the Prime Minister has now asked that further consideration should be given to the mechanics and legality of such action.

I should be grateful if you, in consultation with the copy recipients of this letter, could put in hand the drafting of a paper. It should cover the mechanics of withholding our contribution; the legality of doing so; the scale on which we might do so; the implications; and the way in which such action would be defended publicly.

The Prime Minister will need an interim assessment before departing for Dublin tomorrow morning. I have already discussed this with Sir Kenneth Couzens and he is preparing an interim paper. I am fully aware that it will be impossible to clear an interim paper fully in the time available. Where differences of view exist this should be made clear.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), Bill Beckett (Law Officers' Department) and Martin Vile (Cabinet Office).

Yours ever

Michael Alexander

A.M.W. Battishill, Esq.,
HM Treasury.

SECRET

Ref: A0796

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MR. ALEXANDER

cc Mr. Franklin
Mr. Fretwell, FCO
Mr. Middleton, Treasury

We have further revised the draft of the Prime Minister's Opening Statement for the discussion on the Budget at Dublin. I hope that the revision has sharpened the presentation up, and put the points in the sort of order which the Prime Minister wants, though I recognise that she will want to make further changes in the course of making the Statement her own.

RA

(Robert Armstrong)

28th November 1979

V. firmly <u>not</u> going to
read anything out. She
will extemporise on the basis
of a number of points which
she is going to draw up herself.

1. Public Expenditure W.P.
2. Reconciliation of W.P. ~~[illegible]~~ figures with the Community figures

CONFIDENTIAL

European Council, 29 November: Prime Minister's Opening Statement

I said at Strasbourg that my aim was to put the relationship of the United Kingdom and its partners in the European Community on a sound basis. I want now to explain again, why the vital interests of both the United Kingdom and the Community are at stake in this matter of the United Kingdom's budgetary contribution.

2. In 1980 the United Kingdom will transfer to the rest of the Community through the European Budget more - much more - than any other country. Six of the countries represented round this table are already much better off than we are. [We have just been discussing the current economic difficulties we all face; but] you are all growing more quickly than we are. With the exception of Germany, you at worst break even and in most cases benefit substantially from the Budget. That is, I think we all agree, an unacceptable situation: the sort of unacceptable situation to which, as the ~~Council of Ministers promised~~ Community told us in 1970, the very survival of the Community would demand that the institutions should find equitable solutions.

~~We in Britain are facing this sit'n at the same time as we are making these efforts~~

3. ~~[I am asking you to help me in the efforts which the Government are now taking] to restore the British economy. We have already taken painful measures. Public spending is being cut, in order simply to hold the level of public borrowing. Even so interest rates have risen to unprecedented levels. We are determined to keep the amount of money in circulation under strict control. I know you share my belief that these are the right measures - many of you have told me so in private and in public. [You cannot blame me for the fact that they were not taken earlier].~~

3. Commitment to Europe.

4. We are determined to honour our commitment to the defence of Europe. But we must face a hard time before the economy recovers. We are cutting our social programmes on health, education and welfare, and we are likely to have to cut further. [I do not ask that we should become net beneficiaries from the Community Budget - though I could make a case for that.]

4. Not asking to be net beneficiaries.

But when I am asking the British people to accept cuts in their own social standards, I cannot in the same breath ask them to shoulder a burden of over a thousand million pounds - equivalent to two per cent on direct personal taxation - to help other people in Community countries most of which are more prosperous and have stronger economies. That is the economic case. What of the political one?

5. My wish is to lead a strong Britain and take a full part in building a strong Europe. A Europe which is strong economically and strong in defence. We shall not be deflected from our commitment to Europe. We need the support of the British people - their positive support, as in the referendum four years ago, not just grudging acquiescence. But they are unanimous on this matter of our budgetary contributions. It is a major obstacle in the way of progress.

6. It is in our power, at this meeting, to set this obstacle aside. To set it aside in such a way that it does not return to plague us in two or three years' time. To set it aside so that we can all concentrate our efforts on the major challenges we face, in Europe and outside it, in the coming decade. That is the political case - not just for the United Kingdom but for the strength and effectiveness of the Community. We agreed in Strasbourg to take decisions at this meeting. We now have to complete that task.

7. The size of the budgetary problem is quite apparent from the documents which the Commission have placed upon us. The precise figure depends on allocating MCAs. In my view it is the exporter - not the importer - who benefits from the MCAs on the butter that comes into the United Kingdom from other Community countries. I know that some of you would argue differently, and we obviously cannot conduct any sort of discussion if we have to refer all the time to two sets of numbers. So I am willing to discuss the figures on an importer benefits MCA basis - 1552 million units of account instead of 1814 mua. If I were to accept that basis, I should already be accepting that we should be net contributors to the extent of 262 million units of account. So I must reserve my position on that, and may want to come back to it later.

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8. The United Kingdom has made its own suggestions for tackling the problem. Others of you do not like some of them, and they are not fully reflected in the latest Commission paper. That is disappointing to us. Nevertheless if others are willing to do so, I am ready to take the Commission's paper as a basis for our discussion. Their paper of 21st November (COM(79)680) shows that the problem can be solved within the framework of Community principles. I welcome that, because it enables us to concentrate our discussion on substance. The Commission's paper suggests a way forward in three areas.

9. First, on the structure of the Budget. The Commission ask us to endorse the principle of shifting the weight of Community expenditure from agriculture to structural and investment policies. This should have happened long ago ~~since~~. Such a move would be in the right direction, though it must not involve us all in more expenditure. But its effects can be only gradual, and would contribute little or nothing to solving the immediate problem. And its value will depend on how precise a directive the European Council is prepared to give that expenditure will be redirected.

10. Second, the 1975 Financial Mechanism. So far that has failed to benefit Britain ~~us~~. I hope that as part of a solution we can agree that it should have the restrictive elements in it renewed. To make sure that we do not move into similar difficulties in a year or two's time, this should include not only the balance of payments test, the 3 per cent limit and the tranche system but also the test of 85 per cent rather than simply below average GNP per head, and the 120 per cent growth criterion. With these changes the Financial Mechanism would reduce the United Kingdom contribution by 520 meua according to the normal method of financing. This would enable the Financial Mechanism to achieve its original purpose, and to offer a reasonable safeguard for the future on the contributions side.

11. But on its own it is not enough. We should still be paying net more than a thousand million units of account. We should still be contributing not far short of Germany, and vastly more than France which has a GNP about 50 per cent greater than that of the United Kingdom. It would not put the Community budget on to a sound basis or meet economic or political necessities in the United Kingdom

12. Well over half of our budgetary problem arises from inadequate receipts from Community policies. We are in a unique position here. On any reckoning our receipts per head are less than half the Community average. From the Commission report prepared at the time of our accession negotiations in 1970 (GB/33/70) we were entitled to expect that we should by now be getting a much higher share of receipts than has materialised. The third Commission suggestion is therefore a necessary component in any solution.

13. They have suggested that we should look at special measures over a period of years to increase the low level of our receipts. We have suggested a straightforward mechanism to do just that. This would be simple, direct and effective. We should not lose sight of this suggestion. But if you prefer we can explore the idea of extra receipts linked with United Kingdom public expenditure of a structural character and based on Community policies as suggested by the Commission. They have given some examples.

14. But token amounts will not do. If United Kingdom receipts per head were brought in line with the Community average, the United Kingdom would get 1400 meua. I could of course justify such a sum - but I do not ask for it. Something less - involving an addition of about 1000 meua of expenditure, which would reduce by about three quarters the gap between our receipts and the Community average, would, with the removal of the constraints in the 1975 Financial Mechanism, relieve the United Kingdom of transferring some

X 1550 million units of account in 1980, broadly equivalent to the 1552 which we are due to pay on an importer MCA basis. Looking at it on the "exporter pays MCA" basis, we should still be contributing a net 265 million units of account to the Budget.

15. This is the way in which I invite the Council to deal with the problem: by a combination of the financial mechanism relieved of restraints, and extra receipts under a special regime up to a clearly prescribed level. We can ask the Commission to work out the details. But, as they quite rightly tell us, it is for us to determine the amounts.

16. On the basis I have suggested to you, the pattern of payments and benefits would then be fair. The arrangements would need to last as long as the problem to which they relate. We should not then need to have this sort of discussion again. We should have done more than avert a crisis. We should have taken a major step towards putting the finances of the Community on a sound and durable basis. We should have shown Community solidarity and we should have strengthened it internationally, at a time when the world needs a strong Europe, able to give a clear lead to the councils of the world.

f.s.

Foreign and Commonwealth Office

London SW1A 2AH

28 November 1979

Dear Mr Alexander,

Prime Minister

2

not much

European Parliament

In your letter of 27 November, you asked for further information about the European Parliament's and the Council's budgets for 1980.

A direct comparison between the two institutions is made difficult because the Council normally cuts back the estimates prepared by the Council Secretariat before they are included in the Commission's preliminary draft budget. This year such cuts amounted to 9 mEUA (a 7.7% decrease) and involved in cutting back the number of new posts for 1980 from 84 to 52. There was no further need for cuts after this, and so the amounts entered in the Commission's preliminary draft budget and in the draft budget established by the Budget Council on 13 September were the same. Hence Mr Scott-Hopkins' observation that the Council had failed to cut their budget.

In a normal year the same procedure would be followed in the Parliament as in the Council; they would present their firm estimates, already trimmed, at the earliest stage of the budget procedure. But because the original passage included in the preliminary draft budget was prepared by the old Parliament, the new Parliament's Committee on budgets went into the estimates again in October. As a result of their amendments overall expenditure was raised by 9.5mEUA, an increase of 5.7% over the amount in the draft budget (and the number of posts increased by 240). This takes account of cuts by the Committee on Budgets in some of the more extravagant proposals of the Parliament's Secretariat, but the fact remains that there was an overall increase in the amount for the Parliament included in the draft budget before the Second Budget Council.

In his remarks to the Prime Minister Mr Scott-Hopkins thus took account in the case of the Parliament's budget of the cuts in the budget proposals of the Parliament Secretariat but not of the actual increase in the Parliament's budget over the

/preliminary

M O'D B Alexander Esq
10 Downing Street

preliminary draft; nor in the case of the Council's budget did he take account of the cuts made by the Council on the proposals of the Council Secretariat (of which he may not have been aware).

Yours ever,

pp Janice Banks

(P Lever)
Private Secretary

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Prime Minister
Ruth

UK BUDGETARY CONTRIBUTIONS: ROY JENKINS' MEETINGS WITH HEADS OF GOVERNMENT.

1 A CLOSE CONTACT IN THE COMMISSION HAS GIVEN US AN ACCOUNT OF THE MAIN POINTS MADE BY PRESIDENT GISCARD D'ESTAING AT HIS MEETING WITH ROY JENKINS ON 23 NOVEMBER.

2. AS REGARDS THE UK'S BUDGET CONTRIBUTION GISCARD IS SAID TO HAVE ARGUED THAT THE COMMISSION'S ESTIMATE OF OVER 1500 MEUA GROSSLY EXAGGERRATED THE POSITION. THE TRUE FIGURE WAS 300-350 MEUA. GISCARD MADE TWO OTHER MAIN POINTS:-

(A) HE WOULD NOT AGREE TO ANY NEW SOLUTION TO THE UK PROBLEM UNLESS THERE WAS AT THE SAME TIME AGREEMENT ON A SHEEP MEAT REGIME SATISFACTORY TO FRANCE:

(B) IF THE UK ARGUED THAT THEY SHOULD NOT BE A NET CONTRIBUTOR TO THE COMMUNITY BUDGET, HE WOULD BE READY TO ARGUE THE SAME SHOULD APPLY FOR FRANCE, THOUGH PROBABLY NOT AT THE OUTSET OF THE DISCUSSION.

MORE GENERALLY HE REPEATED THE FAMILIAR FRENCH VIEW THAT THE UK WAS ASKING FOR TOO MUCH AT DUBLIN.

CAP.

3. ON THE CAP GISCARD APPEARED TO SUGGEST THAT THE COMMUNITY SHOULD MOVE TOWARDS A SYSTEM OF GUARANTEEING MINIMUM INCOME LEVELS TO FARMERS. AT PRESENT THIS WOULD MOST BENEFIT THE ITALIANS, BUT AFTER THEM THE FRENCH.

ENERGY.

4. GISCARD SAID THAT SCHMIDT WOULD WANT TO RAISE THE QUESTION OF NORTH SEA OIL PRICES, BUT SAID NOTHING TO SUGGEST THAT THIS WAS A MATTER OF CONCERN TO FRANCE.

COMMENT.

5. GISCARD'S REFERENCE TO A FIGURE OF 300-350 MEUA (SEE PARA 2 ABOVE) PRESUMABLY REFLECTS THE FAMILIAR FRENCH THESIS THAT IF OUR IMPORTS FROM THIRD COUNTRIES WERE BROUGHT INTO LINE WITH THE COMMUNITY AVERAGE, OUR EXCESS CONTRIBUTIONS ON THE REVENUE SIDE WOULD NOT EXCEED 350 MEUA. THIS FIGURE IS NOT, OF COURSE, COMPARABLE WITH OUR (WORD UNDERLINED) NET CONTRIBUTION OF 1552 MEUA. BUT THE POINT MAY HAVE BEEN MISUNDERSTOOD DTHER BY GISCARD OR ROY JENKINS. NEVERTHELESS, COMBINED WITH OTHER EVIDENCE EG THE ECO/FIN COUNCIL, IT SUGGESTS THAT GISCARD MAY BEGIN THE ARGUMENT IN DUBLIN WITH AN ATTACK ON THE REFERENCE PAPER FIGURES. HE MAY ALSO SEEK TO ARGUE THAT ANY REFUND UNDER THE FINANCIAL MECHANISM SHOULD BE LIMITED TO 300-350 MEUA ON THE GROUNDS THAT MORE THAN THIS WOULD QUOTE REWARD UNQUOTE THE UK FOR QUOTE NOT PLAYING THE COMMUNITY GAME UN-QUOTE. ROY JENKINS IS BEING BRIEFED TO GIVE A FIRM PRESENTATION OF THE FIGURES IN HIS OPENING STATEMENT.

6. ANOTHER CONTACT IN THE COMMISSION HAS TOLD US THAT, IN A TELEPHONE CONVERSATION BETWEEN ROY JENKINS AND CHANCELLOR SCHMIDT ON THE EVENING OF 26 NOVEMBER, THE LATTER HAD SAID THAT HE WOULD WISH TO BE HELPFUL AT DUBLIN, BUT THAT HE COULD NOT TAKE A LEAD. HE WAS FAVOURABLE ABOUT REMOVING THE RESTRAINTS ON THE DUBLIN MECHANISM. HE WAS COOL ABOUT THE COMMISSION'S PROPOSED SPECIAL INVESTMENT PROGRAMME BUT ENTHUSIASTIC ABOUT ITS PAPER ON THE CAP, ESPECIALLY PARAGRAPHS 4 AND 5.

7. FINALLY, TICKELL, CHEF DE CABINET TO ROY JENKINS, GAVE US THIS EVENING ON INSTRUCTIONS FROM THE PRESIDENT A COPY OF HIS RECORD OF JENKINS' MEETING WITH THE NETHERLANDS PRIME MINISTER ON 19 NOVEMBER. THE PRESIDENT HAD THIS AFTERNOON SAID THAT HE THOUGHT YOU AND THE LORD PRIVY SEAL SHOULD SEE IT BEFORE DUBLIN. TICKELL ASKED THAT WE SHOULD TREAT THE DOCUMENT WITH PARTICULAR DISCRETION. COPIES FOLLOW TOMORROW BY HAND OF DRACE-FRANCIS. IT IS IN FACT LARGELY OVERTAKEN BY THE COMMISSION'S

/PROPOSAL

PROPOSAL OF 21 NOVEMBER. POINTS OF INTEREST FOR TOMORROW'S BRIEFING MEETING ARE THAT THE DUTCH PRIME MINISTER, FOREIGN MINISTER AND MINISTER OF ECONOMIC AFFAIRS ALL SAID THAT THERE SHOULD BE NO DIFFICULTY ABOUT REMOVING THE RESTRAINTS FROM THE CORRECTIVE MECHANISM. THEY FOUND ACTION ON THE RECEIPTS SIDE VERY DIFFICULT BUT DID NOT EXCLUDE IT. JENKINS SAID THAT OPENING UP INSTEAD THE PROSPECT OF A REBALANCING OF THE COMMUNITY BUDGET IN THE MEDIUM TERM WOULD NOT BE ENOUGH. THE DUTCH DOUBTED WHETHER IT WOULD BE POSSIBLE IN DUBLIN TO TIE UP THE DETAILS OF ANYTHING BEYOND CHANGES TO THE CORRECTIVE MECHANISM. ANYTHING ON THE RECEIPTS SIDE WOULD HAVE TO HAVE A COMMUNITY CHARACTER, BE LIMITED IN TIME AND AVOID JUSTE RETOUR. THE ONLY OTHER POINT OF INTEREST WAS THAT VAN DER KLAAUW VOLUNTEERED THAT THE COMMUNITY HAD MAJOR RESPONSIBILITIES TOWARDS THE OURSIDE WORLD, INCLUDING NEW ZEALAND AND THAT IT WOULD BE WRONG TO MAKE THE COMMUNITY TOO PROTECTIONIST, IN EFFECT BY A FURTHER EXTENSIVE RE-ORDERING OF THE PATTERN OF UK TRADE.

FCO ADVANCE TO:-

FCO - PS/S OF S, PS/LPS, PS/PUS, BRIDGES, FRETWELL, SPRECKLEY
CAB - PS/SIR R. ARMSTRONG, FRANKLIN, ELLIOTT, WALSH
MAFF -EVANS
TSY - PS/CHANCELLOR, SIR K. COUZENS, JORDAN-MOSS, MRS HEDLEY-MILLER, ASHFORD
NO 10 - ALEXANDER
CSD - PS/LORD PRESIDENT

BUTLER

FILES
EID (I)
PS
PS/LPS
PS/PUS
LORD BRIDGES
MR FRETWELL

COPIES TO:
ADVANCE ADDRESSEES

[ADVANCED AS REQUESTED]

X-8

IMMEDIATE

E E C BUDGET [ADVANCES]

MR FRETWELL

HD/EID (I)

MR GOODENOUGH EID (I)

MR MACGREGOR EID (I)

MR ASHFORD TREASURY

MR SHORE TREASURY

~~MRS BLACKBURN~~ CABINET OFFICE

MR HORNE

PS. No 10. D.S

Prime Minister ②

27.11.79

CONFIDENTIAL

FM COPENHAGEN 271615Z NOV 79

TO IMMEDIATE FCO

TELEGRAM NUMBER 266 OF 27 NOVEMBER

INFO IMMEDIATE UKREP BRUSSELS, DUBLIN

YOUR TEL NO 1308 TO UKREP BRUSSELS: COMMUNITY BUDGET

1. I CALLED THIS MORNING ON ERSBOELL (SECOND PERMANENT SECRETARY, MFA) AND HOLM (EUROPEAN ADVISER TO THE PM) TO MAKE SURE THEY HAD RECEIVED A FULL ACCOUNT OF BUTLER'S STATEMENT IN COREPER AND TO SEE WHETHER THEY HAD ANY FURTHER THOUGHTS.

2. HOLM AGAIN MADE THE POINT THAT A SOLUTION MUST NECESSARILY INVOLVE PRINCIPALLY THE FRG AND FRANCE. DENMARK SHOULD BE ABLE TO GO ALONG WITH ANYTHING AGREED, PROVIDED ALWAYS THAT IT DID NOT DAMAGE THE CAP STRUCTURE, PARTICULARLY EXPORT RESTITUTION PAYMENTS (CF MY TELNO 234).

3. ERSBOELL SAW THE SITUATION AT DUBLIN AS DANGEROUS. THE ONLY WAY TO AVOID EITHER DAMAGE TO THE COMMUNITY OR ISOLATING BRITAIN WAS (AS WE HAVE URGED) TO WORK ON BOTH SIDES OF THE ACCOUNT, BUILDING, IN OUR WORDS, ON THE NEW ELEMENTS IN THE COMMISSION PAPER. HE HOPED THAT, ON UK EXPENDITURE, HEADS OF GOVERNMENT WOULD APPROVE THE PROPOSED 520 MEUA RELIEF TO THE UK AND THEN AGREE ON COMMUNITY AIMS FOR VARIOUS SECTORS (REGIONAL, INDUSTRIAL, FISHERIES, AGRICULTURE, ENERGY, EMS) WHICH TOGETHER MIGHT MEAN AS MUCH AS

COMMUNITY AIMS FOR VARIOUS SECTORS (REGIONAL, INDUSTRIAL, FISHERIES, AGRICULTURE, ENERGY, EMS) WHICH TOGETHER MIGHT MEAN AS MUCH AS 500 MEUA FOR UK RECEIPTS. (HE THOUGHT ROUGHLY 1,000 MEUA THE MAXIMUM WE COULD GET.) MINISTERS WOULD THEN LEAVE DUBLIN HAVING STRENGTHENED THE COMMUNITY BY ESTABLISHING GUIDELINES OVER A WIDE FIELD, COVERING POINTS OF INTEREST TO ALL MEMBERS. ERSBOELL HAD ADVISED MR ANKER JOERGENSEN IN THIS SENSE AND BELIEVED THAT HIS ADVICE WAS ACCEPTED. BUT HE REGRETFULLY OBSERVED THAT APPARENTLY NO ONE ELSE WAS YET THINKING ON THESE LINES.

4. ERSBOELL QUESTIONED OUR INSISTENCE THAT THE SOLUTION NOW FOUND SHOULD BE LASTING. WHILE HE ACCEPTED THE DRAWBACKS TO A REPEATED DEBATE, GIVEN THE POLICY DECISIONS FOR WHICH HE HOPED A PERIODICAL REVIEW WOULD PROVIDE A MEANS OF PRESSURE ON THE COMMUNITY AS A WHOLE TO IMPLEMENT THEM AND SO WOULD BE TO OUR ADVANTAGE.

5. EXPRESSING THE HOPE THAT DISCUSSION IN DUBLIN WOULD FOCUS ON THE POLITICAL QUESTIONS RATHER THAN DETAILED SUMS, ERSBOELL TOUCHED AGAIN ON OUR USE OF THE WORD ''INJUSTICE''. AS IT IS ACCEPTED THAT THERE IS A PROBLEM AND THAT THIS SHOULD BE DISCUSSED, THE RIGHT PROCEDURE WAS BEING FOLLOWED AND HE ARGUED THAT THE WORD WAS THEREFORE INAPPROPRIATE. HE CLEARLY READS INTO IT AN ACCUSATION OF DELIBERATE INTENT TO BE UNJUST, RATHER THAN A STATEMENT OF CIRCUMSTANCES, WHICH IS PERHAPS WHY IT RANKLES SO MUCH HERE.

WARBURTON

NNNN

SENT 27/1653Z DB/

RR ROME

RR LUXEMBOURG

IMMEDIATE

(10)

ADVANCE COPY

RC

GRS 750
CONFIDENTIAL
DESKBY 270000Z NOV
FM PARIS 271805Z NOV 79
TO IMMEDIATE FCO
TELEGRAM NUMBER 899 OF 27 NOVEMBER 1979
INFO IMMEDIATE UKREP BRUSSELS
INFO ROUTINE OTHER EEC POSTS

PS
PS/LPS
PS/PUS
Lord Bridges
Mr Fretwell
HD/EID(I)
~~PS~~/NO 10
Treasury (2)

Prime Minister (2)
27.11.79

MIPT
PREPARATIONS FOR DUBLIN SUMMIT:
FRENCH VIEWS AND TACTICS

[EEC BUDGET]

1. IN THA LAST COUPLE OF DAYS FRENCH OFFICIALS HAVE GIVEN US THE FOLLOWING INDICATIONS OF THE BRIEFING PREPARED FOR PRESIDENT GISCARD ON SPECIFIC AGENDA POINTS.

BUDGET/CONVERGENCE

2. IN ADDITION TO FAMILIAR ARGUMENTS IN SUPPORT OF AN UNSYMPATHETC LINE GISCARD WILL BE BRIEFED WITH A LIST OF THE INCOME FROM FEOGA EXPENDITURE RECEIVED PER HEAD OF THE AGRICULTURAL POPULATION IN EACH OF THE COMMUNITY COUNTRIES (CF APPLEYARD'S LETTER TO THOMSON OF 23 NOVEMBER). THIS LIST SHOWS THE ITALIANS AT THE BOTTOM , WITH BRITAIN AND FRANCE NEAR THE MIDDLE AND THE DANES WELL IN FRONT AT THE TOP.

CAP AND SHEEPMEAT

3. THE FRENCH PURPOSE IN RAISING SHEEPMEAT AT DUBLIN WILL BE TO PERSUADE THE EUROPEAN COUNCIL TO CALL ON AGRICULTURAL MINISTERS TO REACH FINAL DECISIONS ON A SHEEPMEAT REGIME BY 12 DECEMBER, SUBJECT TO WHICH THE FRENCH MIGHT OFFER TRANSITIONAL ARRANGEMENTS FOR APPLYING THE EUROPEAN COURT JUDGEMENT. FRENCH OFFICIALS ARE GOING TO BRUSSELS TODAY TO DISCUSS THIS AT THE COMMISSION'S SUGGESTION. M. BARRE REPEATED TO MR JENKINS LAST FRIDAY THAT FRANCE COULD NOT AGREE TO FREE CIRCULATION OF MUTTON WITHOUT A COMMON ORGANISATION, PROGRESSIVELY INTRODUCED. PRESIDENT GISCARD APPARENTLY TOLD MR JENKINS THAT IT WOULD BE POLITICALLY IMPOSSIBLE FOR HIM TO RETURN FROM DUBLIN HAVING

OF MUTTON WITHOUT A COMMON ORGANISATION, PROGRESSIVELY INTRODUCED. PRESIDENT GISCARD APPARENTLY TOLD MR JENKINS THAT IT WOULD BE POLITICALLY IMPOSSIBLE FOR HIM TO RETURN FROM DUBLIN HAVING AGREED TO A SOLUTION OF THE BRITISH BUDGETARY PROBLEM, WITHOUT HAVING ALSO SECURED THE MAIN LINES OF A SETTLEMENT ON SHEEPMEAT. ACCORDING TO ONE OF HIS ADVISERS, HE SAID IN ENGLISH QUOTE IT IS NOT THAT WE WILL NOT. IT IS THAT WE CANNOT UNQUOTE. M. MEHAIGNERIE MADE CLEAR TO MR WALKER YESTERDAY THAT THE FRENCH HAVE NO INTENTION OF MOVING ON THIS QUESTION FOR THE MOMENT.

ENERGY

4. THOUGH IT IS APPARENTLY STILL SUBJECT TO INTER-DEPARTMENTAL DISCUSSION, GISCARD MAY BE ADVISED TO SUGGEST A MAJOR NEW COMMUNITY DECLARATION ON DEVELOPING ALTERNATIVE SOURCES OF ENERGY (THOUGH WHEN I SPOKE TO WALH HE DID NOT SEEM TO ATTACHE IMPORTANCE TO THIS). PRESIDENT GISCARD WOULD START FROM THE PREMISE THAT THE EEC SHOULD NOT THREATEN THE OPEC COUNTRIES, BUT THAT SOMETHING IS STILL NEEDED TO ESTABLISH ITS CREDIBILITY WITH THEM. OFFICIALS CITE THE IMPACT MADE BY THE DECLARATION WHICH NASA MADE SOME YEARS AGO ABOUT PUTTING A MAN ON THE MOON EVEN THOUGH AT THE TIME THIS WAS STILL A LONGER-TERM AIM.

THREE WISE MEN

5. WAHL COMMENTED THAT THERE SHOULD BE NO PROBLEMS BETWEEN FRANCE AND BRITAIN ON THIS ISSUE. FOR FURTHER DETAILS OF THE QUAI'S PROBABLE BRIEFING SEE MIFT.

RELATIONS WITH THE EUROPEAN PARLIAMENT

6. PRESIDENT GISCARD IS EXPECTED TO PUT DOWN A MARKER ABOUT THE SITING OF COMMUNITY INSTITUTIONS AND TO DEPLORE THE EUROPEAN ASSEMBLY'S TENDENCY TO GRAVITATE TOWARDS LUXEMBOURG AND BRUSSELS. WAHL TOLD ME THAT THE FRENCH WANT TO GET BACK TO THE ORIGINAL CONCEPT OF HAVING THREE-QUARTERS OF THE ASSEMBLY'S SESSIONS AT STRASBOURG AND ONLY ONE-QUARTER AT LUXEMBOURG. HE SAID THAT THERE WAS A SUGGESTION MATURING THAT 7ØØ NEW POSTS SHOULD BE CREATED IN THE STAFF OF THE EUROPEAN ASSEMBLY. FRANCE WOULD WANT ALL THESE 7ØØ TO BE ESTABLISHED AT STRASBOURG WHERE AT PRESENT THERE WAS NO PERMANENT SECRETARIAT. THE FRENCH AUTHORITIES REALISED THAT BRITISH PARLIAMENTARIANS WERE CONCERNED ABOUT THE POOR COMMUNICATIONS BETWEEN LONDON AND STRASBOURG. FRANCE WAS READY TO IMPROVE THESE.

TELEMATIQUE

NO PERMANENT SECRETARIAT. THE FRENCH AUTHORITIES REALISED THAT BRITISH PARLIAMENTARIANS WERE CONCERNED ABOUT THE POOR COMMUNICATIONS BETWEEN LONDON AND STRASBOURG. FRANCE WAS READY TO IMPROVE THESE.

TELEMATIQUE

7. FRENCH OFFICIALS STILL ADAPT A TENTATIVE ATTITUDE TO THE COMMISSION'S PROPOSALS, POSSIBLE BECAUSE THEY HOPE TO TURN THEM TO ADVANTAGE LATER.

EMS

8. FRENCH OFFICIALS SAY THEY DO NOT SHARE THE BELGIAN CONCERN TO PRESS ON WITH THE SECOND STAGE OF EMS. THEY ARE CONTENT TO LET THE EXPERIMENT, SO FAR SUCCESSFUL , CONTINUE A BIT LONGER BEFORE ANOTHER MOVE IS MADE. IN THIS CONTEXT THEY HAVE NOTED THE PRIME MINISTER'S STATEMENT TO PRESIDENT GISCARD THAT THE UNITED KINGDOM IS IN PRINCIPLE IN FAVOUR OF JOINING BUT CANNOT DO SO AT PRESENT.
HIBBERT

CCN PAP EEEE PARA 1. LINE 1. WORD 2. SHOULD READ QUOTE THE UNQUOTE.

NNNN

SENT PARIS 27/1949Z MG/IYF

IMMEDIATE

YQW[illegible] XJVKXGTB HAVE AN OO FOR U OK TO GA KK

ADVANCE COPY

[7.6]

PS
PS/LPS
PS/MR HURD
PS/PUS
LORD BRIDGES
MR FRETWELL
HD/ECD(I)
MR ELLIOTT, CABINET OFFICE
PS/No ~~10~~ D/St.
MR EVANS, MAFF
{MISS WRIGHTS
{RMI8/G, TREASURY
RC

HRE GOES KK

LUXFO 007/27

OO FCO

PP BONN

PP COPENHAGEN

PP BRUSSELS

PP UKREP BRUSSELS

PP THE HAGUE

PP PARIS

PP ROME

PP DUBLIN

Prime Minister (2)
27.11.79

GRS 230
CONFIDENTIAL
FM LUXEMBOURG 271700Z
TO IMMEDIATE FCO
TELEGRAM NUMBER 341 OF 27 NOVEMBER 1979
INFO PRIORITY ALL EEC POSTS
YOUR TELNO 1308 OF 26 NOVEMBER TO UKREP BRUSSELS: BUDGET/
CONVERGENCE.

1. I PAID MY FIRST CALL THIS AFTERNOON ON M HELMINGER (MINISTER OF STATE AT THE FOREIGN MINISTRY) IN M THORN'S ABSENCE (HE WAS TODAY INVOLVED IN THE BUDGET DEBATE IN THE CHAMBER OF DEPUTIES AND IS TOMORROW GOING TO LONDON FOR AN HONORARY DEGREE). HELMINGER WILL BE GOING WITH WERNER TO DUBLIN. THORN WILL ONLY BE THERE FOR THE SECOND DAY.

2. I READ OUT THE CONTENTS OF YOUR TELEGRAM UNDER REFERENCE. HELMINGER'S REACTION WAS HELPFUL IN PRINCIPLE. HE SAID THAT LUXEMBOURG RECOGNISED THE SCOPE OF OUR PROBLEM AND THAT IT REQUIRED A POLITICAL SOLUTION. I HAD SAID THAT FOR US THE IMPORTANT THING WAS TO BE ABLE TO DEMONSTRATE TO THE BRITISH PUBLIC THAT THEY BELONGED TO A WORTHWHILE CLUB IN WHICH EVERYONE COULD HAVE ''FAIR DOS''. HELMINGER ACCEPTED THIS. HE SAID THAT, IN A WAY, LUXEMBOURG WELCOMED THE FACT THAT THIS WHOLE ISSUE HAD NOW COME TO A HEAD. IT GAVE THE COMMUNITY THE CHANCE TO RESHAPE ITS POLICIES TO ENSURE THAT THEY WOULD IN FUTURE OFFER A BETTER BALANCE. NO DOUBT WE WOULD ALL BE IN FOR A ROUGH RIDE. HE HOPED THAT, IN SEEKING THE CHANGES WE WANTED, THE UK WOULD SHOW ITS WILLINGNESS TO WORK POSITIVELY FOR MORE RELEVANT COMMUNITY POLICIES AND TO TAKE THE LEAD ON ISSUES LIKE ENERGY. I LEFT WITH HIM A COPY OF YOUR SPAAK FOUNDATION SPEECH OF 26 NOVEMBER.

THOMAS

NNNN

IMMEDIATE

SENT / RECD AT 271716Z MJA/

EUFO 010/27

OO FCO

OO UKREP BRUSSELS

OO BONN

OO COPENHAGEN

OO THE HAGUE

OO PARIS

OO DUBLIN

OO LUXEMBOURG

OO ROME

ADVANCE COPY

PS
PS/LPS
PS/MR HURD
PS/PUS
LORD BRIDGES
MR FRETWELL
Hd/ECD(I)(2)
PS/~~No 10~~ D/St.
MR ELLIOTT } CABINET
MR HORNE } OFFICE
MR EVANS, MAFF
MISS WRIGHT,
RM 18/G, TREASURY
RC

Prime Minister (2)

27.11.79

GRS 600
CONFIDENTIAL
FM BRUSSELS 271640Z NOV
TO IMMEDIATE FCO
TELEGRAM NUMBER 217 OF 27 NOVEMBER
INFO IMMEDIATE UKREP BRUSSELS AND OTHER EEC POSTS

YOUR TELNO 1308 TO UKREP : BUDGET/CONVERGENCE

1. I CALLED UPON DE SCHOUTHEETE, HEAD OF EUROPEAN ORGANISATIONS DEPARTMENT AT THE MFA TO UNDERLINE OUR CONCERN ABOUT THE OUTCOME OF THE DUBLIN MEETING. HE SAID THEY HAD BEEN IMPRESSED BY THE SWEEP OF YOUR SPEECH TO THE SPAAK FOUNDATION HERE THE EVENING BEFORE ON QUOTE EUROPEAN PERSPECTIVES UNQUOTE, BUT REALISED ONLY TOO WELL THAT THE POSITIVE IDEAS YOU HAD PUT FORWARD DEPENDED UPON A HAPPY ISSUE TO OUR BUDGETARY REQUESTS. ON THIS HE FELT VERY GLOOMY. ONLY A MIRACLE COULD PRODUCE A SOLUTION WHICH WOULD BEGIN TO SATISFY WHAT WE WERE DEMANDING.

2. HE THEN WENT OVER THE USUAL ARGUMENTS. HE REPEATED AGAIN THAT OUR PLEADING ON JUSTICE DID NOT WORK BECAUSE WE HAD ACCEPTED THE CLUB RULES. THIS INTELLECTUAL ARGUMENT REMAINS INEXPLICABLE TO ME BUT IT IS STRONGLY HELD. CURIOUSLY HE ACCEPTED THE ARGUMENT THAT THE COMMISSION HAD UNDERTAKEN DURING THE ACCESSION NEGOTIATIONS THAT QUOTE SHOULD AN UNACCEPTABLE SITUATION ARISE ETC UNQUOTE.

IT IS STRONGLY HELD. CURIOUSLY HE ACCEPTED THE ARGUMENT THAT THE COMMISSION HAD UNDERTAKEN DURING THE ACCESSION NEGOTIATIONS THAT QUOTE SHOULD AN UNACCEPTABLE SITUATION ARISE ETC UNQUOTE.

3. I GATHERED THAT MARTENS, THE PRIME MINISTER, HAS BEEN AUTHORISED TO ACCEPT CHANGES TO THE FINANCIAL MECHANISM WHICH MIGHT YIELD UP TO 520 MEUA (BUT SEE PARA 5A BELOW). HOWEVER THIS WOULD NOT BE EASY SINCE THE LIKELY BELGIAN CONTRIBUTION WOULD EQUAL THE SUM FOR WHICH MARTENS WAS RISKING THE FUTURE OF HIS GOVERNMENT BY COMPARABLE CUTS FROM THE SOCIAL BUDGET. I REMARKED THAT IF THIS SUM CAUSED SO MUCH DIFFICULTY TO THE BELGIAN GOVERNMENT, HOW MUCH MORE OF A PROBLEM WAS THE TOTAL SUM FOR US. DE SCHOUTHEETE EXPLAINED THAT MARTENS DARED NOT RISK OFFERING UP THIS CONCESSION AT DUBLIN IF IT WERE TO BE POCKETED WITHOUT PRODUCING ANY RESULT IN TERMS OF CONTINUED COOPERATION IN THE COMMUNITY. MARTENS WOULD FIND THAT IMPOSSIBLE TO DEFEND AGAINST CRITICISM FROM HIS LEFT WING PARTNERS. IF HE COULD SHOW THAT HE HAD HELPED A SOLUTION OF THE COMMUNITY PROBLEM BY CONTRIBUTION THIS SUM AND MAYBE SOME OTHER ELEMENTS SUCH AS UNDERTAKINGS ABOUT THE QUOTE REFORM UNQUOTE OF FUTURE COMMUNITY POLICIES, BELGIUM WOULD NOT OBJECT. SO MUCH WOULD DEPEND UPON THE TONE OF OUR DEMANDS.

4. I EXPRESSED THE FEAR THAT MARTENS AND OTHERS WOULD BE BOUND AT DUBLIN BY INADEQUATE POLICY DECISION AT THIS END BEFORE THEY LEFT, BUT HE THOUGHT MARTENS WOULD BE PREPARED TO TAKE SOME RISKS PROVIDED THE ATMOSPHERE WAS COOPERATIVE AND THEY WOULD LEAD TO A SUCCESSFUL ISSUE. BUT WE SHOULD NOT IMAGINE THE SUMS WOULD COME ANYWHERE NEAR OUR TOTAL AND THERE WAS DANGER ON THE RECEIPTS SIDE OF OPENING PANDORA'S BOX WITHOUT SO MANY RECIPIENTS STANDING ON THE SIDE LINES INCLUDING IRELAND, ITALY, AND WALLONIA.

5. BOTH COUNSELLOR AND COUNSELLOR COMMERCIAL WENT OVER THE GROUND SIMILARLY WITH THUYSBAERT IN THE PRIME MINISTER'S CABINET. IN THE COURSE OF A LONG RE-RUN OF FAMILIAR ARGUMENTS ON BOTH SIDES, THUYSBAERT STILL SEEMED RELUCTANT TO RECOGNISE THE DEGREE OF SERIOUSNESS WE ATTACH TO ACHIEVING BROAD BALANCE. HE MADE THREE COMMENTS WHICH SEEM LIKELY TO REFLECT THE POSITION THEY WILL ADOPT IN DUBLIN:-

A. THE COMMISSION PROPOSAL TO AMEND THE CORRECTIVE MECHANISM IS TOO GENEROUS. THE BELGIANS REGARD ABOUT 420 MUA AS BEING THE LIMIT OF WHAT SHOULD BE CONCEDED BY THIS MEANS (WE UNDERLINED THE VERY SUBSTANTIAL GAP WHICH WOULD BE LEFT).

B. THE BENELUX COUNTRIES SEE THEMSELVES AS HAVING A ROLE TO PLAY IF AND WHEN DEADLOCK IS REACHED, BUT THUYSBAERT CLEARLY ENVISAGED THE AREA OF NEGOTIATION TO RESOLVE A DEADLOCK AS BEING SOMEWHERE NEAR

.GENEROUS. THE BELGIANS REGARD ABOUT 420 MUA AS BEING THE LIMIT OF WHAT SHOULD BE CONCEDED BY THIS MEANS (WE UNDERLINED THE VERY SUBSTANTIAL GAP WHICH WOULD BE LEFT).

B. THE BENELUX COUNTRIES SEE THEMSELVES AS HAVING A ROLE TO PLAY IF AND WHEN DEADLOCK IS REACHED, BUT THUYSBAERT CLEARLY ENVISAGED THE AREA OF NEGOTIATION TO RESOLVE A DEADLOCK AS BEING SOMEWHERE NEAR THE FRENCH POSITION. (HE NATURALLY SOUGHT TO DISABUSE HIM OF ANY IDEA THAT THIS WOULD BE ACCEPTABLE).

C. MUCH WOULD DEPEND ON THE WAY THE BRITISH CASE WAS PRESENTED SEMI COLON BUT IT WOULD BE EASIER TO JUSTIFY MORE GENEROUS CONCESSIONS TO THE UK IF THEY WERE MADE IN THE CONTEXT OF A MAJOR NEW STEP FORWARD IN THE COMMUNITY'S DEVELOPMENT, EG COMMITMENT BY THE UK TO A EUROPEAN ENERGY POLICY DESIGNED TO HELP OUR PARTNERS. (WE POINTED TO THE SINGULAR UNWILLINGNESS OF OUR PARTNERS TO GIVE COAL THE SAME SORT OF PREFERENCE AS AGRICULTURAL PRODUCTS AND THE ABSURDITY OF EXPECTING THE UK TO SELL OIL CHEAP AS A QUOTE COMPENSATION UNQUOTE FOR WASTING OUR RESOURCES ON EXCESSIVE AMOUNTS OF OVER-PRICED FOODSTUFFS.)

CTN PARA 4 LINE 5 FOURTH WORD SHOULD READ WE NOT HE

WAKEFIELD

NNNN

IMMEDIATE

SENT AT 271805ZSH QRU
RECD AT 271805Z JJ

CONFIDENTIAL

Ref. A0779

PRIME MINISTER

Community Affairs

You will wish to tell the Cabinet that you saw Mr. Jenkins again on 26th November, and reaffirmed your general approach to our Budget problem at the European Council in Dublin later this week.

2. On the same subject, you could ask the Foreign and Commonwealth Secretary to report on his talks on 26th November with M. Simonet, the Belgian Foreign Minister; and the Lord Privy Seal ~~to report on his brief airport exchange with~~ Herr Dohnanyi, his German counterpart, on 22nd November.

3. The Chancellor of the Exchequer might be invited to report on the outcome of the 23rd November Budget Council, at which - as you agreed - the United Kingdom voted against the European Parliament's proposals to reduce CAP expenditure and introduce a discriminatory co-responsibility levy, whilst getting agreement to a statement by seven member states making clear their sympathy for the Parliament's objectives.

4. The Minister of Agriculture might be invited to give an account of his talks on fisheries matters with Mr. Dalsager, the new Danish Fisheries Minister, on 23rd November and with M. Le Theule, the French Fisheries Minister, on 26th November. On the same day he also discussed sheepmeat with M. Mehaignerie, the French Minister of Agriculture.

RTA

(Robert Armstrong)

27th November, 1979

Original on:
Euro Pol: Dublin Pol:
Oct 1979

COPY

Ref. A0764

MR. ALEXANDER

cc. Mr. Franklin
Mr. Middleton, Treasury
Mr. Fretwell, FCO

I attach notes for an opening statement by the Prime Minister on the budget item for the European Council at Dublin.

2. These notes are basically the work of Mr. Middleton, and are on the lines we discussed on 25th November. There is, however, one point at which we have suggested a slight modification of the line. On Sunday afternoon we talked about ending up with a "bid" for relief of some £1640 million units of account in 1980. It seems to us that, having at the outset expressed willingness to discuss the figures in terms of "importer pays MCA" and taking credit on that basis for a net contribution of 262 meua, the Prime Minister would be in danger of even further alienating the goodwill of her colleagues in Dublin if she ended up with a bid which significantly exceeded that figure.

3. I attach spare copies of the notes, in case the Prime Minister wishes to circulate them for consideration at this afternoon's restricted meeting.

ROBERT ARMSTRONG

(Robert Armstrong)

27th November, 1979

European Council, 29th November: Prime Minister's Opening Statement

I said at Strasbourg that my objective and that of my Government was to put the relationship of the United Kingdom and its partners in the European Community on a firm and lasting basis. I want now to explain again why the vital interests of both the United Kingdom and the Community are at stake in this matter of the United Kingdom's budgetary contribution.

2. In 1980 the United Kingdom will transfer to the rest of the Community through the European Budget more - much more - than any other country. Six of the countries represented round this table are already much better off than we are. You are all growing more quickly. With the exception of Germany, you at worst break even and in most cases benefit substantially from the Budget. That is, I think we all agree, an unacceptable situation: the sort of unacceptable situation to which, as the Council of Ministers promised in 1970, the very survival of the Community would demand that the institutions should find equitable solutions.

3. In asking for such a solution, I am asking our partners to help my colleagues and me in the efforts which we are now taking to restore the British economy. We have already taken painful measures. Public spending is being cut, in order simply to hold the level of public borrowing. Even so interest rates have risen to unprecedented levels. We are going to have to make even deeper inroads into the spending plans we inherited from our predecessors. We must spend less. We are determined to keep the amount of money in circulation under strict control. I know you share my belief that these are the right measures - many of you have told me so in private and in public. You cannot blame me for the fact that they were not taken earlier. But you also understand that we must face a hard time before the economy recovers.

4. We are determined to honour our commitment to the defence of Europe. That we have spared from the axe. But we are cutting our social programmes on health, education and welfare, and we are likely to have to cut further. I do not ask that we should become net beneficiaries from the Community Budget - though I could make a case for that. But when I am asking the British people to accept cuts in their own social standards, I cannot in the same breath ask them

to shoulder a burden of over a thousand million pounds - equivalent to two pence in every pound on direct personal taxation - to help other people in Community countries most of which are more prosperous and have stronger economies. How can I explain to them that this would be a reasonable outcome of Community policies?

5. Please do not think that this is an artificial or exaggerated difficulty. I am asking you to recognise that I have not only a serious economic problem but also a real and formidable political problem. My colleagues and I are fully committed to the development of the European Community and of making a success of British membership. But we need the support of the British people - their positive support, as in the referendum four years ago, not just grudging acquiescence. They are unanimous on this matter of our budgetary contribution. A solution to the budgetary problem is not only an economic necessity but also a political necessity - not just for the United Kingdom but for the strength and effectiveness of the Community.

6. My wish is to lead a strong Britain and take a full part in building a strong Europe. A Europe which is strong economically and strong in defence. We shall not be deflected from our commitment to Europe. But the unacceptable burden arising from the Budget is a major obstacle in the way of progress. It is in our power, at this meeting, to set this obstacle aside. To set it aside in such a way that it does not return to plague us in two or three years' time. To set it aside so that we can all concentrate our efforts on the major challenges we face, in Europe and outside it, in the coming decade.

7. The size of the budgetary problem is quite apparent from the documents which the Commission have placed before us. The British people will pay out, in 1980, 1814 million European Units of Account to people in other Community countries.

8. This precise figure rests on allocating MCAs to the exporter. I believe that to be right: in my view it is the exporter - not the importer - who benefits from the MCAs on the butter that comes into the United Kingdom from other Community countries. I know that some of you would argue differently, and we obviously cannot conduct any sort of discussion if we have to refer all the time

to two sets of numbers. So I am willing to discuss the figures on an importer benefits MCA basis. But that still makes the United Kingdom's contribution 1552 million units of account. If I were to accept that our contribution should be made on this basis, I should already be accepting that we should be net contributors to the extent of 262 million units of account. So I must reserve my position on that, and I may want to come back to it later.

9. The United Kingdom has made its own suggestions for tackling the problem. Others of you do not like some of them, and they are not fully reflected in the latest Commission paper. That is disappointing to us. Nevertheless if others are willing to do so, I am ready to take the Commission's paper as a basis for our discussion. I am grateful to the Commission for setting out the facts on the budgetary problem. Their paper of 21st November (COM(79) 680) shows that the problem can be solved within the framework of Community principles. I welcome that, because it enables us to concentrate our discussion on the really important issues. The Commission's paper suggests a way forward in three areas.

10. First, on the structure of the Budget. The Commission have asked us to endorse the principle that action should be taken to shift the weight of Community expenditure from agriculture to structural and investment policies. This should have happened long since. Such a move would be in the right direction, though it must not involve us all in <u>more</u> expenditure. But its effects can be only small in the short term, and would contribute little or nothing to solving the immediate problem. And its value will depend on how precise a directive the European Council is prepared to give that expenditure <u>will</u> be redirected.

11. Second, the 1975 Financial Mechanism. So far that has failed to benefit us, because we have been in the transitional period. I hope that as part of a solution we might be able to agree that the Mechanism should be reformed so as to remove the restrictive elements in it. So as to make sure that we do not move into similar difficulties in a year or two's time, I believe the restrictive elements to be removed should include not only the balance of payments test, the 3 per cent limit and the tranche system but also the test of 85 per cent rather than simply below average GNP per head, and the 120 per cent growth criterion.

With these changes the Financial Mechanism would reduce the United Kingdom contribution by 520 meua according to the normal method of financing. This would enable the Financial Mechanism at least to begin achieving its original purpose, and to offer a reasonable safeguard for the future on the contributions side.

12. But on its own it is not enough. We should still be paying net more than a thousand million units of account. We should still be contributing about the same as Germany, and vastly more than France which has a GNP about 50 per cent greater than that of the United Kingdom. It would not put the Community budget on to a sound basis or meet economic or political necessities in the United Kingdom.

13. It has to be recognised that the United Kingdom is in a unique position on receipts from Community policies. Well over half of our budgetary problem arises from inadequate receipts. On any reckoning United Kingdom receipts per head are less than half the Community average. The Commission report prepared at the time of our accession negotiations in 1970 (GB/33/70) shows that we were entitled to expect that we should by now be getting a much higher level of receipts than has materialised. The third Commission suggestion is therefore a necessary component in any solution.

14. The Commission have suggested that we should look at special measures over a period of years to increase the low level of United Kingdom receipts from the Community. We have suggested a straightforward mechanism to bring up United Kingdom receipts. This would be simple, direct and effective. We should not lose sight of this suggestion.

15. But if my colleagues find difficulty with that suggestion, I am ready to consider the idea of extra receipts linked with United Kingdom public expenditure of a structural character leading to economic improvement and based on Community policies. The Commission have made suggestions about the sort of expenditure involved.

16. But token amounts will not do, if Community expenditure in the United Kingdom is to be raised enough to bring the United Kingdom closer to the position of other member countries and thus to provide an adequate solution to the budgetary problem.

17. If United Kingdom receipts per head were by this means brought in line with the Community average, the United Kingdom would gain 1400 meua. I could of course justify such a sum - but, as I say, I do not ask for it. Something less - involving an addition of about a thousand million units of account of expenditure - to bring our receipts up to about 70 per cent of the Community average, would, together with the removal of the constraints in the 1975 Financial Mechanism, relieve the United Kingdom of transferring some 1550 million units of account in 1980, which is broadly equivalent to the 1552 which we are due to pay on an importer MCA basis. Looking at it on the "exporter pays MCA" basis, we should still be contributing a net 265 million units of account to the Budget.

18. This is the way in which I invite the Council to deal with the problem: by a combination of the financial mechansim relieved of restraints, and extra receipts under a special regime up to a clearly prescribed level. The Commission have proposed the methods and mechanisms, and we can ask them to work out the details. As they quite rightly tell us, it is for us to determine the amounts.

19. On the basis I have suggested to you, the pattern of payments and benefits would then be fair. The arrangements would need to last as long as the problem to which they relate. We should not then need to have this sort of discussion again. We should have done more than avert a crisis. We should have taken a major step towards putting the finances of the Community on a sound and durable basis. We should in doing so have shown the solidarity of the Community, and we should have strengthened it internationally, at a time when the world needs a strong Europe, able to give a clear lead to the councils of the world.

EUROP Pol 19 [illegible]

BF 28.11.79

10 DOWNING STREET

From the Private Secretary

27 November 1979

European Parliament

The Prime Minister has seen your letter to me of 21 November on this subject. Her general comment was that it would be better if neither the European Parliament nor the Council of Ministers had any increase in their respective budgets. She has also said that as she understood Mr. Scott-Hopkins, his point was that Parliament had reduced its own budget whereas the Council of Ministers had failed to reduce theirs. I would be grateful for a little further background on this point.

I am sending copies of this letter to Tony Battishill (Treasury) and Martin Vile (Cabinet Office).

M. O'D. B. ALEXANDER

Paul Lever, Esq.,
Foreign and Commonwealth Office.

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 4178

26 November 1979

Michael Alexander Esq
10 Downing Street
WHITEHALL

Dear Michael,

I attach a set of revised tables following yesterday's discussion:

a. Table 1 shows the net position after various sizes of refunds which might come up in discussion. It does this on both an exporter benefits and an importer benefits basis.

b. Table 2 shows the same information on an EUA per head basis and as a percentage of GNP. These are the figures which were shown in manuscript on the copy I handed over to the Prime Minister.

c. Table 3 shows how the refunds described in Table 1 would be financed by various countries on the alternative assumptions; first that all countries contribute, second that the less prosperous do not contribute.

d. Table 4 shows this lot of figures on an EUA per head basis, and as a percentage of GNP per head basis.

e. The remaining 2 tables provide more detail on the UK's Budget problem in 1980, including figures for UK receipts per head relative to the EEC average. Part B of the final table shows that if both per capita contributions and per capita receipts were brought into line with the EEC average (to achieve broad balance on the UK contribution), we should have to <u>increase</u> our gross contributions. Relative to GNP however, we have both excess contributions and deficient receipts.

Yours sincerely

Rachel Lomax

pp. P E MIDDLETON

Encs

TABLE 1. NET CONTRIBUTIONS IN 1980 : ALL COUNTRIES CONTRIBUTE TO UK REFUND meua

Country	BEFORE FINANCIAL MECHANISM	AFTER UK REFUND (GROSS) OF:			
		1814	1552	1000	630
Exporter benefits					
UK	-1814	-315	-531	-988	-1293
Germany	-1048	-1643	-1557	-1376	-1255
France	-19	-466	-402	-266	-174
Italy	+734	+536	+565	+625	+665
Netherlands	+422	+312	+328	+362	+384
Belgium	+550	+468	+480	+505	+521
Denmark	+370	+323	+329	+344	+353
Ireland	+513	+497	+500	+504	+508
Luxembourg	+292	+288	+289	+290	+291
Importer benefits					
UK	+1552	-53	-269	-726	-1031
Germany	-1107	-1702	-1616	-1435	-1314
France	-120	-567	-503	-367	-275
Italy	+871	+672	+702	+762	+802
Netherlands	+359	+249	+265	+299	+321
Belgium	+538	+456	+468	+493	+509
Denmark	+283	+236	+242	+257	+266
Ireland	+436	+420	+423	+427	+431
Luxembourg	+292	+288	+289	+290	+291

TABLE 2 : NET CONTRIBUTIONS IN 1980 : ALL COUNTRIES CONTRIBUTE TO UK REFUND

eua per head and as % of GNP

Country	BEFORE Financial Mechanism		AFTER UK REFUND (GROSS) OF: 1814		1552		1000		630	
	eua per head	as % GNP	eua per head	as % GNP	eua per head	as % GNP	eua per head	as % GNP	eua per head	as % GNP
Exporter benefits										
UK	-32.5	-0.59	- 5.6	-0.10	- 9.5	-0.17	-17.7	-0.32	-23.2	-0.42
Germany	-17.1	-0.18	-26.8	-0.28	-25.4	-0.26	-22.4	-0.23	-20.5	-0.21
France	- 0.4	-	- 8.7	-0.10	- 7.5	-0.08	- 5.0	-0.06	- 3.3	-0.04
Italy	+13.1	+0.27	+ 9.6	+0.20	+10.1	+0.21	+11.1	+0.23	+11.9	+0.25
Netherlands	+30.1	+0.34	+22.2	+0.25	+23.4	+0.27	+25.8	+0.30	+27.4	+0.31
Belgium	+55.7	+0.62	+47.4	+0.52	+48.6	+0.54	+51.2	+0.57	+52.8	+0.58
Denmark	+72.2	+0.68	+63.0	+0.59	+64.2	+0.60	+67.1	+0.63	+68.9	+0.65
Ireland	+157.7	+4.00	+152.8	+3.85	+153.7	+3.88	+154.9	+3.91	+156.2	+3.94
Luxembourg	+817.9	+6.64	+806.7	+6.55	+809.5	+6.57	+812.3	+6.59	+815.1	+6.61
Importer benefits										
UK	-27.8	-0.50	- 0.9	-0.01	- 4.8	-0.09	-13.0	-0.24	-18.5	-0.33
Germany	-18.1	-0.19	-27.8	-0.29	-26.4	-0.27	-23.4	-0.24	-21.4	-0.22
France	- 2.2	-0.03	-10.6	-0.12	- 9.4	-0.11	- 6.9	- 0.08	- 5.2	-0.06
Italy	+15.5	+0.32	+12.0	+0.25	+12.5	+0.26	+13.6	+0.28	+14.3	+0.30
Netherlands	+25.6	+0.29	+17.7	+0.20	+18.9	+0.22	+21.3	+0.24	+22.9	+0.26
Belgium	+54.5	+0.60	+46.2	+0.51	+47.4	+0.52	+49.9	+0.55	+51.6	+0.57
Denmark	+55.2	+0.52	+46.0	+0.43	+47.2	+0.44	+50.1	+0.47	+51.9	+0.49
Ireland	+134.0	+3.38	+129.1	+3.25	+130.0	+3.28	+131.3	+3.31	+132.5	+3.34
Luxembourg	+817.9	+6.64	+806.7	+6.55	+809.5	+6.57	+812.3	+6.59	+815.1	+6.61

TABLE 3 : EFFECT OF FINANCING UK REFUND (through normal VAT key)

meua

Country	% share cost	GROSS REFUND TO UK OF:-			
		1814	1552	1000	630
All countries contribute					
UK NET REFUND	17.4	+1499	+1283	+ 826	+ 521
Germany	32.8	- 595	- 509	- 328	- 207
France	24.7	- 447	- 383	- 247	- 155
Italy	10.9	- 198	- 169	- 109	- 69
Netherlands	6.1	- 110	- 94	- 60	- 38
Belgium	4.5	- 82	- 70	- 45	- 29
Denmark	2.6	- 47	- 41	- 26	- 17
Ireland	0.9	- 16	- 13	- 9	- 5
Luxembourg	0.2	- 4	- 3	- 2	- 1
Less prosperous excluded					
UK NET REFUND	-	+1814	+1552	+1000	+ 630
Germany	46.3	- 839	- 718	- 463	- 291
France	34.8	- 631	- 540	- 348	- 219
Italy	-	-	-	-	-
Netherlands	8.5	- 155	- 132	- 85	- 54
Belgium	6.4	- 116	- 99	- 64	- 40
Denmark	3.7	- 67	- 58	- 37	- 23
Ireland	-	-	-	-	-
Luxembourg	0.28	- 5	- 4	- 3	- 2

TABLE 4 : EFFECT OF FINANCING UK REFUND(through normal VAT key)

EUA per head/As % GNP

Country	GROSS REFUND TO UK OF :-							
	1814		1552		1000		630	
	eua per head	As % GNP	eua per head	As % GNP	eua per head	As % GNP	eua per head	As % GNP
All countries contribute								
UK net refund	26.8	+0.49	23.0	+0.42	14.8	+0.27	9.3	+0.17
Germany	-9.7	-0.10	-8.3	-0.09	-5.3	-0.06	-3.4	-0 03
France	-8.4	-0.10	-7.2	-0.08	-4.6	-0.05	-2.9	-0.03
Italy	-3.5	-0.07	-3.0	-0.06	-1.9	-0.04	-1.2	-0.03
Netherlands	-7.8	-0.09	-6.7	-0.08	-4.3	-0.05	-2.7	-0.03
Belgium	-8.3	-0.09	-7.1	-0.08	-4.6	-0.05	-2.9	-0.03
Denmark	-9.2	-0.09	-8.0	-0.08	-5.1	-0.05	-3.3	-0.03
Ireland	-4.9	-0.10	-4.0	-0.10	-2.8	-0.07	-1.5	-0.04
Luxembourg	-11.2	-0.09	-8.4	-0.07	-5.6	-0.05	-3.5	-0.03
Less prosperous excluded								
UK net refund	32.5	+0.59	27.8	+0.50	17.9	+0.30	11.3	+0.20
Germany	-13.7	-0.14	-11.7	-0.12	-7.6	-0.08	-4.7	-0.05
France	-11.8	-0.13	-10.1	-0.11	-6.5	-0.07	-4.1	-0.05
Italy	-	-	-	-	-	-	-	-
Netherlands	-11.0	-0.13	- 9.4	-0.11	-6.1	-0.07	-3.8	-0.04
Belgium	-11.8	-0.13	-10.1	-0.11	-6.5	-0.07	-4.1	-0.05
Denmark	-13.1	-0.12	-11.3	-0.11	-7.2	-0.07	-4.5	-0.04
Ireland	-	-	-	-	-	-	-	-
Luxembourg	-14.2	-0.12	-12.2	-0.10	-7.8	-0.06	-4.9	-0.04

THE UK'S BUDGET PROBLEM IN 1980

UK GNP share 16%; UK GNP per head as % EEC average approx.75%

Contributions	meua	EUA per head	UK as % EEC total	UK per head as % EEC per head
Agricultural levies	417	7.5	18.6	87.2
Customs duties	1370	24.5	26.7	123.7
VAT	1522	27.3	17.4	80.8
Other*	-196	-3.5	-3.5	100.0
Total contributions	3113	55.8	20.5	95.2
Receipts				
CAP Guarantee	857	15.4	7.6	35.4
Structural Funds	352	6.3	20.7	96.9
Investment, Energy and Industry	55	1.0	12.2	58.8
Other	297	5.3	16.7	77.9
Total receipts (incuding MCAs)	1561	28.0	10.3	47.8
Total receipts (excluding MCAs)	1299	23.3	8.5	39.8

*matching unallocated expenditure and Article 131

CHANGE TO UK BUDGETARY CONTRIBUTIONS

1F

A. Payments and Receipts in line with GNP share

	meua	As % net contribution: exporter pays (1814)	As % net contribution: importer pays (1552)
Excess contribution	676	37.3	43.6
Deficient receipts			
exporter benefits MCAs	1138	62.7	
importer benefits MCAs	876		56.4

B. Payments and Receipts per head in line with EEC average

	meua	As % net contribution: exporter pays (1814)	As % net contribution: importer pays (1552)
Contributions shortfall	158	-8.7	-10.2
Deficient receipts			
exporter benefits MCAs	1972	108.7	
importer benefits MCAs	1710		110.2

Prime ~~Minister~~

ABJ
Duty Clerk
26.11.

SECRET

Ref. A0763

PRIME MINISTER

Tactics on the Budget at Dublin and After

The purpose of your meeting with a restricted group of Ministers is to discuss tactics at and after the Dublin European Council.

2. The Defence and Oversea Policy Committee discussed this question on 24th October and concluded that we should only act within the law. This appeared to rule out withholding our contribution (I am finding out whether we could give the Bank of England a directive not to transfer monies out of an EEC account on the EEC's instruction). Instead the Committee endorsed the course proposed by the Foreign and Commonwealth Secretary, namely -

(a) We should demand that the European Council reconvene within a month and that meanwhile the Finance and Foreign Affairs Councils should concentrate all their efforts on finding a solution to our Budget problem.

(b) If sufficient progress was not made during that period, we should begin to let it be known that we were considering selective or general obstruction.

(c) If we still did not get our way at the resumed meeting, we should carry out our threat flexibly in a way that would maximise uncertainty in the minds of our partners whilst minimising the risks to our own interests.

(d) We should stress throughout our desire to return to full co-operation as soon as our Budget problem was solved.

3. Since then the Secretary of State for Trade, the Chancellor of the Exchequer and the Minister of Agriculture have each minuted you on alternative possibilities. A summary of their respective views is attached. In essence, the Secretary of State for Trade prefers an immediate attack on the CAP to the campaign of obstruction favoured by the Foreign and Commonwealth Secretary and OD; the Chancellor of the Exchequer is more concerned to carry our Budget objective through to a successful conclusion; and the Minister of Agriculture

while opposing a general obstruction campaign as well as Mr. Nott's ideas on de-budgetisation, favours using our insistence on a price freeze for 1980 as a lever to get what we want on the Budget.

4. The important point to bear in mind is that the process of hard negotiation has not yet begun, and will not begin until well into the Dublin meeting. At that meeting the most we can expect from the partners is de-constraining the financial mechanism (say, 520 meua) and a small something on receipts (say, 200 meua). You will probably go no further than to agree to talk in terms of "importer pays MCA" (say, 262 meua). So their position may imply a United Kingdom net contribution of about 1100 meua; yours will imply one of 262 meua. The gap is enormous.

5. This will create a "crisis of the Community". This is probably necessary, to bring home to the partners the strength of your need and commitment and the seriousness of the position.

6. No-one wants such a crisis: not you, not the partners. We want to be good Europeans - if the partners will give us the help we now need to make effective the policies we are pursuing, which will in turn help us not only to be good Europeans but also to be a stronger member of the Community. This is no time - the world under threat of inflation and recession, United States leadership faltering - for the Community to be paralysed by protracted crisis.

7. Therefore we press for a resumed meeting of the Council - no lesser body will do - to resolve the crisis. Obviously this will be possible only if you have not appeared to the partners to close the door completely on negotiation: your strength has to be combined with sufficient ~~direct~~ sweet reasonableness. The procedural outcome might be an invitation to the President of the Commission to explore possible solutions in the interval before the resumed Council (in fact, of course, there will be intense comings and goings). In terms of business, it could for the time being be as usual: obstruction need follow only after an unsuccessful second meeting of the Council.

8. If there was a breakdown at Dublin and no second meeting planned, we should have to think in terms of some degree of immediate obstruction. In that case one possibility could be to proceed in accordance with the decision already

taken by OD, in the light of the list of forthcoming Community decisions being prepared separately by the Foreign and Commonwealth Office. Another would be to address our campaign of obstruction only to Community expenditure decisions which would have an adverse effect on our net contribution. This would meet the reservations voiced by the Chancellor of the Exchequer, the Secretary of State for Trade and the Minister of Agriculture about a wide-ranging campaign of obstruction; and, by linking our action directly to the cause of our dispute, would make it more comprehensible to our partners and the public and enable us to maintain our positive commitment to the Community in other areas. It would also strike directly at the 1980 price fixing and the 1981 Budget.

9. If we were to get partial satisfaction, in the form of agreement on a revised financial mechanism and a commitment to further work on the receipts side of the problem, our response should clearly be adjusted to reflect this situation. In these circumstances we could refrain from open threats of obstruction but still ask for an extraordinary meeting of the European Council in January to keep the pressure up. Alternatively, if the commitment to further work was firm enough and the other member states genuinely needed more time, we could wait until the next regular European Council in March. But this would begin to detract from the sense of urgency with which we want the problem to be treated; and it would add to the risk that the financing of any solution to our Budget problem would get entangled with the question of the 1 per cent VAT ceiling. The obstruction option - whether general or limited to decisions adversely affecting our net contribution - would of course still remain open for use after that second Council.

RtA

(Robert Armstrong)

26th November, 1979

SECRET

EEC BUDGET - AFTER DUBLIN

SUMMARY OF MINISTERIAL VIEWS

1. In the correspondence initiated by the Secretary of State for Trade's minute of 14 November on the means of pressure open to us if we fail to get our way in Dublin, the position of the three Ministers concerned is as follows.

2. The Secretary of State for Trade argues that, while it is right for us not to take the lead in seeking reform of the CAP up to the Dublin European Council, we should make the CAP our main target thereafter if we do not get satisfaction on the budget and say so publicly immediately after Dublin. This will be better understood by the British public than the across the board obstruction campaign suggested by the Foreign and Commonwealth Secretary, and would cause less resentment among our partners.

3. To this end we should

(i) use the imminence of the VAT ceiling to present our case as an attempt to solve a Community rather than a purely national problem;

(ii) work for a shift towards partial national financing of the CAP (de-budgetization), perhaps on a 50-50 basis; and go in particular for a substantial cut in Community aid for milk, coupled with a headage payment per cow funded from national exchequers;

(iii) declare our resolve to block all developments in the CAP, including the 1980 price fixing, until the Community is prepared to tackle the problem of uncontrolled CAP expenditure;

(iv) bring the complex of CAP and 1% VAT ceiling issues forward for resolution in an early resumed European Council in February or March 1980.

4. The Chancellor of the Exchequer, in an undated minute, places his main continuing priority on securing a solution to our Budget problem through a corrective mechanism, and distinguishes between that and our long term objectives for reform of the CAP. He is therefore cool about de-budgetization of CAP expenditure at least until it is clear that spending cannot be kept within the 1% VAT ceiling, preferring to attack the CAP problem through a price freeze for surplus products rather than finding new means of financing extra expenditure. But he accepts that Mr Nott's ideas may have some value as a means of clothing our main budgetary objective in more European dress.

5. The Minister of Agriculture, in his minute of 21 November, opposes most of Mr Nott's ideas on the grounds that

(i) de-budgetisation will be unnegotiable, mainly because it would hit selectively at the Netherlands, Denmark and Ireland while failing to induce the Germans or French to change their agricultural policies;

(ii) de-budgetisation would produce inadequate savings in terms of our net contribution problem: even if half of current Community expenditure on the CAP were switched to national budgets our net contribution would be cut by only about 550 meua;

(iii) anyway headage payments on cows plus a reduction in milk prices would not help. If the headage payments were financed by the Community this would nearly double the present milk bill, and national financing would not be acceptable to the net exporting countries;

(iv) with all its difficulties, budgetary reform is much easier for our partners to swallow than drastic reform of the CAP.

6. Mr Walker concludes that, provided we can get a green pound devaluation first, we should insist on a price freeze for 1980. But we should use it as a lever for securing a solution to our Budget problem rather than a means of reforming the CAP. We should not block all major Community decisions, which might work to our own disadvantage. Instead we should decline to regard an unfavourable outcome at Dublin as final; announce that we shall carry on the fight for budgetary reform; and insist on a price freeze for 1980 in order to put maximum pressure on others to agree to what we want on the Budget.

CONFIDENTIAL

Original on: Euro Pol: Paris Meeting with Jenkins: May 79.

RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND THE PRESIDENT OF THE EUROPEAN COMMISSION, MR. ROY JENKINS, AT 10 DOWNING STREET ON MONDAY 26 NOVEMBER 1979 AT 1015

Euro Pol.

Present

The Prime Minister	Mr. Roy Jenkins
Mr. M. O'D. B. Alexander	Mr. C.C.C. Tickell

* * * * * * * * *

European Council Agenda

The Prime Minister said that she hoped the discussion in Dublin would get on to the problems of the Budget at an early stage in the proceedings. The first item on the agenda was to be the economic and social situation. She hoped that no-one would try to extend the discussion unduly. It was essential that there should be a serious discussion of the Budget problem followed by the issuing of clear instructions to officials so that they could draft overnight. If there were to be a discussion at dinner, there would have to be an official note-taker present. But her own preference would be to continue the pre-dinner discussion until 8 or 9 p.m. and to have a later dinner. Mr. Jenkins said that he agreed about the need for an early and substantive discussion of the Budget but that he thought a short preliminary discussion on a non-controversial subject would be useful. The only draw-back might be that some members of the Council might prefer a pause for thought in the discussion on the Budget before formulating instructions to officials.

The Budget

The Prime Minister said that she hoped other members of the Council would come to Dublin prepared to move from their present positions. She was not prepared to change her own demands. She was looking for a refund lying somewhere between the present net contribution on an importer pays basis (1552 meua) and that

CONFIDENTIAL /on an

on an exporter pays basis (1814 meau). She wanted all restrictions removed from the financial mechanism and she wanted a solution which would last as long as the problem. She did not want to have to go through the present argument again in three or four years' time. Mr. Jenkins observed that to seek to have the 85 per cent of GDP qualification removed from the financial mechanism would instantly precipitate an argument about the duration of the solution being sought by the UK. He added that there was no chance of securing in Dublin a settlement on the figures indicated by the Prime Minister. The Prime Minister replied that she considered she had a good chance of getting a settlement on the basis she wanted before she had finished with the problem. In any case she could not settle for less. Failure to produce an equitable solution would lead to intensified demands in the UK for our departure from the Community. The Government would then find itself in the unenviable position of having to defend British membership of an organisation to which our contribution was demonstrably inequitable. Nonetheless she had no intention of leaving the Community and intended to make this plain in Dublin. She was not seeking a renegotiation on 1975 lines. The question of British membership was not at issue. But Britain had too strong a case to settle for less than broad balance. Indeed Britain ought to be a beneficiary from the Budget. She had perhaps been unwise in giving up this card at such an early stage in the discussion: as it was she did not intend to surrender a penny more. There would be a very genuine crisis unless and until Britain got what it was fully justified in demanding.

Mr. Jenkins said that he was glad that the Prime Minister had no intention of leaving. He agreed that there was no mechanism for expelling a member. Britain's departure from the Community would be a disaster for everyone. A number of members of the Community clearly wished to be helpful. The Benelux countries and the Federal Republic would make no difficulties about agreeing on an unrestricted financial mechanism

/and on

and on something on the receipts side. Ireland would try to provide fair Chairmanship and to help to a limited degree though their position was not so very far from that of France. Italy was "all over the place" and had recently changed their position on the CAP in an unhelpful, and probably unwise, manner. The French and the Danes were likely to be most difficult. President Giscard in particular was likely to deploy a series of casuistical arguments against the British claim. He had claimed in discussion with Mr. Jenkins in Paris on the previous Friday, that Britain had no reason to complain about the CAP because in terms of receipts per head of the farming population she was doing well. Mr. Jenkins said that he had never seen President Giscard as unimpressive as he had been during the course of this discussion.

Mr. Jenkins asked the Prime Minister what she would do if half way through the Dublin meeting it was clear that she could get agreement on a drive against the distortions in the CAP; on an unqualified financial mechanism; and on the opening of a window on the receipts side of the Budget. This would be regarded by many as a triumph. The Prime Minister said that she would reply that it was not enough. Agreement on reform of the CAP would, of course, be important. But it would also be very difficult to implement and would not produce any money in the short term. She wanted a solution on the financial side in 1980/81. Mr. Jenkins said that in these circumstances there could be no solution in Dublin. The various parties were not within hailing distance of each other. What would happen then? The Prime Minister said that she would be prepared to extend the meeting over the weekend. Mr. Jenkins expressed scepticism and mentioned the possibility of a further meeting later. The Prime Minister said that the Community had already had a long time to think about Britain's problem. She was not clear why a resumed meeting some weeks later would produce better results than those on offer in Dublin.

/Mr. Jenkins

Mr. Jenkins said that if there were no solution and if, as the Prime Minister had already said, Britain remained a member, he assumed that the Government intended not to behave illegally. The Prime Minister said that the French had shown the way on this. But, leaving on one side the question of what would or would not be legal, there would be no movement within the Community until Britain got satisfaction.

She did not want Mr. Jenkins to pass this message on because she did not wish other members to think that they were being threatened. Mr. Jenkins said that he would not tell anyone else what the Prime Minister had said. He wondered whether Britain could afford to block all movement. This would, for instance, mean that there would be no agricultural price settlement and no special measures for milk. Last year's prices would obtain. How long could Britain's farmers tolerate this position in a year when inflation was expected to run at 16 or 17 per cent? The Prime Minister repeated that there would be no movement in the Community until Britain received satisfaction.

Mr. Jenkins said that the Prime Minister's position on other issues might be important in Dublin. In making the point, he did not have in mind direct linkage so much as the need to create a good atmosphere. Chancellor Schmidt thought he had a grievance about oil prices. He believed that Britain was taking the lead in pushing up oil prices. The Prime Minister denied this and pointed out that we followed the Libyans, Algerians and Nigerians in charging the OPEC prices for quality crude. Mr. Jenkins asked about the prospects for a fisheries agreement. He said that the discussions were not going too badly. The Prime Minister was non-committal but stressed the need for adequate conservation provisions in any agreement. Mr. Jenkins asked about membership of EMS. The Belgians and the Germans would very much like to see Britain join. The Prime Minister

/said that

said that in the end she would like to join the mechanism but that it was difficult to do so now. Exchange controls had just been relaxed. If there were a collapse in Iran, sterling might go up very rapidly by 4 cents or more against the dollar. Finally, membership of the EMS might make it more difficult to control the money supply. Mr. Jenkins commented that if the Arabs were to switch out of dollars into deutschmarks, the Federal Republic would be equally vulnerable. A statement that Britain contemplated early membership of the EMS would have an excellent effect in Dublin. Membership of the EMS would also, of course, make some additional money available. Mr. Jenkins repeated that in making these suggestions, he did not have in mind bargaining but the need to create the impression that the new British Government was more communautaire than its predecessor.

The Prime Minister expressed impatience with the wish of the other members of the Community to have more evidence that the Government was Community minded. The Government had helped rescue the Europeans after the Tokyo Summit by offering to produce 5 million tonnes of oil more than our own national depletion policy would have indicated. We were providing major agricultural and industrial markets for our European partners. The effect of the CAP had been to raise prices here and to force us to take agricultural products we did not need. In asking for more, the other members of the Community were seeking to elevate expediency into a principle. It would be more helpful if they were to recognise what the new Government was trying to do in the UK to increase the GNP and to acknowledge that removal of Britain's budgetary burden would make this, and hence convergence, significantly easier. Britain's Budget contribution cost every British taxpayer 2p on the income tax. It was more than our entire aid budget. It made no sense at all.

/Mr. Jenkins

Mr. Jenkins said that he saw some danger of building up a head of steam in the UK on the budgetary question that could not be controlled. The Prime Minister said that there was already an uncontrollable head of steam. Mr. Jenkins said that there would have to be bargaining at some stage. The Prime Minister had taken up a very rigid position. Even Chancellor Schmidt was at present inclined to think the Prime Minister was being unreasonable. President Giscard was likely to take the line that whatever the Budget settlement, he would not agree to it until a solution had been found to the sheepmeat problem. The Prime Minister said that if, as a result of the difficulties, members of the Community began to say that they would prefer Britain to leave, they would in effect have lost the argument since they would be admitting that they could find the money themselves. Mr. Jenkins said that some might say they would prefer to find the money than to continue an apparently endless argument about Britain's contribution. The Prime Minister repeated that she wanted to achieve broad balance in 1980/81. She wanted a clear net gain of £1000 million give or take £50 million on either side. She recognised the difficulties of achieving this but considered it might be easier than the renegotiation of the CAP. Mr. Jenkins said that a restructuring of the CAP would have to be achieved in the next two years and before the 1 per cent VAT ceiling was breached since otherwise the Community would begin to collapse. The CAP lay at the root of Britain's problem. If it could be resolved, Britain's budgetary difficulties would be seen to be only temporary. Many of the other members of the Community were prepared to pay more to help overcome this temporary difficulty. Nonetheless, it would not be easy to find a solution. Other members had difficult budgetary situations. Adjustment of their budgets, even if the sums involved were not great, would be hard for them to make. The Prime Minister repeated that whatever the justification, the present situation was wrong and inequitable. She intended to stick to her demands. She had no intention of leaving the Community. She had no intention of boycotting meetings. Mr. Jenkins commented that the Dublin Council promised to be an interesting one.

/At the end

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At the end of the discussion, Mr. Tickell said that it would be useful to the Commission to know how the British Government would use any money that became available through the receipts window. He recalled that the Commission paper mentioned coal, transport and agricultural improvement as areas that might be explored. The Prime Minister undertook to have the necessary study done but stressed that any money that was forthcoming under this head would have to be used as a substitute for existing expenditure.

The meeting ended at 1115.

26 November 1979

Original in Euro Pol:
Dublin Policy: Oct 1979
Folder 2. Forming
PM's strategy for
Dublin Conference.

COVERING CONFIDENTIAL

Tf 02190

MR VILE

cc Mr Franklin
Mr Elliott
Mr Thomas (Treasury)

COMMISSION v PESC FIGURES FOR UK 1979 NET CONTRIBUTION TO THE COMMUNITY BUDGET

I attach a note for you to send to Tim Lankester in response to his minute to you of 22 November about the UK 1979 net contribution to the Community Budget. It has been cleared with the Treasury.

H G WALSH
23 November 1979

COVERING CONFIDENTIAL

1979 UK NET CONTRIBUTION TO THE COMMUNITY BUDGET

The figure for the expected out-turn for our net contribution to the Community Budget in 1979-80 contained in the Public Expenditure White Paper (Cmnd. 7746, page 10, table 2) is £919 million. This figure excludes about £30 million of Community aid expenditure, which is attributed elsewhere in the Survey, and includes a small amount for our contribution to the European Investment Bank and our receipts from the European Coal and Steel Community A figure for the 1979 calendar year consistent with the White Paper figure would be about £890 million. The equivalent of this figure in European Units of Accounts would be about 1367 MEUA.

2. The Commission figure referred to in Mr Lankester's minute (in Annex A of OMV(79)(2)(ii)) is 1254 MEUA on an "exporter-pays" MCA basis, which is the same basis as is used in the White Paper.

3. The difference of 113 MEUA between the two figures is accounted for by several factors. The White Paper figure is based on the latest Treasury forecasts of exchange rates and of UK payments of levies and duties; in particular, it takes account of the latest Supplementary Estimate to the 1979 Community Budget which added between 150 - 200 MEUA to the UK gross contribution. The Commission figures are based on earlier forecasts of levies and duties and of the total size of the Community Budget. They are also based on a different set of exchange rate assumptions.

4. The detailed assumptions made by the Commission in making their forecasts are not known and therefore a detailed reconciliation of their figure with that contained in Cmnd. 7746 is not possible.

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TO IMMEDIATE BONN
TELEGRAM NUMBER 408 OF 23 NOVEMBER
INFO IMMEDIATE UKREP BRUSSELS PARIS ROME THE HAGUE DUBLIN
COPENHAGEN BRUSSELS LUXEMBOURG

EEC BUDGET: UK CONTRIBUTION: TALKS WITH FRG MINISTER OF STATE
HERR VON DOHNANYI, DELAYED BY FOG AND TRAFFIC, ACHIEVED A TEN MINUTE MEETING WITH THE LORD PRIVY SEAL YESTERDAY EVENING (22 NOVEMBER).

2. DOHNANYI FIRST DREW ATTENTION TO THE IMPORTANCE OF THE UK VOTE ON THE PARLIAMENT'S AMENDMENTS TO THE GUARANTEE SECTION OF THE EEC DRAFT BUDGET AT THE BUDGET COUNCIL TODAY (23 NOVEMBER). IT WAS AN ISSUE WHICH WAS CRUCIAL TO FRANCE. IF THE UK WERE TO SUPPORT THE PARLIAMENT IT WOULD BE MORE DIFFICULT FOR THE FRG TO BE HELPFUL TO THE UK AT DUBLIN. THE FRENCH WOULD FIND IT VERY PROVOCATIVE. THE FRG MEANWHILE BELIEVED THAT THE WHOLE QUESTION OF RELATIONS WITH THE PARLIAMENT NEEDED TO BE REVIEWED BY THE COMMUNITY AFTER DUBLIN.

3. ON THE UK BUDGET ISSUE DOHNANYI SAID THAT THE FRG BELIEVED THAT IT WAS VIRTUALLY AGREED THAT BRITAIN WOULD BE OFFERED 520 MEUA (IE THE FINANCIAL MECHANISM SHORN OF RESTRAINTS). THE FRENCH WOULD FIGHT TO HAVE THE OFFER LIMITED TO TWO YEARS. MEANWHILE BRITAIN WOULD HAVE TO MAKE UP HER MIND ABOUT PROPOSING (AND WHICH HE IMPLIED WERE LIKELY TO BE AGREED IN PRINCIPLE AT DUBLIN) SHE COULD ACCEPT. THERE WOULD ALSO BE WHAT HE DESCRIBED AS QUITE HARD ASSURANCES ON FUTURE REDUCTION OF AGRICULTURAL EXPENDITURE. THE LORD PRIVY SEAL COMMENTED THAT THE COMMISSION'S CURRENT PROPOSALS ON SUGAR AND MILK WERE MORE LIKELY TO HARM THE UK THAN TO HELP US. DOHNANYI ALSO SAID THAT IT WOULD BE IMPORTANT FOR THE BRITISH TO SAY SOMETHING HELPFUL ABOUT ENERGY, FOR INSTANCE THAT SHE WOULD CONSULT HER PARTNERS ABOUT NORTH SEA OIL PRICES OR SOMETHING OF THAT SORT. HE REALISED THAT THIS WAS PURELY COSMETIC, BUT IT WOULD NEVERTHELESS BE IMPORTANT. HE MAINTAINED THAT THE FRG NOW APPRECIATED WHY IT WAS WE ADOPTED THE POLICIES WE DID. COMMENTING ON THE PROSPECT OF FAILURE TO AGREE AT DUBLIN, DOHNANYI CONFIRMED VIGOROUSLY THAT THE FRG WANTED BRITAIN TO STAY IN THE COMMUNITY. THE LORD PRIVY SEAL WARNED THAT BRITAIN COULD NOT LIVE WITH WHAT APPEARED TO BE ON OFFER. THE CONSEQUENCES OF FAILURE AT DUBLIN WERE GRIM.

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/4.

4. FROM WHAT DOHNANYI SAID IT APPEARED THAT THE FRG WERE PREPARED FOR THE TIME BEING TO GO ALONG WITH THE FRENCH POSITION ON SHEEP-MEAT, IE TO LIVE WITH THEIR DISREGARD FOR THE JUDGEMENT OF THE EUROPEAN COURT UNTIL AGREEMENT ON A REGIME HAD BEEN REACHED. BUT HE DID NOT APPEAR TO BE FULLY BRIEFED. THE LORD PRIVY SEAL SAID WHAT MATTERED WAS THAT THE FRENCH OBEYED THE LAW. BRITAIN WAS QUITE PREPARED TO LIVE WITH A LIGHT REGIME.

5. DOHNANYI TELEPHONED THE LORD PRIVY SEAL THIS MORNING TO CONTINUE THEIR CONVERSATION. HE REFERRED TO DISCUSSIONS HE HAD JUST HAD WITH RUGGIERO, CHEF DE CABINET TO THE ITALIAN FOREIGN MINISTER, AND SAID THAT HE HAD THE FEELING THINGS WERE SHAPING UP IN AN ACCEPTABLE WAY UNLESS THE BRITISH HAD CONTINUING PROBLEMS ON THE AMOUNT OF MONEY THAT THE COMMISSION'S PROPOSALS OFFERED. THE LORD PRIVY SEAL SAID THAT INDEED THIS WAS BRITAIN'S PROBLEM. WHAT WAS ON OFFER WAS NOWHERE NEAR WHAT WE WERE SEEKING, AND THE BENEFITS FROM THE SPECIAL MEASURES BEING PROPOSED BY THE COMMISSION WERE UNQUANTIFIABLE. IN ANY CASE THEY WERE UNLIKELY TO BE OF MUCH BENEFIT IN 1980 AND IN ORDER TO GET ANYWHERE NEAR SOLVING OUR PROBLEM ON THE RECEIPTS SIDE, THE SUMS INVOLVED WOULD HAVE TO BE IMMENSE. ON AGRICULTURE, HE CONFIRMED THAT THE COMMISSION'S PRESENT IDEAS DID NOT APPEAR LIKELY TO BE OF BENEFIT TO THE UK: RATHER THE OPPOSITE. BRITAIN WOULD PREFER PRICE RESTRAINT. DOHNANYI REMINDED THE LORD PRIVY SEAL THAT BRITAIN STILL HAD LEEWAY OVER THE GREEN POUND. THE FRG AND FRANCE WERE APPROACHING ELECTIONS. THE FRG WAS WITH BRITAIN IN WANTING TO KEEP TO THE 1 PERCENT VAT CEILING AND THUS WANTED CHANGES IN THE CAP. BUT THESE HAD TO BE POLITICALLY ACCEPTABLE.

6. DOHNANYI THEN WENT ON, SPEAKING PERSONALLY, AND ASKING THAT THE SUGGESTION SHOULD NOT BE ATTRIBUTED TO HIM, TO SUGGEST THAT WE MIGHT CONSIDER PUTTING FORWARD AT DUBLIN A REQUEST THAT THE COMMISSION STUDY WHETHER THE PROBLEM OF AGRICULTURAL SURPLUSES AND CONSUMER PRICES COULD NOT BE ADE EASIER IF IN ADDITION TO COMMON PRICING AND INTERVENTION POLICIES THERE WAS ALSO A POSSIBILITY OF NATIONAL INCOME CONTRIBUTIONS BEING INTRODUCED. SUCH A PROPOSAL WOULD HAVE THE SUPPORT OF GUNDELACH AND, HE IMPLIED, EVENTUALLY OF THE FRG GOVERNMENT. IT WOULD HAVE TO BE DONE IN SUCH A WAY THAT THE BULK OF COMMUNITY TRANSFERS UNDER THE CAP, AND ESPECIALLY ON THE MAIN COMMODITIES, REMAINED COMMUNITY FINANCED. HE SUGGESTED THAT OUR OFFICIALS MIGHT FLOAT THIS IDEA WITH THE COMMISSION BEFORE DUBLIN. THE LORD PRIVY SEAL TOOK NOTE.

7. THE LORD PRIVY SEAL INTIMATED THAT WE HAD CHANGED OUR POSITION ON VOTING ON THE PARLIAMENT'S AMENDMENTS ON THE GUARANTEE SECTION IN THE BUDGET COUNCIL TODAY. DOHNANYI MADE A PARTICULAR POINT OF SAYING HOW HELPFUL HE THOUGHT THIS DEVELOPMENT WOULD BE. ON THE GENERAL BUDGET ISSUE, HOWEVER, THE LORD PRIVY SEAL LEFT DOHNANYI IN NO DOUBT THAT WHAT APPEARED TO BE ON THE TABLE AT THE MOMENT CAME NOWHERE NEAR WHAT WE WANTED AND THAT THE OUTLOOK FOR DUBLIN WAS GLOOMY, NOT TO SAY STORMY.

CARRINGTON

FRAME ECONOMIC
EID
WED

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PS|LORD PRESIDENT
No10 DOWNING ST

1. [illegible] AW. 22/xi
2. CF.

Econ Pol
Subject file. Econ Pol.
Strategy - Pt 4

NOTE FOR THE RECORD

c. Mr. Alexander

The Chancellor called on the Prime Minister at 0900 hours this morning.

They discussed briefly the handling of the draft paper which the Treasury had sent over last night on "the Economic Outlook". The Prime Minister agreed that this should be circulated to a small group of Ministers. I have written to the Treasury accordingly, with the names of the Ministers whom the Prime Minister wants to be on this group.

They also discussed the Chancellor's minute of 21 November on our EEC contribution. The Chancellor said that he had pursued his enquiries on the possibilities of reducing or interrupting our contribution rather further than the FCO would have liked; but he felt that all avenues had to be explored. If it was not possible to achieve all that we wanted at the Dublin Council, it might be possible to follow through at the Budget Council meeting shortly thereafter.

The Prime Minister said that there seemed to be plenty of mechanisms for reducing our contribution, given the will. But she wanted to be clearer on precisely what the mechanisms were, and she would like to see more figures. The Chancellor said that the Treasury would be sending over additional material, which should meet the Prime Minister's requirements, by the weekend.

The Prime Minister said that Mr. Scott Hopkins had told her that supplementary estimates of £800 million were likely for this year; of which the UK's share would be £200 million. However, she was not sure that his figures were correct.

Turning to the debate on the EEC budget, the Chancellor explained that it had not been possible to have an FCO Minister speak in the debate. Neither Lord Carrington nor Sir Ian Gilmour were available; and therefore Mr. Peter Rees would be winding-up for the Government. The Prime Minister wondered why Mr. Ridley could not wind-up. The Chancellor explained that he had not had

/ anything

anything to do with EEC budget matters. The Prime Minister then said that she could not understand why Mr. Ridley was not working on economic issues. He was the only FCO Minister who understood economics. She intended to take this up with Lord Carrington (and asked to be reminded to do so).

T.L.

22 November 1979

CONFIDENTIAL

Euro Pol.

10 DOWNING STREET

From the Private Secretary

22 November 1979

<u>1980 Community Budget: Modifications by the European Parliament</u>

The Prime Minister and the Lord Privy Seal discussed your letter to me of 21 November after Cabinet this morning. The Prime Minister decided that we should support the modification proposed by the European Parliament which would result in a reduction of 380m EUA in expenditure on surplus milk production; and that we should oppose the modification providing for an increase in the co-responsibility levy on milk.

I am sending copies of this letter to Garth Waters (Ministry of Agriculture, Fisheries and Food), Martin Hall and Stephen Locke (H.M. Treasury), Jim Buckley (Lord President's Office) and Martin Vile (Cabinet Office).

M. O'D. B. ALEXANDER

TCR

Paul Lever, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

cc. Press Office

European Policy

10 DOWNING STREET

From the Private Secretary

22 November, 1979.

Thank you for your letter of 20 November about your plans to publish on 10 December a White Paper on Developments in the European Communities in the first nine months of this year. Subject to the comments of those who received copies of your letter, we have no objection.

I am sending copies of this letter to John Stevens (Office of the Chancellor of the Duchy of Lancaster), and Peter Moore (Chief Whip's Office).

N. J. SANDERS

E.R. Worsnop, Esq.,
Foreign and Commonwealth Office.

TWR

File

Euro Pol

DSG

b.c: Mr. Franklin, C.O.

10 DOWNING STREET

B/F 27-11-79

From the Private Secretary

MR. VILE

CABINET OFFICE

At the Prime Minister's meeting with the Chancellor of the Exchequer this morning, she referred to Annex A of the brief on the EEC Budget for President Giscard's visit. She expressed surprise that the figures for the UK's net contribution for 1979 were so much lower than the figure in the Public Expenditure White Paper. The difference may simply be because of the distinction between calendar and financial years. But I would be grateful for a short note explaining how the figures are reconciled.

T. P. LANKESTER

22 November 1979

I would be content if neither Parliament nor Council had any increases in posts. (2)

Prime Minister

Foreign and Commonwealth Office

London SW1A 2AH

21 November 1979

21/XI

Dear Michael,

COMMUNITY BUDGET: EUROPEAN PARLIAMENT

You asked for advice on two points raised by Mr Scott-Hopkins with the Prime Minister on this subject.

(1) HMG's attitude to the Parliament's own Budget proposals

Mr S-H's point was that Parliament had reduced its budget whereas the Council had not reduced theirs. Is that so?

Mr Scott-Hopkins asked why HMG were taking the lead in opposing the Parliament's proposed staff increases. In contrast, what action were HMG taking to reduce the Council's own budget in this area?

I enclose a minute of 16 November by the Lord Privy Seal setting out his views on the attitude the UK should adopt on this question. His proposals were agreed by OD(E). UKREP took this line in COREPER on 19 November (UKREP telegram No 6165). But we received little support from other Member States either for abrogating the 1970 Gentlemen's Agreement or over our concern at the size of the increases in staff proposed by the Parliament. It seems unlikely that we will receive significantly more support at the Budget Council itself on 23 November.

The Lord Privy Seal doubts whether it would be in the UK's interests at this moment to press a challenge to the European Parliament too hard. He is suggesting to Mr Lawson therefore that, at the Budget Council, the UK's position might be: not to insist, against a majority view, that the Council could reasonably behave as if the Gentlemen's Agreement had now lapsed; but to place on record our concern about the size of the proposed staff increases.

You will see from the Lord Privy Seal's minute of 16 November that the Council took a restrictive line on the staffing increases proposed by the other institutions. As far as the Council's own staff were concerned, although the Secretary General of the Council Secretariat asked for 84 posts (a fact which should not be revealed to the Parliament) to be added to the 1979 total of 1547, the Council reduced this to 52, an increase of 3.4%. This is in striking contrast to the Parliament's own total proposed increase of over 21%.

/(2)

But if Parliament had minority reduced its expenditure the Council - we'd be in difficulties.

M O'D B Alexander Esq
10 Downing Street

(2) HMG's attitude to the Commission's proposed third supplementary budget for 1979

Mr Scott-Hopkins said that he and his colleagues in the European Parliament were resisting this supplementary budget. What action were HMG taking?

This supplementary budget flows automatically from Agriculture Ministers' decisions at the price fixing in June. It was formally approved by the Budget Committee on behalf of the Council in late October, as the substantive decisions had been taken.

And we agreed! Without [illegible] properly the matter.

The draft was then forwarded to the European Parliament with a request for urgent consideration (and the required formal adoption) at its November session. The Parliament refused to be rushed and said they would consider it in due course. Their Committee on Budgets will take it up this week but it will not be formally voted until the Parliament's next session beginning on 10 December. They have the power to adopt or reject it. There is nothing the Council or Commission can now do.

The Commission are anxious because money is running short: they have already slowed down the rate of advances to Member States for CAP expenditure and these may shortly come to a halt. We have heard that the Commission is considering the possibility of circumventing this hold-up by making interest-free loans to Member States outside the normal budgetary framework from unspent balances to enable them to meet their obligations until the supplementary budget is approved. Mr Tugendhat is to address the Parliament's committee on Budgets about these loans shortly. It is still unclear whether the Council has a role here; our representatives will ask the Commission to clarify this point to COREPER today.

I am sending copies of this letter to Battishill (HM Treasury) and Vile (Cabinet Office).

Yours ever

Paul

(P Lever)

Financial Secretary

1980 COMMUNITY BUDGET : STAFF COMPLEMENTS FOR EUROPEAN PARLIAMENT

We need to decide what line the United Kingdom should take in COREPER on 19 November and subsequently at the Second Budget Council on the European Parliament's own Budget proposals including provision for extra staff for itself. In view of the institutional implications for relations between the Council and the Parliament, I am writing to propose a line.

The total provision in 1979 was for 2112 posts. This was raised by the Commission in its preliminary draft Budget for 1980 to 2329. The Parliament has now proposed raising this figure by a further 240 posts to a total of 2569, an increase over the 1979 figure of over 21%. This is a considerable rise, given that the 1979 figure included an additional 117 posts approved by the nominated Parliament, to meet the needs of the new directly-elected MEPs.

There are substantial arguments against the Council interfering at all in what the Parliament has proposed, although legally the Council is entitled to do so. The 1970 Gentlemen's Agreement between the institutions to abstain from amending each others budgets, lapsed in 1975 when the Treaty article to which it referred was superceded. The Parliament itself broke the agreement in one small respect in its comments on the 1978 Budget. But neither institution has made substantive use of its new freedom. For the Council to challenge the Parliament's staffing proposals would set an example which the Parliament could follow. If they did they would be in a strong position : whereas, under the budgetary procedure, the Council cannot enforce any change in this area on the Parliament, the Parliament itself, if it retaliated, could make cuts in the Council's budget.

/A further

A further consideration is that Robert Jackson MEP has fought hard to get the Parliament to exercise some self-restraint. It was largely as a result of his efforts that the proposed increase has been reduced to 240. The figure originally proposed within the Parliament was 325. United Kingdom support for Council intervention may undermine his position on the Budget Committee.

On the other hand the Parliament's demands seem excessive. They include for example a further 123 staff to serve the political groups even though each MEP already has allowances for a personal research assistant. The Parliament's proposals are in contrast to the restraint imposed by the First Budget Council in September on the staffing increases proposed by the other institutions. These proposals were reduced from 1170 to 462, a cut of about two-thirds, of which the Commission's request for an increase of 886 staff was reduced by 580. The Parliament's own request for an extra 217 staff was not reduced at all. The other institutions may resent the tough approach of the Council in respect of their proposals if the Parliament's own proposals survive unscathed.

The case for Council intervention is finely balanced. My own view is that, even at the cost of final abandonment of the Gentlemen's Agreement, we should not let the Parliament's proposals go unchallenged. We should have difficulty in defending before public opinion at home failure by the Council to act at a time of great financial stringency.

My proposal is that when this comes up in COREPER we should express strong concern at the Parliament's proposed increase and should urge that they be queried by the Presidency before the Budget Council. We should decide what attitude to take at the Second Budget Council in the light of the views expressed by our partners at COREPER and the outcome of the Presidency's enquiries if they are made; but, on the assumption that there was a substantial body of opinion in the Council willing to challenge the Parliament in this area, we should support such a challenge.

The question will arise what level of increases would be acceptable on the assumption that the principle of Council intervention is accepted. I suggest we might aim at a minimum cut of 50%. This would be less of a cut than the two-thirds imposed by the Council on the other institutions and would thus recognise the needs of the new, larger, Parliament.

/The Parliament

The Parliament has made a number of other amendments to its own draft Budget. These include three which colleagues may wish to consider in particular:

(1) A reduction in the amount available for rent of buildings to provide for one rather than the present two sites of the Parliament (Strasbourg and Luxembourg). Since a final decision on the site of the Parliament is for the Council not the Parliament to take, I propose that we resist this proposal.

(2) Token provision for the payment of members' salaries. Since the Council agreed last year that national Governments should be responsible for salaries, we should resist this provision too.

(3) Provision for generous secretarial and other allowances. Although there has been adverse public comments on the level of allowances set by the Parliament, I do not think that we should challenge what is proposed. Although the Council agreed last year that salaries should be the responsibility of national governments, it also agreed that allowances should be left to the Parliament to settle. The logic of resisting the cut at (2) above is to accept (3).

I am sending copies of this minute to other Members of OD(E) and to Sir Robert Armstrong. I apologise for the short notice, but I should be grateful to know if any colleagues disagree by 6.00pm today if possible, or at the very latest by 10.00am on Monday, at which time the meeting of COREPER in question begins.

16 November 1979

E E C BUDGET [ADVANCES]

Lord Bridges
~~MR FRETWELL~~

~~HD~~/EID (I)

MR GOODENOUGH EID (I)

MR MACGREGOR EID (I)

Mr Spreckley EID(I)

MR ASHFORD TREASURY

MR SHORE TREASURY

~~MRS BLACKBURN~~ CABINET OFFICE

Mr Home

Mr Walsh

RC

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TO IMMEDIATE FCO

TELEGRAM NUMBER 6165 OF 19 NOV

COREPER (DEPUTIES) 19 NOVEMBER: 1980 BUDGET.

BUDGET OF PARLIAMENT.

1. NICOLL (UK) SPOKE ALONG THE LINES OF THE LORD PRIVY SEAL'S MINUTE TO THE FINANCIAL SECRETARY OF 16 NOVEMBER. SPECIFICALLY HE SAID THAT, IF THERE WAS AGREEMENT TO ABROGATE THE SO - CALLED GENTLEMEN'S AGREEMENT, THE UK WOULD WISH TO OPPOSE AMENDMENTS NOS 340 (TOKEN ENTRY FOR SALARIES), 370 (RENT) AND 37 (VISITORS FEES) AND WOULD BE LIKELY TO LOOM UNFAVOURABLY ON AMENDMENT NO 328 (OTHER POLITICAL ACTIVITIES). IN ADDITION, THE UK WAS EXTREMELY CONCERNED ABOUT THE SIZE OF THE INCREASES I N STAFF WHICH THE PARLIAMENT WERE PROPOSING.

2. VIDAL (FRANCE) SAID THAT HIS GOVERNMENT COULD NOT ACCEPT EITHER AMENDMENT NO 340 OR AMENDMENT NO 370. THEY FELT THESE AMENDMENTS DEALT WITH SUBJECTS WHICH DID NOT FALL WITHIN THE PARLIAMENT'S COMPETENCE. MISCHO (LUXEMBOURG) ECHOED THIS VIEW.

3. NO OTHER DELEGATIONS EXPRESSED AN OPINION AT THIS STAGE.

4. THE PRESIDENCY SAID THAT THEY HAD ORIGINALLY HOPED TO ACT AS IF THE GENTLEMEN'S AGREEMENT WAS STILL IN FORCE. BUT,

4. THE PRESIDENCY SAID THAT THEY HAD ORIGINALLY [illegible] TO ACT AS IF THE GENTLEMEN'S AGREEMENT WAS STILL IN FORCE. BUT, FOLLOWING THE DISCUSSION, THEY WOULD NOW BE PLACING THE PARLIAMENT'S BUDGET BEFORE THE COUNCIL WITH THE PROVISIONAL POSITIONS TAKEN BY DELEGATIONS RECORDED. IT WOULD THEN BE FOR THE COUNCIL ITSELF TO DECIDE WHETHER TO ABROGATE THE GENTLEMENS AGREEMENT.

FCO PASS ADVANCE COPIES TO:-

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BUTLER.

NNNN

Budget
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PRIME MINISTER

Cabinet: Community Affairs

You may wish to inform the Cabinet about your discussions with President Giscard on 19th-20th November. On defence and foreign policy issues, you and your colleagues had a useful exchange, but on the budget issue there was no meeting of minds. The gap will be difficult to bridge in $1\frac{1}{2}$ days in Dublin. The French are clearly trying to make a link with sheepmeat, which President Giscard will raise at Dublin.

2. The Chancellor of the Exchequer and the Foreign and Commonwealth Secretary might be invited to report on the 19th November Finance Council and the 20th November Foreign Affairs Council respectively. There was no change in member states' attitudes on the budget issue. The Commission will be making further proposals on Wednesday, 21st November. The Germans made a link with recent oil price increases by BNOC, alleging that these increases had gone beyond OPEC agreed prices and giving notice that Chancellor Schmidt would raise this point in Dublin.

3. The Foreign and Commonwealth Secretary might also mention the Report of the Three Wise Men, which will be discussed in Dublin. As expected it recommends that the European Council should lay down, before 1981, a master plan of priorities for the Community as a whole; advocates a reduction in the number of Commissioners to 1 per member state; argues for greater delegation to the Commission and the Permanent Representatives Committee; and urges closer relations between the Council and the Commission on the one hand and the European Parliament on the other.

4. The Minister of Agriculture has recently discussed French intentions on sheepmeat with Commissioner Gundelach, and could report. The Commission will also be announcing this week its proposals for bringing the surpluses, especially of milk and sugar, under control.

M.V.
pp
(Robert Armstrong)

21st November, 1979

1

Prime Minister:
We discussed this yesterday.
My own inclination in all the circumstances would be to oppose the budget modifications proposed by the European Parliament. Agree?
M 21/XI

Could we ask Ian Gilmour. I think our M.P.'s helped to draft the budget amendment on milk surpluses and they would be angry if we failed to support them

Foreign and Commonwealth Office

London SW1A 2AH

21 November 1979

Dear Michael,

1980 COMMUNITY BUDGET: MODIFICATIONS BY THE EUROPEAN PARLIAMENT

You told me on the telephone that the Prime Minister had asked for advice on whether we should, at the Finance Council on 23 November, accept the Parliament's modification concerning the sums available for the support of milk prices. The possible courses of action are set out in the minute of 16 November by the Lord President of the Council to Mr Lawson. We are all, I think, agreed that we must vote against the Parliament's proposals on the co-responsibility levy.

There is no important matter of agricultural or budgetary policy immediately involved. The Parliament's modification relates to an estimated figure in the 1980 Budget and, in supporting the amendment, we would be following the logic of our own policy that milk prices, and therefore surpluses, should be held down as far as possible, as well as demonstrating some support to MEPs (particularly British) who take the same view. The actual prices, and consequently the real expenditure for 1980, will in fact be decided by Agriculture Ministers at the next price fixing and the Parliament's vote will not have any direct effect, whatever attitude the Council takes to it.

It follows therefore that it is open to us to support the Parliament on this point if we want to and if there is no stronger reason for us not doing so. We would not be infringing the Council agreement reached in March this year on the maximum rate since this applied only to non-obligatory (ie non-CAP) expenditure.

The issue therefore turns on the Prime Minister's talks with President Giscard and the impression which the President is likely to have gained. It is obviously important at this juncture to avoid a situation in which he can claim that by voting in favour of the Parliament's modification we have in some way gone back on an understanding he had reached with the Prime Minister. If, therefore, there is any possibility that President Giscard may have concluded from what the Prime Minister said to him that the UK would support French resistance to the Parliament's modification, the wisest course would be to instruct Mr Lawson to take this line in the Budget Council.

I am sending copies of this letter to Garth Waters (MAFF), Martin Hall (HM Treasury), Jim Buckley (Lord President's office) and Martin Vile (Cabinet Office).

Yours ever

Paul

(P Lever)

M O'D B Alexander Esq
10 Downing Street

21 NOV 1979

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(2)

Prime Minister

21.11.79

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

PRIME MINISTER

EEC CONTRIBUTION

As I was able to attend only a part of your meeting on Thursday last on our EEC contribution, I thought it might be helpful to send you a note of my views on some of the points discussed; and also to record some of the factual matters about which you asked.

2. We have to face the real possibility that what is on offer on our contribution at Dublin will fall far short of an acceptable solution. You might have to tell the other Heads of Government that this situation threatened a crisis in the Community. Your case remained as stated and there was no possibility of a settlement on or near the basis proposed. But in the hope of avoiding a crisis you were prepared to attend a further meeting at an early date devoted exclusively to this topic. It would be better still if the proposal for another meeting came from someone else. A proposal that the subject be placed on the agenda for the next regular European Council would not do, but we might have to accept a meeting in, say, January.

3. If such a meeting were agreed I think it would be essential to make it clear in advance of the meeting that if it did not produce an acceptable settlement, you would not thereafter be able to facilitate the operation of the Community. If there is to be a second meeting you need to strengthen your

hand for it, or there may be an expectation that you can be bought off with some minor additional concession. I think this is in line with earlier OD conclusions.

4. We expect to hear a proposal in Dublin that the present Financial Mechanism be improved to yield us about £350m. We could not accept that as a full solution, and under present machinery there would be no great hurry to do so anyway, since the refund would not come until the spring and summer of 1981. But it might be possible, without prejudicing our position, to let officials work out the details of the amendments to the Mechanism, even if they could not be legislated until a full settlement was reached.

5. Another point we need to consider is whether you should say at Dublin that we expect a refund worth perhaps £170m in respect of 1980 under the Mechanism as it stands. The Commission's "Solutions" paper of 31st October states that "under present conditions, the net payment to the UK from the Mechanism in respect of 1980 would be no more than 250 meua if there were to be a balance of payments deficit, and nothing if there were a surplus". So the "new money" on offer from an improved Mechanism is only half of £350m, and the additional burden on the others correspondingly modest. An alert domestic observer could readily spot this. But the £175m refund would bring our net contribution burden for 1980/81 down to a bit less than £900m instead of £1,050m (Commission figures on an "importer pays" treatment of MCAs).

6. If Dublin is to be followed by a further special meeting, the main line of our reply to public questioning about next steps would, I imagine, be to refer to that. If however there is to be no such meeting, I suggest your immediate

reaction might be to seek an interval for reflection by saying you would now want to consider the situation with your colleagues.

7. I gave some information at your meeting about the mechanics of our contribution to the Community and you also .... asked some questions about the legal position. I attach a note which sets out the facts about how our contribution is made. It refers also to what is being done to follow up the advice given by the Attorney General about a possible case under Article 175 of the Treaty of Rome for relief of our contribution position.

8. If we concluded, following an impasse in the negotiations, that such a case was worth pursuing, we could say publicly that in our view the Community instructions (in this case mainly the Council of Ministers) were failing to comply with the Treaty. We would be arguing that the law as expressed in the Treaty was on our side, not theirs. We would have to consider at what point it was wise to take such a case to the European Court, and take account of the risks of failure before the Court.

9. The arguments for going to the Court in this way could be considered on their own merits. But if we were reverting to the possibility of withholding, the better course might be to take the initiative and lodge our case first. This might be preferable to awaiting Commission proceedings against our withholding and then using our case under the Treaty as a defence.

10. I am copying this minute to the Foreign and Commonwealth Secretary, the Lord President, the Lord Privy Seal, the Attorney General and Sir Robert Armstrong.

(G.H.)

21 November 1979

ANNEX

I. THE PAYMENT OF THE COMMUNITY'S OWN RESOURCES

1. The EEC's "own resources" consist of

  i) Customs duties
  ii) Levies on agricultural imports
  iii) A tranche of VAT.

2. Subject to a 1% ceiling, the third item is used to "top up" the amount required for the Community's budget after the first two items have been used in full.

3. The following are the main steps in the payment of the "own resources":-

  i) Amounts due are "established" (eg the Customs "establish" the duty payable on a consignment of imports).

  ii) The amounts established are paid into the UK Consolidated Fund.

  iii) From the Consolidated Fund the amounts of levies and duties established are paid into the EEC's Account with the Paymaster General by the 20th day of the second month following establishment ie on 20 November 1979 a payment will be made to the EEC's Account in respect of levies and duties established in September.

  The VAT tranche is paid into the EEC's Account with the Paymaster General on the first day of each month.

  Any delay in making these payments into the Community's account attracts a penalty rate of interest on a rising scale, currently starting at 17% and rising at ¼% per month, the rate applicable at the end of the delay being applied retrospectively to the whole of the delay.

iv) The Commission draws on its Account with the Paymaster General to meet its obligations either (a) in the UK, or (b) in other member states. In the latter case the Commission transfers sums in the Account with the Paymaster General to an account at the Bank of England, for transmission elsewhere within the Community. So far this year about £700m has been transferred to other member states through the Bank of England Account.

The Community Regulations require that the orders and instructions sent by the Commission to HM Treasury relating to payments out of the Account with the Paymaster General shall be "carried out as soon as possible". No express penalty for non-compliance is provided for in the Regulations, but the normal practice is to comply within 24 hours. It is usual for the Commission to give at least one instruction per month to make a payment out of the Community's Account with the Paymaster General.

4. It is difficult to estimate for how long the Commission could continue to meet its commitments if the UK contribution was cut off. It depends on the incidence of contributions and payments throughout the Community. At present we estimate that the Commission probably has a sufficient balance in its Accounts throughout the Community to maintain its obligations in full for between 3 and 6 months, if the UK contribution were cut off.

II. ARTICLE 175

5. In his letter of 15 October to the Treasury Solicitor (Annex A to OD(79)35), Mr Steel recorded the Attorney General's view that we might have a reasonable argument for contending that the present budgetary arrangements were incompatible with the basic provisions of the EEC Treaty. We would have to pursue such a case under Article 175 of the Treaty. That Article provides that if the Council or Commission fail to "reach conclusions" in accordance with the

Treaty, proceedings against them may be instituted in the European Court provided that the Council or Commission is given a 2-month period in which to act after being formally called on to do so.

6. It might be possible to claim that the Council or Commission had failed in their obligations under the basic provisions of the Treaty in allowing the budgetary arrangements to develop in the way they have. For example, under Article 235 the Council has the power, and arguably the duty, to take measures to ensure that action is taken by the Community which is necessary to achieve the objectives of the Community but for which the Treaty has not provided the necessary powers. It was this power that was used to set up the 1975 Financial Mechanism.

7. A second draft of a paper which could support a possible case under Article 175 is in preparation in the Treasury. The Attorney General is not able to express a definite view at this stage on the UK's chances of getting a favourable decision from the Court in proceedings under Article 175, but, on the information he has so far, he is doubtful about the prospect.

3rd Commission Paper

CONFIDENTIAL
FM UKREP BRUSSELS 211750Z NOV 79
TO FLASH FCO
TELEGRAM NUMBER 6251 OF 21 NOVEMBER
INFO IMMEDIATE COPENHAGEN, THE HAGUE, ROME, LUXEMBOURG, DUBLIN, PARIS, BONN
INFO SAVING BRUSSELS.

EUROPEAN COUNCIL: CONVERGENCE

1. FOLLOWING IS TEXT OFCOMMISSION COMMUNICATION TO THE EUROPEAN COUNCIL APPROVED TODAY:

I. INTRODUCTION

THE COMMISSION HAS MADE TWO COMMUNICATIONS TO THE COUNCIL OF MINISTERS (COM(79) 462 OF 12 SEPTEMBER AND COM(79)620 OF 31 OCTOBER) ANALYSING CERTAIN PROBLEMS CONNECTED WITH ECONOMIC CONVERGENCE AND BUDGETARY MATTERS WITHIN THE COMMUNITY. ON THE BASIS OF THESE COMMUNICATIONS THERE HAS BEEN EXTENSIVE DISCUSSION WITHIN THE INSTITUTIONS OF THE COMMUNITY, INCLUDING THE EUROPEAN PARLIAMENT, IN MEMBER STATES AND BY PUBLIC OPINION GENERALLY. THE COMMISSION BELIEVES THAT THE MOMENT IS NOW RIGHT TO PROPOSE TO THE COUNCIL THE APPROACH AND DECISIONS WHICH WILL BE NECESSARY IF PRESENT DIFFICULTIES ARE TO BE RESOLVED.

2. THESE DIFFICULTIES COVER A NUMBER OF INTER-RELATED QUESTIONS, INCLUDING SOME CONCERNED WITH THE COMMON AGRICULTURAL POLICY. THESE NEED TO BE DEALT WITH ON THEIR MERITS, AND ARE THE SUBJECT OF A SEPARATE PAPER BY THE COMMISSION FOR THE EUROPEAN COUNCIL. THE PRESENT COMMUNICATION DEALS WITH THE COMMUNITY BUDGET, BOTH AS CONCERNS CONVERGENCE AND THE PARTICULAR PROBLEMS WHICH HAVE ARISEN FOR THE UNITED KINGDOM.

II. THE STRUCTURE OF THE COMMUNITY BUDGET

3. THE COMMISSION BELIEVES THAT A LARGER PROPORTION OF BUDGETARY SPENDING SHOULD BE DEVOTED TO THE IMPROVEMENT OF STRUCTURES AND TO GENERAL INVESTMENT PURPOSES WITHIN THE COMMUNITY. SUCH EXPENDITURE WAS ENVISAGED IN THE COMMISSION'S LATEST THREE-YEAR FORECAST TO RISE FROM 14 PERCENT IN 1980 TO 22 PERCENT IN 1982 ON THE ASSUMPTION THAT MARKET SUPPORT EXPENDITURE FOR AGRICULTURE WOULD RISE OVER THE PERIOD AT AROUND 6 PERCENT A YEAR.

4. ON EXPENDITURE WITHIN THE AGRICULTURAL SECTOR, THE COMMISSION POINTED OUT IN ITS COMMUNICATION OF 31 OCTOBER THAT AN INCREASING NUMBER OF MEASURES HAD BEEN ADOPTED IN RECENT YEARS TO STRENGTHEN MARKET SUPPORT ARRANGEMENTS FOR MEDITERRANEAN PRODUCTS AND TO IMPROVE THE INCOMES OF THE PRODUCERS CONCERNED. THE COMMISSION WILL DO ALL IT CAN TO SECURE THE RAPID EXECUTION OF THESE AND OTHER MEASURES AND THE RAPID ADOPTION BY THE COUNCIL OF FURTHER MEASURES IN OTHER AGRICULTURAL SECTORS OF PARTICULAR INTEREST TO ITALY AND IRELAND. THIS SHOULD LEAD TO A BETTER BALANCE IN THE PATTERN OF AGRICULTURAL PRODUCTION AS A WHOLE.

5. IN THE VIEW OF THE COMMISSION THE APPROACH SUGGESTED BY THE ITALIAN GOVERNMENT OF FIXING OBJECTIVES FOR A RISING PROPORTION OF COMMUNITY EXPENDITURE DEVOTED TO STRUCTURES AND GENERAL INVESTMENT PURPOSES OVER A PERIOD IS USEFUL. THE ACHIEVEMENT OF SUCH OBJECTIVES WILL DEPEND ON THE ABILITY OF THE COMMUNITY TO BRING AGRICULTURAL EXPENDITURE UNDER CONTROL. MOREOVER THE SIGNIFICANCE OF THE EFFECTS WILL BE RELATIVELY SMALL SO LONG ASPRESENT LIMITATIONS ON THE SIZE OF THE BUDGET REMAIN.

6. IN THE LIGHT OF THESE CONSIDERATIONS THE COMMISSION INVITES THE EUROPEAN COUNCIL TO ENDORSE THE PRINCIPLE THAT TO ACHIEVE A BETTER BALANCE BETWEEN COMMUNITY POLICIES, THE RATE OF INCREASE IN EXPENDITURE ON STRUCTURAL AND GENERAL INVESTMENT POLICIES SHOULD FROM 1980 ONWARDS BE

/ SIGNIFICANTLY

SIGNIFICANTLY GREATER THAN THE RATE OF INCREASE IN THE SIZE OF THE COMMUNITY BUDGET. THE COMMISSION FURTHER RECOMMENDS THAT IF DURING THE BUDGETARY PROCESS THIS PRINCIPLE IS NOT RESPECTED, THE COMMISSION UNDERTAKES TO DRAW THE ATTENTION OF THE INSTITUTIONS TO THE SITUATION WITHOUT DELAY.

III. BUDGETARY DIFFICULTIES

7. THE COMMISSION BELIEVES THAT THE ACHIEVEMENT OF A BETTER BALANCE WITHIN THE BUDGET WILL, TOGETHER WITH OTHER FACTORS MENTIONED IN ITS COMMUNICATION OF 31 OCTOBER, EVENTUALLY SOLVE MOST OF THE PRESENT DIFFICULTIES OF THE UNITED KINGDOM IN RESPECT OF THE COMMUNITY BUDGET. BUT IT RECOGNISES THAT FOR THE IMMEDIATE FUTURE THERE IS A SERIOUS PROBLEM.

8. THE TRANSITIONAL PERIOD FOR THE UNITED KINGDOM, IRELAND AND DENMARK WAS DESIGNED TO PERMIT THE GRADUAL INTEGRATION OF THESE MEMBER STATES INTO THE SYSTEM OF COMMUNITY FINANCING. THE COMMISSION BELIEVES THAT THIS APPROACH WAS AND REMAINS RIGHT. IN CONSEQUENCE SUCH FURTHER MEASURES AS MAY BE AGREED SHOULD BE TEMPORARY IN NATURE. THE NECESSARY RESOURCES SHOULD BE FOUND FROM WITHIN THE BUDGET.

9. THE COMMISSION BELIEVES THAT ANY SOLUTIONS ADOPTED SHOULD NOT ONLY BE COMMUNITY SOLUTIONS BUT DESIGNED TO STRENTHEN THE COHESION AND SOLIDARITY OF THE COMMUNITY. THEY SHOULD CONFORM TO TWO BASIC PRINCIPLES. FIRST THEY SHOULD RESPECT THE INTEGRITY OF THE OWN RESOURCES SYSTEM, SECOND THEY SHOULD NOT HAVE AS THEIR OBJECTIVE TO PUT A MEMBER STATE IN A POSITION OF ''JUSTE RETOUR'' IN RESPECT OF THE COMMUNITY BUDGET.

10. IN ITS REFERENCE DOCUMENT OF 12 SEPTEMBER THE COMMISSION FORECAST THAT THE UNITED KINGDOM'S FINANCING SHARE WOULD RISE SHARPLY OVER HER FORECAST SHARE OF COMMUNITY GNP BETWEEN 1979 AND 1980. THE MAIN REASON IS THAT PAYMENTS UNDER THE TRANSITIONAL ARRANGEMENTS SET OUT IN ARTICLE 131 OF THE ACCESSION TREATY WILL COME TO AN END.

11. ONE SIMPLE WAY OF APPROACHING THE PROBLEM THUS CREATED WOULD BE TO CREATE A NEW AD HOC MECHANISM TO COMPENSATE FOR ANY BRITISH CONTRIBUTIONOF FULL OWN RESOURCES GOING BEYOND A PREDETERMINED PERCENTAGE INCREASE IN A GIVEN YEAR. IN ITS COMMUNICATION TO THE COUNCIL OF 31 OCTOBER, THE COMMISSION INDICATED THAT IF NO PERCENTAGE INCREASE OVER 1979WERE ALLOWED, THE FORECAST SHARE OF THE UNITED KINGDOM IN FINANCING THE 1980 BUDGET WOULD BE REDUCED BY SOME 500 MEUA GROSS (390 MEUA NET). BUT UNLESS THE BRITISH CONTRIBUTION WERE TO BE FROZEN AT A GIVEN LEVEL, THE ARRANGEMENT WOULD HAVE DIMINISHING IMPACT.

12. A MORE PROMISING APPROACH WOULD BE TO ADAPT THE EXISTING FINANCIAL MECHANISM. THE COMMISSION RECALLS THAT WHEN THE HEADS OF STATE AND GOVERNMENT AGREED IN PRINCIPLE TO CREATE THE MECHANISM IN 1974, THEY HAD EXPRESSLY IN MIND THE COMMUNITY DECLARATION DURING THE ACCESSION NEGOTIATIONS THAT ''IF UNACCEPTABLE SITUATIONS WERE TO ARISE THE VERY LIFE OF THE COMMUNITY WOULD MAKE IT IMPERATIVE FOR THE INSTITUTIONS TO FIND EQUITABLE SOLUTIONS''. AT ITS MEETING IN STRASBOURG OF JUNE 1979, THE EUROPEAN COUNCIL REQUESTED THE COMMISSION TO EXAMINE THE EXTENT TO WHICH THE MECHANISM COULD PLAY ITS PART IN 1980 AND FULFIL THE OBJECTIVES ASSIGNED TO IT.

13. FOR THE REASONS SET OUT IN THE COMMISSION'S REFERENCE DOCUMENT OF 12 SEPTEMBER, PAYMENTS MADE UNDER THE MECHANISM AS AT PRESENT CONSTITUTED COULD SCARCELY SOLVE THE PROBLEM. THE COMMISSION BELIEVES THAT THE QUALIFYING CRITERIA FOR THE OPERATION OF THE MECHANISM REMAIN A VALID MEASURE OF THE RELATIVE PROSPERITY OF MEMBER STATES WITHIN THE COMMUNITY AND SHOULD REMAIN UNCHANGED. BUT TO ENABLE THE MECHANISM TO FULFIL MORE CLOSELY THE ROLE ASSIGNED TO IT, THE COMMISSION RECOMMENDS REMOVAL OF THE LIMITATION THAT IF THERE WERE A BALANCE OF PAYMENTS SURPLUS THE CALCUATION

/ OF THE

OF THE ECESS CONTRIBUTION MUST BE RELATED SOLELY TO VAT. THIS WOULD PRODUCE A PAYMENT OF 300 MEUA GROSS (250 MEUA NET) IN RESPECT OF 1980 WHETHER OR NOT THERE WAS A BALANCE OF PAYMENTS SURPLUS. BUT AS THE UNITED KINGDOM WILL ANYWAY FIND ITSELF IN PAYMENTS DEFICIT IN 1979 AND ALMOST

CERTAINLY IN 1980, THE COMMISSION FURTHER RECOMMENDS THAT THE EUROPEAN COUNCIL IN DUBLIN SHOULD DEFINE THE CONDITIONS UNDER WHICH THE TWO FURTHER RESTRICTIONS ON THE OPERATION OF THE MECHANISM COULD BE LIFTED. THESE ARE THE TRANCHE SYSTEM WHICH PROVIDES THAT ONLY A PART OF THE EXCESS CONTRIBUTION IS REIMBURSED: AND THE CEILING OF 3 PER CENT OF THE BUDGET. IF THESE RESTRICTIONS WERE ALSO REMOVED, PAYMENTS UNDER THE MECHANISM IN RESPECT OF 1980 WOULD RISE FROM 300 MEUA GROSS TO SOME 630 MEUA GROSS (520 MEUA (NET). (+)

14. THERE WOULD BE DIFFICULTY IN ANY APPROACH DESIGNED TO COMBINE A SYSTEM OF LIMITING INCREASES IN THE BRITISH SHARE OF FINANCING THE BUDGET WITH IMPROVEMENTS IN THE OPERATION OF THE FINANCIAL MECHANISM. THIS IS BECAUSE THE REDUCED SHARE OF FINANCING WHICH WOULD RESULT FROM ANY SUCH LIMITATION WOULD LOGICALLY HAVE TO BE USED IN APPLYING THE FINANCIAL MECHANISM. PAYMENT UNDER THE FINANCIAL MECHANISM WOULD THEREFORE BE REDUCED BY THE AMOUNT RESULTING FROM THE LIMITATION.

15. THIS DIFFICULTY WOULD NOT EXIST FOR ARRANGEMENTS AFFECTING THE EXPENDITURE SIDE OF THE BUDGET. SUCH ARRANGEMENTS WOULD HAVE TO FLOW FROM THE STRENGTHENING OF COMMUNITY POLICES WHICH ARE NECESSARY TO IMPROVE THE COHESION OF THE COMMUNITY AND ARE THEREFORE CENTRAL TO THE INTEREST OF THE COMMUNITY AS A WHOLE. IT WOULD BE POSSIBLE TO ENVISAGE SPECIAL, TEMPORARY AND AD HOC MEASURES WHICH WOULD ENSURE A GREATER PARTICIPATION BY THE UNITED KINGDOM IN A NUMBER OF COMMUNITY POLICIES AND WHICH WOULD INCREASE THE PRESENT LOW LEVEL OF COMMUNITY EXPENDITURE IN THE UNITED KINGDOM. SUCH ARRANGEMENTS WHICH WOULD NEED TO BE IN FULL CONFORMITY WITH THE PRINCIPLES SET OUT IN PARAGRAPHS 8 AND 9, COULD, FOR EXAMPLE,

TAK THE FORM OF IMMEDIATE ASSISTANCE FOR EXPLOITATION OF COAL RESOURCES, MEASURES TO PROMOTE TRANSPORT INFRASTRUCTURE, AND SOME AGRICULTURAL IMPROVEMENT SCHEMES. IF THE UNITED KINGDOM WERE TO JOIN THE EUROPEAN MONETARY SYSTEM AN INTEREST REBATE SYSTEM IN RESPECT OF COMMUNITY LOANS COULD COMPRISE ONE VEHICLE FOR SUCH PAYMENTS.

16. IF THIS APPROACH WERE TO BE PURSUED, THE COMMISSION WOULD STRESS THAT ANY CONTRIBUTION SHOULD BE MADE ON THE BASIS OF THE COMMUNITY BUDGET AND SHOULD BE LIMITED IN TIME (PERHAPS THREE OR FOUR YEARS). THE VOLUME OF RESOURCES TO BE FOUND MUST NECESSARILY BE SDTTLED BY DISCUSSION WITHIN THE COUNCIL.

17. SO FAR ONLY SHORT AND MEDIUM TERM SOLUTIONS TO THE PROBLEMS OF CONVERGENCE AND THE BUDGET HAVE BEEN DISCUSSED. BUT AS THE EUROPEAN PARLIAMENT HAS POINTED OUT, THE EXISTING POLICIES OF THE COMMUNITY ARE INSUFFICIENT TO BRING ABOUT THE DEGREE OF CONVERGENCE BETWEEN THE ECONOMIES OF THE MEMBER STATES WHICH IS NECESSARY FOR THE PROGRESS AND COHESION OF THE COMMUNITY. THE COMMISSION BELIEVES THAT THE EUROPEAN COUNCIL SHOULD BEAR THIS LONGER TERM CONSDIERATION IN MIND WHEN EXAMINING THE PROPOSALS IN THIS PAPER.

(+) THESE FIGURES, WHICH WERE CONTAINED IN COM(79)620 WERE BASED ON EXCHANGE RATES OF MID-AUGUST 1979.

FCO ADVANCE TO:

FCO - PS/SOFS PS/LPS PS/PUS BRIDGES FRETWELL SPRECKLEY HAZLE
CAB - FRANKLIN ELLIOTT WALSH
TSY - PS/CHANCELLOR PS/FINANCIAL SECRETARY COUZENS JORDAN-MOSS MRS HEDLEY-MILLER ASHFORD THOMPSON BAKER
CSD - PS/LORD PRESIDENT
NO10 - ~~ALEXANDER~~
BUTLER

FILES:
EID(I)
PS
PS/LPS
PS/PUS
MR FRETWELL
LORD BRIDGES

[ADVANCED AS REQUESTED]

COPIES TO:
ADVANCE ADDRESSEES

~~Chancellor~~ PA MS

I think this does it.
do you want
(a) to clear with PM
(b) take her mind on
who should wind up.
Please let me know if you want No 10
prepared for
an approach
from you.

[initials] 21/11.

FINANCIAL SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY [initials] 21/11

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir A Rawlinson
Sir K Couzens
Mr Jordan-Moss
Mr Unwin
Mrs Hedley-Miller
Mr Lavelle
Mr Ashford
Mr D F Roberts
Mr P G Davies
Mr Dyer
Mr Ridley
Mr Cropper
Mr Cardona

PARLIAMENTARY DEBATE ON EEC BUDGET CONTRIBUTION

I mentioned to you over the telephone that the Financial Secretary had a brief conversation with Sir Kenneth Couzens this morning about the motion for tomorrow's Debate (my minute of yesterday's date refers).

The Financial Secretary has proposed the following amended Motion:*

> "that this House takes note of Commission document 9093/79 (a reference paper on Budgetary Questions), together with supplementary information in documents 9369/79 and 9721 with Addendum 1, and also Commission document COM(79)620 Final (on Convergence and Budgetary Questions), and fully supports the Prime Minister in her determination to secure the objectives approved by the House on 16 July."

approved by PM MS 22/xi

In the Financial Secretary's view, this should be sufficient to enable Opposition support.

SAJL

S A J LOCKE
21 November 1979

*The footnote, of course, still stands.

S E C R E T

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(2)

Prime Minister

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

f.a.

21.11.79

PRIME MINISTER

We have already had a brief word about John Nott's minute of 14 November in which he proposes that if we fail to secure an adequate reduction in our net contribution in Dublin we should press for a debudgetization of the CAP and should use a refusal to increase support prices as a lever to achieve this.

2. Given the proximity of the VAT ceiling we are all agreed that we should oppose increases in agricultural support prices, at least for the products in surplus. Indeed we are pledged to do so in the Manifesto. But our aim in doing this should be to reduce or at least contain total expenditure on the CAP, not to find new means of financing extra expenditure. There are, as John Nott says, various possible mechanisms for debudgetising the CAP and if it does prove impossible to confine expenditure within the 1 per cent VAT ceiling the Community may be forced to adopt one of them. Such a mechanism might involve the UK in paying less at the margin than we would pay by agreeing to an increase in the VAT ceiling, but our total expenditure would be greater than it would be if we can bring the CAP under proper control, and it is total expenditure which should be our main concern.

S E C R E T

3. This objection could be met if we could persuade our partners both to contain the cost of CAP policies and to shoulder a greater share of it than they do at present. Of course, the most direct means of shifting the burden of the cost of the CAP from the UK would be to obtain a form of budgetary correcting mechanism. Clearly there is no case for suggesting any disposition on our part to abandon that objective; and obviously we must take care not to confuse it with our long term strategy towards the CAP. Even so, I can see that there _may_ be some wisdom in John Nott's system, at least as a means - at a critical time - of clothing our main objective in more European dress; but the detailed tactics will need to be very carefully considered.

4. I am copying this minute to the other members of OD, to Peter Walker and to Sir Robert Armstrong.

(G.H.)
21 November 1979

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

8

From the Minister

SECRET

PRIME MINISTER

21 November 1979

EEC BUDGET AND CAP REFORM

John Nott sent me a copy of his minute of 14 November to you about the line we should take in the Community if we fail to secure an adequate reduction in our net contribution to the budget. I was sorry not to have had the chance of commenting when the question was discussed in OD, as of course the great majority of Community decisions concern agriculture and food.

John Nott's conclusion - that we should in effect abandon our aim on budgetary contributions, declare that we were instead going to seek major savings on expenditure, particularly the CAP, and aim for a shift in the bulk of CAP expenditure from the Community to national budgets - seems to me to be based on two mistaken assumptions. The first is that it would be easier to secure agreement to the sort of CAP reform he has in mind than to get what we want on the budget. I believe the opposite to be the case. There will be resistance enough to correcting the manifest unfairness of the budget. But that could at least be done in a way which would distribute the cost between other countries according to their capacity to pay. To shift the cost of the CAP on to national budgets would hit selectively at the agricultural net exporters - particularly the Netherlands, Denmark and Ireland. I see no chance whatever of their agreeing to it on a scale which would go anywhere near meeting our budgetary problem. For them the retention of common financing of the CAP, at least at present levels of expenditure, is a major national interest and they will defend it accordingly.

The table I attach illustrates this very clearly. If, for example, 50 per cent of the cost of the CAP were switched from the Community to national budgets, the Danes and the Irish would lose about a third of their current benefit from the CAP. But Germany is a net contributor to the cost of the CAP and so would gain; and France is more or less in balance on the budget (most of her gain from the CAP comes from selling at high prices to other member countries) and so would not be much affected. It is therefore wrong to suppose that debudgetisation of this kind would make the Germans or the French alter their policies, as John Nott seems to believe, so as to make them bear more hardly on their farmers.

/The second mistaken ....

The second mistaken assumption, in my view, is that there is an easily identifiable and negotiable way of securing an early reduction in CAP expenditure affording us benefits in any way approaching what we are seeking on the budget. Again, if half the current Community expenditure on agriculture were switched to national budgets, our net contribution would be reduced by only about 550 MEUA (taking the figures in the Commission's reference paper for 1980), compared with the 1600-1800 MEUA needed to put us in broad balance. But the point goes wider than this. On my instructions, my Department is doing a great deal of work on how we can best alter the CAP to our advantage. You and our colleagues may find it interesting to glance at the enclosed paper, which was prepared as a basis for discussion with me. We are making a number of follow-up studies and I shall be circulating my conclusions in due course. But we should not delude ourselves into thinking that there is a simple and easy answer. The fact is that most other member countries have done well out of the CAP, as again the table shows. Only two other member states have done badly; and of those, the Italians see the way ahead as special deals for their own agriculture, which will soon make them net budgetary beneficiaries; and the Germans will not do anything to disadvantage their farmers - especially before an election. With all its difficulties, budgetary reform is much easier for the rest of the Community to swallow than any really drastic reform of the CAP.

Whatever the answer, I am quite sure that it does not lie in the device that John Nott suggests - Wallace Day's proposal for headage payments on dairy cows, coupled with a big reduction in milk prices. This would in fact greatly increase the total cost of the milk policy: the headage payments alone would cost nearly twice the present bill for the whole policy, and there would still be some surplus to dispose of as well. If it is argued that headage payments could more readily be switched over to national financing, I can only say again that it seems to me quite unrealistic to expect the net exporters to agree, first to a massive cut in their export earnings through the price reduction and then to a further massive loss from having to finance the headage payments themselves. They would be far better off with the price freeze which John Nott sees as a means of getting them to accept such a policy. Even our own Treasury might fight shy of the annual expenditure of £675m that Wallace Day proposes for headage payments in the UK.

This does not mean that we should not stand firm on prices in 1980, or not seek a gradual switch to the national financing of agricultural support. But in my view it would be more realistic, and potentially more productive, to regard insistence on a price freeze in the Agriculture Council as a lever for securing movement on budgetary reform, rather than as a means of securing a rapid reform of the CAP and massive reduction in its cost. A firm stand on agricultural prices could not legitimately be attacked as unreasonable - quite apart from its being right in principle - since it is the agricultural expenditure that lies at the root of our heavy net contribution. In order that we can hold out for a price freeze throughout 1980 without doing irreparable damage to British agriculture, we should devalue the green pound before the price fixing negotiations begin. I hope Sir Kenneth Berrill's Committee on support for agriculture will propose precisely that.

This is like Peter Carrington's line in some ways, but it does not go to the point of saying we would block all major Community decisions of whatever kind. If we were to go to that extreme, I suspect the result would be that nothing to our advantage, including the green pound change, would get done by any Council, and that a good many things to our disadvantage that can be done without unanimity - like choking off New Zealand's butter imports by changing

/the levy - would be ....

the levy - would be pushed through against us. My own view therefore is that we should decline to regard an unfavourable outcome at Dublin as final; say that we shall carry on the fight for budgetary reform; and take a tough line in the 1980 price-fixing so as to put maximum pressure on others to agree to what we want.

I am sending copies of this minute to the members of OD and to Sir Robert Armstrong. Copies also go to George Younger, Humphrey Atkins and Nicholas Edwards.

PETER WALKER

ESTIMATED TOTAL BALANCE OF PAYMENTS GAINS AND LOSSES FROM THE CAP, 1978

	1 Net budgetary receipt from or contribution to CAP	2 Estimated net gain or loss on agricultural trade	3 Total gain or loss (1 + 2)	4 Total gain or loss if 50% debugetisation of CAP expenditure (½ of 1, + 2)	5 Net benefit (+) or disbenefit (-) of 50% debudgetisation (3 - 4)
	£m	£m	£m	£m	
BELGIUM/LUXEMBOURG	+ 33	+ 54	+ 87	+ 70	- 17
DENMARK	+ 408	+ 275	+ 683	+ 479	- 204
GERMANY	- 122	- 434	- 556	- 495	+ 61
FRANCE	+ 41	+ 575	+ 616	+ 595	- 21
IRELAND	+ 343	+ 184	+ 527	+ 355	- 172
ITALY	- 344	- 588	- 932	- 760	+ 172
NETHERLANDS	+ 241	+ 605	+ 846	+ 725	- 121
UK	- 673	- 110	- 783	- 447	+ 336

Notes: 1. The estimated net gain or loss on agricultural trade is calculated from the difference between EEC prices and world prices on the volume of trade with other Member States. The calculation is confined to products subject to import levies under the CAP. The same effect arises with products protected by ad valorem tariffs, but it is less easy to arrive at a reliable figure for these items. However, the omission overstates Italy's net trade losses, since she is an exporter of these products to other Member States.

2. The figures for gains and losses with a 50% debudgetisation must be treated as only approximate since no allowance has been made for the difference between overall and marginal rates of budgetary contribution.

CONFIDENTIAL

THE REFORM OF THE CAP

SUMMARY OF ATTACHED NOTE FOR THE MINISTER

A. The Defects of the CAP (paras 2-13)

1. The CAP has fulfilled some of the aims set for it in the Treaty of Rome and retains the support of other member countries. But the cost of disposing of increasing surplus production represents a large and growing waste of Community resources (paras 2-9).

2. The CAP transfers resources between member countries through the budget and through its effect on the prices of trades produce. The UK is much the biggest loser from the budget effect, and also a substantial loser from the trade effect. Our primary aim must be to cut the net budgetary cost to this country. The reform of the policy itself must consist essentially in reducing surplus production (paras 10-13).

B. Approaches to Reform (paras 14-66)

3. Three factors make reform very difficult: the surplus problem is exacerbated by rising yields through improved technology; most member governments are very loth to depress farmers' incomes or employment on the land; and other member countries give substantial national aids to farmers, which the Community finds difficulty in controlling and which could increase under the stresses of Community policies to reduce production (paras 14-16).

4. The problem does not lie in the managed-market method of support, nor can it be solved by simply changing the decision-making process. The three possible approaches are through price policies, production quotas, and the transfer of expenditure from Community to national budgets (paras 17-19).

I. Price Policies

5. Price policy is in economic terms the right basic approach and we must continue to advocate maximum restraint on common prices. But it would be unrealistic to expect price policy alone to bring about a significant reduction in surplus production over the next five years. This is because other member countries will not agree to reductions in nominal common prices; because a sustained freeze on the common milk price - in the unlikely event of other countries finding it politically tolerable - would probably do no more than contain present production levels; and because other member countries could be expected to step up national aids to farmers as the price freeze began to bite (paras 20-27). Moreover in the altered monetary circumstances - with common prices denominated in ECUs, sterling relatively stronger than in recent years and cost inflation still relatively high in the UK - a freeze on common prices could hit our producers harder than those in some other member countries (paras 28-31).

6. Social aids to mitigate the effects of a tough prices policy are difficult to justify and, if paid, must be at the charge of national exchequers (paras 32-34).

7. 'Standard quantity" variations on a tough prices policy can be dangerous for us. Both the Commission and other member countries are attracted by solutions which would impose a levy on producers, matching the disposal cost of additional Community production above a given standard quantity and offset by a common price increase, so that the tax would in effect be paid by consumers rather than producers. This would postpone the impending crisis when the Community "own resources" for financing CAP expenditure run out, and impose a new tax on the UK economy, with discriminatory adverse effects on this country if small producers were exempt from the levy (paras 35-39).

8. The taxation of inputs such as soya is economically perverse and impracticable under the GATT (paras 40-41). Payments for not producing are not always cost effective but can be a useful supplement to price policy (paras 42-44). The abolition of aids to investment in the production of commodities in surplus

needs further study (paras 45-46). There is no salvation to be found in structural policy (paras 47-48), in the stimulation of consumption (para 49), in the taxation of substitutes (para 50), or in headage payments coupled with a price reduction (paras 51-52).

II. Production Quotas

9. Quotas have severe disadvantages: they can prevent the optimum location of production, perpetuate surplus production (though this depends on whether or not they can be progressively reduced), afford an excuse for price increases (since if quotas were effective these would not increase surpluses), and present difficult problems of negotiation and administration. In the one field where they have been tried - sugar - they have not prevented large surpluses (basically because they were set too high). But none of the solutions to the surplus problem is without difficulty or disadvantage. We should no longer reject quotas a priori, but consider more thoroughly whether their disadvantages for us are greater than those of other solutions (paras 53-60).

III. National Financing

10. The abandonment of Community financing and the transference of the entire cost of agricultural support to national exchequers would of course be greatly to our advantage; but this is not a practical option. Transfer of some part of CAP expenditure to national exchequers could be helpful to us and may be forced on the Community by the exhaustion of "own resources". But the countries which benefit most from Community financing (see tables on page 6 of paper) can be expected to obstruct a negotiated transfer for as long as they can, and we can expect a period of chaos as the money runs out, with pressures on us to agree that fresh resources should be provided. We should in any case need to be very watchful to ensure that any agreed arrangements for transferring expenditure from the Community budget did indeed assure the UK of net benefit (paras 61-66).

C. The negotiating context (paras 67-72)

11. The need of other countries for increases in common prices in 1980, and the impending exhaustion of "own resources", make the next price-fixing critical. We should strengthen our bargaining position in advance, by devaluing the green pound before the end of 1979. We should then take a very tough line on

common prices, using this as a bargaining weapon to secure budgetary change if we have not by then achieved our budgetary aims, and as an end in itself if we have. All other member countries are softer on the CAP than we are, and the task of securing measures that really reduce production will be formidable (paras 67-71). Enlargement will not help matters in the coming years: the Mediterranean countries will seek extra advantages for themselves, largely at our expense, and before as well as after the accession of the new members (para 72).

Conclusions (paras 73-74)

12. The paper suggests questions rather than conclusions, and stresses the difficulty of identifying or of securing the agreement of other member countries to any reform of the CAP which would eliminate or materially reduce surplus production. Reform of the budgetary arrangements clearly remains an easier and more effective way of reducing the cost of the CAP to the UK than the reform of the CAP itself.

13. Price restraint must remain a central feature of our approach to the CAP reform, but even if feasible over the next five years would not in itself solve the problem of surpluses. Other policies must therefore also be sought, but with care to ensure that they hold net benefit for us. Quotas have marked disadvantages but should be studied further. The transfer of cost to national exchequers may prove the best practicable option for us, though our net gains thereby would probably not be great: we should study how best to maximise the potential advantage to the UK (para 73). The implications of the changed monetary situation for British agriculture also require thorough consideration (para 74).

CONFIDENTIAL

THE REFORM OF THE CAP

NOTE FOR THE MINISTER

Introduction

1. This paper considers what is wrong with the Common Agricultural Policy and what should be done to put it right. It is written from the standpoint of the United Kingdom's interest, but takes account of the differing views and interests of other countries. It is intended to serve as a basis for discussion rather than to offer definitive solutions.

A. The Defects of the CAP

(i) the CAP's objectives

2. The CAP's objectives are set out in Article 39 of the Treaty of Rome and are unexceptionable. The policy has fulfilled more of them than is sometimes acknowledged. It has increased agricultural productivity: over the period 1968-77 the farm population declined by 4 per cent a year on average, with production increasing, and although the rate of decline has now fallen to about 2½ per cent it is at least continuing. The CAP has also ensured, on the whole, a fair standard of living for the agricultural community: since 1970 real agricultural incomes (gross value added at market prices per person employed) have increased by more than 3 per cent a year, which is slightly more than in the Community economy as a whole. It has stabilised markets, in the sense of insulating the Community market from the fluctuations of the world market, albeit at price levels generally far in excess of world prices. It has assured the availability of supplies, all too thoroughly. It has not however ensured that supplies reach consumers at reasonable prices, since self-sufficiency in the main commodities could evidently have been attained at lower real price levels (and it could be argued that self-sufficiency need not in any case have been an aim).

3. This preamble is made as a reminder of the fact that the CAP does not appear to others as grossly defective as it often does to us. Other member countries tend to stress its achievements: the adoption of common policies and, subject to the complications of green currencies and monetary compensatory amounts, of common prices; the improvement of living standards in the farm population; the improvement of farm structure (the average size of holding increasing from 12.1

hectares in 1960 to 17.2 in 1975); above all the maintenance of social and political stability in rural areas - a much more important consideration for them than even for us, for their rural and agricultural populations still make up much larger proportions of the total population than in this country. They concede that the CAP has defects, in particular its high and growing cost; and they are more ready now than at any time since the late '60s to agree that changes must be made. But they will not listen readily to criticisms implying that it should be scrapped or even really radically revised.

(ii) The nature of the CAP

4. Already, however, this paper is falling into the common habit of referring to the CAP as though it were a coherent and consistent policy. In practice it is a heterogeneous collection of regulations for the management of markets for individual commodities and, much less significantly, for improving the structure of production and marketing. In so far as it is based on consistent principles they are generally identified as three: the establishment of a single Community market and therefore of common prices, implying free trade in agricultural produce between member countries, under level terms of competition (though free trade has been substantially eroded by monetary compensatory amounts, and national aids to agriculture and systems of taxation are far from identical in their effect); the establishment of Community preference, assuring Community producers of first place in the common market (though this too is qualified by the preferences afforded to New Zealand butter and ACP sugar); and the common financing of the policy, ie from Community funds (though this also has many exceptions, where national Exchequers are called upon to contribute substantial proportions of the cost of support, eg in the less favoured areas). In general the Treaty leaves the Community institutions a fairly free hand in deciding how the aims of the policy should be achieved. The most characteristic form - a managed market, protected by import levies and supported by intervention buying and export subsidies - has been adopted because it reflects previous practice in the six original member countries and is the most easily applicable form for a Community self-sufficient in the main commodities.

5. The method by which the CAP is negotiated militates against the adoption of a coherent policy, steadfastly pursing medium or long term aims. In practice major decisions are all concentrated in the annual price fixing negotiation in the Council of Ministers (Agriculture). That negotiation

is a complicated package of deals, in which all member countries strenuously seek national advantage until a balance acceptable to all is found. The Luxembourg compromise, under which any member country whose important national interests would be adversely affected by a proposed decision can prevent its being made, makes it far easier to prevent change than to bring it about; and member countries seek to sell their agreement to any change that would be to their disadvantage at a price which would give them more than compensating benefits. By such means Italy is contriving to reverse her unfavourable budgetary position: but this is much easier for her than it would be for us, since the Mediterranean nature of her agriculture makes it relatively easy to invent commodity policies which, though in theory applying to the whole Community, in practice apply only to her; and since her backward agricultural structure gives an excuse for Community expenditure in Italy on structural reform. For the UK, with its relatively small but well-structured agricultural industry, producing the same commodities as the rest of the northern Community, it is virtually impossible to develop Community-wide agricultural policies which would assure us of massive net benefit; and hitherto we have sought net benefit mainly in the less productive field of selectively applied consumer subsidies on butter.

(iii) Cost to the Community

6. What then is wrong with the CAP from the standpoint of the Community as a whole? Its basic defect is that it wastes resources. To produce regularly large and increasing quantities of produce which can only be disposed of by means of heavy subsidies, mainly on exports, is clearly to distort the allocation of resources within the Community economy and to make a free gift to some of them to third countries. If the resources thus wasted could be used in other forms of production or services, the real wealth of the Community would be increased. Part of this waste of resource is concealed in the unnecessarily high market prices at which the policy aims. Part is increasingly visible in the high and rising cost of the policy to Community funds - supplied by the taxes (equivalent to the yield from a notional VAT of up to 1%) which under the "own resources" system together finance the Community's budget. This cost stems essentially from the need to dispose of surpluses by means of subsidies.

7. The essential problem is thus quite simply one of overproduction. This lies also at the root of the policy's disadvantages for third country exporters and so for the Community's trading stance: its illiberal attitude to imports (though not more illiberal than those of some other industrialised countries); and the disruption of world markets by heavily subsidised exports.

8. The scale of the problem and its nature are best illustrated by the Commission's estimates of its budgetary cost over the next three years. The figures are in millions of European Units of Account at current prices (ie assuming inflation of 6½% in 1981 and 5% in 1982):-

	1979	1980	1981	1982
FEOGA Guarantee Section	10,414	11,291	13,634	16,478
FEOGA Guidance	453	491	687	826

The overwhelming bulk of agricultural expenditure is thus on the guarantee section - basically the cost of market management through internal and export subsidies - and it is expected to grow very fast. (The Commission's figures for 1981-82 assume no substantial change of policy. If more stringent policies were adopted they suggest alternative figures for the guarantee section of 11,975 and 12,628 respectively. The figures are also highly sensitive to assumptions about world prices, since the main way of getting rid of surpluses is to subsidise exports down to the world market price. Although the world market is less stable than in the '50s and '60s, it seems realistic to expect its normal state over at least the next decade to be one of a plentiful supply of the main commodities, with prices well below the present level of Community prices.)

9. Within the guarantee section expenditure is divided between the commodities as follows (the percentages are based on figures for 1978; the growth rate is the compound growth rate over the four year period 1974-78):-

Product	Per Cent of total Guarantee expenditure	Growth rate in expenditure: % per annum
Milk Products	46.3	33.7
Cereals	12.8	30.5
Sugar	10.1	69.6
Beef	7.4	18.7
Other products	13.2	7.1
MCAs	10.2	55.7
Total	100.0	29.4

Expenditure on milk products thus accounts for nearly half the total expenditure from the guarantee section (and nearly 30% of the entire Community budget). The second costliest commodity, cereals, costs roughly a quarter as much as milk products, most of the expenditure being on export subsidisation, mainly of milling wheat. Sugar has come up fast in third place as surplus production has grown and world prices fallen.

(iv) Cost to individual member countries

10. The costs and benefits of the CAP fall very unevenly as between the several member countries. The CAP transfers resources between member countries in two ways: by the net cost or benefit representing the difference between a member state's contribution to and receipts from the Community's agricultural budget; and through the increase in the value, which the CAP brings about, in each member state's imports and exports of foodstuffs, net exporters thus gaining and net importers losing. The estimated resource transfers in 1978 resulting from these two effects are as follows (in £ million):-

	Budget effects	Trade effects	Total
A. Gainers			
Netherlands	+ 241	+ 605	+ 846
Denmark	+ 408	+ 275	+ 683
France	+ 41	+ 575	+ 616
Ireland	+ 343	+ 184	+ 527
B. Losers			
Italy	- 344	- 588	- 932
UK	- 673	- 110	- 783
Germany	- 122	- 434	- 556
Bel/Lux	+ 33	- 54	- 21

11. Forecasts for 1979 and 1980 show Italy becoming a substantial net beneficiary from the budget, and the United Kingdom's budgetary loss increasing alarmingly, by no less than £400m., between 1979 and 1980:-

	1979		1980	
	Budget effects	Total effects	Budget effects	Total effects
A. Gainers				
Netherlands	+ 241	+ 846	+ 379	+ 984
Denmark	+ 307	+ 582	+ 278	+ 553
France	+ 123	+ 698	+ 205	+ 780
Ireland	+ 281	+ 465	+ 255	+ 439
B. Losers				
Italy	+ 149	- 439	+ 292	- 296
UK	- 771	- 881	-1170	-1280
Germany	- 300	- 734	- 228	- 712
Bel/Lux	- 30	- 84	+ 38	- 16

(These estimates credit MCAs paid on exports to the UK and Italy to the exporting member country, and assume that the trade benefits or disbenefits will be constant at 1978 levels though in practice they will be affected by changes in world and Community prices and in the volume and direction of transactions.)

12. The total gain or loss per head of population, on the same basis, is estimated as follows:-

	£ per head		
	1978	1979	1980
Gainers			
Ireland	+163	+142	+132
Denmark	+134	+114	+108
Netherlands	+ 61	+ 61	+ 71
France	+ 12	+ 13	+ 14
Losers			
Italy	- 16	- 8	- 5
UK	- 14	- 16	- 23
Germany	- 9	- 12	- 12
Bel/Lux	- 2	- 8	- 2

13. Thus the CAP imposed a resource cost of nearly £800m. on the UK in 1978 and the figure is likely to reach about £1300m in 1980. The breakdown shows that for the UK this adverse resource transfer derives preponderantly from the budget effect rather than from the trade effect. The reasons are twofold: we are relatively big proportionate contributors to the budget, largely because of our greater propensity to buy tariff-bearing imports, particularly of manufactures, from third countries; and, more significantly, we have a relatively small agriculture in relation to our population and so receive only a very small proportion of CAP expenditure on surpluses. Because our disadvantage is essentially budgetary, CAP reform must for us involve essentially a reduction in the policy's net budgetary cost to this country.

B. Approaches to Reform

14. If the critical defect of the CAP is the regular production of much more of the main commodities than the Community market can absorb at the prices determined by the Agriculture Council, it is worth pausing to enquire why this happens. The facile answer is that the prices are too high. This is undoubtedly true, in that there must in principle be an equilibrium price, at a lower level, at which production and consumption would be in balance. But it ignores three central features of the situation. First, there is a rapid underlying improvement of agricultural technology throughout the Community. All other things being equal, this is bound to lead to substantial increases in production. The potential is nowhere near being exhausted. If milk yields, for example, were at the Dutch or British level throughout the Community, the milk surplus would be immensely bigger. The problem the Community faces is not therefore a static one: it has to be dealt with on a technological escalator that is going inexorably upward.

15. The second feature is the fully understandable unwillingness of Governments to inflict on the farm population equilibrium prices which would impoverish many and greatly accelerate the movement off the land. This is partly a problem of farm structure: history and inheritance practice have resulted in huge numbers of tiny holdings in many areas of the Community, so that the numbers of people involved are large, their political importance considerable and the prices they need, if they are to have a reasonable standard of living, excessive in strictly economic terms. But it goes deeper than this. Governments have not been willing to spend the immense sums needed for the painless transfer of a large section of the working population from agriculture into other industries, whether in the countryside or the towns; and in current conditions of relative recession the voluntary movement from the land has slackened and the task of inducing movement been made much more difficult. More basic still is the positive desire of some Continental governments to maintain a large peasant population, as a source of social and political stability and a safeguard against revolution.

16. The third feature is that, as the tables on page 5 show, some countries gain massively in resource terms from the present operation of the policy, since their surpluses are either exported to, or very largely financed by, other member countries. They have a vested interest in preventing major reform; and, as has been noted, Community procedures make it much easier to frustrate change than to bring it about.

17. Against this background, reform designed to eliminate Community-financed surplus production is inevitably difficult. In principle there are three broad approaches:-

I. The adoption of price policies which would force production down towards the level of consumption. With these could be combined other measures designed to accelerate the process or make it less painful.

II. The imposition of physical controls on production through quotas.

III. The transference of cost from the Community budget to national Exchequers.

The following sections of this paper discuss each in turn.

Methods and Decision Making

18. First, however, it may be useful to consider two general points that are often raised in discussion of the CAP: whether the basic method of a managed market is the right one; and whether the decision - making process in Brussels could be radically improved. There are still those who long for deficiency payments systems of the kind we used to operate in this country. The system suited us well: it gave us, as a substantial net importer, access to cheap food from the most economic (often subsidised) sources in the world, to the benefit of our balance of payments and our consumers; while reducing the cost of agricultural support to what the Government decided was desirable. But the circumstances of the Community are radically different, in that it is self-sufficient or more than self-sufficient in nearly all the main temperate commodities. It has no substantial need of imports and their cost is therefore regarded as immaterial. To allow Community prices to fall to world levels by introducing free access would simply transfer a large part of the cost of agricultural support from the consumer, who bears most of it now by having to pay high prices, to the taxpayer, who would have to make good the fall in market returns to the producer. The cost to Community funds - assuming continued common financing - would be enormous, dwarfing the cost of the present policy; and the administrative cost also would be much greater.

19. The decision-making process in Brussels is obviously capable, in theory, of very considerable improvement.. But it is very doubtful whether changes in the process would in themselves effect major changes in the outcome. The outcome of successive price fixings reflects the balance of genuine national interests, both economic and political. These interests cannot be wished away by changing the mechanism through which they operate. The most commonly proposed reform - the involvement of Finance Ministers in agricultural decisions - would almost certainly have very little effect on price decisions, which are determined in response to political pressures that even Finance Ministers cannot control. It might have some effect on fringe decisions - eg special measures for Italy or the UK (the UK butter subsidy would be an obvious casualty since it is self-evidently costly in relation to the benefit to the Community at large). But the net effect on the total cost of the policy - determined essentially by the level of production, which in turn reflects the dynamic effect of price decisions - would be small; and the effect on the net cost to the UK would very probably be adverse.

I. Price Policies

20. In the absence of solutions through a change of support or decision-taking systems, consideration must first be given to the classic economic answer, a reduction in price: the answer, that is, that a free market, even if confined to the Community, would produce. Here and throughout this paper the assessment of options is related to the milk sector only, as constituting by far the largest and most difficult of the CAP's commodity problems.

(i) Reduction of support prices

21. The surplus production of milk - the production, that is, that cannot be sold at the existing levels of support prices - is put, conservatively, at 15 per cent of total Community production. Studies suggest that the price elasticity of supply is about 0.5 (ie that a price reduction of 10% produces a fall in production of 5%); and that the price elasticity of demand for all milk products is about - 0.3 (ie that a price reduction of 10% produces an increase of 3% in consumption). On these assumptions a reduction in support prices of about 20 per cent would be required to eliminate current surplus production.

22. As always with the CAP, the effects of price policies are greatly complicated by potential movements in currencies on the exchange markets, by inflation and by increases in productivity. An initial if highly theoretical assessment of the effect of such a cut in price can however be made by ignoring these and applying the cut to a wholly static situation, ie one which assumes that there is no change in costs or money values. The effect on the Community budget is set out in Annex 1, the net saving of about 2400 million EUAs reflecting mainly the savings on internal subsidies on skimmed milk powder (incidentally, the biggest single item of CAP expenditure), consumer subsidies on butter, and export subsidies on both butter and powder. This saving is over half the current level of Community expenditure on milk; but it may be asked why the saving is not greater since apparently the entire milk surplus is being eliminated. The reason is basically that eliminating the butter surplus does not eliminate the surplus of the by-product of butter production, skimmed milk powder, for which market demand at the full intervention price is very limited.

23. The effects on the UK are also summarised in Annex 1. The saving in our net resource loss from the CAP is put at about £175m. This estimate is based on the somewhat artificial assumption that the reduction in price relates to manufacturing milk (and milk products) only and has no effect on the price of liquid milk.

(ii) Reduction in real terms through freeze on common prices

24. These calculations are clearly quite unreal. First, the situation is far from static; there is inflation in all the member countries, at widely differing rates; rates of exchange are certain to change over time; and productivity increases will almost certainly continue. Secondly, there is almost certainly no chance of the Agriculture Ministers agreeing on an actual reduction of common prices, reducing support prices in terms of national currencies, particularly in a period of general inflation. An attempt has therefore been made to construct a model of what might actually happen if common support prices for milk were held unchanged in ECUs for the four years to 1983.

25. This is set out in tabular form in Annex 2. The model has to predict rates of exchange against the ECU, and rates of inflation in member countries. Both are taken from the Treasury's World Economic Prospects study. Assumptions have

also to be made about movement in the "green" rates at which common prices are converted into national currencies. It is assumed that countries whose currencies are shown as depreciating against the ECU will devalue their green rates to reflect the full devaluation of their market rates, thus raising their prices in terms of national currency and eliminating negative monetary compensatory amounts; but that countries with appreciating currencies would not change their green rates, thus maintaining prices unchanged in terms of national currency and increasing positive monetary compensatory amounts.

26. Before too much weight is placed on the resulting forecasts, it should be said that the prediction of future exchange rates is as hazardous as that of any other commodity price, if not more so. The Treasury model assumes that exchange rates will alter to reflect relative competitiveness in manufactures, ie broadly to reflect differential rates of inflation. In practice, other factors also have their effect: UK experience has shown that general concern about the country's economic prospects can hold sterling at values lower than differential rates of inflation would imply; and, in the other direction, that a feeling of confidence engendered by our healthy situation in regard to oil supplies can hold sterling higher than its relative internal purchasing power warrants. The Treasury's figures are moreover being revised. The model takes no account of the recent fall of sterling and reemergence of a sizeable MCA, but assumes a starting point of broad parity between the green and market rates of the pound.

27. The results of these very tentative projections are striking in two respects. First, even as tough a policy as this - involving real price reductions ranging from 18 to 32 per cent over the four-year period in the various member states - would be expected to reduce Community milk production by 1984 by only about 1 per cent. (It is worth noting that reductions in average real prices in the last two years have as yet had no apparent effect on the continuing increase in production.) Central to this estimate is the assumption that productivity will increase by 1.5 per cent per annum. This may be incorrect, since feeding practices in particular might well change as profitability fell, and a reduction in expenditure on feed could reduce yields. On the other hand the first reaction of many producers to a cost/price squeeze is to increase production through higher efficiency - and there is still plenty of room for efficiency improvement in Continental milk production. No allowance is made for the likelihood that, when a price freeze really began to hurt, many governments would find ways of giving

aid to their producers to keep them in business (thus giving them an advantage over our own producers unless we followed suit). But the likelihood of agreement on a freeze in common prices for four years in any case seems remote, given the extent of the unrest it could be expected to cause if cost inflation continues at anything approaching present rates.

28. Secondly, and still more relevant for this country, a freeze on common prices could hit production in the United Kingdom much more than, say, in Germany. The reason is the combination of a relatively high rate of inflation here with the relatively limited scope for green pound devaluation allowed by the expected depreciation of sterling against the ECU. At the other end of the spectrum, Germany would be least affected, because of its low inflation rates and the assumed absence of any green rate revaluation. The real price reduction would be nearly 6 per cent a year here and only 4½% in Germany. (The change in real support prices here assumes that the sterling price for liquid milk would more pari passu with the price of manufacturing milk. In practice it might be possible to temper the effect on UK dairy farmers by increasing liquid milk prices faster. But this depends on being able to continue to exclude liquid milk imports, and the larger the differential between liquid and manufacturing prices the smaller the chances of this. No such possibility of tempering the effect of a common price freeze is in any case available here for the other main CAP commodities.)

29. The assumption made here about the future relationship between the pound and the ECU is critical, and potentially of immense importance to the whole of British agriculture. In the past we have been able to advocate very restrictive policies on common prices in the happy confidence that even if common prices were at substantially lower levels they would still be attractive to UK producers, if the green pound were devalued to equate with the pound's market value. There were two reasons for this: the relative weakness of the pound; and the fact that common prices were in effect denominated in European Monetary Units of Account - a strong unit confined to currencies in the "snake" and therefore dominated by the D Mark. Now the pound, despite its recent weakening, is stronger; and the adoption for CAP purposes of the European Currency Unit - the ECU based on a basket of all Community currencies - has weakened the unit in which common prices are denominated. The result is to reduce the likely headroom for green pound devaluation, and so to reduce the levels to which UK prices can be raised without an increase in common prices.

30. It can be argued that the Treasury's assumption about the future movement of the pound against the ECU underestimates the pound's potential weakness. The most notable features of the pound's recent movements have however been their suddenness and their unpredictability. Certainly it would be unsafe to assume that the pound will be weaker, over time, than differential rates of inflation would imply; or to assume that, even if it was, a sudden upward surge might not occur at the least convenient time, eg just before a price fixing. This is one of the central facts we have to take into account in considering the prospects for British agriculture over the next few years.

31. The fall in UK milk production predicted by this model would of course reduce materially the resource gain to this country brought about by the reduction of Community surpluses. The resource gain of £175m predicted by the static model would in fact fall to £80m on this more realistic basis. This raises, of course, the further question whether it would be right, or indeed politically possible, to inflict long-term damage on British dairy (or other agricultural) production in order to reap this more limited and possibly short-term net benefit to the economy. If, of course, the model's predictions of exchange rates over-value sterling, we would not face this dilemma. But we cannot be sure that we shall not have to face it, and we need to consider thoroughly the consequences for British agricultural production.

(iii) Social aids to mitigate effects of tough price policy

32. It is sometimes argued that a necessary concomitant of a tough prices policy is social aid to the smallest producers so as to avoid creating great hardship and social upheaval by driving them out of production. This seems a dubious argument, on a good many grounds. First, there are vast numbers of milk producers in the Community whose herds are so small they they cannot conceivably be dependent on them for a living. They are in fact part-timers, and often very prosperous ones. 40% of German farmholders work less than half-time in agriculture; 35% in Belgium, 30% in France, 60% in Italy. A great many of these are small milk producers. There has been a considerable exodus of the very small producers from milk production over the years. To pay the survivors social aid which had the effect of keeping them in production would be perverse, and would retain a part - perhaps not large or necessarily growing, but unwanted nonetheless - of the Community milk surplus. It would moreover seem difficult to defend special payments to the least competitive while those slightly more competitive were being squeezed out by the price policy.

33. Despite these arguments, the proposition should not be dismissed out of hand. If one could ensure that the price was frozen, and mitigate the unacceptable social and political effects of this by relaxing the Community's competition rules so as to enable the member states to pay direct income aids to those who would not otherwise be viable, there could be net benefit to the UK (always assuming that a tough policy on common prices did not in practice damage our interests). The proposal would be very unpopular with the smaller countries, who benefit greatly from Community financing of the agricultural policy. But it would help contain the overall cost of the CAP. If national payments were allowed to build up over the years, part of the financial burden on the UK would in fact have been gradually transferred to other countries. And a relaxation of the Commission's current rigidity on competition policy could be helpful to us internally, both in dealing with the special problems of Northern Ireland and perhaps in other sectors too.

34. The possibility of social aid raises however the much wider question of how to get surplus labour off the land. It has been argued that society, which benefits from increasing agricultural productivity and the lower real prices of foodstuffs to which it should lead, has an obligation to help in the painful transference of labour from agriculture to other industries, and that without such help a really stringent price policy cannot be maintained, nor land and livestock that are surplus to Community requirements be taken out of production. But even if this obligation is accepted, it is not clear that its cost should be borne by Community funds. Put bluntly, there is no obvious reason why a relatively poor country like the UK should subscribe to the cost of solving social problems in substantially richer countries, like France and Germany. We too have our problems of adjustment, in our case in the industrial sector, and there are no massive injections of Community money to help us solve them. It must be one of our aims to ensure that the cost of social payments - whether to carry on producing or to stop producing and take up some other activity - are borne by national Exchequers.

(iv) "Standard quantity" variation on a tough price policy

35. Mr Gundelach is evidently considering a standard quantity approach to limit Community expenditure. The UK has itself advocated something on these lines in the past. Under our own proposal, intervention prices would have been reduced if production exceeded certain fixed levels. This has the merit of simplicity. It acts directly on prices, both to producers and consumers (since market prices would reflect a reduction in intervention prices)

and so should marginally stimulate consumption as well as reducing production. It simulates the effect of a free market, but on a much more modest scale. But other member states have all rejected it out of hand as politically not presentable to their agricultural interests. Its attraction for us may also be smaller now, if our fears on the monetary front are realised.

36. Mr Gundelach's ideas are different, in that they are intended not merely to depress production but to afford a new source of finance to help pay for the policy. The Commission have two different propositions in mind. One would be to limit Community guarantees to a given overall level of production. If production exceeded this, the cost of disposing of the excess would be recovered by a levy on all producers. This is simply the existing co-responsibility made variable in relation to production levels. There would be no effect on market prices. The second is to limit Community guarantees to a limited quantity of intervention purchases. If intervention purchases exceeded this level, then the cost of disposing of the excess would be recovered by a levy on all intervention purchases. The collection of this levy might be facilitated by paying only a proportion of the full intervention price initially. This second proposal would have an effect on market prices, which reflect the return which the producer can alternatively get by selling into intervention.

37. Proposals of this kind have the political advantage of enabling Governments to say that the resulting reduction in producer returns has been brought about by producers themselves, through their decisions to increase production. They can in theory result in an actual reduction in producers' returns, and thus produce an earlier and quicker effect on production than a mere price freeze. They are difficult to oppose in principle.

38. In practice, however, they might turn out very badly. If the levy applied to intervention purchases its incidence would be unpredictable, arbitrary as between member countries, and subject to manipulation by the Commission, since the volume of intervention depends largely on the Commission's policy on export subsidies - the other, and indeed principal, means of disposing of surplus production. There would be strong pressures to exempt small producers from the levy (though it would fortunately be difficult to do so in a system related to intervention purchases, which are made from processing dairies not milk producers). If this were done, it would of course lead to an unfairly heavy incidence of cost on UK producers and the UK economy. Finally, and most significantly, there would be strong pressures for an increase in common prices to offset the expected cost of the levy.

39. This last danger deserves a little attention. Mr Gundelach discounts the possibility, saying he would not countenance it. But he also says that a zero price increase for next year is not a practical possibility, so that he is clearly not as tough on prices as he ought to be. It would not be unusual for the Council to ignore Mr Gundelach's wishes in any case. Other Ministers might well be attracted by a settlement which increased the price by x per cent and offset this increase for producers by a corresponding levy. The reason is that the levy would represent a new source of Community finance, not counted as part of "own resources" and relieving the existing pressures on the budget. In effect a new tax on consumers would have been introduced to supplement the existing "own resources". This would have three detrimental effects for the UK. It would increase consumer prices unnecessarily (thus incidentally increasing the size of the surplus by choking off consumption). It would postpone the day when "own resources" ran out - a day when our negotiating position for securing changes in the CAP will be at its strongest. And it would add a further resource cost to the UK economy, for the balance of payments cost to us (of the levy and the higher import price) could be expected to be substantially greater than our marginal rate of contribution to the cost of surplus disposal in the absence of the levy; and the total budget to which we were contributing would be larger.

(v) Taxation of inputs

40. An alternative method of making milk production less profitable would be to tax inputs, and in particular the imported input, protein feed in the form of soya. It is true that a fairly close inverse correlation can be demonstrated between the price of soya and the level of Community milk production. When farmers find that the cost of feeding cows more protein and so getting more milk is outweighed by the return from sales of the additional milk, they naturally feed more protein. The Dutch industry in particular is known for this and attracts criticism from the French, who argue that production from Community grass is somehow morally superior to production from imported soya, particularly when the latter is American.

41. A tax on inputs would however be wholly perverse in economic terms. If a commodity can be produced more cheaply by an alternative method it is right that it should be so produced. In this way resources are deployed more economically and consumers benefit from lower prices, thus stimulating demand both for the product itself and for other products of the economy. The argument that it weakens the Community's overall balance of payments is weak: first, in the absence of economic

and monetary union balance of payments considerations are a national concern, not Community-wide; secondly, because the Community's prosperity depends on a thriving world economy, and to depress the US economy further by raising fresh barriers to its exports would be perverse. Fortunately the proposition is in any case a non-runner in terms of international negotiation unless the GATT is to be torn up, for it is difficult to see how the Community could compensate the US adequately for the damage which a tax on soya could inflict on her.

(vi) Payments for not producing

42. An option which the Community has already adopted is the payment for not producing: the non-marketing premium, which gives producers money for taking their animals and land out of milk production for five years, and the conversion premium, which pays them to switch from milk to beef or sheep. These payments have three justifications. First, they can bring about a fall in the dairy herd and milk production more rapidly than price policy alone can hope to do. Secondly, they ease the political problem of squeezing producers' returns by offering them cash if they find the going too tough. Thirdly, it can be argued that the reduction needed in the dairy herd to get rid of the milk surplus would depress beef production unduly (since most Community beef production is from dual-purpose herds) unless producers getting out of milk were positively encouraged to go into pure beef production. For all these reasons, and because inducements to leave the industry represent a soft option for producers by comparison with any attempt to reduce profitability, an increase in these premiums is likely to prove the main, if not indeed the only, plank in the UK Farmers' Unions' platform for CAP reform.

43. The difficulty about these premiums is to demonstrate that they are cost-effective. The number of milk producers has for many years been going down anyhow all over the Community. Self-evidently, therefore, a good deal of the money is being paid to people who would have left off producing milk anyway. If, moreover, this paper is right about the possibility of a tough policy on common prices hitting the UK producer harder than those in other member countries, the effect of more attractive premiums might be to increase still further the resulting decline in milk production here, which would certainly not be in the national interest in the longer term. It would be hard to argue that premiums for not producing have no place in a reform policy; but their role must clearly be that of a complement to, not a substitute for, a tough policy on prices. One possibility that deserves consideration is to relieve them from tax: one reason why they have so far been relatively ineffective is that they are taxed as income.

44. A more extreme form of the non-marketing premium - which is a once-for-all payment to go out of milk production - would be to pay producers regularly year by year not to go on producing milk. It can be argued that this would be cheaper than letting them go on producing and disposing of their produce at Community expense: at the margin their milk production is wholly surplus to the Community's requirements and can at present be disposed of only at a virtually total loss; whereas a payment not to produce at all could be limited to the current profit on their production, since they need no longer go on incurring the costs of production. The difficulty again however is to demonstrate the payments' cost-effectiveness when so many would be going out of milk production anyway; and without a time limit on the payments the main result would be to create a new class of pensioners at Community expense. If national Exchequers could be induced to carry the burden, however, the proposal could clearly be more attractive to the UK.

(vii) Abolition of investment aids

45. The Commission have for some years argued that national aids to investment in milk production or processing should be abolished, since these can only act as a stimulus to additional surplus production. The UK has been among the countries opposing this proposal. We have done so on two grounds: first that the promotion of efficiency and productivity must be good in itself, since it should make possible lower price levels and a better use of resources; and secondly on the less disinterested grounds that we wanted to expand our own milk production and saw capital grants as a useful way of helping secure this. We have also doubted whether any formal ban would be applied as strictly in other member countries, where the general subsidisation of interest rates for farmers would make it difficult to implement, as in the UK, where the abolition of capital grants for milk production could be effected at the stroke of a pen. Finally, we have suspected that other member countries might regard this as a substitute for, and an excuse for not pursuing, a tough prices policy, which it certainly is not.

46. We should however consider whether circumstances may not change the balance of advantage for us. If our own dairy industry is to go through a cost-price squeeze we may not succeed in getting substantial new investment here. In such circumstances there could be advantage in inflicting a similar standstill on other countries, to the cost of whose additional production we should in any case have to contribute. There is moreover more scope for additional capital investment in other countries than there is here: our dairy industry is relatively highly capitalised already. Finally, a general ban would have the incidental

effect of reducing Exchequer cost here, while passing the blame for this on to Community institutions rather than the Government alone. A ban on national investment aids is not of course a policy for getting rid of surplus production; but if it could be made effective throughout the Community - an important and difficult condition - it should help at any rate marginally to prevent further production increases. We need to study further the balance of advantage and the practical aspects of control. Meanwhile we certainly should not volunteer an abolition of capital assistance for dairying here in the absence of agreed and effective measures for a similar abolition throughout the Community.

(viii) Structural policy

47. In the early days of the Community the Dutch agricultural commissioner and creator of the CAP, Sicco Mansholt, used to argue that the answer to the policy's problems lay in the improvement of farm structure. If all farmers could be modern, efficient and large enough to afford a family a good living, he reasoned, it would be possible to reduce prices substantially, thus cutting production; and since there would be fewer farmers their political influence, which lay at the root of excessive price levels, would be diminished. It would therefore be worthwhile to spend large sums on persuading farmers to retire, encouraging amalgamations and so on, in order to produce this happier and healthier state of affairs.

48. This thesis is now largely discredited, and with some reason. The initial effect of making farms larger and more efficient would be to increase production, not diminish it. Attempts to correct this by a really tough price policy would still face acute political difficulties, even with fewer farmers. Meanwhile the cost of the CAP would have been increased by the addition of heavy structural expenditure. Finally, other member countries, as has already been pointed out, are not anxious to depopulate the countryside. We for our part have seen little national advantage in contributing heavily to the cost of improving farm structure elsewhere in the Community, when the end-product of a smaller guarantee expenditure could not be guaranteed and indeed seemed implausible.

(ix) Stimulation of consumption

49. The UK has always been in the forefront of those arguing for consumer subsidies as a preferable method of disposing of surpluses to the subsidisation of exports, particularly when the latter were destined for Russia. Consumer subsidies do not however offer a solution of the surpluses problem. The price elasticity of demand for milk products is low: so low that to subsidise all internal sales in order to dispose of surplus production involves a cost roughly three times the value of the additional tonnage disposed of. Export subsidisation is far cheaper; so would be

destruction. Since our concern is primarily budgetary we could scarcely argue for so massive an increase in expenditure. The net effect on our balance of payments should not be adverse, since our share of Community consumption is greater than our share of VAT - based contributions to the budget. But the increased Exchequer cost would run counter to the Government's basic economic policy. The familiar argument that consumer subsidies represent a mere transfer payment within the Community economy, whereas subsidised exports represent a transfer of real resources to third countries, has some validity; but not so much as to justify the huge additional expenditure that would be involved in disposing of the entire surplus by internal subsidisation. The best use of consumer subsidies from the UK's standpoint is the current one, whereby a butter subsidy financed wholly from Community funds is paid in the UK only.

50. An alternative method of stimulating consumption is to tax substitutes for milk products, or ban them by legislative action. A tax on margarine, or the prohibition of alternative fats in the manufacture of ice cream, are familiar suggestions in Brussels. Both are economically perverse, in artificially raising the cost of living of consumers when the basic problem is caused by excessive prices to producers.

(x) <u>Headage payments plus lower price</u>

51. One heroic alternative to a soya tax as a means of discouraging the extra production that comes from heavy feeding of concentrates, and to a subsidy as a means of stimulating consumption, has been put forward by Mr Wallace Day. Under his proposal, the common price of milk would be drastically reduced, so that feeding for increases of production at the margin would become uneconomic; the price reduction would stimulate consumption; and the incomes of dairy farmers would be made good by a headage payment on every dairy cow.

52. The main objection to this is that, like any other system which substitutes payments on all production for expenditure simply on the disposal of the surplus, it would greatly increase the budgetary cost of the milk policy. Under Mr Day's proposals, the headage payment alone would cost almost twice what the whole milk policy costs now. He suggests that part of this should be recouped by a levy on milk wholesalers; but in a saturated market this would be passed back to the producer, thus necessitating a higher headage payment to assure

the same income. Because of the low price elasticity of demand for milk products it seems highly unlikely, too, that the price reduction would clear the surplus from the market; so that there would still be some expenditure on surplus disposal, in addition to the cost of the headage payments. Finally, the UK, with only 13% of the Community's dairy cows, would be contributing substantially more to the cost of the headage payments than we could hope to receive.

II Production Quotas

53. So far this paper has considered ways of reducing the surplus by creating an economic environment in which the producer voluntarily leaves off producing or produces less (or, less significantly, in which the consumer consumes more). An alternative is to take out the voluntary element and impose physical controls on production. So far the Commission has set its face against this. Some member countries see it, however, as an attractive means of combining the elimination or containment of costly surpluses with their other (and weightier) imperative of maintaining farmers' incomes. Certainly a good deal more will be heard of quotas over the next year or two, and they therefore deserve careful consideration.

54. In order to assess the economic effects of quotas, a very simple quota policy has been assumed. As with the options of a 20% price cut, it should be regarded as theoretical only. The assumption is that quotas are set at a level which adds up to consumption at present support price levels (taking account of the commitment to import from New Zealand), and that the reduction from present levels of production is applied at the same percentage rate for each member country. Since this would at a stroke deprive producers of the profit from surplus production it is further assumed that this loss is made good, not by increasing prices, but by making degressive cash payments over a transitional period.

55. On this highly theoretical basis the net saving to the Community budget is put at 1682 EUAs initially, increasing to 2282 million when the degressive payments are phased out. On the same basis the net saving to the UK balance of payments is put at £89m. Details are given in Annex 3.

56. The implausibility of this scenario is manifest. The sudden reduction of production is physically impossible and means would have to be found initially - and probably later too, since production cannot be controlled with precision - of disposing of production that was surplus to quotas. In practice it would have to be converted into products and exported at the world price (which should be distinctly firmer if the volume of Community production fell as planned), without assistance of any kind from Community funds. More serious is the problem of negotiating quotas at a level far below that of current production. The history of the sugar quotas suggests that, except in circumstances of real crisis, quotas could only be negotiated at the current level of production or above it. This would of course institutionalise and perpetuate existing surplus production, though it should at least - provided the disincentive to production in excess of quotas was adequate - prevent it from growing.

57. The UK has consistently supported the Commission in condemning quotas, for the following reasons. First, they would restrict the capacity of the lower-cost farmer or country to expand production, and the pressure on the higher-cost farmer or country to contract. Even if quotas were on a farm basis and transferable across frontiers (as in logic they should be) the price of a quota would act as a tax on the efficient who wish to expand. It must, in theory at least, be economically wrong to prevent market forces from determining where production should take place, and thereby producing the lowest-cost pattern of production. (Against this, it must however be admitted that with widely different price levels applying in the various member countries, market forces are scarcely the determinant factor under present arrangements.)

58. Secondly, we have believed that the effect of ossifying a particular pattern of production, or at least of hindering the transference of production from higher-cost to lower-cost producers, would be particularly damaging to the UK. This is because we have believed that if prices were at the sort of level which would deter surplus production, and if that level were common to all member countries at market rates of exchange, UK production would prove itself the most competitive and would continue to expand, while that in other member countries would rapidly contract. Because of the monetary factors already discussed it is far from clear that this is any longer true.

59. Thirdly, we have been acutely conscious of the difficulty of negotiating quotas at levels which would do more than enshrine and perpetuate existing production levels. We have also wondered whether the practical problems of administering and policing quotas for milk could be solved everywhere in the Community. The task in countries with an agricultural or administrative structure inferior to our own would be daunting: unlike sugar, milk products can be made and marketed on a small scale and thus in a myriad of locations. Finally, we have argued that if quotas could be negotiated and applied they would offer an excuse, which other member countries would be swift to accept, for increasing prices to maintain farmers' incomes, since this could then be done without incurring the risk of bigger surpluses. This would increase the cost of UK imports of milk products, thus offsetting some of the advantage to us of reducing the net budgetary cost to this country of financing surplus disposal.

60. With the possible exception of our belief that quotas would hit expansion here harder than in other countries, these arguments still seem valid and cogent. The exception is important, however; and if quotas have many disadvantages so also have many other of the possible solutions of the surplus problem. It seems no longer appropriate to reject quotas a priori: rather we should make a more thorough study of them than has been done so far, so as to establish clearly whether their disadvantages make them a worse solution for us than the other possibilities.

III National Financing

61. So far discussion has been confined to means of eliminating or reducing surplus production. For the UK, however, it would be equally desirable to find a way of placing part of the Community burden on to national Exchequers, always assuming that the net cost of the policy to this country was thereby reduced.

62. A crude way of doing this would be to "debudgetise" the main commodities: to remove expenditure on them from the Community budget and to fund it nationally instead. A calculation of the net gains and losses for each country if each of the four main commodities were treated in this way is as follows. It is based on the provision for total Community expenditure on each commodity made in the 1980 budget (ie excluding monetary compensatory amounts), and on the assumption that the proportion spent in each country would be as in 1978. The last line in the table shows what rate of VAT would then be needed for the calculation of national contributions to the reduced Community budget.

Net gains and losses (-) from debudgetisation (MEUA)

	Milk	Cereals	Sugar	Beef
Germany	-188	285	108	9
France	394	-253	-223	90
Italy	483	- 38	74	- 58
Netherlands	-568	- 40	1	- 1
Belgium/Luxembourg	- 99	- 85	-102	11
UK	427	200	158	65
Denmark	-235	- 77	- 20	- 28
Ireland	-216	12	6	- 90
Total FEOGA Savings	4692	2021	1087	482
Implied VAT rate (%)	.411	.681	.775	.836

Thus the UK would be a substantial gainer on all four commodities. Rather remarkably, France would be a substantial gainer from the debudgetisation of milk, and this doubtless accounts for the fact that the French have informally floated the idea for this one commodity. The reason is that they are successful in exporting their excess production of milk products to other member countries. The gains to their economy from milk thus come from trade rather than from the budget. (Surpluses involve costs to Community funds only where they are intervened (the subsequent loss on disposal being met from Community funds), stored or subsidised for internal consumption at Community expense, or exported to third countries with export subsidies.)

63. The negotiating problems associated with this approach are sufficiently indicated by the costs to the small countries who are net exporters. The Netherlands (whose self-sufficiency ratio for butter fat in 1977 was 242%), Denmark (215%) and Ireland (185%) would all lose very large sums as a result of having to finance their own intervention and exports to third countries. They would claim that this was grossly unfair when France, for example, gained so heavily on milk from her exports to other member countries.

64. A further complication of this approach is that if member countries had to finance guarantee expenditure themselves there would be a mad rush to "pass the parcel" to some one else. Countries would try to export to other EEC members instead of to third countries, and to force their own surpluses into other member countries to be intervened there or to displace the home product from the market. The UK might well find itself the target of dumped exports of ths kind, particularly if a succession of green pound devaluations continued to give other member countries the advantage of pre-emptive shipments at the rate of MCA prevailing before each devaluation.

65. An alternative to total debudgetisation would be to debudgetise only a fixed proportion of expenditure in each member country; or only expenditure that arose in excess of the level observed at the time when existing "own resources" were exhausted. The fixed proportion idea is the simplest. Provided that there were no significant changes in trade flows, it would operate to our advantage. It would however be very unwelcome to the main current beneficiaries of CAP expenditure. The second proposition would need watching with some care. If expenditure in excess of the given base were identified by simply observing the subsequent level of guarantee expenditure in each member country its incidence would be largely arbitrary, and the UK might well find itself a substantial net loser, as others found means of sending their surpluses here. If it were identified by observing the increase in production in each country following the exhaustion of own resources, or from some other base date, then we might not, given somewhat less buoyant prospects for our own production than we have hitherto assumed, be losers to the same extent. But we would be unlikely to gain substantially from such an arrangement.

66. The conclusion must be that debudgetisation of milk expenditure, in whole or in part, could have advantages for us, since a disproportionately large part of CAP expenditure on milk takes place in other member countries. But we would need to watch any detailed arrangements with great care, so as to ensure that we did indeed emerge as net gainers from the change. Since the countries which benefit from common financing will clearly be very resistant to change, the negotiation of agreed arrangements will be very difficult and is likely to be preceded by a period of chaos as the money runs out and the Commission tries to cope with resulting problems. Both before and during this period there will be strong pressures on us to agree that fresh resources should be provided.

C. The Negotiating Context

67. The CAP is approaching a climacteric when change of some sort seems inevitable. This is because the "own resources" used to fund the policy will probably run out some time in 1981: in other words, the level of expenditure in all sectors of the economy falling to be financed by the Community will exceed total receipts from levies and tariffs on all imports from third countries and the yield of VAT at 1% on the notional basis assumed for calculating member states' residual contributions. Unless the Council of Ministers decides to increase the VAT percentage - which will require unanimity and a Treaty amendment - some part of Community expenditure will have to stop. Whatever the changes in the CAP in 1980 and 1981 they cannot be expected to reduce surplus production in time to prevent this. In the course of 1980, therefore, the Community ought to decide how it will mee the crisis when it comes.

68. Another crunch will come before 1981. The 1980 price fixing promises to be the most important since accession. The reason is that, unless there are significant changes in central rates of exchange before then, no member country other than the UK will be able to give its own producers a substantial price increase by devaluing its green currency. All will be confined to the percentage increase in common prices or something fairly close to it. Since cost inflation is continuing in varying but significant degrees in all member countries, there will be very strong pressures for a significant increase in common prices. This will make our bargaining position a strong one, provided that we are ready to accept the consequences of a common price freeze ourselves, and to sit out the storms which insistence on a price freeze in the Agriculture Council will raise.

69. This raises two further questions: first, how can we best prepare ourselves for a common price freeze; and secondly, what should we seek to achieve through the use of our veto on common price increases? As to the first, we can best strengthen our position by devaluing the green £ before the price-fixing negotiations begin. This in effect means a devaluation before Christmas, since in the New Year it would be easier for the Commission and other member

countries to argue that this should await the price-fixing (even though it is now supposedly Community doctrine that a member country can accelerate movement towards the common price at any time). If we could increase our own support prices by a pre-emptive green £ devaluation, we should be in a much stronger position to hold our against increases in common prices. If we postpone a green £ devaluation, our own producers, faced by rapid cost inflation and deteriorating cash flow, will be desperate for one by the spring and this will present other member countries with a lever to use against us.

70. The second question is the critical one of what we can best hope to achieve by holding out for a price freeze. A price freeze itself would of course be a helpful achievement, though not in itself the solution of the CAP problem. If we have not by then achieved our budgetary aims, the pressure we can exert in the Agriculture Council may be best deployed in securing the co-operation of other countries towards a solution of the budgetary problem.

71. The current attitudes of the other member countries to CAP reform may be summarised as follows:-

France professes herself conscious of the need to do something about surpluses, especially milk. Giscard has agreed with Schmidt that the 1% VAT tranche should not be increased. France's Foreign Minister has said that price policy is not the right answer. He has suggested that a certain amount of each surplus should be nationally financed; and he has pointed out that the surpluses (by which he apparently means intervention stocks) are much larger in Germany and the Benelux countries than in France. On the other hand the senior official in the French Ministry of Agriculture dismisses debudgetisation as an unacceptable blow at the principle of common financing: his Minister favours differential rates of co-responsibility levy linked to the number of cows per hectare, so that the more intensive producers, eg in the Netherlands, Belgium and Denmark, paid most and the least intensive, ie in France, paid least. France is certain, too, to seek arrangements that will in time reduce the competitive advantage which positive MCAs give to the German producer. The political rivalries within France mean that no French government can appear to neglect the interests of French producers; and, as Giscard has said, agriculture is France's North Sea oil. France gives national aids to her agriculture on a very large scale and can be expected to go on doing so.

Germany claims to be determined not to agree to any increase in the 1% VAT tranche. But there is as yet no clear German line on how to contain expenditure within the resulting limit. The Chancellor's cabinet have begun to talk about passing some of the cost of surplus production (defined in terms of national self-sufficiency) back to national Exchequers. The German Ministry of Agriculture reject this as impracticable in view of its unacceptability to the small-country net exporters (Netherlands, Denmark, Ireland). They suggest instead a variable co-responsibility levy on milk producers, sufficient to offset the cost of disposing of all additional production, beginning at 3½% of the common price in 1980 and, for reasons of political necessity (ie the German election), partly offset by an increase in the common price; and a reduction in sugar quotas. Past experience suggests that it would be mistaken to expect Germany to stick to a tough line when the crunch comes: Herr Ertl's concern for the German producer and the German desire to maintain an entente with France are usually too strong for any good intentions expressed before-hand by the Chancellor. Both the Federal and the Länder governments give substantial national aid to German farmers.

Italy is concerned about the burden which the CAP imposes on her economy through the high price of imports (she is in future expected to be a large net recipient from the budget). She will clearly seek to use the own resources crisis to secure national advantage. On past form this may lie rather in increasing Community expenditure on, or protection of, Italian agriculture than in reducing the cost of existing surpluses. She would also view with equanimity arrangements for levying Community producers from which Italian producers were substantially exempt.

Netherlands has a substantial interest, as the tables on page 6 show, in the continued existence of the CAP. She regards this as threatened by mounting surpluses and rising costs and is therefore prepared to contemplate moderate reform, trusting to her competitiveness in production and marketing to see her through. She has also recently introduced tax changes which give substantial national aid to her farmers, including payments to those who pay no or little income tax. She is against quotas and differential producer levies and in favour of moderately firm price policies. But she is careful not to get too far out of line with Belgium and Luxembourg, both of whom give great weight to the interests of their dairy farmers.

Denmark's attitude is similar to the Netherlands'. She does not want the policy to collapse, for she is a major beneficiary; and she is therefore prepared to contemplate moderate reform. In the recent past her primary aim has been to eliminate all MCAs, so that her exports to Germany would no longer bear MCA levies.

Ireland is the largest beneficiary of all, in terms of per capita benefit, and has so far shown no awareness that a problem even exists, beyond routine complaints about the importation of New Zealand butter. Her agricultural production is rapidly expanding under the stimulus of EEC prices. Her basic philosophy is that the maximum possible proportion of CAP expenditure in Ireland should be financed by the Community and the least possible by the Irish Exchequer.

All other member countries wish to preserve the CAP and attach great importance to the social and political stability it has brought to rural areas, to its symbolic value as a co-operative venture between the members of the Community, and to the assurance it affords of ample supplies of temperate food-stuffs.

Enlargement

72. Finally, there is the question of enlargement and its impact on the CAP. Two contradictory theses are sometimes advanced on this: first, that the accession of three Mediterranean countries will reinforce those who want to cut the cost of the CAP, which stems essentially from the over-production of temperate commodities in the north of the Community; and second, that the formation of a Mediterranean bloc will lead to a much heavier total cost as a result of their demands for more expenditure in the south. On balance, the latter seems the more likely of the two. Experience of the Italians has indicated that although they can be useful allies in the attack on "northern" expenditure, when matters come to a crunch they are ready to compromise on the basis of heavier expenditure in the south - expenditure to which the UK has to contribute but from which it generally derives no benefit. We shall need to be watchful that, as Spanish and Portuguese accession draws nearer, the Community is not asked to pay out further larger sums to Italy to compensate her for the increased competition her producers will face from the acceding countries. She has been paid once, in the package of structural measures agreed last year; but there is every sign that she will seek further payment.

Conclusions

73. This paper has led to questions rather than conclusions. If there were a simple solution to the problems of the CAP it would indeed have been found long ago. But the following points emerge:-

(i) The main disadvantage of the CAP for us is its heavy budgetary cost and the large net contribution we have to make to it. Because of the great difficulty of effecting a genuine reform of the CAP, our primary aim must continue to be the correction of budgetary arrangements so as, at best, to eliminate our net contribution. It is easier for other countries to make concessions on the budgetary arrangements than to make the painful changes needed to reduce the cost of the CAP itself. If other countries are still refusing to give us what we want on the budget by the time of the next price-fixing, we should refuse to agree to any common price increases until our budgetary needs have been met. In order not to weaken the additional lever given us by the impending "own resources" crisis, we should be very wary of measures which postpone or evade that crisis by imposing new taxes on producers.

(ii) Price policy is in economic terms the right basic approach to the problem of surplus production and restraint on common prices must remain an essential part of our CAP strategy. But although it may help to contain the problem it cannot be expected to solve it: first, because it is very unlikely that other member countries will accept price restraint over the period or to the extent that is needed, when this will be so painful to their farmers and in some cases inflict real damage on their economies; second, because a freeze on common prices, even over a four or five year period, would seem likely to have very little effect on milk production; and third, because as price policy begins to bite, other member countries can be expected to step up their national aids to agriculture, which are already much larger than ours. Moreover, in the changed monetary circumstances a pure price solution could be more painful for the UK than for some other member countries. We must therefore look for other policies as well. But we must be careful to examine such policies against the criterion of net benefits to the UK. Some of those so far suggested - notably the co-responsibility levy - could weaken rather than strengthen our position. Others, such as payments for ceasing production, or Community-wide restraint on aids to investment in dairy expansion, could be in our interest. But in all cases the detailed implementation will need watching with the utmost care.

(iii) Quotas have very marked disadvantages. But none of the possible approaches to CAP reform is without difficulties and disadvantages, and we should no longer, as in the past, dismiss quotas on a priori grounds. We should consider thoroughly whether their disadvantages for us are greater than those of other solutions.

(iv) Debudgetisation of some CAP expenditure may well prove a helpful and practicable option for us. It is also the most likely solution to emerge from the crisis over own resources, since those who want new Community resources will be the demandeurs, and if no decision is taken to increase own resources national Exchequers will have to take over some part of Community expenditure, willy-nilly. But there will be formidable difficulties in negotiating agreed arrangements with the current beneficiaries of Community expenditure. And we shall have to be extremely watchful to ensure that the revised arrangements do in fact assure us of net benefit. The net benefit to us is in any case unlikely to be very large.

74. This paper has been concerned with the CAP and not, except incidentally, with the future of British agriculture. That future clearly depends very heavily on the future movement of sterling against the ECU. The difficulties of predicting this are manifest. It may be that everything will be all right on the night. But we cannot and must not assume this. Rather we should assume the worst, and consider urgently its possible consequences for British agricultural production and all possible ways of alleviating them.

November 1979

Effects of a 20% reduction in milk prices (based on 1980 budget)

	MEUA
A. Savings to FEOGA:-	
Subsidies on skimmed milk powder (1)	858
Butter consumption subsidies (2)	744
Butter export subsidies (3)	728
Storage of butter stocks (3)	8
Reduced level of MCAs on intra-Community trade (4)	13
Total savings	2454
Loss of income from New Zealand levy	8
Net saving to FEOGA (5)	2446

NOTES

1. The assumed reduction in butter production will bring a reduction of about 825,000 tonnes in the production of skimmed milk powder. It is assumed that this lower level of production would make possible a substantial reduction in the subsidies now paid to encourage its use in animal feed.

2. The assumption is that all internal butter subsidies would be discontinued, as the support price would have been reduced to the level which enabled the reduced production of butter to be sold without subsidy on the Community market.

3. The decline in butter production of 412,000 tonnes would result in a budgetary saving of at 1980 costs 728 MEUA in the cost of subsidising exports of 321,400 tonnes, and at the same time reduce the forecast level of stocks by 90,000 tonnes, thus saving 8 MEUA on storage.

4. The reduced level of production and increased consumption would result in a change in the pattern of intra-Community trade. The effect on MCA payments has been calculated on the basis of MCA percentages for the week beginning 16 July 1979.

5. The calculation of net saving assumes that the non-marketing and dairy herd conversion schemes would be retained, at an estimated cost of 150 MEUA in 1980.

B. Effects on UK

		£m
(i)	Loss of revenue to producers	271
(ii)	Reduced expenditure by consumers	184
(iii)	Balance of payments gain	174

The balance of payments net gain of £174m is arrived at as follows:-

	£m
Costs	
Reduced receipts from retained proportion of New Zealand levy	1
Reduced receipts from subsidy on skimmed milk powder	71
Loss of butter subsidy	75
	147
Savings	
Reduced cost of butter imports (price lower, quantity higher)	24
Reduced level of imported inputs	26
Reduced contribution to FEOGA	271
	321
Net gain (£321m - £147m)	174

NOTES

These estimates are based on the assumption that the price of milk for liquid consumption would not be reduced to reflect the fall in manufacturing prices. The calculation of the saving on imported inputs assumes that for UK agriculture as a whole some 60% of the value of total production is accounted for by input expenditure, some 40% of which is imported. The saving in contributions to the EEC budget is based on a UK marginal percentage contribution of 16.5% and an exchange rate of £1 = 1.49 EUA.

EFFECTS ON MILK PRODUCTION (DELIVERIES TO DAIRIES) OF ASSUMED EXCHANGE RATE AND INFLATION RATE CHANGES (1979-1983) UNDER A COMMON PRICE FREEZE

ANNEX 2

	WG	Fr	It	Neth	Bel/Lux	UK	Ir	Dk	EEC
Estimated Inflation, %	18.6	43.9	64.1	17.6	19.1	59	59	20	
Estimated % change in exchange rates against ECU	+17.1	-10.4	-26.2	+13.8	+14.0	-25.5	-25.5	0	
Estimated % change in real prices, including effects of devalued green rates (1)	-18.6	-32.3	-28.5	-17.6	-19.1	-25	-25	-20	
Real price effect, % p.a.	- 4.4	- 7.25	- 6.5	- 4.15	- 4.5	- 5.75	- 5.75	- 4.6	
(A) Reduction in annual deliveries due to price changes(2), including productivity growth(3) of 1.5% p.a.									
(i) 000 tonnes	+107	-716	-160	+91	+12	-185	-57	+12	-896
(ii) % 1979 production	+ 0.5	- 3.0	- 2.1	+ 0.8	+ 0.4	- 1.2	- 1.2	+ 0.2	- 1.0
(B) Reduction in deliveries if no lags in price response(4) (000 tonnes)	-607 (-2.8%)	-1935 (-8.2%)	-513 (-6.8%)	-259 (-2.3%)	- 97 (-3.0%)	-836 (-5.4%)	-258 (-5.4%)	-162 (-3.2%)	-4667 (-5.0%)
(C) Reduction in deliveries by 1986 including productivity growth(5)	+370 (+1.7%)	-931 (-4.0%)	-188 (-2.5%)	+249 (-2.2%)	+ 49 (+1.5%)	-157 (-1.0%)	- 48 (-1.0%)	+ 66 (+1.3%)	-590 (-0.6%)

Notes overleaf

NOTES TO TABLE

(1) Only those countries with depreciating currencies are assumed to change their green rates of exchange.

(2) Constant supply elasticity of +0.5 is assumed, spread over four years.

(3) Due to improved management, breeding, feeding practices, etc.; assumed invariant with respect to milk prices.

(4) Supply elasticity assumed to operate instantaneously, without lags over time.

(5) Effects by 1986, assuming milk prices in terms of units of national currency remain constant in real terms from 1983 onwards, such that production changes only as a result of productivity growth and the lagged effect of price changes prior to 1984.

ESTIMATED UK BALANCE OF PAYMENTS EFFECTS OF A COMMON PRICE FREEZE FOR MILK.

£m(1979/80 real prices)

Increase in Costs		
1.	Increased costs of butter imports.	40
2.	Reduction in value of subsidy receipts in butter and SMP, and loss of value of exports of SMP.	20
3.	Total	60
Increase in Savings		
4.	Reduction in UK FEOGA contribution	100
5.	Reductions in value of imported imports.	40
6.	Total	140
7.	Net gain to UK balance of payments (£120 ua - £60 ua)	80

Effect of quota system described in text

A. Saving to FEOGA

	MEUA
Subsidies on skimmed milk powder	802
Butter consumption subsidies	744
Butter export subsidies	728
Butter storage	8
Total savings	2282

If cash income payments of 600 million EUAs were made, saving would be reduced to 1682 MEUA.

B. Effect on UK

	£m.
(i) Loss of revenue to producers (assuming income payments)	Nil
(ii) Increased expenditure by consumers (including loss of butter subsidy)	100
(iii) Balance of payments gain	89

The balance of payments net gain of £89m is arrived at as follows:-

Costs

Increase in butter imports	162
Loss of butter subsidy	75
	237

Savings

Reduction in imported inputs	76
Reduced contribution to FEOGA (net of income receipts)	250
	326
Net gain (£326m.-£237m.)	89

FLASH

X-21

E E C BUDGET [ADVANCES]

7

PS
PS/LPS
PS/MR HURD
LORD BRIDGES
MR FRETWELL

HD/EID (I)

MR GOODENOUGH EID (I)

MR MACGREGOR EID (I)

PS/CHANCELLOR
SIR K COUZENS
MR. JORDAN MOSS
MRS HEDLEY-MILLER
MR. ASHFORD
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MR. THOMSON

Treasury

MR EVANS MAFF
~~MR ASHFORD - TREASURY~~

~~MR SHORE - TREASURY~~

~~MRS BLACKBURN~~ CABINET OFFICE
MR FRANKLIN
MR. ELLIOTT
MR. WALSH

MR ALEXANDER No 10 Downing St.

(File)

GR 580
SECRET
FM UKREP BRUSSELS 200840Z NOV 79
TO F L A S H F C O
TELNO 6176 OF 20 NOVEMBER.
AND TO IMMEDIATE BRUSSELS, COPENHAGEN, THE HAGUE, ROME, DUBLIN
PARIS, BONN AND LUXEMBOURG.

Prime Minister

BUDGET/CONVERGENCE

1. THERE HAS BEEN A LOT OF ACTIVITY WITHIN THE COMMISSION IN THE LAST FEW DAYS. BUT I DOUBT IF ITS FINAL POSITION HAS YET CRYSTALLIZED FOR ITS MEETING ON 21 NOVEMBER TO APPROVE THE PAPERS FOR DUBLIN. FROM TALKS YESTERDAY WITH DAVIGNON AND TUGENDHAT AND FROM OTHER SOURCES, MY ASSESSMENT IS THAT

(A) THE BATTLE TO SAY THAT A REFUND OF 520 M E U A (IMPROVING DUBLIN I) IS NOT ENOUGH IS JUST ABOUT WON:

(B) THEY WILL NOT PROPOSE A SINGLE FIGURE:

(C) BUT JENKINS HAS NOT BEEN FIGHTING FOR A MECHANISM ON THE RECEIPTS/EXPENDITURE SIDE AND IT IS PROBABLE THAT THE PAPER WILL ONLY CONTAIN GENERAL REMARKS ABOUT THE POSSIBILITY OF INCREASING COMMUNITY EXPENDITURE IN THE UK EG DECLINING INDUSTRIES OR COAL.

2. I SAID THAT ONLY A MECHANISM DEALING WITH RECEIPTS/ EXPENDITURE COULD CONCEIVABLY BRING ABOUT AN OUTCOME IN 1980 IN OUR AREA FOR NEGOTIATION. A LITTLE MONEY FOR THIS POLICY OR THAT COULD NOT POSSIBLY MEASURES UP TO THE TOTAL SIZE OF THE GAP ON THE RECEIPTS SIDE. FOR THE COMMISSION'S NARROW RANGE OF OPTIONS NOT TO INCLUDE THE POSSIBILITY OF ONE OR EVEN TWO RECEIPTS MECHANISMS WOULD BE A SERIOUS BLOW TO THE CHANCES OF GETTING A NEGOTIATION GOING AND WE SHOULD THEN FACE THE CRISIS. TUGENDHAT WAS GLOOMY ABOUT HIS CHANCES OF CARRYING THE COMMISSION ON A MECHANISM. DAVIGNON SEEMED AT ONE POINT PERSONALLY TO BE HALF-PERSUADED, BUT FELL BACK WHEN HE CONTEMPLATED THE REACTION OF OTHER MEMBER STATES. THE BELGIAN PRIME MINISTER HAD JUST BEEN LECTURING HIM ON THE GREAT DIFFICULTY FOR BELGIUM OF PAYING THEIR SHARE OF 520 M E U A.

3. COMMENT. QUITE APART FROM THE FACT THAT ''SPECIAL EXPENDITURE'' OF THIS KIND COULD HARDLY AMOUNT TO MORE THAN A VERY FEW HUNDRED MEUA, IT WOULD BE HIGHLY DISADVANTAGEOUS FOR US TO PROCEED IN THIS WAY. WE SHOULD HAVE TO FIGHT AGAIN AND AGAIN FOR EVERY INCH OF GROUND OVER AMOUNTS, DEFINITION OF PROJECTS AND THE RATE AT WHICH THE MONEY WOULD BE PAID OUT.

4. JENKINS IS SAID TO BE ULTRA-SENSITIVE ABOUT ANY FURTHER PRESSURE FROM US. BUT AS THE CHANCELLOR OF THE EXCHEQUER SAID TO ME YESTERDAY MORNING, THERE IS NO BETTER CAUSE IN SIGHT, FOR THE COMMUNITY ANY MORE THAN FOR THE UK, IN WHICH HE CAN SPEND THE CREDIT HE HAS BUILT UP BY NOT TOEING THE BRITISH LINE DURING HIS FIRST THREE YEARS. SO I THINK THAT YOU AND/OR THE LORD PRIVY SEAL SHOULD HAVE A GO AT HIM LATER TODAY. HE COULD STILL SWING THE COMMISSION ANOTHER FEW DEGREES IN OUR DIRECTION IF HE WAS DETERMINED TO DO SO.

FCO ADVANCE TO:
FCO - PS/S OF S, PS/ LPS, PS/MR HURD, BRIDGES FRETWELL SPRECKLEY
CAB - FRANKLIN, ELLIOTT, WALSH
MAFF -EVANS
TSY - PS/CHANCELLOR, COUZENS, JORDAN-MOSS, MRS HEDLEY-MILLER
ASHFORD, BAKER, THOMSON.
NO 10-ALEXANDER

BUTLER

cc Press Office 22

Foreign and Commonwealth Office

London S.W.1

20 November 1979

N Sanders Esq
10 Downing Street
London
SW1

Dear Nick,

Developments in the European Communities

We propose to publish on Monday 10 December a White Paper on Developments in the European Communities covering the period January - September 1979. The report is by definition factual and one of a series normally produced every six months.

I should be grateful if you, and those to whom I am copying this letter, would kindly confirm that there is no objection to publication.

Yours sincerely,

Edric.

E R Worsnop
Parliamentary Clerk

cc: J Stevens Esq
Office of the Chancellor of the Duchy of Lancaster
70 Whitehall SW1

P Moore Esq
Chief Whip's Office
12 Downing Street
SW1

FINANCIAL SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Sir L Airey
Sir F Atkinson
Sir A Rawlinson
Sir K Couzens
Mr Jordan-Moss
Mr Unwin
Mrs Hedley-Miller
Mr Lavelle
Mr Ashford
Mr B F Roberts
Mr P G Davies
Mr Dyer
Mr Ridley
Mr Cropper
Mr Cardona

PARLIAMENTARY DEBATE ON EEC BUDGET CONTRIBUTION

The Financial Secretary received this morning a telephone call from Peter Shore. Mr Shore said that he was not happy with the draft motion proposed for Thursday's EEC Budget Debate. (For convenience, I attach a copy.) Instead, we would prefer a simple reaffirmation of the Resolution passed by the House on 16 July, which stated,

> "That this House urges Her Majesty's Government, in view of the United Kingdom's massive and ever-increasing net contribution to the Community Budget, to press for a fundamental reform of the budgetary arrangements so that Britain's contribution to the Budget is at least not greater than the receits."

This was, of course, Opposition amendment to the Government's "take note" motion, no doubt drafted by Mr Shore, which the Government accepted.

The Financial Secretary sees no reason why the Government should accede to Mr Shore's request. But there is no doubt that if the present draft is adhered to, the Government will be accused by the Opposition of retreating from the robust terms of the Resolution passed the House on 16 July and of generally watering down its demands in advance of Dublin. It may well be that the present draft can be strengthened, perhaps by introducing the "broad balance" objective. As it stands, the motion really calls for an "equitable reduction" in the net contribution.

Mr Shore also told the Financial Secretary that he would be opening for the Opposition, with Denzil Davies winding up.

SAJL

S A J LOCKE

20 November 1979

ANNEX

"That this House takes note of Commission document 9093/79 (a Reference Paper on Budgetary Questions), together with supplementary information in documents 9369/79 and 9721 with Addendum 1, and also Commission document COM(79)620 Final (on Convergence and Budgetary Questions), and fully supports the Prime Minister in her determination to secure ~~from our Community partners an equitable and early reduction in the unacceptable large net contribution by the United Kingdom to the Budget of the European Communities~~"

the objectives ~~as~~ approved by the House on 16 July."

Italicised footnote on the Order Paper:-

"Commission document 9250/79, and unnumbered documents on the Draft of the General Budget of the European Communities for 1980, and on a Letter of Amendment thereto, are also relevant."

GRS 400
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FRAME ECONOMIC
FM FCO 191652Z NOV 79
TO IMMEDIATE DUBLIN
TELEGRAM NUMBER 228 OF 19 NOVEMBER
INFO IMMEDIATE UKREP BRUSSELS PARIS BONN ROME THE HAGUE COPENHAGEN LUXEMBOURG BRUSSELS.

Prime Minister

EEC BUDGET: UK CONTRIBUTION

1. THE LORD PRIVY SEAL HAD AN HOUR'S BILATERAL WITH THE IRISH FOREIGN MINISTER IN DUBLIN THIS MORNING WHICH WAS DEVOTED EXCLUSIVELY TO THE UK BUDGET ISSUE.

2. O'KENNEDY HAD LITTLE NEW TO SAY. HE REHEARSED REPORTS ALREADY GIVEN TO US BY IRISH OFFICIALS LAST WEEK OF THE CONSENSUS EMERGING AMONG OTHER STATES THAT THE MOST WE COULD HOPE TO BE OFFERED AT DUBLIN WAS AN IMPROVED VERSION OF THE FINANCIAL MECHANISM OFFERING A MAXIMUM RELIEF OF 520 MUA (POUNDS STERLING 350 MILLION). ONLY THE LUXEMBOURGERS WERE SAID TO BE PREPARED TO CONTEMPLATE OFFERING A LITTLE MORE. THE LORD PRIVY SEAL MADE CLEAR THAT AS FAR AS BRITAIN WAS CONCERNED RELIEF TO THE TUNE OF ONLY ONE-THIRD OF OUR NET CONTRIBUTION WAS DERISORY AND IF THAT WAS ALL THAT WAS ON OFFER AT DUBLIN THEN THE MEETING WAS HEADING FOR DISASTER. O'KENNEDY CONCLUDED THAT THE GAP APPEARED TO BE UNBRIDGEABLE BUT THAT THE PRESIDENCY WERE THINKING IN TERMS OF FURTHER DISCUSSIONS AT THE POLITICAL LEVEL AS A FOLLOW UP TO THEIR OFFICIAL CONTACTS LAST WEEK IN THE LIGHT OF DISCUSSION AT THE FINANCE AND FOREIGN AFFAIRS COUNCIL AND IN THE LIGHT OF THE COMMISSION'S FINAL PROPOSALS PROMISED FOR 21 NOVEMBER, ALTHOUGH THE TIMING AS A RESULT OF THE DELAYED PRODUCTION OF THE LATTER WAS GOING TO BE TIGHT. AS A PRELIMINARY HE PROPOSED TO DEVOTE DISCUSSION AT THE MINISTERIAL LUNCH AT THE FOREIGN AFFAIRS COUNCIL ON 20 NOVEMBER TO THE HANDLING OF THE BUDGET ISSUE AT DUBLIN.

3. ON PROCEDURE O'KENNEDY AGREED THAT THE HEADS OF GOVERNMENT WOULD NEED TO CONCENTRATE ON A LIMITED RANGE OF POINTS FOR DECISION. HE SEEMED TO BE THINKING IN TERMS OF HANDLING BY THE PRESIDENCY AS COREPER WAS UNLIKELY TO BE ABLE TO AGREE A PAPER, THOUGH THIS WAS NOT EXCLUDED. HE AGREED THAT IN ANY CASE THE PRESIDENCY SHOULD FOCUS DISCUSSION UNDER THE FOLLOWING HEADINGS: SCALE OF THE PROBLEM, TIME FOR WHICH A SOLUTION WAS NEEDED, AND MECHANISM BY WHICH A SOLUTION MIGHT BE SECURED. HE THOUGHT THERE MIGHT HAVE TO BE A FOURTH HEADING ON ARRANGEMENTS FOR FINANCING A SOLUTION BUT ACCEPTED THIS MIGHT BE ENCOMPASSED IN DISCUSSION OF THE MECHANISM ITSELF.

CARRINGTON [COPIES SENT TO NO 10 DOWNING ST]

FRAME ECONOMIC
EID (I)

COPIES TO:
PS/LORD PRESIDENT

Original on:- France - July 79 Eurolol: Budget

PM/Giscard Plenary on 19 Nov 79 at No10

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to supply the members of the Community and the IEA. 28% of our total production and 50% of our exports were at present going to the EEC.

President Giscard said that he shared the gloomy estimates which had just been advanced. There was probably not a great deal that Governments could do. The most likely scenario was that prices would go on rising until they reached a point where the production of synthetic alternatives became profitable. He did not know where this level was but it was clearly far above the present price. (M. Giraud interjected that it was not only a question of price: the production of synthetic alternatives on an adequate scale would take 15 years.) The only alternative scenario was the organising of a Western cartel to regulate the allocation and distribution of oil. This would be a radical change but, given the West's lack of control of production, was the only way open. In the past the same people had determined the production level and the price. This had given consistency to the market. Now the oil companies were dealing with distribution; the individual producing countries with the level of production; and OPEC with prices. Operating individually, consumer countries had no leverage on the producers. The larger producers would probably be prepared to co-operate with a cartel: if so, the smaller ones would have no option but to go along. Meanwhile the West would have to take what action it could but without any great hope of success. The right time to take a first look at the structure of the market might come in the spring of next year.

Finance

The Chancellor of the Exchequer said that he and M. Monory had not had a bilateral talk the previous day since they had been in Brussels. He was far from underestimating the importance of the Community in the present troubled international economic situation. The British Government thought the EMS had an important role to play. They wanted it to prosper and would support it. However the British Government still had some hesitation

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/about

about joining the exchange rate mechanism. Owing to the recent abolition of exchange controls, to Britain's domestic economic situation, and to sterling's petro-currency status the position of sterling was still too unstable.

The Chancellor said that the Budget problem was a distressing one. The British Government sought a solution commensurate with the scale of the problem. They thought that the language approved by the Council in 1970 applied in the present case. The proposals under discussion were not contrary to the acquis communautaire. On the contrary it was part of the Community philosophy that the Budget should not be an instrument for the transfer of resources from one member state to another. It was an instrument for the implementation of Community policies. The basis for Britain's case was set out in the Commission documents already prepared for Dublin. We awaited with interest the further document which we understood the Commission was preparing. It was important that the problem should be solved. It inhibited Britain's ability to participate in the Community as fully as we would like.
M. Monory said that the budgetary problem had been fully discussed in Brussels the previous day. The mood of the meeting was that the general philosophy of the EEC should not be brought into question. Equally any idea of a "juste retour" should be put aside. Solutions should be sought in development of the Dublin mechanism or in Article 131. There was also a feeling that the figures produced by the Commission did not give sufficient weight to the disequilibrium in UK trade with non-member countries and member countries. Nobody had closed their mind to agreement in Dublin on a suitable mechanism but equally nobody envisaged a miracle solution.

Foreign Affairs

The Foreign and Commonwealth Secretary said that he and M. Francois-Poncet had discussed the political situation in Iran following President Carter's telephone call to the Prime Minister and President Giscard. It had been agreed that the Community should issue a statement after the political co-operation meeting later that day. They had sent a draft of the statement

/ to

Original:- France : July 79

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Euro Pol: Budget

PM/Giscard Discussion at 1615 on 19 Nov 79 at No10

b) The formulation of joint attitudes on basic energy choices e.g. the scale and direction of nuclear reactor development.

The Foreign and Commonwealth Secretary said that the Danish Foreign Minister seemed to think that Britain ought to be supplying oil to the Community at preferential prices. The difficulty was that the British Government was not in a position to police what the oil companies did. The fact was, in any case, that 30% of Denmark's oil imports already came from Britain. President Giscard said that there was a vague feeling in the Community that the market could be better organised. The spot market in Rotterdam was destroying the market mechanism as it had previously existed. The profits of the oil companies had trebled. But the problems of energy policy had become too big to be handled by the oil companies. It was no longer possible to live by simple market rules. The oil consuming countries should establish a cartel. They were, after all, dealing with a product which was going to be scarce for another twenty years and on which any price could be set by the producers. Unfortunately no-one seemed able at present to propose anything. Paradoxically the countries which would suffer most were the new industrialised countries like Greece and Brazil rather than the highly industrialised countries like France. An oil crisis would hurt France less now than it would have done three years ago. The Prime Minister and President Giscard agreed that the energy problem was the most urgent now facing the world.

Institutional Problems

President Giscard said that he hoped that the Prime Minister would be able soon to define her position on various organisational problems facing the Community. There were three problems which preoccupied him:-

/a)

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a) There were far too many Commissioners. In tackling this problem it would not be enough simply to suppress the second Commissioner slots held by the larger members of the Community;

b) The rotation of the presidency was too rapid. The equivalence between, say, Luxembourg and the Federal Republic implied in the present system was ridiculous. It meant, in effect, the Community had no external representation on occasion. This was a key problem. Whatever solution was found, it should not hurt the smaller members; and

c) The rules for voting in the European Parliament and in the European Council were arbitrary. The weighting in the Council of Ministers did not reflect the true importance of member countries. If progress was to be made in the direction of using majority voting regularly, adjustments would have to be made so that the majority in the Council reflected the majority in the Community as a whole.

The President raised the question of the recent votes in the European Parliament to amend the budget. He said that despite the advantage that votes in the European Parliament would sometimes give to one member or another, there should be stricter rules about the relationship between the Parliament and the Council of Ministers. France had therefore agreed with the Federal Republic to oppose the amendments recently voted through. Neither country was prepared to be out-manoeuvred by the combination of a majority in the Parliament and a minority on the Council of Ministers. If Britain also agreed, there would be no problem. The Prime Minister said that the British Government had not yet taken a position.

The Chancellor of the Exchequer said that it was not altogether simple to reject out of hand the proposals made by an elected Parliament. To do so aroused questions about why its Members had been elected in the first place.

M. Francois-Poncet said that if policies unanimously adopted in the Council of Ministers could be overturned by the European Parliament and a minority on the Council, the balance of the Community's institutions would be radically altered. In the present instance the French Government would welcome the co-responsibility levy on milk while the British Government would not. But the merits of the case were secondary compared with the institutional implications. President Giscard said that he hoped the Prime Minister would review the question, considering the matter not on the basis of the merits of the present proposals but on the basis that the member states did not want policies imposed on them. Once Spain and Portugal had joined the Community, the potential spending nations would have a majority in the European Parliament. The Prime Minister said that she had the impression that the Parliament had acquired its powers over the budget almost by accident. M. Francois-Poncet said that when the budgetary regulation had been adopted member states had not recognised its implications. What had happened in Strasbourg recently had not been foreseen. The French Government regarded it of great importance that member states should not get into an institutional position that would imply fundamental uncertainty on all the problems with which they dealt. At present member states were able to find compromises on controversial issues. The new arrangements would imply that they could never be sure that those compromises would be acceptable. The change would be radical.

/France's attitude to the CAP

Original on:- France : July 79

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Euro Pol: Budget

RECORD OF A DISCUSSION BETWEEN THE PRIME MINISTER AND THE PRESIDENT OF FRANCE, PRESIDENT GISCARD D'ESTAING, AT NO. 10 DOWNING STREET ON 19 NOVEMBER 1979 AT 1615.

Present:

Prime Minister	President Giscard d'Estaing
Foreign and Commonwealth Secretary	M. Francois-Poncet
Chancellor of the Exchequer	M. Monory
Mr. M.O'D.B. Alexander	M. Leclercq

* * * * * *

Community Budget

The Prime Minister said that she wanted to deal first with the question of the Budget. It was a very worrying problem for the British Government. But she did not want it to dominate the day's discussions. She was concerned lest, in raising the Budget issue, she should sound as though she was complaining about Britain's membership of the Community. This was not the case. Britain was in the EEC because the British Government wanted to be in and intended to stay in. They were there because of the larger values that the Community represented.

Nonetheless the anomalous situation which had arisen in the Budget posed very great practical and political problems. Over the last six years Britain's contribution had gone up from 22 million units of account to 1550 million units of account (on the reckoning most favourable to the Community). This was an enormous burden. Britain had become a larger contributor than the Federal Republic even though the national income here was below the Community average. The present British Government intended to remedy Britain's poor economic performance. But until their measures took effect, the British Government wanted to achieve a position of broad balance in their net contribution to the Community. Failure to achieve

/ a broad balance

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a broad balance would intensify the deep public resentment which already existed in this country. Britain's present net contribution was bigger than our entire aid programme; it cancelled out all our invisible earnings; it was being paid, to countries richer than us, at a time when cuts were being made in planned expenditure on education, housing and health.

The Prime Minister said that the President would be familiar with the papers, the calculations and the mechanisms. He would also be aware of the feeling in some member countries that Britain could be given some of what was being sought in Dublin and could wait for the rest. This would not be politically saleable here. The solution found in Dublin must be equitable, reasonable and fair. Britain's net contribution ought to be of the same order and magnitude as that of France, or perhaps a little less since France was a considerably richer country. It was essential that the President should not underestimate either the intensity of feeling in Britain or the resolve of the British Government to achieve a satisfactory result. The position of the whole Community would be problematical if such a solution was not found.

President Giscard said that he recognised the difficulty of the problem. But it was not a bilateral issue and he was anxious that it should not cloud the meeting as a whole. There were some factors that he wished to underline. There had been a renegotiation, initiated at British request, and culminating in an agreement signed and approved by all members of the Community. The negotiation had been a painful one. But the rules then evolved had been presented and ratified as dealing with the problem until 1982. The agreement might be subject to reconsideration in that year.

The President said that he did not dispute that the mechanism approved in Dublin had produced results that were unsatisfactory from a British viewpoint. But other analyses were possible. Most members of the Community had at one time or another been substantial net contributors. Britain's

/ gross contribution

gross contribution, as distinct from her net contribution, exceeded the share that would be indicated by her share of the Community's GNP by 700 million units of account. The other 850 million units of account reflected Britain's failure to get receipts on the appropriate scale. Of the excess 700 million units of account, 50 per cent were due to the fact that Britain's imports from non-members were proportionately higher than those of other members. In other words if the proportion were the same, the excess would be 350 million units of account. France understood that Britain needed time to adjust her trade pattern. But the French Government saw no moral need to compensate Britain for the fact that British consumers preferred Japanese cars to their European equivalents.

The President said that he did not dispute the fact that Britain did not get sufficient receipts from the Community Budget. But the Community could not agree to follow this logic. The Community was founded on the basis that there were common policies that members should implement rather than that everyone should get out of the Budget the same amount as they put in. France in any case was in a position of broad balance and could therefore excuse herself from the discussion of Britain's budgetary problem. The Irish, the Dutch, the Danes and the Italians were the major recipients. The question of transferring resources from those who were net beneficiaries to those who were net benefactors should be addressed to them. But this would of course be absolutely against the spirit of the Community. No other country had ever asked for "broad balance".

Summarising his position, President Giscard said that it was a fact that the UK paid more than her share and received less than her share. Some adjustment would have to be considered. But there could be no compensation for the particular pattern of British imports and there could be no discussion of the concept of broad balance. Moreover, this was a Community problem, not a bilateral one. Of the ideas put forward by the Commission, France could only consider the first two. In any discussion of an adjustment for Britain, every member would have to take its share of the burden.

The Prime Minister said that Britain had adjusted the pattern of her trade faster than any other country had ever done. We had provided an excellent market for both the agricultural and manufactured products of our partners. She did not complain about the increasing share of our market won by continental manufacturers: British manufacturers had been inefficient. She felt more strongly about the fact that although our agriculture was highly efficient, we had had to take the competing products of less efficient agricultural industries. The country did not in fact need German butter or Danish bacon. The present situation on the Budget was bitterly unfair and could not go on. She expected the other members to recognise that Britain was getting a raw deal and that there was no justification for the continuation of the present situation. She hoped that she had made her position clear. There would be no histrionics in Dublin. But she intended to stick to what she had said. Britain expected fair and reasonable treatment.

The Foreign and Commonwealth Secretary, speaking as someone who had been a committed European all his political life, said that the present British Government wished to be good members of the Community. But the budgetary problem was politically very inflammable in this country. The Prime Minister could not ignore the head of steam building up on the question. If she returned from Dublin with something derisory, she would not find it easy to prevent the undoing of everything that had so far been achieved. The latent "little Englandism" in the country could not be defended but it was a fact. The Chancellor of the Exchequer pointed out that it was generally accepted that the Community did not exist to provide for net transfers of resources between member states. But Britain was transferring resources and on a remorselessly upward trend.

President Giscard expressed concern about the political aspects of the Dublin meeting. Council meetings tended to have political consequences. He saw little chance of achieving

/ a solution

a solution in Dublín of the type envisaged by the Prime Minister. The other eight countries could not agree to a sudden transfer of resources on the scale to which the Prime Minister had referred. The small countries were certain to oppose it. He had understood at Strasbourg that the Prime Minister sought a correction of the excess of injustice in the present position. Now she was seeking more. A failure in Dublin need not necessarily be a drama. But the chances of avoiding failure were limited. The Prime Minister said that she recognised that there would be enormous problems if Dublin failed to produce a fair result. But she would stand out for what was fair both at Dublin and thereafter. If the other member countries found it difficult to find their share of Britain's excess contribution, how much harder was it for Britain to find the whole sum?

Sheepmeat

The Prime Minister asked President Giscard whether he was going to sort out the lamb question. President Giscard said that the Community had been at peace on the lamb question until this year. Then it had been raised by Britain, or by the Commission on Britain's behalf, in the courts. For a number of reasons (climate, the inclusion of the wool value in the costing of the meat, the imports from New Zealand, etc.), British lamb was cheaper than French lamb. His Government would oppose the export of British lamb so long as Britain objected to a sensible organisation of the market in sheepmeat. The Commission had made proposals which should be studied. France would wish to see a regime which included a mechanism to stabilise prices; safeguards against disruption; and an agreement by external suppliers to exercise auto-limitation. As a result of the European Court's decision, Britain was legally in a good position. But morally she was in a weak position. At a time when Britain was calling for changes in the rules of the Budget, she was insisting on the rigid application of the rules governing the trade in sheepmeat. The Prime Minister asked whether, on the basis of the President's reasoning, she would be justified in excluding

 / cheap cars

Ref. A0695

MR. ALEXANDER

Community Budget

Vicomte Davignon rang me this morning to let us know of the latest state of the Commission's thinking.

2. He said that their thinking had not departed from the lines indicated in earlier discussions. They would be concentrating their attention on types of solution to the problem which were within the framework of Community principles - what he described as the "corset" - and would indicate possible outcomes which, he said, would please neither side. Though they would please neither side, the hope would be that they would be a useful basis for discussion in Dublin.

3. The Commission is likely to finalise its thoughts and produce a paper later this week, perhaps on Wednesday.

(Robert Armstrong)

19th November, 1979

PM/79/92

THE PRIME MINISTER

The Community Budget

1. I have seen a copy of Geoffrey Howe's minute of 13 November about MCAs and the 1% VAT ceiling.

2. I agree with what he says about the attribution of MCAs.

3. The 1% ceiling problem will not be easy to handle in Dublin. Some Member States may invoke the ceiling as a reason for limiting both the scale and duration of budgetary refunds to the UK. Others, who have an interest in the growth of Community expenditure, may try to secure our acquiescence in lifting the ceiling in order to accommodate our refunds. I do not think we shall face concerted pressure on this: Chancellor Schmidt appears to be firm on maintaining the ceiling; and Giscard is unlikely to shift at this stage. But we obviously have to be careful about our own line.

We have already done so.

4. I agree with Geoffrey Howe that we should not take the lead on the inviolability of the 1% ceiling until we have got a settlement. But it is of major importance to our long term Community strategy that we should not agree to anything in Dublin which would weaken our ability to maintain the ceiling. If one day we agree to raise the ceiling we should exact a substantial price beyond what we have secured in Dublin on a budgetary refund. The ceiling can only be raised by agreement of all nine Member States, duly ratified in accordance with each of their constitutional requirements. What is involved is in effect a new Treaty. So the ceiling provides a powerful lever for securing control over CAP expenditure and a more favourable arrangement for raising new Community revenues; and in due course we should insist on these conditions as the price for raising the ceiling. In the shorter term we may want to point out after Dublin that in addition to obtaining substantial alleviation of our budgetary problem we have retained this lever for securing more fundamental reform in the Community.

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5. Against this background I suggest that our best tactic at Dublin will be to try to defer discussion of how our budgetary mechanism is financed until we have agreement on its other elements. We could then suggest the possibility of financing outside the budget, but there is little prospect of support and it would be very risky to leave such a basic question unresolved at the European Council. A better solution I suggest, would be to accept financing through the budget and to throw our weight behind the Italian proposals to bring down the share of agricultural expenditure. If the Italians, with our support, can obtain a commitment on the limitation and indeed reduction of agricultural expenditure, we should be able to argue that there will be headroom for our refunds within the existing 1% VAT ceiling. In this sense the Italian proposals can be regarded as a valuable adjunct to our own requirements on the budget.

6. I am sending copies of this minute to the members of OD(E) and to Sir Robert Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office

19 November 1979

GRS 770 CONFIDENTIAL

CONFIDENTIAL [FRAME ECONOMIC]

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TO PRIORITY FCO

TELEGRAM NUMBER 587 OF 16 NOVEMBER

INFO PRIORITY EEC POSTS

Mr. M. Alexander
No.10. DS.

COMMUNITY BUDGET CONTRIBUTIONS

1. GERMAN MINISTERS AND OFFICIALS CONTINUE TO EMPHASISE THE DIFFICULTIES OF REACHING AGREEMENT IN DUBLIN.

2. ON 15 NOVEMBER CHANCELLOR SCHMIDT TOLD A MEETING OF THE SPD FRAKTION IN THE BUNDESTAG THAT THE PROBLEM WAS A VERY DIFFICULT ONE BUT NOT INSOLUBLE. THERE WAS NOT MUCH TIME BEFORE DUBLIN. THE FEDERAL GOVERNMENT HAD EXPRESSED ITS UNDERSTANDING TO THE PRIME MINISTER. BUT AT THE SAME TIME QUOTE WE HAVE HAD TO POINT OUT THAT THE PROBLEM CANNOT BE SOLVED BETWEEN TWO COUNTRIES. WE AT ANY RATE CANNOT PUT UP THE DM 1.5 MILLIARD. IF SOMEONE IS EXPECTING AN IMPROVEMENT BY DM 1.5 MILLIARD THAT MEANS THAT OTHERS MUST BE DISADVANTAGED TO THE TUNE OF AT LEAST DM 1.5 MILLIARD. IF AT THE SAME TIME OTHER COUNTRIES .. SAY THAT IF THE BRITISH POSITION IS IMPROVED WHY SHOULD WE NOT ALSO BE GIVEN A BETTER POSITION, IN THAT WAY THE AMOUNTS WOULD INCREASE OVERALL AND THE NUMBER OF COUNTRIES WHICH COULD PARTICIPATE IN RAISING SUCH A SUM WOULD DECREASE. WE DO NOT EXPECT THEREFORE THAT THIS SUM CAN BE ACHIEVED. I SUSPECT THAT THE BRITISH GOVERNMENT GETS RELATIVELY THE BIGGEST DEGREE OF UNDERSTANDING FROM US. HOWEVER, WE DO NOT INTEND TO ASSUME A KIND OF MEDIATING ROLE IN DUBLIN BETWEEN BRITAIN AND THE REST OF THE COMMUNITY. UNQUOTE

3. GERMAN CONTACTS WITH THE FRENCH APPEAR TO HAVE TAKEN MATTERS LITTLE FURTHER AND HAVE DRAWN ATTENTION TO NEW COMPLICATIONS. DOHNANYI WAS IN PARIS EARLIER THIS WEEK ON A MISSION SIMILAR TO THAT WHICH HE WILL UNDERTAKE IN LONDON ON 23 NOVEMBER. THE AUSWAERTIGES AMT HAVE TOLD US THAT HE FOUND THE FRENCH GREATLY PREOCCUPIED WITH THE EUROPEAN PARLIAMENT'S PROPOSALS FOR AGRICULTURAL EXPENDITURE. FRANCE'S NIGHTMARE WAS OF A COMMUNITY RULED BY THE MAJORITY IN THE PARLIAMENT AND THE MINORITY IN THE COUNCIL, BLOCKING THE QUALIFIED MAJORITY VOTE. THE FRENCH THEREFORE ATTACHED THE HIGHEST IMPORTANCE TO THE REJECTION OF THE EUROPEAN PARLIAMENT'S PROPOSALS AT THE BUDGET COUNCIL ON 23 NOVEMBER. THE FRENCH HAD ADDED THAT BRITISH FLEXIBILITY ON A SHEEPMEAT REGIME AND/OR ON FISHERIES COULD AFFECT THEIR POSITION IN DUBLIN.AM DOHNANYI TOLD ME LAST NIGHT THAT THE GERMANS AND THE BRITISH WOULD HAVE TO LINE UP WITH THE FRENCH AT THE BUDGET COUNCIL IF WE BOTH WANTED TO MOVE THE FRENCH AT DUBLIN.

4. GENSCHER'S DISCUSSIONS IN BONN YESTERDAY WITH FRANCOIS PONCET WERE KEPT TO A VERY RESTRICTED CIRCLE BUT OFFICIALS BELIEVE THAT THE STORY WAS MUCH THE SAME. ON MECHANISMS THEY UNDERSTAND THAT THE FRENCH SHOWED SOME SIGNS OF WILLINGNESS TO MOVE IN THE DIRECTION OF THE GERMAN POSITION. BUT THEY REMAINED ALMOST OBSESSED BY THE QUESTION OF THE PARLIAMENT'S PROPOSALS.

5. THE GERMANS, AT LEAST IN THE AUSWAERTIGES AMT, APPEAR TO HAVE CONCLUDED THAT IF THEY WISH TO INFLUENCE THE FRENCH IN DUBLIN IT WILL BE NECESSARY TO LINE UP WITH THEM AT THE BUDGET COUNCIL: AND THEREFORE THAT GERMAN IDEAS SUCH AS THAT EXPRESSED BY LAHNSTEIN TO THE MINISTER (ECONOMIC) (BONN TELNO 672) WILL REQUIRE SOPHISTICATED HANDLING IF THEY ARE NOT TO FALL FOUL OF THE FRENCH. THIS WILL HAVE STRENGTHED THEIR OWN CONCLUSION THAT THE PARLIAMENT'S PROPOSALS CANNOT BE ACCEPTED. ON FISHERIES THE GERMANS WILL, OF COURSE, GO ALONG WITH EVERYTHING THE FRENCH SAY. BUT THIS DOES NOT APPLY TO SHEEPMEAT WHERE THIS WEEK BOTH LAHNSTEIN (FINANCE MINISTRY) AND MORAWITZ (ECONOMICS MINISTRY) HAVE SEPARATELY EXPRESSED TO US THE FIRM HOPE THAT WE WILL NOT OFFER AN EXPENSIVE SHEEPMEAT REGIME TO THE FRENCH AS A QUID PRO QUO.

6. OFFICIALS, CONCERNED AT THE RALATIVE LACK OF MOVEMENT ON THE DIRECT QUESTION OF BUDGET CONTRIBUTIONS, HAVE STARTED TO CAST AROUND FOR OTHER INCENTIVES TO BRITAIN. MORAWITZ SUGGESTED TO COUNSELLOR (ECONOMIC) THAT THE OVERALL SUM OF MONEY FOR BRITAIN COULD PERHAPS BE IMPROVED BY INCREASING THE NON-QUOTA SECTION OF THE REGIONAL FUND. THE COMMUNITY MIGHT AGREE TO AUGMENT THIS IN THE INTERESTS OF THE UK, ITALY AND IRELAND BY, SAY, 2 - 300 MEUA: AND ALLOCATIONS THEREFROM MIGHT BE BIASED IN FAVOUR OF THE UK TO GIVE BRITAIN AN EXTRA 250 - 300 MEUA. THIS WOULD BE SUBSTANTIALG ADDITION TO 520 MEUA ACHIEVED BY REMOVING THE DUBLIN BRAKES. HE AND OTHER OFFICIALS HAVE IN THE THE SAME CONTEXT MENTIONED COMMUNITY MONEY FOR BRITISH COAL INVESTMENT AND INTEREST RATE SUBSIDIES FOR THE UK ON JOINING THE EMS EXCHANGE RATE MECHANISM. WE HAVE DONE NOTHING TO ENCOURAGE THE GERMANS TO THINK THAT SUCH IDEAS WOULD HAVE MUCH APPEAL IN LONDON.

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FRAME ECONOMIC:
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Civil Service Department,
Whitehall,
London, SW1A 2AZ

With the Compliments

of the

Lord President of the Council

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Euro-Pol

Civil Service Department
Whitehall London SW1A 2AZ
01-273 4400

16 November 1979

Mr Nigel Lawson, MP
Financial Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Nigel,

EEC 1980 BUDGET

will request if needed

Your minute of 14 November about the line which you propose to take at the Second Budget Council on 23 December was discussed at the Prime Minister's briefing meeting yesterday and as a result we agreed that there was no need for OD(E) to meet. The Foreign and Commonwealth Secretary has agreed that I should circulate this minute, recording the outcome of the discussion.

2. I think there is now agreement that, at the Council, you would not seek an increase in the maximum rate of increase in Budget Expenditure to accommodate increases in the Regional and Social Funds which we would otherwise support, but that we should adhere to the terms of the Gentleman's Agreement reached during the 1979 Budget discussions on a scaling-down procedure.

3. We also agreed that, subject to the outcome of the Prime Minister's discussion with President Giscard, we should vote for the proposed reductions of provision for milk expenditure in Chapter 62, mainly for transfer to Chapter 100. You would however vote against the co-responsibility levy on the grounds that your support for this would mean the usurping of the authority of the Agriculture Council; such opposition would therefore not rule out the possibility of a non-discriminatory levy agreed by the Council.

4. If, however, the Prime Minister is pressed by President Giscard to adopt a tougher line towards the Parliament's attempt to arrogate financial and policy-making powers to itself, she could if she so wished agree to vote against all amendments proposed for the milk sector, including the minor estimating changes. A supplementary brief is being prepared accordingly.

5. I am sending copies of this minute to the Prime Minister, members of OD(E), and to the Secretaries of State for Industry and Employment.

Yours ever
Christopher

SOAMES

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19 NOV 1979

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MOTOBA

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OMV(79)2(ii)Addendeum COPY NO 3

16 November 1979

VISIT OF PRESIDENT GISCARD D'ESTAING
19/20 NOVEMBER 1979
EUROPEAN COMMUNITY QUESTIONS: BUDGET
1980 COMMUNITY BUDGET

Supplementary Brief by the
Foreign and Commonwealth Office

INTRODUCTION

1. President Giscard may seek to obtain the Prime Minister's support in opposing the European Parliament's modifications to certain agricultural items in the 1980 Community Budget. There are two main issues here. On the constitutional issue we would agree with Giscard that it would be undesirable for the Parliament to increase its influence at the expense of the Council. On the other hand, we want to encourage British MEPs who have worked hard to get the European Parliament to criticise the cost of the CAP. On the policy issues we could support some of the proposed modifications such as the Regional and Social Fund, and go along with the main proposals affecting the milk sector but not that relating to a co-responsibility levy which would discriminate against the UK. In any event we would not wish the maximum rate of increase of budgetary expenditure to be exceeded. The Prime Minister will wish to judge for herself at the meeting whether or not she should offer UK support for the French position on the agriculture proposals, which is to oppose the minor proposals as well as the proposal for a co-responsibility levy

2. This brief supersedes paragraph 8 of the Background on European Community questions (Institutions)

/POINTS TO MAKE

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POINTS TO MAKE

3. [If Giscard raises the 1980 Budget and the Prime Minister does not wish to make a concession to the French position].
We are considering both the constitutional and agricultural aspects which arise from the Parliament's action in preparation for the Second Budget Council on 23 November, but in any case would not support any proposals to exceed the maximum rate of increase of budget expenditure.

4. [If the Prime Minister judges that a concession to Giscard would be helpful on the Budget issue].
The UK maintains its view that CAP expenditure on milk production is excessive and must be reduced and will pursue the matter vigorously in other contexts. But, in view of the need to avoid an increase in the influence of the Parliament at the expense of the Council, the UK is prepared to support the French (and others) in resisting the Parliament's proposed reduction of 380 mEUA in support for dairy production as well as the provision they have proposed for a co-responsibility levy on milk.

5. [For use if Giscard raises the Parliament's proposals on other budgetary items].
Still considering what line to take at the 23 November Budget Council. Likely to support Parliament's proposals for a larger Regional Development Fund, question their request for an additional 240 staff and agree that the total figures should if necessary be scaled down so as not to exceed the maximum rate.

/BACKGROUND

BACKGROUND

AGRICULTURAL EXPENDITURE

6. Two of the Parliament's proposed modifications to the agricultural items in the draft Community Budget are of particular concern to the French since this is the first time that the Parliament has proposed modifications to agricultural guarantee expenditure:

(i) a reduction of 380 mEUA in expenditure on dealing with surplus milk production (although most of this amount would reappear in the reserve Chapter of the Budget);

(ii) provision for an increase in the co-responsibility levy on milk.

It is the decisions of the Agriculture Council and the Commission, not the Budgetary position, that will in the end determine what is spent or whether the co-responsibility levy will be increased. How far, if at all, these decisions would be affected by the acceptance of the Parliament's modifications is a matter of judgment.

7. As far as (i) is concerned, the apparent UK interest is to support the reduction, since we believe the expenditure in this area could and should be reduced. Moreover, expenditure depends to a great extent on the day to day decisions of the Commission on the management of the milk market and it is possible that the lower figure could have some influence on the Commission's actions. At the least, we could argue that acceptance of the Parliament's modifications should be regarded as a sign of the Council's determination, in principle, to curtail agricultural expenditure. The proposal will stand unless the Council musters a qualified majority against it. This means in practice that two large States, acting together, can ensure that it is approved. The Italians are almost certain to support it. The attitude of the UK is therefore of central importance.

8. On (ii), the UK interest is to oppose the co-responsibility levy which is in a form that would discriminate against UK milk producers. If the Parliament's modifications were accepted, our opponents in the Agriculture Council would be likely to claim that the Budget Council had agreed in principle to such a levy. The voting rules governing Council acceptance of this proposal are not

/clear.

clear. It seems possible that a qualified majority is needed in its favour. This is unlikely to be formed.

9. Even though the French probably favour a discriminatory levy, they are against the Parliament's proposals because they are afraid they will set a precedent which the Parliament will subsequently exploit to increase its influence over the CAP. Given that the Parliament is acting within its powers we believe French fears are exaggerated, though they are not groundless. It is probable, though not certain, that the Parliament's influence would tend to be exerted in the direction of curbing some of the excesses of the CAP. This would be the objective of the British MEPs who seem to have done quite well so far in mustering support for their views.

10. If nothing is to be won from the French, the right line to take at the Budget Council will probably be to vote <u>for</u> 5(i) above (this will please the Italians) and <u>against</u> 5(ii) (we will want to vote against the latter, in any circumstances). But this can only be decided in the light of the meeting with Giscard and the tactical situation next week.

<u>OTHER EXPENDITURE</u>

11. The Parliament have made numerous other proposals to modify and amend the draft Community Budget including a proposal to increase the size of the Regional Fund. None of them, however, raises the same kind of institutional questions as those on agriculture (see above) and Giscard is unlikely to raise them. A line to take is provided on the Regional and Social Funds and on the Parliament's proposal to increase its staff by 240 in paragraph 5 above.

<u>BUDGETARY PROCEDURE</u>

12. Under the Treaty, a Second Budget Council is required to meet this year, not later than 23 (or possibly 26) November, to consider the Parliament's modifications and amendments to the draft Budget approved at the First Budget Council in September. The Second Budget Council will thus take place before the European Council. It votes on what the Parliament has proposed (the voting rules vary according to the category of expenditure and certain other criteria). The Parliament then considers the draft Budget again,

/has the

has the power to alter some of the Council's decisions and is required to adopt or reject the entire Budget by about the middle of December. Information on the internal Second Budget Council agreement of March 1979 is contained in paragraph 9 of the Background of Brief OMV(79)2(vi). The maximum rate of increase of budget expenditure declared by the Commission in the light of certain economic criteria may be altered if both the Council (acting by a qualified majority) and the Parliament (acting by a 3/5 majority) agree.

Foreign and Commonwealth Office

16 November 1979

E11(i)
cc PS
PS/PJS
Mr Bullard
Lord Bridges
Mr Fretwell

LORD CARRINGTON

EEC 1980 BUDGET

I shall be attending tomorrow's meeting of OD(E) in the Chancellor's place tomorrow.

Before that meeting, you and other members of OD(E) may like to be aware of a number of points which have arisen in connection with the meeting of the EEC Budget Council on 23 November to which I shall be going. The Council will have to consider amendments and modifications proposed to the Draft Budget by the newly-elected European Parliament. The changes cover a wide field; many are to re-instate proposals made by the Commission in the Preliminary Draft Budget which the Budget Council on September 11 reduced or deleted, either on grounds of economy or because there had been no Council policy decisions to which the proposed budgetary provision would relate. But the Parliament's amendments include in particular increases of 350 MEUA for the Regional Fund, and 110 MEUA for one item of the Social Fund (Item no 5100 of the Draft Budget), above the level agreed by the Council on 11 September. If these were accepted the total net benefit to us would be unlikely to exceed about £25 million. The Parliament has also proposed a series of modifications relating to CAP expenditure on milk, including a co-responsibility levy. The intention of these changes appears to be to reduce CAP expenditure. The changes proposed in two of the modifications could be regarded as being within the margins of error of the FEOGA estimates as a whole. But the modification relating to the co-responsibility levy involves a different principle in that it requires a change in Council policy and would not be in the UK's financial interest.

Our partners will probably want to reject most of the Parliament's amendments and modifications and to assert the primacy of the Council of Ministers. But the Italians will want to support the Parliament on the Regional and Social Fund amendments; the Irish may do the same on the former.

4. We have considered whether the line to be adopted in Budget Council on these Parliamentary proposals could have any bearing on our negotiation to redress the net UK contribution position, and in particular whether there would be any possibility of action by us to achieve deferment of decisions on the 1980 Budget until after Dublin. This, however, is not possible. The Presidency must hold the Budget Council not later than 26 November, ie before Dublin, because if the Council does not inform the Parliament of its decisions on the latter proposals by 27 November the Parliament would be entitled under the Treaties to assume that all its proposals had been accepted.

5. The next possibility might be to take action at the Budget Council which would serve as a warning to other Member States of the possibility of our disrupting budgetary procedures later, if the outcome of Dublin is not satisfactory to us. There seem to be two possible ways in which we might do this, but we would for both need the support of the Italians.

a. One way would be to support all the Parliament's modifications on CAP expenditure. Because of the relevant voting rules we could together ensure that at least some of these were accepted by the Council (there is uncertainty about which rules would apply to the Parliament's proposal involving the co-responsibility levy). The majority of Member States would be strongly opposed to the proposals, not only because they would reduce provision for the CAP but also because they would result from the action of the Parliament in an unacceptable area.

b. The other way would be to support the Parliament's proposals for increased provision on the Regional and Social Funds which would take the total of increases in non-obligatory expenditure beyond the ceiling permitted under the "maximum rate" arrangements but then, since other Member States would not agree to a new higher maximum rate, to refuse to honour the agreement reached between Member States (except the Netherlands) earlier this year on a scaling-down procedure designed to prevent a repetition of last year's dispute between the Council and Parliament.

However, such actions would in the end be unlikely to produce significant financial benefit for the UK and in any case would be a considerable provocation in the run-up to Dublin. It would certainly not pre-dispose tho majority of our partners in our favour in the negotiation on the UK contribution.

7. If we do not want to serve any warning on other Member States as set out above, we could reject all the Parliament's modifications on CAP expenditure, and their proposals on the Regional and Social Funds - such rejections being what most other Member States are likely to favour.

8. This course would, however, produce no financial benefit for the UK, but the Council's actions in rejecting the Parliament's major proposals would undoubtedly provoke maximum difficulties between the Parliament and Council.

9. Between the two courses set out in paragraphs 4 and 6 above, there are two others:-

a. We could support increases for the Regional and Social Funds, but within the maximum rate, thereby aiming at a compromise acceptable to the Germans and French; we would also reject the Parliament's modifications on the CAP.

b. While opposing those modifications on the CAP which involve a point of principle such as the co-responsibility levy (but perhaps accepting the others), we could support in full the amendments on the Regional and Social Funds, but accept thereafter the scaling down provisions referred to in paragraph 4(b) above. This would ensure a higher level of UK receipts than would the course in paragraphs 4(b) and 6 because the Regional and Social Funds would take up a larger proportion of the margin.

10. To sum up, we appear to have three basic options:-

i. an extremely tough approach, taking the line discussed in paragraph 4; or

ii. a very modest line, as discussed in paragraph 6; or;

iii. a middle course, as set out in paragraph 9.

For the reasons set out in paragraphs 5 and 7, it is unlikely to be in our interest to support either (i) or (ii) above. The choice therefore lies between the two variants set out in paragraph 9. The second of these seem preferable because it produces a greater financial gain to the UK. This would not appeal so much to the French and Germans as the first, but since they would be likely to expect us to adopt it, there would be very little risk of a violent reaction from them, during the run-up to Dublin.

It is possible that at the end of the day, ie after Dublin, there will in any case be a clash between the Council and the Parliament over the 1980 Budget, resulting primarily from the Parliament's own attitudes and actions. This clash could, as last year, raise questions about the legality of any Budget adopted by the Parliament. Alternatively, the Parliament may reject the Budget entirely and call for a new draft. In either event we can consider out attitude at the time, though , depending on what happened, our influence on the outcome might be limited. The line in paragraph 10 would preserve our freedom of action.

President Giscard may well ask about the UK attitude to the Parliament's amendments and modifications. The French are strong on the supremacy of the Council of Ministers. We could, if necessary, have a word about the whole question at OD(E) tomorrow, or at our briefing meeting for President Giscard's visit.

Subject to the decision of Legislation Committee, there is likely to be a debate in Parliament here next week on Community Budget matters. The debate is likely to concentrate on the net contribution issue but the order paper will include reference to documents on the 1980 Budget. Members may well expect some indication of the main lines of the likely Government attitude at the Budget Council later the same week.

I am copying this to other members of OD(E) and to the Secretary of the Cabinet.

NIGEL LAWSON
14 November 1979

Ref: A0671

copy on: France, July 79, Giscard visit.

MR. ALEXANDER

You may like to have a note of those who are attending this afternoon's meetings:

Meeting on EEC Budget

Foreign and Commonwealth Secretary
*Chancellor of the Exchequer
Lord Privy Seal
Lord President
Sir Robert Armstrong
Sir Michael Palliser
Sir Kenneth Couzens
Mr. Franklin

*TheChancellor of the Exchequer may well now be engaged in media briefings and with the 1922 Committee after his statement this afternoon. I believe he has asked if the Financial Secretary can attend in his place. The Financial Secretary will not be familiar with the papers, and I doubt if his presence is necessary, given that Sir Kenneth Couzens is coming.

Briefing Meeting for Visit of President Giscard

Foreign and Commonwealth Secretary
Chancellor of the Exchequer
Secretary of State of Industry
Secretary of State for Defence
Secretary of State forEnergy
Lord Privy Seal
Lord President
Minister of Agriculture
Sir Robert Armstrong
Sir Michael Palliser
SirReginald Hibbert

Mr. Fretwell

Sir Kenneth Couzens

Sir Frank Cooper

Sir John Lippitt, Department of Industry

Mr. Priddle, Department of Energy

Mr. Franklin

M.J.V.

(M.J. Vile)

15th November 1979

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PP ROME

PP UKREP BRUSSELS

PP BONN

PP WASHINGTON

RR BRUSSELS

RR LUXEMBOURG

RR THE HAGUE

RR DUBLIN

RR COPENHAGEN

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Mr Ferguson
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Prime Minister

(FCO)

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TELEGRAM NO 827 OF 14 NOVEMBER
INFO PRIORITY ROME UKREP BRUSSELS BONN WASHINGTON
INFO ROUTINE BRUSSELS LUXEMBOURG THE HAGUE DUBLIN COPENHAGEN

FRANCE/ITALY : VISIT OF THE ITALIAN PRIME MINISTER

1. SIGNOR COSSIGA SPENT 13 NOVEMBER IN PARIS FOR TALKS WITH THE FRENCH GOVERNMENT. HE HAD TETE-A-TETE MEETING WITH PRESIDENT GISCARD AND DINNER WITH THE FRENCH PRIME MINISTER . THE FOLLOWING REPRESENTS WHAT WE HAVE LEARNED FROM THE MINISTER AT THE ITALIAN EMBASSY AND FROM THE ELYSEE (DEPUTY DIPLOMATIC ADVISER AND COUNSELLOR FOR ECONOMIC AFFAIRS). THE FRENCH VERSION OF THE TALKS CLEARLY REFLECTED THEIR OWN SLANT ON COMMUNITY ISSUES.

UK BUDGET CONTRIBUTION

2. THERE SEEMS TO HAVE BEEN NO DETAILED DISCUSSION ABOUT THE COMMISION OPTIONS. SIGNOR COSSIGA TOOK THE LINE THAT THE UK PROBLEM HAD TO BE ACCOMODATED. HE WAS CONCERNED ABOUT THE POLITICAL ONSEQUENCIES OF FAILURE AT DUBLIN, BUT DID NOT THINK IT WOULD BE POSSIBLE TO SATISFY COMPLETELY BRITISH DEMANDS. SIGNOR COSSIGA, EXPRESSED THE HOPE THAT THE FRENCH WOULD BE PRAGMATIC AND FLEXIBLE.

EXPRESSED THE HOPE THAT THE FRENCH WOULD BE PRAGMATIC AND FLEXIBLE.
THE FRENCH TOOK THE LINE THAT BRITISH DEMANDS WERE EXCESSIVE BUT THAT SOMETHING HAD TO BE DONE. FOR THE ELYSEE, AN IMPORTANT DEVELOPMENT WAS THAT SIGNOR COSSIGA DID NOT ARGUE THAT THE ITALIANS SHOULD BE FREED FROM ANY OBLIGATION TO CONTRIBUTE TOWARDS THE UK REBATE. THE ELYSEE DECLINED THAT THE ITALIANS SHOWED SIGNS OF SHARING THE FRENCH VIEW THAT ANY SOLUTION SHOULD BE BASED ON EXISTING MECHANISMS.

3. SIGNOR COSSIGA EMPHASISED HIS VIEW THAT TOO MUCH WAS BEING SPENT ON SUPPORT FUNDS AND NOT ENOUGH ON DEVELOPMENT AND ''ORIENTATION''. THE FRENCH EXPRESSEDM A CERTAIN SYMPATHY FOR THE ITALIAN COMPLAINT THAT NOT ENOUGH FUNDS WERE GOING TO THE MEDITERRANEAN BECAUSE OF FRANCE'S OWN PROBLEMS IN THE MEDITERRANEAN LINKED TO ENLARGEMENT. (SEE PARAGRAPH 5 BELOW).

COMMON AGRICULTURAL POLICY

4. THERE WAS A GENERAL TOUR D'HORIZON. ACCORDING TO THE ELYSEE, PRESIDENT GISCARD EXPRESSED NO MORE THAN ''PRUDENT SYMPATHY'' FOR ITALIAN VIEWS ON CAP REFORM. THE FRENCH WERE READY TO CONSIDER ''REASONABLE CHANGES'' TO THE CAP, PARTICULARLY AS REGARDS SURPLUSES. BUT THIS HAD TO BE CONSIDERED ON A ''COMMUNAUTAIRE'' BASIS. THE FRENCH GOVERNMENT WERE UNDER CRITICAL PRESSURE FROM GAULLISTS TO CONCEDE NOTHING ON AGRICULTURAL EXPENDITURE. THE GAULLISTS WERE NOW LINKING THIS WITH THE DEMANDS IN THE EUROPEAN PARLIAMENT WHICH THEY CLAIMED WERE GOING BEYOND THE COMPETENCE OF THAT BODY AND AFFECTED FRANCE'S SOVEREIGNTY. THE FRENCH COULD NOT ACCEPT THE WAY IN WHICH THE EUROPEAN PARLIAMENT WERE TACKLING THE AGRICULTURAL PROBLEM.

ENLARGEMENT

5. THE ELYSEE CONFIRMED FRENCH PRESS REPORTS THAT SIGNOR COSSIGA EXPRESSED SUPPORT FOR ENLARGEMENT TO SPAIN AND PORTUGAL BUT WAS ANXIOUS TO ENSURE THAT ITALY DID NOT CARRY THE COST. ACCORDING TO THE PRESS, COSSIGA SAID THAT HE INTENDED TO MAKE SOME ''ROBUST OBSERVATIONS'' ON THE COMMISION DOCUMENTS ON ENLARGEMENT AT DUBLIN AND TO ASK FOR A CLEAR COSTING. ACCORDING TO THE ELYSEE, THERE WAS A CONVERGENCE OF VIEWS ON THE NEED TO SAFEGUARD MEDITTERRANEAN AGRICULTURE IN THE CONTEXT OF ENLARGEMENT, GIVEN FRANCE'S OWN AGRICULTURAL INTEREST IN THE SOUTH.

COMMON JUDICIAL AREA

6. SIGNOR COSSIGA INDICATED THAT THE COMMON JUDICIAL AREA WOULD

COMMON JUDICIAL AREA

6. SIGNOR COSSIGA INDICATED THAT THE COMMON JUDICIAL AREA WOULD BE ONE OF THE MAIN PRIORITIES FOR THE ITALIANP PRESIDENCY NEXT YEAR. HE WANTED THE SCOPE OF COMMUNITY AGREEMENT ON MEASURES TO DEAL WITH CRIMINALS WHO COMMITED ACTS OF VIOLENCE TO BE CLEARLY DEFINED, WITHOUT, HOWEVER, SPECIFIC REFERENCE BEING MADE TO TERRORISTS. PRESIDENT GISCARD NOTED THAT THE FRENCH TRADITION OF POLITICAL

ASYLUM MADE THIS A FAIRLY SENSITIVE SUBJECT FOR FRENCH PUBLIC OPINION.

THEATRE NUCLEAR FORCE MODERNISATION

7. SIGNOR COSSIGA WAS OPTIMISTIC THAT DECISIONS ON TNF MODERNISATION WOULD BE TAKEN IN DECEMBER. WHEN ASKED WHAT ACTION FRANCE WOULD CONTE

WOULD BE TAKEN IN DECEMBER. WHEN ASKED WHAT ACTION FRANCE COULD CONTEMPLATE TO BACK UP THESE DECISIONS, PRESIDENT GISCARD TOLD SIGNOR COSSIGA THAT HE WANTED TO SHOW SOLIDARITY WITH THE REST OF THE ALLIANCE AND WAS HOPING TO BE ABLE TO MAKE AN ANNOUNCEMENT ABOUT THE MODERNISATION OF FRENCH NUCLEAR FORCES AT ROUGHLY THE SAME TIME AS DECISIONS ON TNF WERE TAKEN IN BRUSSELS. (COMMENT: THIS MAY MEAN AN EARLY FRENCH DECISION ON A LAND-BASED MOBILE MISSILE.)

MIDDLE EAST

8. THERE WAS A LENGTHLY DISCUSSION ON THE MIDDLE EAST AND THE PLO . THE FRENCH AND ITALIANS SEEM TO HAVE SIMILAR PROBLEMS ABOUT A POSSIBLE VISIT BY ARAFAT. THE ITALIAN EMBASSY JUDGE THAT THE FRENCH ARE EXPECTING TO INVITE ARAFAT BUT THIS IS NOT IMMINENT.

FCO PLEASEPASS ALL

HIBBERT

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TELEGRAM NUMBER 6033 OF 14 NOVEMBER
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PARIS, BONN, ROUTINE LUXEMBOURG.

COMMUNITY BUDGET

1. SOME POINTS FROM A ROUND OF INFORMAL BILATERALS.

2. LUXEMBOURG. DONDELINGER TOLD ME (NOT FOR QUOTATION TO HIS AUTHORITIES) THAT THEY WERE THINKING ALONG THE FOLLOWING LINES. THE RESTRICTIONS SHOULD BE TAKEN OFF THE DUBLIN I MECHANISM. IN ADDITION, THERE SHOULD BE A COMMITMENT AT DUBLIN TO RESTRUCTURING THE COMMUNITY BUDGET ALONG LINES FAVOURED BY THE ITALIANS. THERE COULD BE AN ORIENTATION THAT THE BRITISH SHOULD GET EACH YEAR SOME ADVANCE PAYMENT ON THE RECEIPTS SIDE TO BE USED FOR PURPOSES IN ACCORDANCE WITH COMMUNITY AIMS, PENDING IMPLEMENTATION OF THE BUDGET RESTRUCTURING. BUT HE ARGUED STRONGLY THAT WE COULD NOT HOPE TO TIE UP THE SECOND PART AS EARLY AS DUBLIN. I LEFT HIM IN NO DOUBT OF OUR UNWILLINGNESS TO ACCEPT A PARTIAL SOLUTION AND VAGUE PROMISES FOR THE FUTURE.

3. ITALY. PLAJA HAD JUST RETURNED FROM ROME. ITALIAN OFFICIALS HAD GIVEN HIM A GLOOMY ACCOUNT OF THE COSSIGA/ GISCARD TALKS ON MONDAY. THE LATTER HAD TAKEN A VERY HARD LINE. THE FRENCH SEEMED TO BE PREPARING FOR A LONG DRAWN OUT

GISCARD TALKS ON MONDAY. THE LATTER HAD TAKEN A VERY HARD LINE. THE FRENCH SEEMED TO BE PREPARING FOR A LONG DRAWN OUT BATTLE. I URGED THE ITALIANS NOT TO BE DISCOURAGED. THE FRENCH ALWAYS TOOK UP A VERY EXTREME POSITION IN ADVANCE OF A MAJOR NEGOTIATION.

4. PLAJA SAID (NOT FOR QUOTATION) THAT HIS MINISTERS WERE AT SIXES AND SEVENS. THEY WERE DEEPLY WORRIED ABOUT THE NEGATIVE RESPONSE OTHERS HAD GIVEN TO THEIR SUGGESTION THAT THEY SHOULD NOT PAY THEIR SHARE OF OUR REFUND. SOME WERE ARGUING THAT THEY COULD NOT POSSIBLY RETURN FROM DUBLIN HAVING SURRENDERED MOST OF THE GAIN FROM THE EMS INTEREST RATE SUBSIDIES IN FAVOUR OF THE BRITISH AND HAVING GOT NOTHING PRECISE FOR ITALY IN RETURN. ORTOLI WOULD BE GOING TO ROME TOMORROW AND AN ITALIAN MINISTERIAL MEETING TODAY WOULD TRY TO AGREE ON A LINE TO BE TAKEN WITH HIM. IN RESPONSE TO MY MILD COMPLAINT THAT, SINCE THE PRIME MINISTER'S VISIT TO ROME, WE HAD GIVEN GOOD SUPPORT TO THE ITALIANS AND THEY LITTLE TO US, HE WARNED ME THAT ITALIAN MINISTERS WERE NOW ONLY THINKING OF THEIR OWN PROBLEMS.

5. FRANCE. DE NANTEUIL (SPEAKING PERSONALLY AT LUNCH WITH ME) SAID THAT HE SUPPOSED THERE WOULD IN THE END BE A TWO-STAGE APPROACH - HARD-FOUGHT AMENDMENTS TO THE DUBLIN I MECHANISM ENDING IN AGREEMENT AND A SECOND STAGE IN WHICH THE COMMUNITY WOULD TACKLE THE PROBLEM OF BRITAIN'S INADEQUATE RECEIPTS. AS REGARDS THE LATTER THE ARGUMENT AT DUBLIN WOULD BE ABOUT WHETHER THERE WAS ANY PRECISE COMMITMENT. I REPORT THIS FOR WHAT IT IS WORTH - NOT MUCH SINCE HE IS ALMOST CERTAINLY NOT IN PRESIDENT GISCARD'S CONFIDENCE.

6. BELGIUM. NOTERDAEME SAID THAT HE WAS ATTENDING A MEETING OF MINISTERS WITH THE BELGIAN PRIME MINISTER TOMORROW AFTERNOON TO DISCUSS THE BRITISH PROBLEM. HE PERSONALLY WAS CONVINCED THAT A COMMUNITY SOLUTION MUST DEAL WITH BRITAIN'S INADEQUATE RECEIPTS AS WELL AS OUR EXCESSIVE GROSS CONTRIBUTION, THOUGH HE WAS NOT ALLOWED TO SAY SO BECAUSE THE BELGIAN FINANCE MINISTRY WERE RAISING SERIOUS OBJECTIONS TO PAYING THEIR SHARE EVEN OF REMOVING THE RESTRICTIONS ON DUBLIN I. HE THEN SPOKE VERY MUCH ALONG THE SAME LINES AS DONDELINGER (PARAGRAPH 2 ABOVE). IN REPLY TO MY RESPONSE HE ACCEPTED PERSONALLY THAT IT WOULD BE MUCH BETTER TO SETTLE THE WHOLE THING IN DUBLIN, BUT WAS WORRIED ABOUT THE FRENCH. HE SEEMED VERY INTERESTED IN MY EXPOSITION OF THE VIRTUES OF A RECEIPTS MECHANISM WHICH WOULD BRING US UP TO NEARER THE COMMUNITY AVERAGE IN RECEIPTS PER HEAD.

Ref: A0666

PRIME MINISTER

COMMUNITY BUDGET

1. The Chancellor of the Exchequer has sent you a minute on two aspects of the Budget negotiations. They may be referred to at your meeting tomorrow afternoon.

2. The first concerns monetary compensatory amounts (MCAs). This problem has become more important than we thought in the summer with the weakening of sterling. United Kingdom MCAs are now back at 12 per cent; so we can no longer argue that the Commission's figures for 1980 exaggerate the difference between our way of viewing MCAs and the view of most other member states that they should be counted as a benefit to us.

3. The Government is committed to a gradual reduction in MCAs (and the Minister of Agriculture wants another Green £ devaluation before the end of this year). For this reason and because MCAs are now linked to the ECU and ours are therefore likely to be smaller than when they were calculated in relation to the DM, it is reasonable to assume that the difference will not reach the proportions it did in 1976-77. Moreover, the way MCAs are treated does not affect our gross contribution but only the receipts we are reckoned to have obtained from the Community. It is therefore likely to be important only if we secure a corrective mechanism related to our inadequate receipts. Since, if we secure this at all, we can only expect to get partial adjustment, it is not worth dying in the last ditch over the MCA issue. To the extent that MCAs are not regarded as offsetting our net Budget contribution, then they must be regarded as increasing the resource cost of the CAP to us. We should still be able to deploy this argument if we lost it in the Budget context. You may therefore wish to agree with the Chancellor of the Exchequer that we should not give this point away before Dublin; but we should not make it a sticking point. We should not exclude the possibility of a compromise deal eg splitting the difference.

4. The second point concerns the VAT ceiling. There is no doubt the French will use this as an argument for limiting the size and duration of any Budget refund to us. We, on the other hand, must retain the 1 per cent ceiling as a means of holding down the cost of the CAP and eventually as a weapon for securing agreement to fundamental changes. But we shall needlessly offend the smaller countries if we make too much of the 1 per cent ceiling until our budget problem is solved: the Benelux countries, for general communautaire reasons, and the Irish and Danes, in order to protect the CAP, want to see the 1 per cent ceiling raised.

5. The Chancellor suggests that this situation makes it all the more necessary to solve the budget problem before the ceiling is reached: but this would only get us over 1980. Most people now accept that the ceiling will be reached at least by 1981 when we will still need a refund. It is only true to say, as the Chancellor does, that "once we achieve a settlement we have every interest in upholding the 1 per cent" if our refund is inviolate and cannot be squeezed out by what other member states will consider to be more pressing needs eg to finance CAP commitments. We must therefore have an answer to this dilemma -

i. In the first place we must press for commitments by the European Council to cut the level of CAP expenditure: to the extent we succeed, there will be more headroom to finance our refund;

ii. if that fails we would have to try to get our refund financed outside the Budget. This will be difficult for the Germans and others to accept, and the Commission will be very hostile;

iii. we might therefore, as the Chancellor's minute suggests, need to fall back on financing devices within the Budget which avoid our refund appearing as an increase in the total size of the Budget. We cannot assume that this will be any more welcome to other member states, but at the end of the day the Germans might find it less difficult than any of the alternatives. From our side, there is a fear that, if we proposed such a device for our Budget refund, we should appear to be condoning the somewhat similar way in which the milk responsibility levy appears as negative expenditure and thus gets round the curb on CAP expenditure. But the two cases can be differentiated: what we are seeking in the Budget is purely re-distributive between member states. The milk co-responsibility levy on the other hand taps another source of income - the milk producer.

6. On the 1 per cent ceiling you may therefore want to agree with the Chancellor on tactics, but emphasise the vital necessity for us not to give way on the 1 per cent ceiling in Dublin even if this were to ease our task on the Budget. You might ask the Chancellor for more details on the "financing possibilities" which he says officials have identified.

MR.
PP
ROBERT ARMSTRONG

14 November 1979

6

PRIME MINISTER

EEC BUDGET - AFTER DUBLIN

We agreed in OD that if we fail to secure an adequate reduction in our net budget contribution "we would be unable to subscribe to the taking of any major decisions in the Community" (Peter Carrington's words).

The Chancellor's proposals that we might also seek to act directly on the contribution itself met with a cool response from colleagues due to its legal implications.

In earlier discussions we agreed that it would be a tactical error to confuse our objective for a thorough overhaul of the CAP with the size of our Budget contribution, since each was justified on its own merits. This was right while we were hoping for substantial satisfaction on the Budget issue at Dublin or soon after. But if this prospect recedes I consider we should reconsider bringing forward the CAP issue.

Your response to the Press in Dublin could be vital for the whole of our future relationship with the Community - and to public opinion here at home. I am concerned that your personal prestige and that of the Government as a whole could be at risk if we do not have an adequate and convincing answer to the question "Where do we go from here?" The first post-Dublin Press Conference is crucial.

Quite regardless of Dublin - Within 18 months the relationship of a Budgetary contribution with the proportion of that Budget accorded to agriculture, the VAT ceiling, and the nature of EEC agricultural support and its financing in the 80s will come up for a crunch decision. It seems likely to be accompanied by a major crisis in the Community's affairs. This would provide the context, if we fail at Dublin, for us to declare that since we had been unable to secure adequate redress on the income side of the Budget we were determined also to secure major savings on the expenditure side of it, and in particular on the CAP which generates the bulk of the spending.

If we could solve the foolishness of the CAP and reject new revenue for the EEC (by VAT or levies) our own budgetary problems would be close to a satisfactory resolution. Moreover, we would be seen in the UK to be fighting for our national interest in a doubly just cause - a reform of the CAP to the benefit of British consumers and a fair share of the Budgetary contribution. But, equally important, in the EEC we could present our case, not as special pleading for a national problem, but as trying to face Community problems which in the near future will threaten its very survival and must be faced sooner rather than later. I believe this would be a more credible reaction than a generalised obstructiveness.

We should need to be able to say broadly both what sort of changes we wanted in the CAP, and how we proposed to secure them. As for the sort of changes, there is widespread recognition - outside Community circles - that the CAP can hardly be solved unless there is greater resort to national exchequer support for agriculture's social/structural problems. Whilst we remain the paymaster through the EEC Budget - and the structurally unsound/part-time/marginal farmers of France and Germany are the principal beneficiaries - there can be no financial sanction forcing forward a basic reform.

There are no doubt many ways in which farm funding could be shifted to national Exchequers. One most interesting proposal of Wallace Day (a maverick Devon farmer) for a substantial cut in Community financial support for milk - coupled with a headage payment per cow - meets with a covert approval from the NFU (I talked to Richard Butler about this last night) and grudging respect in the EEC. It would produce a dramatic cut in the EEC Budget if the headage payments were nationally funded. But this will probably be opposed by the Commission and the Community purists (because it would entail giving up 100% Community financing) and by those with a financial interest in the existing system. But it is right in its substance and direction.

There is room for endless debate on the basis for the reform. But at its heart must surely lie the overriding need to place financial sanctions on the politicians of member states to force them to end the financing of surpluses. Only when their tax-payers are forced to pay for their social problems will we have the beginnings of a solution. Only if the EEC tempers its communautaire ideology by the economic realities of Europe can the EEC survive.

An agricultural market financed by, say, 50/50 EEC/national finance will be neither more nor less a "Common Market" than now - with all its present distortions and the MCAs etc. If it is suggested that national support for national social/farm problems removes all sanctions from a competitive subsidy race in favour of each national group of farmers - and hence even greater surpluses - I think it's wrong.

As for how we proposed to secure such changes, we should need to declare our resolve to block all developments of the CAP, and in particular any increases in support prices, until the Community as a whole was prepared to confront the financial crisis the CAP has created. The first opportunity to demonstrate our resolve would be at the price-fixing negotiations early in the New Year.

My growing view is that we would be in a better moral and political position - following a failure in Dublin - if we were to be the instrument for bringing forward the "crunch" on these questions (now likely in 18 months) to the beginning of 1980.

I find it hard to believe that 'Gaullist-type' obstruction, spread across the whole field of Community business, as proposed by Peter Carrington is in the interests of the Community - or of ourselves. It will lead to increasing bitterness - and the connection between our justified resentment on the Budget question and our spoiling tactics in a hundred unconnected areas will be quickly lost on the British and the European media. We will be seen as no different from our predecessors. I believe we must direct our fire.

Is it not better to point our action directly to the real absurdity of the EEC, and bring the whole issue forward for urgent resolution (VAT/levies/CAP/) in an early Second Summit in February/March 1980? At least, it will appear like "constructive" obstruction, rather than pure negative bloodymindedness.

I am copying this minute to our colleagues on OD, to Peter Walker, and to Sir Robert Armstrong.

JN

Department of Trade
1 Victoria Street
London, SW1

14 November 1979

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

PRIME MINISTER

THE COMMUNITY BUDGET

I have been considering the line we should take between now and Dublin on two important questions affecting the Community Budget issue.

2. The first of these is the question of the attribution of MCAs. Our view (and that of the Italians) on the substance of this is quite clear. We believe that MCAs paid on imports of food into the UK should count as a benefit to the exporting member states because they enable them to dispose of their high price agricultural produce on our relatively lower priced markets. The majority of other member states, because they believe that the "common price" for agricultural produce is the "right" price consider that MCA payments are a concession to the importing member state enabling it to apply a price below the common price. This view of MCAs is enshrined in the 1975 financial mechanism and tends to be the one held by the Commission. We have continued to argue our point of view, but in the absence of acceptance of it by our partners, discussion of our net contribution has tended to assume that this will be 1550 meua in 1980 (attributing MCAs to the importer) rather than 1814 meua (attributing MCAs to the exporter).

3. There has not been any possibility of compromise over this argument, although we did succeed in making sure that the

Commission's "Reference Paper" presented the figures on both bases. During the summer, the point lost some of its importance as the combination of green pound devaluations and a strong pound drove our MCAs down. Now however they have risen again to 12 per cent - more than the average of 9 per cent for 1980 assumed in the Reference Paper.

4. Our public expenditure totals reflect the figure of 1814 meua for our net contribution. If the rest of the Community were to concede to us a refund of the whole of our net contribution as they see it - 1550 meua - we would still be some 260 meua (£170 m) short of our goal for the reduction of the public expenditure burden of EEC membership. If in the event our average MCA in 1980 exceeds 9 per cent the shortfall would be greater because our partners will argue that these larger MCAs mean our net contribution should be reckoned to be less than 1550 meua.

5. If it were possible to remove this complication from the Dublin discussions on satisfactory terms, there might be advantage in doing so. If we had to argue it seriously in Dublin, it could prove a distraction, in which we could look for support only from Italy. However I see no prospect of a compromise between our view and the majority view in the coming weeks. This means there is nothing for it but to maintain our view until and at Dublin. If then a settlement is obtainable which, taken as a whole, is acceptable, we could simply leave the point on one side. If there is no, or no immediate settlement, it pays usto maintain our view. How important the point is depends on the one hand on the nature and mechanics of the solution offered to us; and on the other on whether our MCAs in fact remain substantial. It could be important if they do.

6. The second issue is the 1 per cent ceiling. My officials have just produced a new assessment on when the Community is likely to reach the 1 per cent VAT ceiling. They agree with the Commission that it is likely that the Community will need to levy the full 1 per cent in 1981 to cover planned expenditure. A radical reduction in the rate of growth of CAP expenditure could postpone this to as late as 1983. The annual rate of increase in agricultural spending would have to come down from the 22 per cent experienced in 1975-79 to 10 per cent for 1980-82 for this to be possible, and 1981 or possibly 1982 are the more likely years.

7. In 1980 the headroom under the 1 per cent ceiling is at the moment estimated by us at 2,000 meua and by the Commission at nearer 1,000 meua: though these estimates are extremely speculative and variable. Unless the growth of CAP expenditure comes down, there will be no headroom for new expenditures in 1981. Some of our partners will no doubt want to argue both that any relief for the UK must be financed by repayment from the 1981 Community Budget, and that it must be subject to the 1 per cent ceiling. The present financial mechanism operates by repayment in arrears. Any relief to us in 1980 would require a supplementary budget, though there are precedents enough for this. But all this means that we are unlikely to be able to keep entirely separate in Dublin the two issues of our Budget claim and the 1 per cent ceiling.

8. Our starting point should clearly be that we seek relief from our 1980 contribution in 1980 (when there is more room for it within the 1 per cent ceiling). At the same time we shall want to oppose other increases in expenditure, especially on the CAP, not only on the merits but also in order to give as much headroom as possible in 1980 and 1981. It would be

much more difficult to get new expenditure into the Budget once the 1 per cent ceiling was biting, because other expenditure would have to be cut to accommodate it. We could also argue that in our view there are ways of meeting the UK's problem without increasing the size of the Budget; and that this is wholly appropriate for what is a redistribution, not true expenditure. My officials have identified a number of financing possibilities outside the normal own resources arrangements which, notwithstanding the Commission's dislike of such possibilities, might provide a way of meeting the UK's problem without breaching the 1 per cent ceiling if there were political will among our partners to do so. But some of these possibilities do resemble the proposals we are beginning to hear for accommodating more CAP expenditure without breaching the 1 per cent.

9. My conclusion is that we have to be careful to avoid a situation in which the 1 per cent limit is used as a means of defeating or substantially limiting our budgetary refund. We should certainly not rule out the financing of part or all of our refund outside the Budget, but we should face the possibility, perhaps probability, that financing will be inside the Budget. That is what the Commission are leaning towards, it is how the present financial mechanism works and it is what our partners will go for. This situation makes it all the more necessary that we should secure a solution to our problem before the ceiling is reached. It also suggests that we should not take the lead on the inviolability of the 1 per cent until we get a settlement. Once we achieve a settlement we have every interest in upholding the 1 per cent. I think at that stage it may be found that some of our partners, including the French, are not so keen on enforcing it, especially if their electoral situation makes domestic legislation to raise it rather easier.

10. I am copying this to OD(E) colleagues. I would be grateful to know whether you and they are content with the line on these two issues that I have set out. A copy also goes to Sir Robert Armstrong.

(G.H.)

13 November 1979

10 DOWNING STREET

Prime Minister

So far this year we have paid £ 871 million (net) to the Community. By the end of the year the figure will be £ 920 million (net).

The gross figure for the year will be £ 1570 million. We shall get back £ 650 million in receipts.

Rob

13.11.79

file

dS

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

SIR ROBERT ARMSTRONG
CABINET OFFICE

BF

Community Budget

The Prime Minister has seen your minute of 9 November and its enclosure. She agrees that a single copy should be sent to each of the participants at the Restricted Meeting which is to take place to discuss this subject next week.

M. O'D. B. ALEXANDER

12 November 1979

GP

CONFIDENTIAL

CABINET OFFICE

With the compliments of
The Private Secretary to the
Secretary of the Cabinet

M. O'D. B. Alexander, Esq.

70 Whitehall, London SW1A 2AS
Telephone 01-233 3000

SECRET

3

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref. A0633

12th November, 1979

Community Budget

14

As you will know, the Prime Minister is to discuss our negotiating objectives for Dublin at a meeting at 10 Downing Street at 4.30 pm on Wednesday, 12th November. The meeting will be attended by the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Lord President, the Lord Privy Seal, Sir Robert Armstrong, Sir Michael Palliser, Sir Kenneth Couzens and Mr. Franklin.

The Prime Minister has agreed that the attached paper, prepared by the Cabinet Office in consultation with the Foreign and Commonwealth Office and the Treasury, should serve as a focus for discussion. I am therefore circulating it, with a copy of this letter, to all those who are to attend the meeting.

I need not remind you of the sensitivity of this subject. The paper should be handled accordingly, and no copies made.

A copy of this letter goes also to Michael Alexander at No. 10.

M. J. VILE

(M.J. Vile)

G.G.H. Walden, Esq.

SECRET

COMMUNITY BUDGET AIMS

Note by the Cabinet Office

1. This note is designed to help Ministers form a view as to what might be a tolerable outcome at the European Council in Dublin on 29/30 November.

2. All the numbers in the paper are quoted in sterling, with equivalents in units of account, converted at the exchange rate used in the Community's draft budget for 1980 of 1.4813 = £1, noted in the margin.

3. In considering figures, there are two complications Ministers will need to have in mind.

4. The first complication is the <u>treatment of monetary compensatory amounts</u> (MCAs). The Commission's reference paper of September (COM(79) 462 Final)
1814 meua estimates our net contribution in 1980 as £1,225 million if MCAs are attributed to
1552 meua the exporter and £1,050 if they are attributed to the importer. We are still maintaining the view that MCAs should be attributed to the exporting country, but in their latest paper the Commission side with most other member states who take the opposite view, and we are unlikely to win the point. The Chancellor of the Exchequer will be writing to his colleagues explaining how this difference could affect the negotiations, but for the purpose of this paper, possible refunds are
1552 meua compared with an assumed net contribution of £1,050 million.

5. The second complication is <u>whether or not we contribute to our own refund.</u> The net gain from any refund we receive will depend on whether, as is the case with the present Financial Mechanism, we are called upon to contribute to our own refund. The Irish and the Italians will try to get exemption as countries with below average GNP, in which case we must try to do the same. But it is not very likely that any of us will succeed. Since our marginal rate of contribution to the budget is 17 per cent, the net benefit we receive from any given refund would then be lower by that amount. In this paper (as in the Commission's latest document) the <u>net</u> figures are used, followed by gross figures in brackets.

6. We are seeking a corrective mechanism to produce "broad balance" between our contributions and our receipts starting in 1980 and lasting as long as the problem lasts. In the Commission's latest paper discussing a range of possible solutions

(COM(79) 620 Final), those which it quantifies would reduce our net
415 meua contributions by amounts ranging from £280 million (£340 million
1075 meua (net) gross) to £725 million (£880 million) i.e. reductions of between
1140-480 meua 30 and 70 per cent. There is no doubt that several member states, including notably the French, have in mind figures at the bottom of this range. The French also appear to be thinking of a corrective which would last for only a year or so. The Germans are hoping that part of the gap between our stated requirements and what the French and others have in mind could be met by the evolution of the future pattern of Community expenditure more in our favour, and this line would suit the Italians too.

7. There are thus three interconnected elements in what might be an acceptable outcome for the United Kingdom. These are:-

I. The amount of the relief as compared with our expected net contribution.

II. The duration of any arrangement.

III. Various ways in which the solution might be phased.

The following paragraphs discuss these in turn.

I. THE MINIMUM ACCEPTABLE REFUND

8. It is not realistic to expect that we can secure a refund which will wholly cover our net contribution. The signs at the moment are that we shall, at best, be offered the removal of the existing constraints on the Financial Mechanism. As compared with the refund of £170 million (£200 million gross) which we expect to get for 1980 this would produce a refund of £350 million and thus reduce our net contribution by only a third. The Prime Minister has already let it be known (to Mr Roy Jenkins and Chancellor Schmidt) that a cut of one half in our refund would not be acceptable. On the other hand, if we could achieve a lasting reduction of three quarters, it would be widely recognised as a major achievement. It is within this area that Ministers may wish to consider what, having regard to the other elements, could be a politically acceptable result.

9. There are certain considerations which could be used to justify an outcome which still left us paying a modest net contribution:

a. We should obviously pay less than the Federal Republic of Germany (net contribution for 1980 estimated at £750 million before allowing for any refund to us). The more appropriate comparison is with France, next to us in the league table of GNP per head although substantially above our own. On the Commission's estimate, France
118 meua will be a net contributor of only £80 million in 1980. To the extent that she will contribute to our refund, her net contribution will go up as ours comes down. If the aim was to produce a net contribution which more or less equalled France we would both be paying about
450 meua £300 million. Would it be acceptable if our net contribution lay somewhere between that of France and Germany?

b. A possible line of argument would be to refer back to the indications we were given at the time of entry that the proportion of the budget spent on the CAP might decline to as little as 40 per cent of the total. If this had in fact happened and the extra within the present budget had been allocated to the Regional and Social Funds then our net
630 meua contribution might have been of the order of £430 million. Such a line of reasoning would suggest a readiness to accept the entry terms (in spite of our poor economic performance) but not the unforeseen and unwelcome rise in the cost of the CAP.

c. We could say that it was reasonable for the United Kingdom to
160 meua regard as a net contribution its share (£110 million) of the administrative costs of running the Community.

10. Apart from the figure, Ministers will wish to be satisfied that, whatever the corrective mechanism, it will operate to reduce our refund in any foreseeable situation in the future. The possibility of the United Kingdom becoming an above average GNP member has already been considered by OD and a line approved. The Commission's latest paper (paragraph 21) offers one possibility for achieving a level of refund which comes close to our objective but only operates on our excess contribution. This is the system of <u>weighting</u> the baseline from which excess gross contributions are estimated (thereby increasing our refund) so as to take account of our below average GNP per head

Besides being a difficult concept for some other member states to accept, it would not by itself protect us in future years if the gap between our gross contribution and our weighted GNP share were to narrow while our receipts continued to be below the Community average. The only way to avoid this risk is to have a corrective mechanism which takes account of our inadequate receipts as well as our excess contribution i.e. is based on our net position. The Commission's paper makes it clear that this threshold is going to be extremely difficult to cross. If it can be done at all, it would help us if we could agree that any refund in respect of our low receipts would be earmarked for public expenditure consistent with Community policies and eg subject to annual discussion with the Commission. We should want to ensure that the refund so far as possible related to planned rather than additional public expenditure.

II. DURATION OF ANY ARRANGEMENT

11. We have a very strong case for arguing that any corrective mechanism should not be subject to a time limit. The Commission say that our problem is temporary, and some of our partners may well argue for an arrangement for a limited period. But it would be intolerable for the Government (and the Community) to face the prospect of another negotiation on this issue in two or three years' time. The Financial Mechanism was for seven years with a review after five years. A review clause in any arrangement would be acceptable. But should the absence of any time limit be a sticking point or would, say, a five-year arrangement with provision for extension if necessary be an acceptable fall-back?

III. PHASED SOLUTIONS

12. The question whether we can gradually build up to "broad balance" may present itself in several forms:-

a. We may be offered partial relief through the Financial Mechanism with indications that the future pattern of the Community budget will evolve in our favour. If these were vague assertions of the kind which were made at the time of our entry negotiations, we could not regard them as "bankable assurances" and they would not carry conviction with public opinion in the United Kingdom: we could not accept them. On the other hand, specific commitments (such as the Italians are seeking) that the proportion of the budget spent on agricultural support would decline could be helpful to us. Much would depend on the form of the wording. Ministers will wish to consider how far they could accept commitments of this kind as a contribution towards achieving the negotiating objective.

b. Chancellor Schmidt has spoken about settling "principles" in Dublin. If this meant no more than recognition of a United Kingdom problem it would not be acceptable. If however Heads of Government agreed that the United Kingdom net contribution needed to be reduced by a specified percentage and settled the question of duration, leaving the Finance Council (or the following European Council) to decide on methods by which this could be achieved, would that be a possible outcome? Another possibility is that we would be offered the changes in the Financial Mechanism necessary to rectify our excess contributions with an agreement to return to the problem of our inadequate receipts (and no doubt the 1 per cent VAT ceiling and ways of holding down the budgetary cost of the CAP) at the next meeting. In return for any of these understandings we should no doubt be expected to subscribe to statements that the problem could be expected in due course to solve itself through structural changes, that the solution must not call into question the principle of "own resources" and that there was no question of applying the principle of juste retour.

c. Some countries like the Belgians and the Danes might say that because of their own public expenditure problems any agreed level of refund for the United Kingdom could only be reached in stages. This would to some extent be the obverse of the French wish to see any arrangement rapidly phased out, but if the size and duration of the eventual relief we were offered was satisfactory, some phasing need not be ruled out.

ISSUES FOR CONSIDERATION

13. i. In a package dealing satisfactorily with ii. and iii. below, what would be the minimum proportionate reduction in our net contribution on which we would be ready to settle (paragraphs 5 and 6 above)? Could we agree to get there by stages (paragraph 9c.)? If so, what would be the acceptable level for a first stage?

ii. Is it necessary to ensure a lasting solution that the mechanism should relate not just to our excess contribution but also to our inadequate receipts (paragraph 7)?

iii. What can we accept on duration (paragraph 8)?

iv. To what extent should we be willing to see our objective partially met by future commitments (paragraph 9a.)?

v. What would be the minimum degree of detail which would have to be settled in Dublin (paragraph 9b.)?

14. The discussions leading up to and including the Dublin meeting will cover all these aspects. Other member states will see a link between eg duration and the amount of the refund. The same will be true for us. It will be the package as a whole which will determine whether what can be negotiated at Dublin constitutes an acceptable settlement or whether we should need to put into operation the contingency plan approved by OD on 24 October.

Cabinet Office

9 November 1979

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

(2)

9 November 1979

Prime Minister

R Sanders

Mr +

Dear Peter

PARLIAMENTARY DEBATE ON
EEC BUDGET CONTRIBUTION

The House of Commons Scrutiny Committee has recommended debate on four Community documents:-

9093/79	-	Commission communication to the Council on the convergence of the economic performance of the Member States of the Community
9250/79	-	Second Letter of Amendment to the Preliminary Draft Budget of the European Communities for 1980
unnumbered	-	Draft of the General Budget of the European Communities for 1980
unnumbered	-	Letter of Amendment to the Draft General Budget of the European Communities for 1980

The first of these is the Reference Paper on budgetary questions prepared by the Commission following the meeting of the European Council in June; it contains the figures which demonstrate the unacceptable nature of the present and prospective size of the UK contribution to the Community Budget compared with those of other Member States.

Document 9250/79 has been superseded by the second of the unnumbered documents referred to above; all these relate to the Community Budget for 1980.

The Commission have recently circulated document COM(79)620 Final containing their Communication to the Council on Convergence and Budgetary Questions; this document is being deposited this week, followed by an explanatory memorandum. It contains the Commission's views for consideration by forthcoming meetings of the Finance and Foreign Councils, and subsequently the European Council at the end of the month. I have no doubt that the

/Scrutiny

The Rt. Hon. The Lord Carrington, KCMG., MC.

Scrutiny Committee will recommend that it be added to the documents for debate. The Treasury will also be depositing some additional factual documents circulated by the Commission supplementing document 9093/79 and they may also be added to the recommendation for debate.

The recommendations of the Scrutiny Committee follow discussion last week with the Financial Secretary to the Treasury on the documents concerned in which most attention was given by the Scrutiny Committee to document 9093/79 and to the Government's general attitude on the overall net budgetary contribution. This would certainly be the matter of most concern to the House in any debate that was arranged. Debate on the Draft 1980 Budget documents would in fact be somewhat sterile because there is no current proposal before Council; nevertheless the Scrutiny Committee considered that they were relevant to the wider issue. (The Council will shortly be presented with the European Parliament's amendments and modifications to the Draft 1980 Budget on which the European Parliament voted on 7 November. The Budget Council is due to consider these on 23 November and the proposals of the European Parliament will be deposted when they are available in suitable form, although this is unlikely to be very long before the meeting of the Budget Council and it is therefore most unlikely that they could also be debated before the Council meets.)

I think that we should concentrate on the recommendation regarding document 9093/79, together with a potential recommendation on COM(79)620 Final, and my view is that it could well be to the Government's advantage to hold a debate if this can be arranged before the meeting of the European Council in Dublin. It could strengthen the hands of the Prime Minister and yourself if there was full backing from the House of Commons.

The documents on the Draft Budget for 1980 could be included on the Order Paper, although it is unlikely that much attention would be paid to them in debate; if they were not so included they would have to be left outstanding for some future occasion after the Budget Council on 23 November. If they were included it would be desirable that the Financial Secretary to the Treasury should be available to handle any questions on the 1980 Budget that did arise, and timing of the debate would therefore need to take into account his planned attendance at the Budget Council on 23 November, (and travel to Brussels the previous afternoon).

/ In considering

In considering the terms of a motion it is necessary to bear in mind:-

a. That when debate was held in the House of Commons on 16 July on the Preliminary Draft Budget for 1980, the Government accepted an Opposition amendment which added to the Government's Take Note Motion the words:

> "urges Her Majesty's Government, in view of the United Kingdom's massive and ever-increasing net contribution to the Community Budget, to press for a fundamental reform of the budgetary arrangements so that Britain's contribution to the Budget is at least not greater than the receipts."

b. That there is currently on the Order Paper an Early Day Motion by Mr John Major:

> "That this House, recognising Great Britain's contribution to the EEC Budget is unacceptably high, offers the Prime Minister every encouragement in her determination to secure an equitable and early reduction."

A simple Take Note Motion would almost certainly invite an Opposition amendment about taking drastic action if negotiations are not successful; the risk of this might be reduced (but not eliminated) by the Government motion being more positive, perhaps on the following lines:

> "That this House takes note of Commission documents 9093/79, a Reference Paper on Budgetary Questions and COM(79)620 Final, on Convergence and Budgetary Questions [also documents .... containing supplementary information], and fully supports the Prime Minister in her determination to secure from our Community partners an equitable and early reduction in the unacceptably large net contribution by the United Kingdom to the Budget of the European Communities."

There could be an italicised footnote on the Order Paper:-

> "Commission document 9250/79, and unnumbered documents on the Draft of the General Budget of the European Communities for 1980, and on a Letter of Amendment thereto, are also relevant."

/ I am copying

I am copying this letter to the Prime Minister, Chancellor of the Duchy of Lancaster, Members of OD(E), Members of Legislation Committee, and Sir Robert Armstrong.

GEOFFREY HOWE

12 NOV 1979

Top Copy on: Euro Pol, CAP, Pt 2

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Ref. A0601

PRIME MINISTER

Community Affairs

OD(E) will have met immediately before Cabinet to discuss the line to be taken at the 12th-13th November Agriculture Council especially on sheepmeat. The Foreign and Commonwealth Secretary might be invited to report the conclusions reached. He may also wish to report on his talks with Mr. van der Klaauw, his Netherlands counterpart, in The Hague on 6th November, and the current state of discussions in COREPER on the handling of the Commission's paper on possible solutions to our Budget problem.

2. The Chancellor of the Exchequer might similarly be invited to report on the French attitude to our Budget problem as revealed in his talks with M. Monory, the French Finance Minister, also on 6th November.

ROBERT ARMSTRONG

(Robert Armstrong)

7th November, 1979

SAVING TELEGRAM

BY BAG

FROM BONN

UNCLASSIFIED

PS Prime Minister

FRAME GENERAL

TO FCO TEL NO 33 SAVING OF 6 NOVEMBER. Repeated to UKREP BRUSSELS, EEC POSTS

SCHMIDT'S INTERVIEW IN "EUROPA"

1. The following is our translation of the passage on Community matters in the interview, which is carried in the "Europa" Supplement of "Die Welt" of 6 November.

2. Asked what policies the Community should pursue in the '80's, Schmidt replied" Firstly, the Community should develop a Common Energy Policy; secondly it should reform the structure of the present Common Agricultural Policy; thirdly it should work more strongly than hitherto for the convergence of the economic policies of its member states. The word convergence is now used within the Community in a curious abbreviation of its real meaning, as if it only had something to do with contributions to the EEC Budget. In my estimation that is not a question of supreme importance."

3. Asked if the FRG, as strongest partner in the Community, would seize new initiatives in the '80's, Schmidt replied, "At the moment I think that it is not so much the Community which should change itself; it is actually more Great Britain. The British, even the advocates of British membership of the Community, are relatively the greatest sceptics among the Community partners. I fully understand why this is so.

4. The British first joined the Community one and a half decades after Italy, France, Germany, Luxembourg, Holland and Belgium. They do not posses the same degree of experience of the Community. I also understand very well the feelings of alienation which some British pragmatists have about the bureaucratic activities in Brussels. Economically Britain has not been in a very favourable position for a number of years and Britain tends to make the Community responsible for its economic difficulties, which can be traced back to quite other reasons. I understand all this well."

/"However

"However, I do not believe that this should serve as a course setting. I was always convinced that British common sense, with the world-wide experience of Britain - its historical, political and trading experience - would have a very welcome, necessary effect. I hope it will function as a stimulus for common sense in the Community. Anyway, that has always, since 1975, been my hope and I continue to hope that Britain will play this role."

WRIGHT

FRAME GENERAL

EID (1)

Foreign and Commonwealth Office

London SW1A 2AH

Prime Minister.

You asked me to look into this following your meeting with Mr Scott-Hopkins. It does not look as though the UK MEPs could block the Budget on their own.

Ld. Rud

5 November 1979

Dear Michael,

Rud 6/XI

Community Budget: Rejection by the European Parliament

I enclose, as you requested by telephone, a note on whether the UK MEPs can, on their own, block the adoption of the Community Budget. You will see they cannot.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

Yours ever

Paul

(P Lever)
Private Secretary

M O'D B Alexander Esq
10 Downing Street

Rejection of Community Budget by European Parliament

Article 203(8) of the EEC Treaty reads:

"However, the Assembly, acting by a majority of its members and two-thirds of the votes cast may, if there are important reasons, reject the draft Budget and ask for a new draft to be submitted to it."

There are 410 members of the European Parliament (MEPs). Thus 309 members would need to vote on and 206 would need to be in favour of any resolution to reject the budget.

There are only 81 UK MEPs (and only 64 MEPs in the European Democratic Group (ie mainly Conservatives) of whom three are Danes.) It is thus impossible for the UK MEPs to block the adoption of the Budget on their own.

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DSG

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10 DOWNING STREET

From the Private Secretary

BF 7.11.79

SIR ROBERT ARMSTRONG

CABINET OFFICE

COMMUNITY BUDGET

The Prime Minister has seen your minute to her of 2 November on this subject.

The Prime Minister agrees:-

(a) That there should be a meeting on Wednesday 14 November at 1630 (not 1600) to discuss the Community Budget;

(b) That attendance at this meeting should be as proposed in your minute;

(c) That the preparation for the meeting should be as in your minute and that no copies of the papers produced should go outside No. 10 and the Cabinet Office. The Prime Minister has noted in this connection that she regards the Commission paper as unsatisfactory;

(d) That the Lord President should visit Brussels before the Foreign and Commonwealth Secretary's visit on 26 November;

(e) That Mr. Whitmore and Mr. Franklin should visit Dublin after 20 November to discuss the handling of the Dublin meeting;

/ (f)

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(f) That she should have another meeting with the President of the Commission before Dublin.

The Prime Minister has noted the proposal that the Lord Privy Seal should visit Dublin soon, but has asked to be informed as to whom he would be talking.

M. O'D. B. ALEXANDER

5 November 1979

Ref. AO569

MR. ALEXANDER

In connection with Sir Robert Armstrong's minute of today's date, the Prime Minister may wish to have the attached summary of the Commission's report. The report was approved by the Commission on Wednesday and submitted to the Council, but it is still confidential.

M.J.V.

(M J VILE)

2nd November 1979

CONVERGENCE AND BUDGETARY QUESTIONS

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

A SUMMARY

1. The Commission say that the purpose of their paper is to set out for the consideration of member states the pros and cons of a wide range of possible approaches. But they will exercise their right to make a formal proposal only when it seems to them likely to contribute to the resolution of the problem. The paper is in nine parts. The first seven - Introduction, the Budgetary Problem, Financial Mechanism, New Mechanisms, Financial Aspects and Legal Aspects - deal with the UK's budgetary problem; the remaining three are addressed to the wider problems of convergence raised by the Italians.

Introduction

2. The Commission considers that the long-term resolution of the problems raised in the convergence debate by the less prosperous countries lies in a better-balanced development of Community policies. Any short-term correction need therefore only be temporary. It should also respect certain fundamental principles, including that Budget expenditure should remain the expression of Community policies, and the rejection of "juste retour". It must also take account of the limitations on the Community's resources.

The Budgetary Problem

3. The UK's net deficit in 1980 is forecast at 1550m EUA - i.e. the Commission have attributed our import MCAs as a benefit to us. (In their reference paper the Commission reckoned the net deficit at 1810m EUA if MCAs were attributed to the exporter as we prefer). This deficit is expected to reduce as the UK's pattern of imports changes in favour of the Community and as new Community policies develop.

Financial Mechanism and New Mechanisms

4. In these two sections the Commission discuss four basic options for dealing with our immediate problem. These are summarised below and the refunds which each would yield are listed in the table attached.

i. Remove Constraints on Refunds under Existing Financial Mechanism

The constraints which the Commission would remove are: the balance of payments constraint, the tranche system which provides that only part of an excess contribution is reimbursed, and the ceiling of 3% of the Budget. The Commission do not consider it necessary to alter before enlargement the qualifying conditions for the Mechanism (which include the rule that per capita GNP must be less than 85% of Community average). Estimated gross benefit to UK from removal of all three restraints 630m EUA; net benefit (after allowing for our own contribution to gross) 520m EUA.

The Commission comment that the UK's budget deficit has proved greater than expected when the Mechanism was set up. They do not cite any objections to the removal of constraints.

ii. A Mechanism to Compensate for Increases in Contributions

The contribution ~~of~~ to Community revenue ~~contributed~~ by UK will rise from 17.58% in 1979 to 20.49% in 1980. This suggested mechanism would protect a member state against such a sudden increase. Benefit to UK if no percentage increase over 1979 allowed in 1980; 500m EUA gross, 390m EUA net.

The Commission comment that this proposal has the merit of providing a temporary solution to a temporary problem. No objections cited.

iii. A 'Weighted' Financial Mechanism

The existing Financial Mechanism operates on the difference between a member state's share of Community GNP and its share of Own Resources contributions. Weighting would be introduced by multiplying each member state's GNP by a percentage representing the rates between that member state's GNP per capita and Community average GNP per capita. As the UK's GNP per capita is about 75% of Community average, our excess share of contributions would be the portion lying above 75% of our GNP share. Benefit to the UK (see attached table) would depend on whether market exchange rates were used or purchasing power parities (PPPs).

The Commission comment in favour of this scheme that it builds on the existing arrangements. They cite two possible objections; it could become expensive as more states with below average GNP per capita join the Community and the implications for financing the Budget of introducing this concept in order to solve a problem of net deficit.

iv. Mechanisms to Reduce Disparities in Receipts

A Mechanism designed to raise the UK's budgetary receipts could take the form either of an increase in our share of receipts to bring them into line with our share of Community GNP or a straightforward limit on our net contribution. Benefit 850m EUA if our receipts raised to GNP share; benefit of straightforward limit not given (it would obviously depend on the terms in which it was drawn).

The Commission comment in favour that the larger part of our net deficit is in fact due to inadequate receipts and that a receipts mechanism could be combined with a mechanism on the contributions side to deal with a variety of situations. But the weight of their comment is against. A receipts mechanism would involve juste retour; give rise to problems with the attribution as between member states of Community expenditure; and appear to over-ride the Community's policies unless the extra receipts for the UK were explicitly linked to Community objectives.

Financial Aspects

5. The Commission will shortly make a proposal for new Own Resources but these will not be available for the next two years. Without them, the headroom available to accommodate a refund for the UK will depend essentially on the rate of growth of agricultural expenditure. The

distribution of the cost of any UK refund paid for through the Community Budget is shown on two assumptions: (a) that all member states contribute, (b) that the less prosperous countries (Italy, Ireland, UK) are exempted. The shares for France and Germany are on (a) 24.7% and 32.8% and on (b) 34.8% and 46.3%. The Commission favour (a) but note that certain delegations support (b).

Legal Aspects

6. The Commission argue that any Regulation providing for a refund for the UK should be based on Article 235 of the Treaty of Rome (which requires unanimity). The refund should be financed through the Community Budget; it would be anomalous (though possible) to correct a Budgetary problem through an extra-Budgetary mechanism.

Wider Convergence Questions

7. The remaining three sections of the paper deal with the Italian requests for -

(i) a re-balancing of the CAP in favour of Mediterranean products at the expense of Northern products;

(ii) a re-balancing of the Budget as between the CAP and structural and investment policies. //

In short, on (i) the Commission say that a good deal has already been done for Mediterranean products and to develop Italian production of products for which they are in deficit; and they acknowledge the need to contain Community expenditure on the most expensive Northern product, milk. On (ii) the Commission undertake to pursue vigorously policies to restrain expenditure on agricultural surpluses so as to make room for more spending on structural and investment policies.

Cabinet Office
2 November 1979

TABLE

REFUNDS YIELDED BY COMMISSION SOLUTIONS

	GROSS m EUA	GROSS £m	NET m EUA	NET £m
i Remove restraints on Existing Financial Mechanism	630	430	520	350
ii No increase in Contribution in 1980	500	340	390	260
iii A 'weighted' Financial Mechanism				
a. i+ weighting (Market exchange rates)	1300	880	1100	740
b. i+ weighting (Purchasing power parities)	900	610	750	510
iv Make up of UK Receipts to GNP share	850	570	[700]	[470]
UK net contribution in 1980			1552 - 1814	1050 - 1225

	m EUA	£m
Commission Range (GROSS)	500-1300	340-880
Commission Range (Net)	390-1100	260-740

NOTES

1. The exchange rate used to convert EUA to sterling is 1.4813 EUA = £1, the rate used in the Community's Draft Budget for 1980.

2. [ ]. Figures not included in Commission Paper.

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Ref. A0565

PRIME MINISTER

The Commission paper would do.

Community Budget

This minute makes proposals for further work and meetings following your visit to Bonn.

2. First, you decided at OD on 24th October to have a small meeting of Ministers to consider what might be an acceptable outcome at the Dublin European Council. I suggest that this meeting should be held in the week beginning 12th November (in my note on Business I am suggesting Wednesday, 14th November at 4.00 pm), i.e. before your meeting with President Giscard on 19th-20th November and the Finance and Foreign Affairs Councils which meet on the same two days. You will need to have the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary at the meeting; I suggest you should invite the Lord President of the Council and the Lord Privy Seal as well. A limited number of officials who will be intimately involved in the negotiations up to, and including, the Dublin meeting should also, I suggest, be present, so that no records need be circulated. That means Sir Michael Palliser, Sir Kenneth Couzens, myself and Mr. Franklin. You and your colleagues might find it useful to have for the meeting a note setting out the questions you will need to consider and giving a few "bench marks" against which to measure possible outcomes, e.g. where we would stand in relation to the net contributions by France and Germany. If you agree, we will produce such a note in the Cabinet Office; we will consult Sir Michael Palliser and Sir Kenneth Couzens in preparing it, but no copies will go outside No. 10 and the Cabinet Office.

3. Chancellor Schmidt stressed the need for adequate preparation in advance of the Dublin meeting. While we remain doubtful whether President Giscard will show his hand much before the Dublin meeting itself, we must be seen to be taking trouble to take matters as far as we can before Dublin.

4. The State Secretary in the Federal German Ministry of Finance, Herr Lahnstein, is planning to call a meeting, probably on 12th November, which Sir Kenneth Couzens will attend. This may shed further light on the attitude of other member states; we ourselves will stick on the line of "broad balance".

5. COREPER in Brussels will be considering the Commission's report and our aim there will be to produce a paper which the Finance Ministers and and Foreign Ministers can endorse setting out as clearly and concisely as possible the issues for decision in Dublin.

6. We must also keep up the pressure in bilateral Ministerial contacts. You have now spoken to the Belgians, the Italians, the Luxembourgers and the Germans; and you will be meeting President Giscard on 19th-20th November. The Chancellor will be meeting his French opposite number on 6th November, and the Foreign and Commonwealth Secretary will be visiting The Hague. The new Danish Foreign Minister is due to visit London on 16th November. The Belgians, who are not being particularly helpful, probably need another visit. The Foreign Secretary will be in Brussels on 26th November and will see Monsieur Simonet; but that is very much the eleventh hour, and we should have a go at him before then. Given the current preoccupations of the Foreign Secretary and the Lord Privy Seal with Rhodesia, we might ask the Lord President, who knows Monsieur Simonet well, to visit him in Brussels.

Agreed

Agreed

7. That leaves the Irish, who are of course especially important because of the Presidency. We ought to have another go at them on the issue, and we ought also, later in the month, to discuss with them the handling of the Dublin meeting, though this should wait until after the Council meetings and your meeting with the French President. On the issues, I think we should ask the Lord Privy Seal to visit Dublin as soon as he can. On the handling of the Dublin meeting, this could, as suggested by Sir John Hunt earlier, be undertaken by Mr. Whitmore and Mr. Franklin after 20th November.

To talk to whom?

8. Finally, the Commission has reserved the right to make further recommendations before Dublin: this reinforces the case for you to see Mr. Jenkins again before then. Agreed MT

RTA

(Robert Armstrong)

2nd November, 1979

 Euro Pol, Pt 3
Budget

SUMMARY RECORD OF A PLENARY MEETING BETWEEN THE PRIME MINISTER AND HERR SCHMIDT, CHANCELLOR OF THE FEDERAL REPUBLIC IN BONN ON WEDNESDAY, 31 OCTOBER 1979, AT 1700

Present:

The Prime Minister	Chancellor Schmidt
Foreign and Commonwealth Secretary	Herr Genscher
Chancellor of the Exchequer	Herr Matthofer
Secretary of State for Defence	Herr Lambsdorff
Minister of Agriculture	Herr Apel
and Officials	Herr Ertl
	and Officials

* * * * * * * *

Community Budget

The Prime Minister took up the question of the Community Budget. She said that it represented a very great political and practical problem for HMG. Next year Britain's contribution would be larger than our entire aid programme. The following day the Government would be announcing reductions in planned expenditure on housing, welfare, education etc. at the same time as the contribution to the EEC Budget was going over £1,000 million per annum. She recognised the difficulty for Britain's partners in finding the money to ease Britain's problem. But if they found it difficult, how much more difficult was it for Britain! The Conservative Party had always espoused the EEC cause and always would. It was better for the free world and for Britain if Britain was a member of the EEC. But it was becoming increasingly difficult to convince the British people their country was getting a fair deal. Britain was seeking in Dublin understanding of the problem and cooperation in agreeing a solution.

The Prime Minister said she did not want the Budget problem to dominate the scene. Britain was playing a full role in other ways. In the context of Theatre Nuclear Force Modernisation, we had agreed to increase the number of GLCMs based in the United Kingdom. We were increasing our expenditure on defence: policies of détente would be meaningless without a credible defence effort.

/ We had

We had fulfilled the Tokyo remit in helping the Community to formulate a position on oil import targets even though this had been against our own interests. We had made it clear that we were anxious for an agreement on the Common Fisheries Policy. We had relaxed exchange controls and expected this to be helpful.

Chancellor Schmidt said that his discussions with the Prime Minister had deepened his personal understanding of the significance of the budgetary transfer problem. However, it could not be solved unilaterally. The Community as a whole would have to solve it. The problem was not insoluble but it was very difficult. It was not enough merely to ask for a solution. Decisions had to be taken about who would pay, how they would pay and on what time-scale. It was doubtful whether Heads of Government on their own could resolve the issue. It was too complicated and their meeting was too short.

The Commission's proposals would be very important. Thereafter Foreign Ministers and Finance Ministers would have to prepare the ground. The pros and cons of the various options would have to be clarified. Some elements of Community policy could not be questioned.

a) Own resources;

b) The principle that budgetary outlays were determined by Community policies; and

c) The legal framework of the Community.

The Commission and the responsible Ministers should come up with tangible written options for a solution.

Chancellor Schmidt said that he did not like the use of the word convergence in the present context. Convergence meant more than a fair distribution of contributions and receipts. Ensuring that the poorer countries were net recipients was not the only way of bringing about convergence. Nor would a fair budget deal of itself bring about convergence.

/ Chancellor Schmidt

Chancellor Schmidt repeated his intention to be as helpful as possible. Although the Federal Republic would not accept a role of mediator, they understood that if anyone's position needed alleviation, it was that of Britain. The Federal Republic would put up its share of the money. Britain had a legitimate case but in order to win it good lawyers would be needed. Moreover in this instance the judges were interested parties. The Prime Minister would have to be as frank with others as she had been with him. If anything was to be achieved in the European Council, it would in effect have to be achieved before Dublin.

[Reports on the discussions between Foreign Ministers and Finance Ministers were delivered before the above exchange, and on those between Defence Ministers and Agriculture Ministers after it]

At the end of the meeting, Chancellor Schmidt raised the question of the timing of the next Anglo/German Summit. He and the Prime Minister agreed that it should if possible be combined with the Konigswinter meeting in Cambridge on 28 March. They agreed, as a consequence, to press for the spring meeting of the European Council to take place on 31 March and 1 April.

The discussion ended at 1745.

6 November 1979

Prime Minister

Ld. [initials]

Weekend Box

(2)

CONFIDENTIAL

Selfish, wilful and short sighted though our partners are, they are so far as I can see the only partners we have. I therefore agree with paras 28 & 29 & believe that you personally could play a major role in pointing the community in the right direction. [initials] 2/XI

OFFICE OF THE UNITED KINGDOM
PERMANENT REPRESENTATIVE
TO THE EUROPEAN COMMUNITIES
ROND-POINT ROBERT SCHUMAN 6
1040 BRUSSELS
TELEPHONE 736 99 20

Four years ago the mood of the Community was one of sober optimism. Several developments have significantly affected its internal structure and external relations. Today the Community stands on the verge of a major crisis. (Paragraphs 1 - 2)

The European Council has emerged as the main motive force in the Community. Its role is likely to develop further. (Paragraphs 3 - 6)

The standing of the Foreign Affairs Council has declined. So has the prestige of the Commission. Nevertheless it is important that the Commission should retain its right of initiative. (Paragraphs 7 - 8)

Relations between the Council of Ministers and the European Parliament have deteriorated and decisions by the Court of Justice which extend Community competence pose problems. (Paragraphs 9 - 10)

Arguments over the future shape of the Community (federal or otherwise) are largely dead. (Paragraph 11)

A healthier attitude to criticism of Community policies now exists. The UK is in the vanguard of those pressing for change (largely because we joined late and had to accept existing policies), but we are making headway in securing acceptance of the need for a new balance of interests (Paragraphs 12 - 16)

A crisis within the Community over our contribution to the budget is approaching. Our commitment to the Community could compensate for the relative disadvantage of our negotiating position on many issues. (Paragraph 17)

The UK is not less skilful in negotiation than its partners. All member states doggedly defend interests of particular concern to them. We, especially as the advocates of reform, cannot and should not imitate our partners' methods; we could, however, concentrate our effort more on our main objectives and pick fewer nits off proposals of minor concern. (Paragraphs 18 - 25)

The founders of the Community drew on existing patterns when devising a basis for the integration of Western Europe. The problems we face require us to construct a wider basis. We should consider taking the lead in proposing that the area of cooperation be widened. (Paragraphs 26 - 30)

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OFFICE OF THE UNITED KINGDOM
PERMANENT REPRESENTATIVE
TO THE EUROPEAN COMMUNITIES
ROND-POINT ROBERT SCHUMAN 6
1040 BRUSSELS
TELEPHONE 736 99 20

31 October 1979

The Right Honourable
The Lord Carrington KCMG, MC
etc etc etc

My Lord,

1. When I arrived in Brussels in 1975 I found a mood of sober optimism. Everyone I met was preoccupied with the gulf between the economically strong and the weaker members of the Community which was wider than when the Treaty of Rome was signed. Yet they regarded the emphatic result of the British referendum a few months earlier as a clear statement of the United Kingdom's commitment to work wholeheartedly within the Community to solve its problems. That, they felt, was a great gain. Now, as I leave Brussels four years and 30,796 telegrams later, the optimism has evaporated. The mood is sober, if not sombre. The Community faces a range of challenges, many of them familiar, and stands on the verge of a major internal crisis.

2. During the past four years several events have significantly affected the Community's internal structure and cohesion and its external relations. These developments - and notably the applications for membership by Greece, Portugal and Spain and the signature of the Greek Accession Treaty; the virtual conclusion of the Tokyo Round of Multilateral Trade Negotiations; the decision that the Community as such should be represented at Economic Summit meetings; the negotiation of a successor to the Lomé Convention with 58 African, Caribbean and Pacific countries; the first direct elections to the European Parliament, indeed the first multinational direct elections

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in world history - these developments have been so well chronicled that there is no need for me to retell the story.

3. In a number of less obvious ways the Community has changed over the same period.

4. The most important of these is the emergence of the European Council as the main motive force in the Community. It is now accepted as normal that the conclusions which emerge from its meetings will entrust the Council of Ministers and the Commission with specific tasks, and sometimes with precise timescales within which these are to be accomplished. The European Council has also become the great conciliator. In 1977 the question was raised whether meetings of the European Council should be "a fire-side chat" about the major issues confronting Western Europe, or a court of appeal where problems which the Council of Ministers in any one of its formations had been unable to settle might be resolved. After months of debate the startlingly obvious conclusion was reached that the European Council was bound to be both, and the programmes for its meetings have been arranged accordingly.

5. Whether or not a particular meeting of the European Council is successful depends on circumstances at the time. But it is inevitable that the role of the European Council will grow in importance. Coordination of policies is still the weak spot in the Community's procedures. This is likely to be highlighted by the report of the Three Wise Men, who will no doubt suggest how the problem might be overcome. For myself I wonder whether the remedy

.../might

might not be for the European Council, at its final meeting of the year, to establish broad priorities for the next period ahead on the basis of suggestions put forward by the Commission. These broad priorities could constitute guidelines for the Commission when it comes to elaborate its proposals for the Community budget.

6. The role of the European Council has been enhanced at the expense of the Foreign Affairs Council which, under its informal title of General Affairs Council, was supposed to (but never did) coordinate Community policies and moderate the ambitions of colleagues who met in other formations of the Council. The influence of the Foreign Affairs Council had already been diminished by another development. In the early years, when the Community was being constructed on the basis of the Treaties of Paris and Rome, it was natural for Foreign Ministers to occupy the driving seat. But the Community has long since moved into uncharted territory such as energy policy, the environment and social affairs. More and more of the important problems are now discussed in the so-called specialist councils. Increasingly specialist Ministers even attend the Foreign Affairs Council to cover particular agenda items. In recent months, apart from the renegotiation of the Lomé Convention and the enlargement negotiations, there have been no major Community issues for Foreign Ministers themselves to discuss. No wonder then that Foreign Ministers have become increasingly reluctant to attend meetings of the Council and that so many are represented by a Deputy.

.../7.

7. For various reasons the standing of the European Commission has diminished over the past few years. The emergence of the European Council as the principal motor is one factor. Another is that, inasmuch as the Community operates increasingly beyond the limits of the Treaties, the decisive word rests more often than in the past with the Council rather than with the Commission. Public impatience with the Commission's fussy interventionism and the publicity given to instances of personal extravagance on the part of certain Commissioners have also played their part. Mr Roy Jenkins was amongst the first to appreciate the need for the Commission to react to these trends. His invitation to Mr Dirk Spierenburg and his colleagues to "examine how the Commission's organisation and staff resources can best be adjusted to meet future needs, and thus cope with a rapidly changing workload in the light of defined priorities" was one part of his response. Another was his insistence, at the Commission's week-end retreat at Comblain la Tour in September 1978, that any future proposals presented by the Commission to the Council of Ministers must be tested against certain criteria to ensure their relevance and desirability.

8. It remains to be seen how many of the generally sensible recommendations of the Spierenburg Committee and of the Three Wise Men on wider institutional questions will in the end be put into effect. While the Commission must clearly adapt its role to conform with new realities, it is important both for the Community and for our interests that it should retain the formal right of initiative. Commission proposals have the immense benefit of neutrality and hence

.../of

of respectability. The dialectic between the Commission, representing the Community interest, and the Council of Ministers, representing the interests of Member States, has proved its worth time and again. Our own ideas for the redress of inequities and the removal of anomalies in Community policies will have far more chance of success if they emerge in the form of proposals from the Commission.

9. In two other institutional fields developments over the past years have not been auspicious. Relations between the European Parliament and the Council of Ministers have deteriorated. The fact that it is the Council of Ministers which legislates in the Community is a natural source of frustration for the Parliamentarians. It is difficult for them to accept that for the foreseeable future democratic control over decisions in the Community will continue to rest with national Parliaments. The directly elected European Parliament will no doubt use its ingenuity (as proposed for example in the Dankert Report on the 1980 Budget) to wrest more control from the Council as its predecessor did in 1975, both over the conciliation procedure and later over the budget. From the point of view of the Council of Ministers these two concessions now seem to have been unwise, and the Council will undoubtedly be more wary in future.

10. In relations between the Council and the Court of Justice the seeds of future controversy have been sown. The Court's ruling in November 1978 on Community competence with regard to the draft convention on physical protection of nuclear materials provoked a

.../strong

strong reaction from the French. For their own purposes the French exaggerated; but they have a point when they argue that, since any reference to the Court seems invariably to result in a decision extending Community competence, the Court is threatening to usurp the prerogatives of the Council of Ministers.

11. Another of the less obvious changes over the past few years has been in attitudes to the future development of the Community. Since the Tindemans Report of December 1975, which may have been the federalists' last throw, the sterility of the argument has been increasingly recognised. In his lecture in September 1977 in Florence, which hit the headlines with its proposals for a leap towards economic and monetary union, Mr Jenkins made a statement on the evolution of the Community which received little attention at the time but which, because it was made by the President of the Commission, has since acted as yeast. He said then:

> "Some support the federal model, others would prefer something confederal; others like neither .... we must only give to the Community functions which will, beyond reasonable doubt, deliver significantly better results because they are performed at a Community level .... we must equally leave to Member States functions which they can do equally well or better on their own."

Few today would question that recipe. Not only does it prescribe a sensible ordering of the Commission's resources day by day, but it would also serve to eliminate proposals which individual Member States would find unacceptable and which, when taken before the Council, would lead them to invoke the Luxembourg Compromise.

.../Experience

Experience has shown that advance in the direction the federalists would wish will do nothing to solve the Community's current problems. And with the second enlargement any hope of reviving the intimacy which bound the original Six will have gone forever.

12. Likewise there is far less disposition to regard criticism of Community policies as heresy. Those Member States who benefit substantially from the Common Agricultural Policy (CAP), and notably France and Denmark, can still be relied on to misrepresent our criticism of the CAP as an attempt to dislodge a cornerstone of the Community. But their argument has become less credible as Italy and Germany - and it was Chancellor Schmidt who called for a stocktaking four years ago - have joined in the attack on how the Policy works, and as the absurdities it produces have become so evident. This more objective, even sceptical approach to the CAP is one of the healthier developments of the past few years, not least because it has loosened attitudes to other Community policies.

13. Far and away the most important trend over the past few years has of course been the increasing perversity of the operation of the Community budget. Resources have been transferred in increasing volume from poor to rich. Unlike the other trends I have mentioned this directly and most adversely affects United Kingdom interests.

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14. For historical reasons the task of safeguarding and furthering United Kingdom interests in the Community is far from easy. The fact that we were not ready to join in the European endeavour in the Fifties allowed the original Six to strike a balance which suited their interests. This balance was enshrined in the Treaties of Paris and Rome. In the interval between the veto of our first application to join the Community in 1963 and the successful conclusion of our negotiations in 1971, the original Six established the CAP, devised the Own Resources system of funding the budget, and evolved a common fisheries policy. All three policies were appropriate to their circumstances. The Six, and particularly the French, were well aware of what they were doing. Indeed their insistence on "deepening" the Community before "enlarging" it betrayed their intention of presenting the United Kingdom with a fait accompli. The train deliberately accelerated just as we were hoping to board it.

15. History will judge whether these were wise tactics on the part of the Six. Anyone called on to carry a disproportionately heavy burden will go on trying to ease it. The Six should therefore have known that the United Kingdom would not tolerate for long arrangements which were clearly detrimental to its national interests. Whatever the judgement of history, the fact is today that it is for the most part we who press for change, and on many occasions we start the negotiation at a corresponding disadvantage.

16. Despite this disadvantage we have made progress. The trends of opinion which I described earlier and which in due time will turn the Community into something closer to what we would wish it to be, owe much to our advocacy. That there is a serious problem over our net contribution to the budget is more widely accepted today than

.../even

even a year ago. The Community cannot now escape the problem of the unrequited transfer of resources from the poorer regions of the Community to the richer through the operation of the Community budget. In the longer term the problem of economic divergence and the central role of the budget as an instrument of Community economic policy rather than a traditional money-raising device will come under scrutiny. And many of those involved here in the work of the Community recognise that a new balance of interests will have to be struck before long.

17. This will not happen overnight. Nevertheless circumstances seem certain to combine very soon to create a crisis within the Community. This could arise from an unreasonable delay in solving our budgetary problem on satisfactory terms; or later when the 1% VAT limit on contributions to the Own Resources is reached. We should be ready to sieze these opportunities and the disturbance which will inevitably follow the enlargement of the Community to work with our partners to amend existing policies and, where appropriate, to develop new ones in a way which will produce a better balance of interests and incidentally serve our own. In equity and in common sense we will have a strong case. But, as any rebalancing of interests will reduce the benefits some of our partners now derive from the Community, the going will be rough. Though we will in some cases be the <u>demandeurs</u> we will have one strong card in our hand - our commitment to (and not merely our membership of) the Community. The importance of this commitment to our partners who have been longing for us to play our appropriate role in the Community should not be

.../underestimated

underestimated. In my view, together with the approach of the 1% VAT limit, this could go a long way to compensate for the relative disadvantage of our negotiating position in the Community on many of the main issues.

*** *** ***

18. In the day to day task of protecting and advancing United Kingdom interests we learn all the time by experience. When you took office I sent you a list of do's and don'ts about the conduct of business in the Council of Ministers. It may be helpful to amplify these.

19. The United Kingdom Presidency in the first half of 1977 completed our Community experience and enabled us to see more clearly than before how the Community works. From the President's chair in the Council chamber, as from the schoolmaster's, the motives and tactics of those who sit in front are unusually transparent. Holding the Presidency also gives one a special insight into the relationship between the Community institutions.

20. It is often alleged that we are less adept at looking after our interests than are our partners. The French are normally held up as paragons of how to get your way in the Community without tears. In commentaries on the French Presidency in the first half of this year I saw two conflicting views expressed. On the one hand it was said that the French had got away with murder; on the other, the French were credited with superior diplomatic skills.

.../21.

21. My experience over the past few years leads me to take a somewhat different view of our partners' tactics and performance. So many of the interests of the Benelux countries can be identified with those of the Community that it is relatively easy for them to give the impression of being communautaire. But when one of their important national interests is at stake they can be persistent and obstinate, as for example the Dutch over relations with the third world, and the Belgians on nuclear issues. Talk about the site of the European Parliament - and the Luxembourg Jekyll becomes Hyde. The Irish like things as they are: and why not, when they are doing so well? Any derogation from the CAP gets their blood up, whether it is New Zealand butter or Botswana beef. The Danes too react fiercely to suggestions that the CAP should be reformed. They are also especially concerned about the Community's energy prospects and nurse a rather incoherent ambition for a common energy policy which might well alarm their partners if it were more explicit.

22. Like ourselves the Italians have a genuine grievance. It is difficult to understand how the Italian Government of the day could have accepted the terms on which the CAP was established, so weighted is it in favour of the northern producers. Over the past few years, by resolutely opposing any concessions in the agricultural field to the Community's Mediterranean partners, the Italians have received some measure of compensation for their own producers. All the signs are that they will persist with and intensify these successful tactics.

.../23.

23. German attitudes even up to and including the level of the Council of Ministers can be curiously incoherent. Six weeks ago State Secretary Lahnstein told the Finance Council that the United Kingdom's budget problem should not become entangled with subjects such as North Sea oil or fisheries. Two days later he was being disavowed in Bonn. This incoherence was especially noticeable during the last two months of the German Presidency in 1978. At the time we put this down to the lack of close control by Herr Genscher and to poor coordination between the ministries in Bonn and between Bonn and Brussels. But, even when their policies are clear, for historical reasons the Germans are disinclined to throw their considerable weight around and they try hard to avoid finding themselves in a minority of one. The close personal relationship between Chancellor Schmidt and President Giscard is not reflected in Brussels, even at the level of the Council of Ministers. Indeed, more often than not the French and Germans find themselves on opposite sides of the argument. One is left to conclude that the hard-headed opinions of the individual ministries in Bonn still prevail so far as routine Community business is concerned.

24. The French neither get away with murder, nor are they outstandingly skilful. They pursue their objectives in the Community with rare singlemindedness, even ruthlessness, and they can count on the support of a patriotic press. They pay little regard to the wishes of their partners and even less to their feelings. No-one for example was consulted before President Giscard announced that the Greek Accession Treaty, contrary to precedent, would be signed in Athens.

.../Although

Although they dislike being isolated as much as every other member of the Community, the French are prepared to accept this for long periods. For reasons I have never had satisfactorily explained the other Member States seem in some way to be mesmerised by the French. They vituperate in the corridors about the more offensive aspects of French behaviour; but they will not speak out in the Council chamber unless the British give a lead. Nor are the French particularly successful or efficient. Over energy policy for example they have made no headway with their efforts in recent months to undermine the International Energy Agency or to curb the operation of the Rotterdam spot market. Indeed in this field they have recently had a long run of failures. It is also argued that the French have a special talent for dressing up their national interests in Community clothes and that this in some way immunises them from criticism. No-one here is so easily deceived. By now the original Five know their French partner very well and have developed a special tolerance and scepticism.

25. It is not open to us to imitate the conduct of our partners, least of all the French, and it would be foolish of us to try. For one thing, as I have said, we are the advocates of reform and, with the exception of the Italians, our partners are the defenders of the status quo; so our posture is fundamentally different. For another, we cannot in the English language talk with a straight face about our European vocation or our fidelity to our European destiny. Yet there are two ways in which we can learn from the French. We could well

.../borrow

borrow some of the ruthlessnes and dedication with which they concentrate their diplomatic effort on their main objectives for the time being. Like the French we could also more often leave it to others to defend our interests, thereby conserving ammunition for the big battles. The service this Office has received from Whitehall over the years has been admirable. Instructions for meetings of the Committee of Permanent Representatives and its working groups invariably arrive in time (sometimes only just) and for the most part they are pertinent and clear. But I have sometimes wished that our instructions were less insistent. It is easy to find one or two short-term or detailed objections to almost any proposition. But there are cases where it might well be asked: compared with what we have at stake elsewhere in the Community, does this particular consideration really matter? Or, at least, could we not wait to see whether some other Member State is not just as unenthusiastic as we are about what is proposed? It does nothing to still the remaining doubts about our commitment to the Community that, when a new proposition comes to be discussed, we are so often the first to administer the cold douche.

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26. Much of the work of the Committee of Permanent Representatives and the Council of Ministers is concerned with points of detail; and it is not always easy to keep in mind the underlying political considerations. It is even more difficult, given the volume and pace of work in the Community, to place these issues correctly in the

.../context

context of the Community's development. Neither the thirteen Commissioners nor the Council of Ministers have the time constantly to assess the validity or relevance of what they are doing. Part of the problem is historical.

27. When they sat down to devise an instrument for integrating the countries of Western Europe, the founding fathers did not start with a blank page. A generation before Robert Schuman won his place in European history, another French Foreign Minister, Louis Loucheur, had proposed a coal and steel community. Loucheur's suggestion formed part of the movement for European cooperation inspired by Briand and Herriot. They in turn had followed the course already charted in the pan-European union of the early 1920s, which looked to what the Treaty of Rome thirty years later was to proclaim as the foundation of an ever closer union among the peoples of Europe. The Europeans of the Fifties had this lead to follow. And when they chose as their instrument a common market and a community based on a customs union, they were drawing on the historical and empirical experience of the binding force - both economic and political - of a <u>Zollverein</u>, as well as the perceived economic benefits of other forms of trade liberalisation as in the OEEC and the Benelux.

28. Given the complexities of our societies and the fact that the solution to so many of our problems lies beyond our control, a common market and a community based on a customs union clearly constitute an inadequate basis on which to face the challenges of today, let

.../alone

alone tomorrow. That is why the Community long since moved into territory uncharted in the Treaties, almost always in response to external events. This empirical approach has much to commend it. Yet I doubt whether the common market (even when it has been completed), the customs union, the subsequent decisions which constitute the rest of the Community's patrimony - the so-called <u>acquis communautaire</u> - together with the coordination of foreign policy through the Political Cooperation system will provide a sufficient platform on which to mobilise Europe's potential. These are of course all essential ingredients. But, against the background of uncertain US leadership, the threat to our security, to our economic prosperity and to the stability of our societies is such that we will need to construct a wider basis. In our democratic institutions, our freedoms and our respect for the individual, we have priceless attributes which we share with other states in the industrialised world. It is no doubt still too early to see even the outlines of an eventual political community in Western Europe based on these attributes which, one would hope, would have the same essential evolutionary characteristics as its existing economic counterpart. One would also hope that such a community would appear to the rest of the world less preoccupied with the material and less often in disarray. If this is premature it is surely not too early to add a dimension to the existing basis by extending the area of cooperation not only within the Community, for example, in the fields of industry and energy, but also outside. I do not believe that close collaboration particularly with the French and Germans in East/West relations, in European/United States relations or in the

.../field

field of defence would, if handled with tact and prudence, create difficulties either with the Americans or with our other Community partners.

29. If, once the present inequitable situation over our contributions to the Community budget has been remedied, we could take the lead in proposing that a wider basis be established through cooperation in these fields, we would not only be playing the full role for which our partners have been waiting, but we might also, in the process, rid ourselves of some of the complexes from which our handling of our interests in the Community still suffers.

30. I am sending a copy of this despatch to Her Majesty's Representatives in EEC posts, Washington, UKMIS New York, UKMIS Geneva and UKDEL NATO.

I have the honour to be
My Lord
Your obedient Servant

Donald Maitland

Donald Maitland

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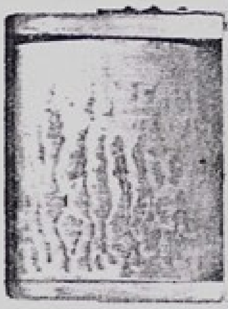
Original filed on Germany June 79 PM's meetings with Chancellor Schmidt in Germany.



EXTRACT FROM RECORD OF DISCUSSION BETWEEN PM & CHANCELLOR SCHMIDT BONN 31 OCT 79

The Community Budget

The Prime Minister stressed the importance of this problem for Britain. Popular resentment on the question was very great. She was constantly being faced in the House of Commons with statements that if no solution was found in Dublin, Britain should withhold its contribution. She had constantly replied that the Government intended to remain within the law. Nonetheless, it was essential that Britain should get satisfaction. There could be no half measures. There had to be a broad balance. Although entitled to it as one of the poorer members of the Community, Britain was not asking for net benefit from the Community budget. But it would be impossible for Britain to make an annual contribution of £1,000 million or more. Chancellor Schmidt said that the English newspapers were over-stating Britain's case. The take-it-or-leave-it attitudes which were being expressed were not prudent. The Prime Minister said that the media were merely reflecting general resentment at Britain's position as the main contributor to the budget.

The Chancellor said that he agreed that Britain had a case. But the psychology of the situation was of great importance. The Prime Minister should be under no illusions about what would happen if the future of the Community came into doubt. It would not fragment: the other eight members of the Community would remain together. However, a split between Britain and the rest of the

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/Community

Community would represent a terrible weakening of the West's position in the 1980s. There was now no US leadership and no prospect of it. The Foreign and Commonwealth Secretary said that the Community must not break up. Chancellor Schmidt said that it was necessary to look at the worst option. The tone of the British press was detrimental to the prospects of success in Dublin. The French were saying it reflected official briefing. President Giscard was telling him not to be flexible. Chancellor Schmidt was replying to President Giscard that it was essential to be flexible and that no member must be left feeling so dissatisfied as Britain at present did. Nonetheless, President Giscard was building up a tough position.

The Prime Minister said that President Giscard's position was not a strong one. France had after all been a net beneficiary from the budget for many years. Britain's position was neither fair nor equitable. At the same time as she was reducing planned expenditure on education, housing, health and other things of importance to her electorate, she was having to increase Britain's contribution to the budget. Moreover, the budget was going to countries with lower rates of tax. Chancellor Schmidt said that the difficulty with Britain's membership had of course been that she had had to make the necessary structural changes so rapidly. The original members had had many years in which to do it. Nonetheless, Britain would only get the undertakings she required in Dublin if there was an atmosphere there of give-and-take. All the participants would have to be able to defend the outcome of the European Council meeting when they returned to their own countries. The Prime Minister repeated that Britain was paying more than she could afford. The Foreign and Commonwealth Secretary said that it seemed to him legitimate for the other members to say it was Britain's own fault that she was in such a mess. He was ashamed at having to point out that Britain was the third poorest member of the Community. The Prime Minister was determined to rectify the situation but this would take time and would involve the British Government in taking some extremely unpalatable decisions. As and when these decisions were taken and cuts were made, there would be major repercussions. People were going to have to do without things to which they had become accustomed. If the economy was prospering, there might be fewer objections to a major British contribution to the Budget. But how could the present contribution be justified when people were in any case having to make sacrifices?

/Chancellor Schmidt

Chancellor Schmidt said that he fully understood the British problem. But to solve it, the Prime Minister would have to put herself in the shoes of the other members. The German Government had no intention of making difficulties. Equally they could not and would not fight with the French on the question. The Prime Minister said that she had not asked the German Government to do so. Nonetheless, it was difficult to accept the attitude of the French Government. Chancellor Schmidt said that the French would argue that there had already been three negotiations about British membership and that the Dublin mechanism, even if functioning imperfectly, was in place. Their position would be that everyone must obey the agreements which already existed and that a solution should be found by adapting the corrective mechanism. The Prime Minister said that the British people were not prepared to go on financing the other members. Chancellor Schmidt said that the only payment from the British budget was the one per cent VAT contribution. The contribution from levies and tariffs did not go through the budget. The Foreign and Commonwealth Secretary said that nonetheless they represented a transfer of resources. Chancellor Schmidt agreed but went on to argue that if the CAP were abolished, Britain's budget would not benefit in any way. The Prime Minister said that if sugar and beef were de-budgetised, Britain would derive a major benefit. Chancellor Schmidt said that the Prime Minister was right to focus on the question of the financing of the agricultural surpluses. A reduction in the overall outlay on agriculture would reduce the deficit of those who were net contributors. An attack on the financing of the surpluses would have the support of Community Finance Ministers. In approaching the problem in this way, the Prime Minister might find the allies that she needed. No one would lightly agree to shoulder their share of the 1.5 billion units of account needed to bring Britain into a position of broad balance. The Prime Minister said that if the other members were not prepared to pay their share, how could Britain be expected to bear the entire burden. Chancellor Schmidt said that the Federal Republic was certainly prepared to pay more. It was equally clear that Italy, Ireland and France were not at present prepared to pay more. Luxembourg did not count. Belgium, the Netherlands and Denmark were all in surplus. But even if they were prepared to pay, that would not be enough. A way had to be found to bring intelligent people together to find ways of tackling the problem. It could not be left to the last moment

/because

because Heads of Government did not understand all the intricacies. The Prime Minister said that the problem was a political one and recalled the language approved by Community Ministers in 1970, during Britain's accession negotiations, about the need to take action to avoid unacceptable situations arising. Chancellor Schmidt said that he recognised that Britain had a legitimate case. Unfortunately to state this was not sufficient. A way of solving the problem also had to be found. The problem should be tackled in slices. Agreement should be sought on the need to decrease the outlay on agricultural products. It would be difficult for President Giscard to reject this since it would not hit France specifically. Other problems could be dealt with later. The regional and structural funds should not be touched but changes in the operation of FEOGA were badly needed. Eight of the Agriculture Ministers would no doubt threaten to resign but the Finance Ministers would be sympathetic and President Giscard would understand. (Chancellor Schmidt suggested that the Prime Minister should remind President Giscard that Communist firms in France sold butter out of intervention to the Soviet Union and used the profits to finance the French Communist Party.)

Chancellor Schmidt said that it was essential that the meeting in Dublin should be carefully prepared. If the various locomotives now in motion ran on down the rails without action being taken, there could only be a collision with unforeseeable consequences. The meetings of Finance Ministers and Foreign Ministers in mid-November would be important. Perhaps there could be a private meeting of Foreign Ministers in the evening. The Foreign and Commonwealth Secretary said there would have to be a technical in-put because the Foreign Ministers would not be familiar with the detail. Chancellor Schmidt agreed that the technical problems were formidable. He instanced the problem of how the net transfers would be divided up assuming the scale of relief for Britain had been agreed. Germany could not accept payment on a GNP basis because she would then end up paying more than would be indicated by the one per cent VAT contribution. This would be totally unacceptable. If the budget had to be decreased, there would be a quarrel as to where and how the reduction should take place. Unless the Commission produced a paper with sensible

/ options

options and unless the Foreign Ministers (not the Ministers of Agriculture) had discussed the paper, the Community would find itself in considerable trouble. Mr. Lynch was unlikely to prove a sufficiently strong President to be able to pull things together in Dublin.

The Prime Minister pointed out that she had been willing to take a decision to accept an extra flight of GLCMs without hesitation and without bargaining. She had been prepared to contribute to the achievement of the targets laid down at the Tokyo Summit (with the establishment of which she had disagreed) without haggling. But when it came to meeting Britain's grievances no one was willing to help. She felt deeply resentful that Britain's grievances were not being dealt with. Chancellor Schmidt pointed out that the decision on the GLCMs and on oil were unilateral decisions. A decision to solve Britain's budgetary problem would have to be a multilateral decision. The Prime Minister said that her unilateral decision in this area appeared to be to contribute £1,000 million per year to the Community budget. The Foreign and Commonwealth Secretary said that the problem was to persuade our friends in the Community that there was a problem and that action had to be taken. Chancellor Schmidt said that if Britain failed to persuade her friends she would have to leave the Community. In order to persuade them, it would be necessary to offer them a means of maintaining face vis-a-vis their own electorates. The other Heads of Government could not simply pay over several hundred MUAs and then return with equanimity to face their respective Parliaments. The Federal Republic might be the only member of the Community who could get away with an offer of as much as two or three hundred MUA per year. Compared with President Giscard, who had to deal with M. Chirac as Leader both of the Guallist Opposition and of the agriculture lobby, the situation of the German Government was relatively easy. Their opponents tended to say

/ that

that the Government was not doing enough for the Community. But even within his own Cabinet there would be trouble with Herr Ertl if the agriculture budget was cut, and with the rest of the Cabinet if cuts were made elsewhere. The position in some of the smaller member countries would be even less favourable. In Denmark, where Mr. Jøergensen had just been returned with a reduced majority, it would be very difficult indeed for him to agree to transfer 100 MUA to Britain.

The Foreign and Commonwealth Secretary asked what steps Britain should take to help the other members to reach the right kind of decision. Chancellor Schmidt said that a solution of the fisheries problem might be helpful with the French and the Danes. Energy was the greatest unsolved problem facing the Community. The UK, the Netherlands and Germany had some resources. The other members had nothing, and were getting no help from the Community. France, it was true, had a very large nuclear programme, and by the late 1980s would have substituted nuclear power for something like 70 per cent of its present oil requirements. But they would be awkwardly placed in the interim. Germany would rely on coal and on oil derived from coal. The cost of such oil would be three times the cost of oil today in real terms. The Germans' position would probably be manageable eventually. But as with France, there would be a difficult interim period. Italy, Denmark and Ireland had no energy resources and no alternative programme in prospect.

The Prime Minister said that Britain had already made a concession on energy. As regards fish, the present difficulties had arisen because Britain had conserved her resources, and the French had not. France's waters had been fished out. Britain had done the right thing where others had failed to do so. Chancellor Schmidt said that the British Government should not think they were doing the right thing and others were not. This was not true. Britain had joined a club

/with fixed

with fixed rules. She had discovered that the rules were unbearably unjust. But in order to change them, the consent of the other members would be necessary. It would be necessary to campaign with them to convince them of the need for change. They knew that Britain had a case and that they ought to give something up. But Britain would have to give up something as well. If they were given a pretext for saying no or for delaying and confusing the issue, they might well decide that it suited them to take this way out. They would have to be persuaded to subscribe to an undertaking in Dublin. If Britain's attitude were to be one of "take-it-or-leave-it", the other members might well say leave it. This was a real and serious danger. The Prime Minister said that the attitude of the other members, as described by Chancellor Schmidt, mirrored the attitude of her electorate. She herself had always been strongly pro-European, and did not wish to be faced with the prospect of having to tell the anti-Europeans that they had been right.

The Chancellor said that part of the problem was that the judges were party to the dispute. Even a good case needed a good lawyer. For the other eight members to help Britain out, they would have to accept that they would suffer financially. The Foreign and Commonwealth Secretary said that it would be a terrible thing for the Community to break up. But if Chancellor Schmidt was correct in suggesting that President Giscard did not accept that Britain had a case, the Eight would have some very difficult decisions to take. Was it possible that they wanted Britain to wreck the Community? Chancellor Schmidt said that the other members of the Community had long since ceased to believe the previous British Government. They had got fed up with hearing from No. 10 that the situation was intolerable. So far, most of them had only got as far as accepting that Britain wanted yet another renegotiation, they were disinclined to agree. The Foreign and Commonwealth Secretary said that the present British Government had spent its first five months in office trying to remove misunderstandings inherited from their predecessors. However, the lack of a fair deal on the budget was a serious obstacle. The Prime Minister said that Mr. Callaghan had set out Britain's budgetary problem plainly in his speech at the Lord Mayor's Banquet twelve months previously. The situation was worse now than it had been then. Chancellor Schmidt repeated that he agreed that Britain had a legitimate grievance. He agreed that a solution had to be found. But the presentation of that solution in the other member countries would be a matter of the greatest importance. It would be difficult for all the members, notably for the Italians and the Danes. Foreign Ministers would have to meet informally to try to find relevant procedures and principles. If the principles could be agreed in Dublin, the difficulties would be on the way to a solution. If the principles were not agreed, the break-down of the Community could follow within a year.

The Prime Minister said that her Government would probably face considerable criticism following the publication of the Public Expenditure Paper the following day. There was an increasing likelihood that the Government would be faced on the issue of the Community budget with increasingly strong anti-Community feeling. Chancellor Schmidt said that nonetheless it was necessary for Britain to do more than simply ask for a solution to be found. If everyone was to ask for their money back, the Community would be bankrupt within a very short time. In the search for a solution, much would depend on the way the President of the Commission presented the problem. One difficulty was that Mr. Jenkins was English. Nonetheless his standing and reputation were good. He would have to produce the options. The British Government would have to be clear before Dublin which options it preferred. It would be essential for Britain's representatives to be concrete. The German Government would consider before going to Dublin what concessions it could make. They would adopt a middle of the road position, but would not be willing to act as mediators.

/The Prime Minister

The Prime Minister stressed that she was not prepared to seek a solution which involved a larger budget. Expenditure on the CAP would have to be reduced. Chancellor Schmidt urged the Prime Minister to have this worked out in concrete terms. Without cutting into the CAP, the problem would not be soluble. The Prime Minister said that one way of reducing the expenditure on surpluses would be to de-budgetise a substantial part of the CAP and to fund it nationally.

Chancellor Schmidt said "the man on the moon", looking at the problem, would say it was difficult but not impossible to solve. If it were to be solved, there would have to be contacts before Dublin. The number of options on the table would have to be limited and clear. It was no use expecting Mr. Lynch to do much more than call the speakers in order. There was a risk that the performance of the Presidency would be as weak as that of the Japanese in Tokyo. The Prime Minister said that in the end the problem came down to finding the money. She was afraid that those who were getting it at present would want to go on getting it. She would be looking closely at the legal position in regard to withholding contributions. Chancellor Schmidt said that he hoped the Prime Minister would also look closely at all the various mechanisms which might be used to assist in resolving the issue. Commissioner Gundelach might turn out to be an essential participant in any discussion, Even if there were no problem with net transfers, the CAP might explode under the pressure of existing problems.

The discussion ended at 1700 hours.

1 November 1979

CONFIDENTIAL

EXTRACT FROM RECORD OF DISCUSSION BETWEEN PM & CHANCELLOR SCHMIDT
BONN 31 OCT 79

Original filed on
Germany June 79
PM's meetings with Chancellor
Schmidt in Germany.

EEC Budget

The Prime Minister said that the problem of the Community Budget was politically extremely difficult for the British Government. It might seem small to the Germans but it loomed very large for the United Kingdom. The facts were simple. Britain was unique within the Community in having below average gnp per head and being a nett contributor to the Budget. We were in fact the seventh poorest member of the Community and in 1980 we would be the biggest nett contributor. The domestic background to next year's nett contribution of £1,000m was that, as part of its efforts to turn round the British economy, the British Government was having to cut expenditure on a number of socially important programmes: for example, spending on housing would be reduced by £700m in 1980 and the education programme by over £300m. There was a good deal of public opposition to these cuts, and this was made much stronger when people saw an outflow of £1,000m, most of which was going to other members of the Community who were far wealthier than Britain. She was now being urged from a number of quarters to withhold the British contribution to the Budget. But she was taking a firm line in reply and making it clear that the British Government would not flout the law. Once Community law was ignored, it would be the end of the Community. Hitherto the United Kingdom had always obeyed Community decisions carrying the force of law. She had told the House of Commons that to withhold our contribution would be contrary to European law and she was not prepared to do this. But this made it all the more necessary that the Community should accept the fairness of our case and agree to an equitable solution to the problem of the Budget. The United Kingdom was not asking

/for a penny piece

for a penny piece out of the Budget. We were seeking a broad balance between our gross expenditure and our receipts. This meant that Britain should not be a substantial net contributor. During a recent visit to London Mr. Roy Jenkins had told her that there were those who thought that Britain would accept a 50 per cent reduction in our net contribution. She had told him that this would not do: she would not be able to hold British public opinion if our net contribution was reduced by no more than half. It had also been suggested that it would be enough if Britain became the second biggest net contributor after the Federal Republic, but this was not acceptable either: if we were to be compared with anybody it should be with France who was only just becoming a small net contributor now. Because of the growing pressure on the British Government it was imperative that she came away from the Dublin European Council at the end of November with a full answer to the problem. It would not be sufficient for her to be offered a little now with the promise of more negotiations later. She had to return from Dublin with an-arrangement which would bring the British contribution into broad balance in 1980. Moreover, Britain wanted to arrive at this solution without the total size of the Budget being increased.

The Prime Minister continued that she believed passionately that Britain should be in Europe. The reasons for her conviction were primarily international political reasons. But she could not stress enough the seriousness of the crisis which would arise if a solution to our Budget problem could not be found. We simply wished to be treated as equitably as our partners in the Community.

Chancellor Schmidt said that it was his personal conviction that the problem had to be solved. When he had spoken to President Giscard about it recently, the President had told him that he was being too forthcoming, but he had replied that a solution had to be found. But he did not believe that this could be done if those concerned staked out maximum positions now. It

/was essential

was essential to create an atmosphere in which it would be possible for people to move. It was not so much a question of what was fair and unfair but of adopting the right psychological approach. It would be, nonetheless, extremely difficult to find a solution acceptable to everybody for several reasons. First, because of their complexity, the mechanics of the Community Budget were not understood by the Heads of Government. Second, other countries would have to contribute more or receive less in order to relieve the United Kingdom, and none of them would want to do that. They would argue that the Community's finances were functioning precisely according to the arrangements which had been negotiated and their was no need to change them. The French, in particular, were likely to take this line. Third, a figure of £1,000m was an enormous sum, even if Heads of Government could be brought to comprehend the mechanics of the Budget and they were ready to compromise. An added difficulty was there was as yet no proposal from the Commission on the table, and time was now very short before the Dublin meeting in which to work out a solution to such a highly complex problem. For these reasons he believed that the most the British Government could hope for from Dublin was a clear-cut declaration of intent. It was no use expecting Heads of Government to grapple with the details of a technical solution. The European Council should give Finance Ministers a clear directive to work out a detailed solution, and this would allow the Prime Minister to report to Parliament that Britain had been given satisfactory undertakings. Even this would be difficult to achieve. He believed that the European Council would have to recognise at Dublin that an answer could be found only if expenditure on agriculture was substantially reduced next year: much of the present difficulty was caused because of the explosion in agricultural outlays. He had not made an assessment of which countries would suffer by such an approach, and he had not discussed the matter with his Agriculture Minsiter, Herr Ertl. But he wanted to find a way forward.

/The Prime Minister

The Prime Minister said that when the United Kingdom's gnp rose to an appropriate level, the British would expect to be net contributors. The Government was making every effort to improve the country's economic performance. One of their recent economic measures designed to make the economy freer was to lift exchange controls. Stirling had had to be supported hard the previous day. It was no part of the Government's policy to let stirling go down but if it did so at a reasonable pace, the Government would have to let it do so. We could not stop the market but only smooth movements in the value of stirling. Britain would not restore exchange controls. Generally, the Government would hold firm to its economic policies, although things would get worse before they got better. The Government was telling the trade unions that they had freedom to negotiate pay deals but that they should use it responsibly. The Government was not going to increase the money supply to finance excessive wage settlements. Chancellor Schmidt said that this was a line he had pursued over the years. He thought that stirling would-hold up over the next few months. The British Government could look forward to another 4½ years in office, and he was sure that there would be light at the end of the tunnel by the end of that period.

The Prime Minister said that Britain was prepared to take the lead on many things in Europe such as the much needed reform of the CAP but only when a solution to the Budget problem had been found. Following the last meeting of the European Council, it was for the Commission to come forward with proposals for dealing with the problem, and we had already offered them a number of ideas of their own. She recognised that the other members of the Community would be reluctant to give up some of their present benefits in order to help solve Britain's problems, but if it was difficult for them each to give up something, how much more difficult was it for the United Kingdom to bear the whole burden of its net contribution as it was doing at present.

/Chancellor Schmidt said

Chancellor Schmidt said that Britain should recognise that if a solution to the Budget problem was to be found, the other Governments would need to be able to show that they had got something out of whatever changes were agreed: they had their publics and Parliaments to think about as well. France, for example, wanted to remain in broad balance as she was now. Italy wanted a bigger slice of the cake than she had received hitherto. Sr. Cossiga thought that British and Italian interests were parallel. But the fact was that if the United Kingdom was relieved of its net contribution and the Italians received a bigger transfer of resources, other members of the Community were going to have to give up even more. Moreover, it was inevitable that the other members would not want to meet the Budget in isolation but would want to draw in other problems such as fisheries and energy. It was, in particular, important to give the French the feeling that we were ready to seek a fair deal on fish as well as on finance.

The Prime Minister said that the United Kingdom had tried to be fair in every field: we had not only played our part properly on agriculture by opening up our markets to the other members of the Community on fish and on energy but also on matters like defence which, though not strictly Community business, were of vital concern to members of the Community. But we could not go on being fair if others were not ready to treat us in the same way. At the time of the British accession negotiations in 1970 the Community had recognised that if unacceptable situations arose on our Budget contributions, the very survival of the Community would demand that the institutions find equitable solutions. Britain now expected that to be done. A solution to the fisheries problem should be found separately on its own merits. We wanted a solution and we would abide by any decisions of the European Court on fish as on other things. It was our view that we should reach agreement first on conservation: there would be no point in having a Common Fisheries Policy if there were no fish left. Similarly, we had dealt with energy on its merits and we did not wish to re-open recent decisions.

/Chancellor Schmidt said

Chancellor Schmidt said that he wanted to be frank. It was essential that the Prime Minister should distinguish herself in the eyes of her European colleagues from her two predecessors and must not appear as a third edition of the last two Labour administrations. At present events within the Community were moving towards a clash between the United Kingdom and France. This must be avoided in view of the present world situation. If ever the Community broke up, the Soviet Union would pick its members off piece-meal. When the Commission's proposals on the Budget were on the table, Britain, France and Germany should concert together to establish what each others vital interests were in an attempt to arrive at a solution. It was essential to do this before the meeting in Dublin. It was no good looking to Mr. Lynch as the Chairman of the meeting of the European Council for he knew nothing of the complexities of the problem and would not be able to bring about an agreement.

The Prime Minister said that her approach and that of her Government to the Community was entirely different from that of her Labour predecessors. She did not believe that they would have taken the decision to accept the 16 additional GLCMs or to go beyond self sufficiency in the recent exercise on oil import targets. Nonetheless she did not like the present atmosphere which she recognised would be associated by other members of the Community with previous Labour Governments but she had to emphasise once again the need to find an equitable solution to a problem which imposed such a heavy burden on Britain.

Euro Pol.

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copy on: Euro Pol., CAP, May 79

Ref. A0533

PRIME MINISTER

Community Affairs

You may wish to inform the Cabinet of the highlights of your talks on 31st October with Chancellor Schmidt, with reference in particular to his attitude towards the Dublin European Council discussion of our Community Budget problem.

2. The Minister of Agriculture might be invited to report on the 29th October Fisheries Council, which passed off without major controversy and set further work in hand on conservation for resumed Council discussion on 3rd-4th December.

3. The Minister of Agriculture might also be invited to report on the discussions in the 29th-30th October Agriculture Council on sheepmeat and the Commission's ideas for containing CAP expenditure. France was unanimously condemned for her continuing defiance of the European Court judgment on sheepmeat and the Commission threatened immediate legal measures. The United Kingdom came under pressure to agree to Community financing for any eventual sheepmeat regime. In an informal discussion of the CAP, Commissioner Gundelach suggested that economies could be made by cutting subsidies on skimmed milk powder and export refunds on butter, by reducing the sugar quotas, and through a modified co-responsibility levy for milk. No clear consensus emerged on any of these measures.

4. The Foreign and Commonwealth Secretary might be invited to report on the main results of the 29th-30th October Foreign Affairs Council. France blocked the endorsement of the Multilateral Trade Negotiations (MTNs) package, which will now come back to the 20th November Council. The Irish Presidency outlined their ideas for the agenda of the Dublin European Council; the Commission's paper on solutions to the Budget problem will be considered first in a special meeting of COREPER on 6th November in preparation for the 19th and 20th November Finance and Foreign Affairs Councils. To avoid the

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United Kingdom being stigmatised as the only obstacle to a further humanitarian gesture, we agreed that the Community should provide 25 mua for new aid for famine relief in Cambodia but insisted that the budgetary imputation of this sum should be further discussed in COREPER.

M.J.V.

(M.J. Vile)

31st October, 1979

CONFIDENTIAL

Prime Minister

To note

TL 29/10

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

29 October, 1979

Dear Tim,

UK CONTRIBUTION TO THE EEC: REFUND FOR 1980 UNDER THE EXISTING FINANCIAL MECHANISM

The Prime Minister may like to know that we are now pretty confident that the UK will qualify under the existing Financial Mechanism negotiated in 1975 for a refund of about £200m. from our 1980 net contribution. We would expect to claim the refund during the first half of 1980, to receive about three-quarters of it as a payment on account in the first quarter of 1981 and to get the balance in about the middle of 1981. The public expenditure forecasts are already framed on a basis consistent with this, so that the refund is not a new relief to public expenditure.

As the Prime Minister knows, the 1975 Financial Mechanism is full of conditions and restrictions. The critical one for a refund from our 1980 contribution on anything like this scale is the balance of payments test. If we are in cumulative deficit, however minimally, on the current account of the balance of payments for the 3 years 1977-79, we are likely to qualify for about £200m. If we are in cumulative surplus, however minimally, the refund would be trivial - probably less than £10m.

We have now reached the point where is looks very unlikely that we shall show any cumulative surplus. For the 2 years and 9 months from January 1977 to September 1979 there is a cumulative deficit of £1.3bn, and the current account deficit so far in 1979 is £2.6bn. It seems extremely unlikely that we will suddenly show a £1.3bn. surplus in the last 3 months of 1979 and even allowing for some late revisions of the figures, which in the past have usually improved the picture, it now seems very probable that we shall qualify under the cumulative deficit provisions.

I should add that the net benefit to us will be less than £200m. because our refund scores as expenditure in the Community Budget and we have to contribute towards the cost of it. That reduces the net benefit to something like £170m. The £200m. will also score against the VAT 1 per cent ceiling.

Because the refund is payable in 1981 it will, of course, still leave the net contribution we pay in 1980 at well over £1 billion (at 1979, let alone 1980 prices). And even after the refund paid in 1981 we are still forecasting our net contribution

T. P. Lankester, Esq.,
No.10 Downing Street.

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in that year as over £1bn, at 1979 prices.

We doubt whether the prospect of this refund has very much bearing on negotiating tactics on the budget at this stage. No claim can be made until well after the Dublin European Council and there is no incentive for us to refer to it. At a later stage those arguing against conceding our case in full could point out that even the present imperfect system was already yielding us a substantial benefit. We could point to the hit and miss character of this refund, which may not be repeated for our 1981 contribution; and could say that the £200m. refund reduces the extra money that our partners would have to find to meet our case properly. However, you may agree that it would be useful for the Prime Minister to know that the refund is in prospect.

I am copying this letter to the Private Secretaries to the Foreign and Commonwealth Secretary and to Martin Vile in the Cabinet Office.

Yours ever,

Tony Battishill

A.M.W. BATTISHILL

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cc Master Ops } Sels

NOTE FOR THE RECORD

c. Mr. Alexander

The Chancellor called on the Prime Minister at 0845 this morning. They discussed the following matters:-

(i) The Chancellor's minute of 24 September about public expenditure on defence in the later years of the PESC period. It was agreed that the Chancellor would reconsider the possible formula which he might put to Mr. Pym and that he would then discuss the matter with Mr. Pym with a view to reaching agreement.

(ii) Contribution to the EEC Budget. The Prime Minister referred to recent correspondence between Mr. Walker and Mr. Biffen about the projections of the UK's contribution to the EEC in PESC. Mr. Walker had pointed out that the Treasury were assuming that the 1% VAT ceiling would be broken, and that our net contribution would accordingly increase substantially in the years ahead. The Prime Minister said that this point ought to be considered by Treasury Ministers. A more realistic assumption could leave room for a reduction in total public expenditure in the later years, or alternatively it might provide some accommodation for extra spending on defence. In any case, when we were trying to renegotiate our budgetary contribution, it would be wrong to publish a White Paper with figures that effectively implied that the negotiation would be unsuccessful. The Chancellor said that he would look into this.

The Chancellor then said that he was worried about the conclusions of OD the previous day on possible measures to hold back our contribution. He had since spoken to the Attorney General, who had agreed that there might be some basis within the terms of the Treaty for holding back our contribution. In any case, he felt it was essential that we exercise our room for manoeuvre within the law to the limit. The Prime Minister said that she would want something in writing before agreeing to go beyond the conclusions of OD: she certainly was not willing to go outside the law.

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(iii) The Chancellor said that the Governor had put forward various proposals for appointments to the Court of the Bank of England - and he (the Chancellor) would like the Prime Minister's endorsement of them. First, he proposed that Mr. McMahon should succeed Sir Jasper Hollom as Deputy Governor when the latter's term runs out next February. Second, he proposed that Mr. George Blunden should be re-appointed to the Court; and thirdly, that Mr. Page, the Chief Cashier, should be appointed for the first time.

The Prime Minister said that she was unhappy with the proposed appointment of Mr. McMahon - who, as far as she was concerned, did not have sufficient personality or banking flair for the job of Deputy Governor. She would like to see alternative names for this appointment. She was content with the re-appointment of Mr. Blunden, but she had doubts about Mr. Page's appointment. The Chancellor said that he would consider further and let the Prime Minister have a note.

(iv) Rhodesia. The Chancellor said that he had agreed with the Foreign and Commonwealth Secretary that Treasury and FCO officials should do some work on the economic implications of possible outcomes of the Lancaster House talks - for example, compensation which the UK might have to provide to white farmers. The Prime Minister took note.

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25 October 1979

PART 2 ends:-

Cab Office to MAFF 25.10.79

PART 3 begins:-

Note for the Record 25.10.79

END

Filmed at the National Archives (TNA) in London

February 2010