

PART 17

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The Community Budget

EUROPEAN POLICY

Developments in the European Community

PT 1: MAY 1979

PT 17: JULY 1982

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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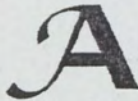
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PRIME MINISTER

DEFENCE AND OVERSEA POLICY COMMITTEE: 22 JULY 1982

ITEM 2: A COMMUNAUTAIRE ENERGY INITIATIVE

(OD(82) 61)

BACKGROUND

1. The idea of an energy initiative has been considered before. It was canvassed in Community circles before the 30 May 1980 agreement on the Mandate, and following that agreement officials suggested it (OD(80) 57) as a proposal which could be put forward by the UK in the budget restructuring exercise as a possible means of reducing the net UK contribution to the Community budget. OD decided on 13 October 1980 (OD(80) 20th meeting) that "the British Government should not advocate an oil levy but internal studies of its feasibility should continue on a restricted and confidential basis." At the meeting, doubts were expressed about the possibility of negotiating a scheme which brought the UK significant budgetary advantage to set against its difficulties. Since then, officials have done further work on the fiscal and legal implications and on the impact on industry. Detailed studies on the fiscal and industrial aspects have recently been completed by the Treasury and the Department of Industry, and will have been submitted as background to some of those attending. (We have not troubled you with these papers but can let you have them if you wish.)

2. The idea has recently been looked at again within the Commission. Mr Tugendhat mentioned it at a recent informal meeting of the Commission - but the reaction of his colleagues was generally reserved. It is not very likely that it will emerge as a formal Commission proposal.

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3. You will wish to ask Mr Lawson to introduce his paper. The Foreign Secretary will want to speak in support. The Industry Secretary will wish to comment on how it will affect the costs and competitiveness of UK industry; the Chancellor will probably also wish to comment on this aspect as well as its implications for the taxable capacity of the existing excise duties and for the Community's interest in our North Sea oil policy and its legal basis. The points to establish in discussion are:

- (a) Would an oil levy reduce the costs of UK membership?
Almost certainly 'yes', while we remain a major oil producer, as our share of own resources contribution will be lower than under the present system. The precise form and coverage of the levy will however influence the extent to which the costs of UK membership will be reduced, as will how the Community disposes of the additional revenues, and these considerations would need to be kept in mind in any Community negotiation of an oil levy.
- (b) Are there other advantages?
The proposed levy would provide an opportunity for UK oil producers to match in Community markets the post-levy price of other oil delivered in the EC and thus to increase their revenues, and the UK government tax take under the UK oil regime. The domestic oil price increase would also probably lead to a fall in oil consumption.
- (c) Would there be unacceptable effects on UK industry?
There would be significant adverse effects on the costs of most sectors of industry because of higher oil prices and probably higher electricity and transport costs. Certain sectors (metal manufacture, textiles and vehicles) could be severely hit. Department of Industry officials estimate that the impact on the UK manufacturing industry's trade balance could range from £30-£90 million per annum

/depending

depending on what reliefs were given and on whether all EC countries operated the same regime. The psychological effects of an apparent penalisation of industry could also be serious unless other taxes on costs were cut as Mr Lawson suggests. On the other hand, if industry believes that a settlement of the British budget problem involving an oil levy were necessary for continued UK membership of the Community, they might accept it as being in their wider interest.

- (d) Are the other disadvantages of major significance?
 There will certainly be OPEC protests, and Mr Pym could be invited to confirm whether these would be manageable. An oil levy would be seen by consumers as an additional tax on oil; this could make it more difficult for the Chancellor to increase excise duties. The present UK "landing requirement" means that all oil and gas from the North Sea must first be landed in the UK unless the Energy Secretary gives permission for direct export. This preserves the security of UK supplies, ensures the economic benefits of refining oil in the UK and facilitates price control and tax collection. The imposition of a levy might increase the risk of challenge to this regime and of a Community claim to "competence" over North Sea oil. But there are still legal arguments we can use to rebut such a challenge, as Mr Lawson points out in OD(82) 61.
- (e) Are the coverage and form proposed by the Energy Secretary those most likely to maximise the benefits to the UK minimise the disadvantages?
 Probably "broadly yes". The exclusion of gas would work to UK advantage given that the UK is still a significant importer. Whether the levy should be on an ad valorem or a specific basis might need further examination: both have advantages and disadvantages. The domestic production tax is necessary to avoid conflict with GATT rules which require that imports

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should not be subject to taxes not applied to domestic products. The UK would in practice be virtually the only Community country which would need to impose it, and it could be done on a national basis, with the proceeds accruing to the Exchequer.

- (f) Would Mr Lawson's proposal be seen as communautaire by our partners?

It can be argued that an oil levy would so obviously work to the UK's advantage that our partners will see it as an entirely self-interested ploy. The Foreign Secretary could be asked to comment on whether, if it is taken with the other proposals in Mr Lawson's skeleton draft speech, the oil levy proposal will have the desired presentational effect as an indication of UK willingness to seek constructive solutions to the Community's long-term problems. Mr Pym could also be asked to comment on whether the other energy proposals in the draft speech would add up to enough of a communautaire initiative to be worth making by themselves. Although most are little more than a reiteration of previously announced policy, the specific hint in paragraph 4 about Community companies strengthening their holdings on UK Continental Shelf licences is new and could be extremely well received by our partners.

- (g) Would the proposal be negotiable within the Community?

So far there are no real signs that either the Commission or our partners would be seriously interested in the proposal. But once it was on the table, and as the 1% VAT ceiling came closer, interest in it could grow. Even if it were rejected by our partners, the very fact we had made a constructive proposal of this nature could burnish our communautaire image. On the other hand, if the idea caught on, there is a distinct risk that the scheme would be severely altered in negotiation to our disadvantage.

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- (h) How best could the proposal be presented within the Community?

It is probably likely to make more impact if, as suggested by Mr Lawson, it is presented in a speech in a Community country on a separate occasion rather than during a normal Community meeting on either the budget or energy matters.

CONCLUSION

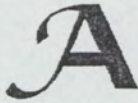
The Committee may decide to endorse Mr Lawson's proposal. If not, the Committee might be guided to reach the following conclusions:

- (a) While the United Kingdom should not put forward publicly at this stage the idea of an oil levy, they should keep it in mind and respond constructively to any such proposal which emerges from the Commission in the context of its studies of own resources.
- (b) The Secretary of State for Energy should make a speech in a Community country in the autumn putting forward the other ideas outlined in his draft skeleton speech.

D.H.

D J S HANCOCK

21 July 1982



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Debate on the 1983 European Community Budget

It is hoped that Members will find the following notes helpful for the debate on Friday, 23rd July on the 1982 (No. 1) preliminary draft supplementary and amending Budget, and on the 1983 preliminary draft Budget.

Contents

	<u>Page</u>
1) Background	1
2) The 1982 (No. 1) Supplementary and Amending Preliminary Draft Budget	2
3) Main Features of the 1983 Preliminary Draft Budget	2
(a) The British Contribution	2
(b) Major Proposals in the 1983 PDB	3
(c) The European Parliament's Guidelines	4
4) The 30th May Mandate	5

Annex I

Annex II

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EUROPEAN COMMUNITY BUDGET

1) Background

Mr. Christopher Tugendhat, the Vice President of the Commission responsible for the Budget told the European Parliament in unveiling the preliminary draft budget (P.D.B.) for 1983:

"The 1983 preliminary draft budget represents the first steps in the implementation of the new policies and orientations of the May 30th Mandate. It constitutes a significant shift in balance and in emphasis. In particular, it provides for a modest increase in agricultural expenditure and for a renewed impetus in Community policies over a broad front. The central theme in all this is the fight against unemployment" (Strasbourg, May 12th 1982).

Key Facts

- * The 1981 Community Budget was equal to 0.8 per cent of Community GDP and about 1.7 per cent of expenditure by the Government's of Member States.
- * The Budget is funded by the "own resources" system which consists of: agricultural levies, collected on trade in agricultural products with non-Community countries; sugar and isoglucose levies; customs duties from the Common External tariff; and a topping-up element equivalent to a VAT rate of up to 1 per cent levied on a harmonised basis (Greece, which has not yet implemented the Sixth VAT Directive will make a financial contribution based on her share of Community GNP). The percentage of the harmonised VAT base required to finance the 1983 preliminary draft budget is 0.79 per cent.
- * The exchange rate used for the 1983 Budget procedure is £1 = 1.79 ecus (which compares with £1 = 1.91 ecus for the 1982 Budget round).
- * Leaving aside the "refunds" for the United Kingdom, paid under the May 30th Agreement, as they affect both the 1982 and 1983 Budgets, the Commission are proposing a total increase of 11 per cent for commitments and 8 per cent for payments. This represents the smallest growth in overall Community expenditure proposed by the Commission since British accession in 1973. The increases proposed for non-obligatory expenditure in the 1983 PDB, compared with the 1982 Budget as adopted, are 25 per cent for payments and 33.7 per cent for commitments.
- * Excluding the UK special measures, total commitments and payments in the 1983 PDB amount to 23,960 million ecu and 21,865 million ecu respectively. This compares with an estimated total of potential "own resources" of 24,700 million ecu, leaving a margin of unused resources of 3,000 million ecu, part of which could be consumed by the 1983-4 Farm Price Settlement.

At the end of 1981, for the fifth successive year, the adoption of the Community Budget was the subject of controversy between the Council and the Parliament. The problem arose because at the final reading of the 1982 Budget by the European Parliament they adopted amendments in the non-obligatory sector which exceeded the margin of manoeuvre agreed by the Council and increased appropriations for food aid by 31.4 million ecu. The Council considered food aid to be "obligatory" and not therefore open to change by the Parliament at that late stage of the budgetary procedure. However, the President of the European Parliament ignored the Council's request to delay formal adoption of the Budget pending agreement on a new maximum rate and signed the Budget as adopted and the Commission agreed to implement it.

.../This

This resulted in the Council taking legal action against both the Parliament and the Commission whilst simultaneously pursuing a political solution to the dispute. Such a solution was attained, before the hearing of the cases in the Court - these cases have now been withdrawn - through an agreement between the three Institutions on the classification of expenditure (the 30th June 1982 Agreement).

2) The 1982 (No. 1) Supplementary and Amending Preliminary Draft Budget

The 1982 (No.1) Supplementary PDB has been introduced because the Commission believe that agricultural expenditure for this year will be 500 million ecu lower than expected even taking into account the results of the 1982-3 Farm Price Review. The proposed reductions have been made possible by better world market conditions, improved management of the CAP and the strength of the $\$$. However, in proposing this decrease Mr. Tugendhat urged caution on the European Parliament in saying: "In view of the volatile character of agricultural expenditure, the Commission reserves the right to make further alterations later in the year" (EP Verbatim Report, May 12th 1982).

The main points of the Commission's proposals are for a reduction of 487.259 million ecus (£254,869,2000 at the 1982 exchange rate) in both payments and commitments in obligatory expenditure. The Commission propose to use the reductions to fund increased expenditure on the Social Fund (£112 million), food aid and aid to Central America (£103 million), research (£18.3 million), housing in Northern Ireland (£6.3 million), EMS interest rate subsidies (£6.7 million) and steel production monitoring (£2.6 million). There is a balance between the proposed increases and decreases and there is thus no effect on the VAT levy to be raised for the year of 0.786 per cent.

The Commission are also committed to producing a supplementary budget in the Autumn, in order to adjust 1981's out-turn of expenditure relative to the "own resources" actually collected.

3) Main Features of the 1983 Preliminary Draft Budget

(a) The British Contribution

The 1983 PDB at present only contains a token entry to finance the British refunds in respect of 1982. The UK refunds are always entered in the Budget of the year after that to which they relate and the bulk is paid over during the first quarter so as to coincide with the British financial year. At the time of the drafting of the 1983 PDB the amounts involved in the refunds had not been determined and these will have to be added into the draft Budget later in the budgetary procedure by a letter of amendment once the means of financing the refunds have been clarified. At the meeting of the Council on 25th May it was decided, on the basis of the Commission's estimates that the United Kingdom should receive a rebate for 1982 of £480 million leaving us with a net contribution of £375 million. This agreement on a third year of refunds means that whereas the May 30th Agreement envisaged an annual rebate of about two-thirds of the British net contribution, over three years the refunds will amount to almost 75% of our total net contributions. Whereas for 1980 and 1981 the Germans bore by far the largest share of financing the UK special measures, it is notable that France, and to a lesser extent Italy and the Netherlands, are being required to be more forthcoming for 1982.

The share of "own resources", drawn from the United Kingdom, needed to finance the 1983 Community Budget, is estimated to be 22.4 per cent of the total - i.e. a gross contribution of £2,713 million.

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(b) Major Proposals in the 1983 PDB

Although the 1983 PDB contains some fairly radical increases in the non-obligatory sector it is difficult to see full justification for the Commission's claim that this is the first of the post-Mandate Budgets with a radically different balance of expenditure. However, the following table shows how, slowly, the Community's expenditure is taking on a better balance. Figures are percentages of total Community Budget. The figures in brackets show the annual percentage growth, in each sector, of expenditure in cash terms:

	<u>EAGGF</u> - <u>Guarantee</u>	<u>EAGGF</u> - <u>Guidance</u>	<u>Regional</u> <u>Fund</u>	<u>Social Fund</u>
1973	75	7	-	6
1974	68	6	-	6
1975	70	6	-	7
1976	70	4	4	5
1977	75 (14.95)	2 (35.98)	4 (34.33)	2 (23.64)
1978	71 (-)	3 (-)	4 (-)	4 (-)
1979	73 (12.46)	2 (24.66)	4 (101.29)	4 (109.16)
1980	72 (8.35)	2 (49.06)	3 (41.63)	4 (23.42)
1981	64	3	5	3

(Source: Hansard, 13th November 1981, cols. 188-9 and 8th March 1982, cols. 301-4)

If the Supplementary Measures in favour of the United Kingdom (which account for something in the region of 8% of the Budget) are included the proportion of total spending allocated to projects in the less-prosperous regions rises considerably.

On the question of agricultural spending in 1983, Mr. Tugendhat had the following to say:

"EAGGF expenditure in 1983 is estimated to increase by 7% over likely 1982 expenditure. More significantly, the average annual increase of 1982/3 over 1980/1 is 8% compared with a growth of "own resources" of 10%. Thus the rate of growth in EAGGF Guarantee spending is less than the rate of growth in "own resources" " (Ibid.).

The three financially significant sections of the Community Budget from which the United Kingdom derives a higher percentage benefit than her share of the contributions to "own resources" are the Social Fund, the European Regional Development Fund and Steel Social Measures. Looked at in this light, and given the severe common European problem of unemployment, the Commission's proposals have some merit. As Mr. Tugendhat stressed:

"The Regional Fund has increased in 1982 and 1983 compared to 1980 and 1981 by about 30% in payments and about 25% in commitments. Similarly, the Social Fund has increased by about 30% in comparison with the initial budgetary figures for 1982. If you take the amending budget for 1982 and the 1983 preliminary draft budget you come to a 55% increase in payments and a 60% increase in commitments" (Ibid.).

The Regulations which govern the operation of both the ESF and ERDF are currently being revised.

The Commission is proposing a global increase of almost 50% in the comparatively small Community spending on the environment, public health, .../youth

youth, education and culture. A 30% increase is envisaged, in addition, for innovation, research and development with particular emphasis on the telematics sector.

The energy sector is one where appropriations are rarely fully used because of a lack of legal base for some of the envisaged programmes. However, the Commission are proposing increases of 170% and 120% respectively for commitments (65 million ecu - 167 million ecu) and payments (47 million ecu to 104 million ecu).

The PDB also contains proposals for an increase of 50% in funds for the co-operation agreements with Mediterranean non-Member States, and in response to much work done in the area by the European Parliament a significant increase in the food aid programme is provided for.

Thus the main increases in non-obligatory expenditure (payments) proposed by the Commission are:

	<u>MECU</u>		<u>MECU</u>
Regional Fund	+366	Industry	+19
Social Fund	+289	Transport	+30
Energy	+57	Food Aid	+115
Research	+132	Mediterranean	+72

(c) The European Parliament's Guidelines

The Parliament's rapporteur on the Commission section of the 1983 PDB is Mr. Robert Jackson (Conservative MEP, Upper Thames) who has sought to increase the Parliament's influence over the Commission by initiating a debate on the guidelines to which the 1983 Budget should conform.

The main features of the Jackson Resolution adopted on 22nd April 1982 were:

- a call for the fight against unemployment to be given priority in the allocation of extra resources in the Budget, including a 130% increase in provision for the Social Fund (this is not a random figure but represents the extent to which the Fund was over-subscribed in 1981);
- a reaffirmation of the Parliament's support for a restructuring of the Budget and for the use of the Community Budget to aid economic convergence between Member States (an important consideration looked at in terms of the excessive British net contribution);
- in combatting unemployment the Parliament has shown itself, this year, to be much better disposed towards the Social Fund than the Regional Fund. They seem to be awaiting the completion of the revision of the Regulation covering the latter to see if it will become a more effective instrument rather than being primarily an instrument for shifting funds between national Treasuries because of the non-implementation of the principle of additionality. Within the ESF they call for more resources to go to: training opportunities for 16-18 year old (15% of the YOP programme was funded by the Community last year); vocational training with an emphasis on new technologies; and to assist young women and the handicapped;
- a challenge to the Commission and the Council to make more resources available for the restructuring of crisis-hit industries and to ensure a better rate of utilisation for appropriations in the energy sector.
- on the question of the control of agricultural spending the Jackson

.../Resolution

Resolution had the following to say:

"The right way to further control of expenditure in EAGGF (Guarantee) activities lies in the termination of open-ended and unlimited price guarantees ... In pursuit of this end, the Commission and the Council should propose a draft Budget for 1983 which reflects the financial consequences of the introduction of a global Community guarantee for each sector related to targets established for Community agricultural production for those products where the market is based primarily on intervention prices; and the introduction of a system of co-responsibility by means of a progressively reduced guarantee price for each tranche of output beyond the relevant guarantee."

4) The 30th May Mandate

At the time of the agreement on the level of Britain's budgetary refunds for 1982 the Council agreed to complete its deliberations flowing from the May 30th 1980 Agreement by the end of November 1982. The course of the negotiations over the past two years has been extensively covered in previous Research Department briefs, most recently in PEAC (82) 2 of 25th May 1982 which is available on request from CRD.

Britain's budgetary problems arise because of two main factors. Firstly our contribution to the "own resources" system is higher than our share of Community GDP because our level of trade with non-Community countries is proportionately slightly higher than that of other Member States - making Britain liable to pay more import tariffs into the Budget. This is exacerbated by the fact that we pay a high proportion of the total levies collected on agricultural imports within the Community because of our consumption patterns and our position as a net importer of food. However, a still more significant problem is the United Kingdom's low level of receipts from the Community Budget - this arises because of our relatively small agricultural sector. As CAP expenditure accounts for about two-thirds of the Budget and Britain only receives about 10% of it while providing about 21% of Budget revenue, this leads to a serious imbalance. This problem was foreseen at the time of Britain's accession but it was intended that the Community should develop new policy areas to balance the preponderance of agricultural spending. At the time of the negotiations leading to Britain's entry to the Community, the original Six Member States agreed that "should an unacceptable situation arise within the present Community or an enlarged Community, the very survival of the Community would demand that the Institutions find equitable solutions" (Cmnd. 4715, July 1971).

The British position on the May 30th Mandate was outlined by the Chancellor of the Exchequer, in a speech in The Hague in June 1981, the central tenet of his proposals for reform being that the Community should be more rational and deliberate in its distribution of resources so that they flow from richer to poorer areas rather than in a perverse and random manner.

Amongst the Chancellor's detailed proposals were that:

* the 1 per cent VAT ceiling should under no circumstances be lifted before the completion of the restructuring exercise, and he expressed considerable scepticism about whether even then Member States would feel able to release proportionately larger funds to the Community at a time of stringency for national public expenditure;

.../*

- * some regard should be had to the non-budgetary costs and benefits of Community membership (e.g. Italy's net receipts from the budget are broadly offset by adverse resource transfers outside the budget on trade in agricultural produce);
- * expenditure on agriculture should rise annually by less than the rate of growth in "own resources" and should thereby be reduced as a proportion of the budget;
- * although there should be increases in expenditure on regional and social projects, these would be insufficient to offset the perverse budgetary transfers of the CAP thus giving rise to a need for a corrective transfer mechanism;
- * the cost of the CAP should be reduced through the elimination of structural surpluses, a reduction of the levels of financial support for products in excessive surplus (e.g. the dairy and cereal sectors) and by subjecting agricultural spending to the same financial discipline as applies to major national public expenditure programmes.

The Chancellor also argued that greater play should be given to the operation of market forces in the agricultural sector. He accepted the need to maintain Community preference but counselled against seeking to solve the problems of the farm sector through increased protectionism.

Since the interim agreement of 25th May 1982 on a third year of refunds a lull has occurred in the Mandate negotiations, and the only new ideas to be produced which have had any publicity have come from a leaked paper recently discussed by the Commission prepared by Christopher Tugendhat on widening the base of "own resources". These proposals argue that the 1% VAT ceiling is likely to be reached by 1985 at the latest, and earlier if the Iberian enlargement were to take place in 1984. In the main any increase in "own resources" has to date been considered in terms of raising the 1% ceiling but the Tugendhat paper argues that there are sound arguments for broadening the base of the sources from which the Community derives its income. Taken together with the slow shift in the balance of expenditure which should result from the Mandate exercise, these proposals could make a significant contribution to helping to solve the British budgetary problem. Amongst the ideas put forward by Mr. Tugendhat, but which have not been subject to more than preliminary discussion in the Commission are:

- that the VAT element of "own resources" should be made progressive with richer countries paying a higher percentage levy;
- that a levy should be imposed on the import into the Community of either oil or energy. This would be justifiable on communautaire grounds in applying the same principle as operates for the CAP of favouring domestic producers. The UK would pay a proportionately low share of the levy; such a mechanism would also have the side-effect of raising the price we would receive for our oil in the Community market. Derogations from the levy might be necessary for Italy and Greece;
- the extension of the co-responsibility principle (a levy on production similar to that on steel operated to finance the ESCS Budget) to provide resources for the Community in relation to Member States' agricultural production;
- in order to ensure that an expansion or widening, of "own resources" was not immediately absorbed by an increase in agricultural spending, it is suggested that a "maximum rate" system should apply to agriculture, as is currently the case for non-obligatory expenditure. Should the Council wish to breach the "maximum rate" the excess increase would have to be financed by an extra levy on agricultural production.

Procedure for Adoption of the Community Budget

1) Under Article 203 of the Rome Treaty each Community Institution is required to forward to the Commission by 1st July each year estimates of their expenditure in the following year. The European Commission prepares the preliminary draft Budget and forwards it to the Council, where it is originally examined by officials in the Council's Budget Committee and then by the Committee of Permanent Representatives (COREPER).

2) The Council of Budget Ministers acting by qualified majority decides on the Commission's proposals and then formally "establishes" the draft Community Budget. This draft is then forwarded to the European Parliament which has to respond within 45 days.

3) The European Parliament makes amendments and modifications to the draft Budget and the Council, acting by qualified majority, has to act within fifteen days to reject, accept or alter the Parliament's modifications, and it may propose changes to the Parliament's amendments.

4) The European Parliament then has a further fifteen days to act on any alterations made by the Council to its changes deciding on the Council's proposed modifications by a three-fifths majority of the votes cast. When this procedure has been completed, and where necessary conciliation meetings have taken place between the two arms of the budgetary authority, the European Parliament finally adopts, or rejects, the Budget, and it is signed by the President of the Parliament.

B) Payments, Commitments and Provisional Appropriations

The appropriations included in the draft Budget cover both commitments and payments. Commitment appropriations lay down the limit within which commitments giving rise to future payments may be entered into during the year, whereas payment appropriations lay down the limit on actual expenditure which may be undertaken during the year. Where it is expected that actions initiated during the year cannot be completed within that year, (e.g. Regional Development Fund, EAGGF Guidance Section), separate commitment appropriations are entered in the Budget. Where action can be completed within the year (e.g. staff pay, administrative expenditure, EAGGF Guarantee Section) the appropriation is not divided but serves as the limit on both commitments and payments.

Where it is expected that a new policy will be agreed, during the course of the financial year to which the draft Budget applies, provision can be included in Chapter 100 with only a token entry included on the operational chapter. The provision entered in this Chapter for Provisional Appropriations can later be transferred, with the agreement of the Budgetary Authority, to the relevant operational Chapter when agreement has been reached. The same result can also be achieved by means of a supplementary Budget.

C) Qualified Majorities in Council

When the Council considers the Budget it acts by qualified majority. Member States have the following weighted votes in Council under Article 148 of the Rome Treaty, forty-five votes constituting a qualified majority:

France	10	Netherlands	5
Federal Republic of Germany	10	Greece	5
Italy	10	Denmark	3
United Kingdom	10	Eire	3
Belgium	5	Luxembourg	2
		Total	63

D) Amendments and Modifications to the Draft Budget

The European Parliament has different powers relating to "obligator" and "non-obligatory" expenditure, under the Treaty of Rome as amended by the Treaty of Rome of 22nd June, 1975:

(a) The European Parliament can propose modifications in the draft Budget to appropriations relating to expenditure "necessarily resulting from the Treaty or from Acts adopted in accordance therewith" (e.g. Agriculture and most Aid expenditure). Such proposals for modifications are subject to an overriding veto by the Council acting by qualified majority. Where a modification would increase overall expenditure it is not included in the Budget unless the Council positively approves it, acting by qualified majority (i.e. 45 votes). Where a modification would not increase overall expenditure, it is included in the Budget unless rejected by a qualified majority in the Council (i.e. 19 votes are required to uphold such a modification).

(b) The European Parliament can make amendments to the draft Budget appropriations relating to "non-obligatory expenditure" (i.e. not arising directly from the Treaty or acts adopted in accordance with it, e.g. administration, energy, regional and social spending). The Council has the power to alter the Parliament's amendments but this is subject to a further overriding power of the Parliament to insist upon an amendment by a majority of its members and 60% of the votes cast.

E) The Maximum Rate

A limit is set each year on the allowable increase in total appropriations for non-obligatory expenditure compared with the previous year. At the beginning of the budgetary process the Commission proposes a "maximum rate" of increase based on trends in the GNPs in real terms of Member States, public expenditure and cost of living indices. In accordance with this for 1983 the Commission have declared a maximum rate of 11.8%, which may be set aside if both the Parliament, (acting by three-fifths of the votes cast and a majority of its members) and the Council (by qualified majority) agree. In the absence of such agreement the maximum rate limits the increase in non-obligatory expenditure as outlined below.

If the rate of increase in non-obligatory expenditure in the draft Budget is more than half of the maximum rate, the European Parliament can further increase the total of non-obligatory expenditure by an amount not exceeding half the maximum rate. For example, if the Commission declared a maximum rate of increase of 10%, and the Council's draft Budget provided for an increase in non-obligatory expenditure of 6% compared with last year, the Parliament could put forward amendments adding a further increase of 5%, making an increase of 11% in all. If the rate of increase in non-obligatory expenditure of the draft Budget, as established, is less than half the maximum rate, then the European Parliament may increase the total up to the ceiling of the maximum rate.

The Parliament's margin for manoeuvre applies as from the draft Budget as adopted by the Council at its first reading.

F) Provisional Timetable for Budgetary Procedure

The informal timetable to be followed for the 1983 Budget is:

Meeting between the delegation from the European Parliament and the Council of Ministers	27th July
Meeting of the Budget Council to establish the draft Budget	27th/28th July
Consideration of the draft Budget by the Parliament	3rd Aug-25th Oct
Consideration of the Parliament's amendments and modifications by the Council	26th Oct-16th Nov
Further consideration of the draft Budget by the Parliament	17th Nov-16th Dec
Adoption of the 1983 Budget	17th December

ANNEX II

(Source: Explanatory Memorandum on the Preliminary Draft
General Budget of the European Communities for 1983)

COMMITMENTS
million ECUs

	1982 Budget	PDSAB No 1 for 1982	1983 FDB
Administrative and other expenditure	735.773	760.945	790.313
Industry, Transport and Energy Policies	123.460	123.460	255.746
Research and Investment	347.250	382.337	478.502
Miscellaneous Social, Environmental, Agricultural and Scientific expenditure	85.620	97.620	168.523
Repayment to Member States for the cost of collecting non-VAT Own Resources	962.410	962.410	1014.622
Refunds to Greece	98.762	98.762	54.120
Financial Mechanism	token entry	token entry	token entry
Supplementary Measures in favour of the UK	1654.212	1654.212	token entry
Social Fund	1242.765	1457.765	1800.000
Regional Development Fund	1610.500	1610.500	2400.000
EMS interest rate subsidies	259.695	272.436	255.777
Steel Social Measures	50.000	50.000	50.000
Disaster relief to Member States	46.670	46.670	42.770
EAGGF - Guarantee Section	13189.000 ¹	13143.000 ¹	14050.000 ¹
EAGGF - Guidance Section and Fisheries	828.286	828.286	875.472
Food and other aid	577.876	712.876	691.277
Aid to non-associates	198.135	263.135	307.950
Co-operation with non-member states	54.500	54.500	190.512
Provisional appropriations	815.776	361.776	96.270
Contingency Reserve	4.948	4.948	5.000
SUB-TOTAL	22885.638	22885.638	23526.854
Other institutions	374.495	374.495	405.020
TOTAL	23260.133	23260.133	23931.874

¹ Including 266.8 million ECUs for 1982 and 258 million ECUs for 1983 which the Commission have proposed be included in Chapter 92

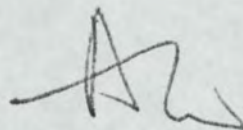
Mr Coles ✓ ADL 22/7
To see Mrs 21/7

cc Mr. Mount ✓
Mr. Scholar ✓

MR. VEREKER

A COMMUNITY ENERGY INITIATIVE - THE COMMUNITY OIL LEVY

1. If I were advising Mitterrand or Schmidt, I would tell them that the Secretary of State for Energy's proposal is a cynical attempt, with no hope of approval, to tax the rest of the Community for the benefit of the Community's only oil producer. Furthermore it proposes increases in taxation, and especially taxation that impinges seriously on industry's costs. He admits that the additional burden on oil consumers would be only partially offset by a reduction in other taxes. It is remarkable when all other countries are cutting down the public sector, the Secretary of State is proposing a substantial increase in, not only the taxes, but also Community spending. Furthermore, one of the objectives of the United Kingdom has been to ensure that the Community does not build high external tariff barriers, especially for raw material imports, but this proposal gives rise to exactly that.
2. Each member Government of the Community may well argue that it has produced domestic oil and gasoline taxes which are appropriate for its domestic policy. Member Governments have considered increases or indeed reductions in oil taxes and settled on their present rates. Thus, if the oil levy were imposed, then they would be induced to reduce domestic taxes and presumably increase taxes elsewhere. Not a very satisfactory outcome to say the least.
3. Since it is most unlikely to be adopted, I wonder what conceivable benefit there will be for the UK in pursuing it.



ALAN WALTERS

21 July 1982

Ref. A09069

PRIME MINISTER

Cabinet: Community Affairs

The Foreign and Commonwealth Secretary is unlikely to want to say much about the inconclusive first day of the Foreign Affairs Council on 19th-20th July, which agreed to return to a number of topics, including aid for Central America and trade relations with Japan, at the next meeting in September. The Secretary of State for Trade may, however, wish to report on the second day's discussion, when the United Kingdom was represented by the Minister for Trade, which agreed that negotiations with the United States Administration on their steel import restrictions should be resumed on the basis of bilateral talks with the member states concerned, co-ordinated by the Commission.

2. The Minister of Agriculture, Fisheries and Food may wish to report on the Agriculture Council on 19th-20th July and the Fisheries Council on 20th-21st July. The Agriculture Council agreed the wine reform package left over from the prices settlement, subject to confirmation from the Germans after their Cabinet meeting on 28th July, with improved safeguards for the United Kingdom spirit and ethyl alcohol industry. The Fisheries Council were trying to reach agreement on the main outstanding items of the Common Fisheries Policy.

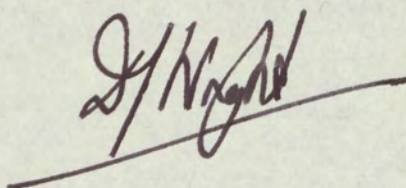
3. The Minister of Agriculture, Fisheries and Food may also wish to report the European Court's judgment in the Newcastle disease case that this country's restrictions on poultry imports were inconsistent with the Treaty. The judgment was less unfavourable than might have been expected, since the Court recognised that means must be found of safeguarding the health of our poultry flock in any changes to our import regime, and noted the Commission's intention of contacting the United Kingdom on this.

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4. On 21st July the Commons debated the White Paper on Developments in the Community, July-December 1981, and on 23rd July will debate the Community's 1982 amending budget and draft 1983 budget. The Budget Council meets on 27th-28th July.



ROBERT ARMSTRONG

*(Approved by Sir R Armstrong
and signed on his behalf.)*

21st July, 1982

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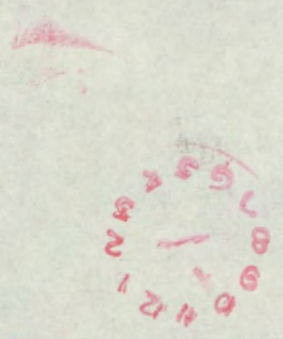


On 21st July the Commission received the White Paper on Development in the
Community, July - October 1982, and on 23rd July will debate the Community's
1982-83 budget and draft 1983 budget. The Budget Committee will meet on
27th - 28th July.

[Handwritten signature]

ROBERT AMSTRONG

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21 JUL 1982

21 JUL 1982

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FM BONN 151555Z JULY 82

TO IMMEDIATE FCO

TELEGRAM NUMBER 650 OF 15 JULY

AND TO PRIORITY WASHINGTON PARIS UKREP BRUSSELS AND UKDEL NATO

YOUR TELNO 339: (NOT TO ALL) MEETING WITH CHANCELLOR SCHMIDT

1. I HAD AN HOUR AND A QUARTER WITH THE CHANCELLOR LAST NIGHT DURING WHICH WE RANGED OVER THE MAIN SUBJECTS COVERED IN YOUR BRIEFING. SCHMIDT WAS A LITTLE BRISTLY AT FIRST, HAVING PROBABLY BEEN BRIEFED THAT I WAS CONCERNED ABOUT THE EFFECTS ON OUR RELATIONS OF GERMAN ATTITUDES OVER E.C. AND FALKLANDS ISSUES: BUT AS THE MEETING WENT ON HE BECAME MORE AND MORE FRIENDLY AND SEEMED MORE PERSUADED OF THE GREAT RANGE OF COMMON INTERESTS AND VIEWS ON THE PROBLEMS WHICH WE WILL BE FACING IN THE NEXT MONTHS. AT THE END OF OUR TALK HE SUGGESTED THAT THE PRIME MINISTER (AND YOU IF YOU WISHED) SHOULD VISIT HIM PRIVATELY AT HIS HOUSE IN HAMBURG AFTER THE ANGLO/GERMAN SUMMIT EITHER ON HER WAY BACK FROM BERLIN (A VISIT HE WOULD WARMLY WELCOME) OR DIRECT FROM BONN IF A VISIT TO BERLIN WERE NOT TO TAKE PLACE. WHETHER OR NOT IT IS POSSIBLE TO ARRANGE A VISIT TO HAMBURG, THE INVITATION IS A MOST SIGNIFICANT INDICATION OF THE CHANCELLOR'S FRIENDSHIP. WE SHALL FOLLOW THIS UP SEPARATELY.

2. SINCE SCHMIDT WAS IN DISCURSIVE MOOD, (HE ASKED ME NOT TO TAKE NOTES OF HIS REMARKS) AND WAS CLEARLY NOT INFORMED IN DETAIL ABOUT MANY ISSUES, I WAS NOT ABLE TO GO DEEPLY INTO DISCUSSION ON MANY SUBJECTS MYSELF. THE MAIN POINTS OF INTEREST WERE AS FOLLOWS.

FALKLANDS

3. AFTER I HAD REFERRED TO MY CONCERN OVER POSSIBLE GERMAN LACK OF UNDERSTANDING OF THE SITUATION, AND THEIR EXAGGERATED WORRIES OVER THEIR RELATIONS WITH LATIN AMERICA AND THE THIRD WORLD, SCHMIDT WONDERED WHETHER WE REALISED THE COST TO GERMANY IN TERMS OF TRADE WITH ARGENTINA (DM 4,000 MILLION EXPORTS, MAINLY OF SHIPS) I ASSURED HIM THAT WE DID AND THAT YOU WERE MOST GRATEFUL FOR GERMAN SUPPORT. HE RESTATED HIS OPPOSITION TO THE IDEA OF SANCTIONS AS AN EFFECTIVE MEASURE BUT AGREED WHEN I POINTED OUT THAT AN EMBARGO ON MILITARY EQUIPMENT WAS A DIFFERENT MATTER. HE THEN SAID THAT HE REGARDED THE FALKLANDS CRISIS AS SOMETHING THAT IS NOW OVER AND NEED NOT IN ANY WAY TROUBLE OUR RELATIONSHIPS. IN VIEW OF THIS ATTITUDE I DID NOT ARGUE THE ISSUES WHICH I HAD EARLIER DISCUSSED WITH GENSCHER.

4. SCHMIDT SAID HE HAD RECENTLY MET TWO PERUVIANS WHO IMPRESSED HIM ENORMOUSLY. ONE WAS ULLOA, THE PRIME MINISTER, WHO HAD A REMARKABLE GRASP OF POLITICS AND OF WORLD ECONOMIC ISSUES AND WHO WAS FUNDAMENTALLY VERY HOSTILE TO ALL MILITARY REGIMES, HAVING HIMSELF HAD TO GO INTO EXILE: HE STRONGLY RECOMMENDED THAT HMG SHOULD CULTIVATE THIS IMPRESSIVE MAN. THE OTHER WAS PEREZ DE CUELLAR,

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AND I WAS ABLE TO EXPLAIN THAT YOU AND THE PRIME MINISTER HAD BEEN MEETING HIM THAT DAY AND EXPLAINING OUR POSITION. I WAS ALSO ABLE BRIEFLY TO EXPLAIN THE NEED FOR A LONG PERIOD OF SETTLING DOWN BEFORE DECISIONS ABOUT THE FUTURE COULD BE TAKEN, AND I REFERRED TO THE STATE OF PARLIAMENTARY AND PUBLIC OPINION IN THE UK.

COMMUNITY

5. SCHMIDT BEGAN BY REPEATING HIS WELL KNOWN STORY OF HOW, HAVING GROWN UP WHOLLY ANGLOPHILE, THE HISTORY OF BRITAIN'S MEMBERSHIP OF THE COMMUNITY AND THE VARIOUS QUOTE RENEGOTIATIONS UNQUOTE HAD DRIVEN HIM INTO THE ARMS OF THE FRENCH. HE THEN GAVE VENT TO HIS VIEWS ABOUT THE ABSURDITY OF MANY ASPECTS OF THE COMMUNITY, IN PARTICULAR THE CAP (WHERE IT WAS TOTALLY IMPOSSIBLE TO CONTROL AGRICULTURE MINISTERS, INCLUDING HIS OWN) AND THE FACT THAT BRITAIN AND GERMANY HAD TO BE LARGE CONTRIBUTORS. HE HAD LAST WEEK TOLD THE DUTCH PARLIAMENT THAT THE BUDGETARY SITUATION WAS INTOLERABLE FOR BRITAIN AND GERMANY. THIS ALLOWED ME TO MAKE THE POINT ABOUT THE IMPORTANCE OF GETING A LONG-TERM SETTLEMENT AND THE INIQUITY OF THE SITUATION FROM OUR POINT OF VIEW. SCHMIDT WAS MOST DOUBTFUL ABOUT THE ABILITY OF THE COMMISSION AND THE DANISH PRESIDENCY TO PRODUCE A RESULT AND THEREFORE FEARED THAT IT WOULD FALL TO THE GERMAN PRESIDENCY TO SETTLE THE QUESTION. AFTER SOME SLIGHTLY DISOBLIGING REMARKS ABOUT GENSCHER'S ABILITY TO COME UP WITH A SOLUTION HE SAID IT WAS HIS VIEW THAT THE SOLUTION SHOULD BE WORKED OUT BETWEEN THE FEDERAL REPUBLIC, BRITAIN AND FRANCE AND THEN SOLD TO THE OTHERS. HE ASKED ME TO TELL YOU THAT HE PERSONALLY WAS CONVINCED OF THE NECESSITY OF MAINTAINING THE RIGHT OF VETO IN THE COMMUNITY (THOUGH HE WAS PREPARED TO ACCEPT THE NEED FOR A WRITTEN EXPLANATION OF A VETO): GERMANY, FRANCE AND BRITAIN COULD NOW ALLOW THEIR VITAL INTERESTS TO BE VOTED DOWN. HE ADDED THAT GENSCHER WAS LESS SOUND ON THIS POINT. HE DID, HOWEVER, REITERATE THE GERMAN EXCUSE THAT OUR LINKING THE PRICE ISSUE WITH THE MANDATE HAD FORCED THE VOTE IN MAY: I REBUTTED THIS.

FISHERIES

6. I TOOK THIS OPPORTUNITY TO POINT TO THE NEED FOR A SUCCESS IN AGREEING THE CFP AND MADE THE POINTS CONTAINED IN YOUR BRIEFING. SCHMIDT ONCE MORE WAS TOTALLY UNBRIEFED AND SAID THAT THE COMMUNITY HAD KILLED THE GERMAN FISHING INDUSTRY AND HE DID NOT THINK THERE WAS ANYTHING TO BE DONE. I EXPLAINED THAT THE SITUATION WAS NOT SO DESPARATE FOLLOWING THE DISCUSSIONS THAT WE HAD HAD AND THAT THE IMPORTANT THING WAS TO GET THE DANES TO COOPERATE. SCHMIDT INSTRUCTED DEPUTY UNDER-SECRETARY VON DER GABLENTZ, WHO WAS PRESENT, TO PURSUE THIS MATTER.

EMS

7. THE CHANCELLOR SAID THAT HE COULD SEE NO REASON WHY WE SHOULD STILL REMAIN OUTSIDE THE SYSTEM. ITS VALUE LAY IN IMPOSING ON GOVERNMENTS THE NEED FOR ECONOMIC DISCIPLINES SUCH AS HMG WAS IN ANY CASE FOLLOWING. HE THOUGHT IT WOULD BE OF ENORMOUS POLITICAL AND PSYCHOLOGICAL BENEFIT IF BRITAIN WERE NOW TO JOIN. THE FACT THAT

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EVEN WITHIN THE SYSTEM EXCHANGE RATE ADJUSTMENTS HAD TO TAKE PLACE WAS NO ARGUMENT AGAINST THE SYSTEM ITSELF: EVEN UNDER BRETTON WOODS, EXCHANGE ADJUSTMENTS TOOK PLACE. JOINING NOW WOULD GREATLY HELP US IN CREATING THE RIGHT ATMOSPHERE IN THE COMMUNITY FOR SETTLING SOME OF THE OUTSTANDING PROBLEMS THOUGH, HE ADDED, THE FRENCH WOULD WONDER WHAT WE WERE UP TO.

TRANS-ATLANTIC RELATIONS

8. THE CHANCELLOR CLEARLY SAW THAT OUR CONCERNS AND POLICIES HERE WERE LARGELY IDENTICAL. HE WAS WORRIED ABOUT LACK OF PROGRESS IN THE GENEVA INF TALKS AND FEARED THAT SOME AMERICANS REGARDED THIS NEGOTIATION SIMPLY AS A SOP TO THE EUROPEANS WHILST PRIVATELY WISHING TO CONTINUE THE ARMS BUILD-UP. IF THE AMERICANS COULD NOT CONVINCE EUROPEANS THAT THEY WERE MAKING A REAL AND GREAT EFFORT THERE WOULD BE SERIOUS DIFFICULTIES NEXT YEAR AS INF DEPLOYMENT APPROACHED, AND BELGIUM AND THE NETHERLANDS AND POSSIBLY EVEN ITALY MIGHT FALL BY THE WAYSIDE. HE WAS SLIGHTLY MORE OPTIMISTIC ABOUT START.

9. ON US/EUROPEAN ECONOMIC RELATIONS (INCLUDING THE GAS PIPELINE AND STEEL) THE CHANCELLOR WAS CLEARLY HAPPY ABOUT THE LINE THAT HMG HAVE BEEN TAKING. ON THE QUESTION OF THE WORLD ECONOMY THE CHANCELLOR APPEARS STILL TO BE IN HIS APOCALYPTIC MOOD. FOLLOWING A TALK WITH MY AMERICAN COLLEAGUE ARTHUR BURNS, HE FEARS THAT THERE IS NO HOPE OF GETTING THE US BUDGET DEFICIT ADJUSTED AND INTEREST RATES UNDER CONTROL BEFORE NEXT SUMMER WHEN THE NEW CONGRESS WILL HAVE HAD A LOOK AT THE QUESTION. IF THIS SHOULD TURN OUT TO BE SO, HE FEARS FURTHER MASSIVE UNEMPLOYMENT AND STAGNATION IN OUR ECONOMIES.

10. ON EAST/WEST RELATIONS THE CHANCELLOR ALSO APPEARED REASONABLY HAPPY WITH THE GENERAL UNDERSTANDING BETWEEN OUR TWO COUNTRIES.

CHANCELLOR'S VISIT TO MR SCHULTZ

11. THIS PRIVATE VISIT TO MR SCHULTZ HAD BEEN FIXED LONG BEFORE SCHULTZ WAS PICKED AS SECRETARY OF STATE. THE CHANCELLOR THOUGHT THAT SCHULTZ WOULD HAVE A GREAT DEAL OF UNDERSTANDING FOR EUROPEAN CONCERNS BUT HE HAD INHERITED A LOT OF VERY DIFFICULT ISSUES ON WHICH US POLICY WAS NOT SATISFACTORY. THESE RANGED FROM CENTRAL AMERICA, THROUGH THE MIDDLE EAST, THE GAS PIPELINE PROJECT AND ECONOMIC RELATIONS. IT WOULD BE IMPOSSIBLE FOR SCHULTZ TO CHALLENGE ALL THE POLICIES AT ONCE AND THE CHANCELLOR THOUGHT HE WOULD HAVE TO CONCENTRATE ON THE MOST VITAL. SCHMIDT THOUGHT THAT SCHLUTZ UNDERSTOOD THE EFFECTS IN EUROPE AND THE REST OF THE WORLD OF US ECONOMIC POLICIES BUT IT WOULD BE VERY DIFFICULT FOR HIM TO EXERT ANY EFFECTIVE INFLUENCE. NONETHELESS, THE CHANCELLOR IS CLEARLY HOPING THAT SCHULTZ WILL HAVE A STEADYING AND BENEFICIAL EFFECT AND THAT HIS TENURE OF OFFICE WILL BE HELPFUL TO EUROPEAN INTERESTS.

TAYLOR
STANDARD)
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PRIME MINISTER

Community Affairs

← The Chancellor of the Exchequer may wish to report on the meeting of the Finance Council on 12th July, when he welcomed a firm line by the Commission on the need for greater discipline in the 1983 national Budgets. A discussion of the promotion of investment generally endorsed an approach consistent with the Government's own economic policy. The Council will return to both subjects later in the year.

2. The Energy Council on 13th July was a "low key" meeting which confirmed the Community's existing energy strategy, and the Secretary of State for Energy is unlikely to wish to draw any specific items to the attention of Cabinet. There was, however, agreement that the Community should again try to produce a comprehensive coal package, while France blocked agreement on the energy labelling directives.

3. The Commons will be debating the Common Fisheries Policy this afternoon, and it is intended that there should be a debate in the week beginning 19th July on the Community's 1982 amending Budget and the Budget for 1983. The Agriculture Council will meet on 19th July, the Fisheries Council on 20th July and the Foreign Affairs Council on both days. On 22nd July OD will be discussing the approach the Government should adopt to the autumn negotiations on the United Kingdom budget problem, including the part which might be played by a positive initiative on energy and the possibility of using the withholding of all or part of the United Kingdom's contribution to the Community's budget as an instrument in the negotiations.

Robert Armstrong

14th July 1982



You may like to see how the
Chancellor, Foreign Secretary and Minister
of Agriculture are approaching next
week's OD discussion.
A-J.C. 15/7

NOTE OF A DISCUSSION ON THE COMMUNITY BUDGET AT NO.11 DOWNING
STREET AT 9 A.M. ON 14 JULY

Present:-

Chancellor
 Sir Kenneth Couzens
 Mr. J.O. Kerr

Foreign Secretary
 Sir Michael Butler (UKREP)
 Mr. D.A. Hannay

Minister of Agriculture
 Sir B. Hayes
 Mr. D.J. Hancock
 (Cabinet Office)

Papers

1. The meeting considered:-

The Secretary of State's paper OD(82)55 of 17 June, and
 minute of 8 July to the Chancellor;

The Chancellor's minute of 6 July, covering two draft
 OD papers;

Sir Michael Butler's letter of 29 June, and UKREP Telegram
 No. 2831 of 12 July; and

The draft list of questions at Annex A to EQS(82)19.

Withholding

2. The Secretary of State accepted that "withholding" must inescapably
 be an integral part of our strategy, though it should be regarded as a
 last resort weapon, for the risks inherent in using it would be very
 considerable. To brandish it now would be a great mistake, and would
 only serve to exacerbate the bitterness towards us currently shown by
 the Nine. Sir Michael Butler agreed that direct threats to
 withhold would certainly be counter-productive, but that there would
 be no harm in the Government making it known, when pressed by
 Opposition/Anti-European critics, that "withholding" was not ruled out,
 though we would be reluctant to take a course so damaging to the
 Community unless it proved impossible to safeguard our position by



other means.

3. The Chancellor thought that we would certainly have to say that in the last resort we were prepared to contemplate "withholding". Nor did he think that it would be damaging domestically if, having fought again to ensure that we paid only a modest net contribution, we were obliged in the end to start to "withhold". Conversely, apparent acceptance by the Government of the prospect of net contributions rising to £1 billion would not be understood, and could be electorally damaging. The Minister of Agriculture was however inclined to feel that a situation in which we were "withholding", with the inevitable attendant chaos, both domestically and internationally, would itself be electorally damaging: it would be a gift to the anti-Europeans. Like the Secretary of State, he thought that the period between now and November should be propitious for negotiation on budget issues, but that the climate for diplomacy would worsen sharply if we were openly to threaten "withholding". The Nine's reaction could well be to get down to serious examination of the idea of two-tier Community membership. We should only move to "withholding" when we had been seen to have tried every other tack.

4. The Chancellor agreed that the "withholding" card should not be put on the table in negotiations in the summer and early autumn.

Negotiating objectives

5. The Chancellor thought it important that we should identify a clear budgetary objective: the strategy should determine the tactics, and not vice versa. He believed that we should aim for a satisfactory and durable settlement of the specific budget problem: he had no faith in schemes to circumvent it by an enlargement in the



scope of Community financing. The ideal solution would be one along the lines proposed in his Hague speech. It was important to move away from a situation, damaging both to the Community and to the case - which he strongly endorsed - for our continued membership, in which our budget contribution generated debilitating annual rows. The objective should be to ensure that our net contribution would be modest. (The Secretary of State however, thought that to re-emphasise the aim of modest net contributions would continue to put community membership in the wrong perspective.) The Chancellor saw little joy in waiting for the 1 per cent VAT ceiling to come under threat: in his view (and the Secretary of State concurred) we would find little support among the Nine for keeping the ceiling intact. Even the Germans would crumble.

6. The Minister of Agriculture thought that the psychological moment for securing a satisfactory long-term budget arrangement would then arise. It would be our quid pro quo. Sir Michael Butler, agreeing, thought that the effects of enlargement, and the threat to the 1 per cent ceiling, would create a wholly new situation. Our partners would be obliged to join the search for a satisfactory long-term budgetary solution. In the interim, we might hope to get refunds for the next two years at the rate of 66 per cent over the full five years, but we could not hope for more. From the start of 1985, a new chapter would open.

7. The Chancellor thought that an interim deal involving two more annual refunds at a rate of 66 per cent over five years would undesirably institutionalise and build in the concept of degressivity. The refunds for 1983 and 1984 would be at only around 50 per cent. An average of 75 per cent would be a more appropriate aim. Moreover, the crunch might not come soon enough: there were ways of fudging the 1 per cent problem, as Mr Tugendhat's paper showed. Mr Hancock suggested, and the Chancellor agreed, that it



would be easier to use the "withholding" weapon following, rather than before, a review of the Community's "own resources". And a successful outcome to such a review, plus more Community expenditure in the United Kingdom, could indeed open a new chapter, in which arguments about precise past percentage refunds would no longer be relevant. Sir Kenneth Couzens thought this unlikely: past experience suggested that increases in total Community expenditure tended to entail changes in the balance of spending which were adverse to us. Enlargement could hardly change this, and might indeed exacerbate it. The question for our partners would remain how much it would take to buy us off; and for us, how large we were prepared to allow our net payments to become.

8. The Minister of Agriculture thought it wrong to pick a figure now: we would have to settle for the best we could negotiate. The Secretary of State thought that for the next two years the absolute maximum which we could hope to obtain would be refunds producing 66 per cent over 5 years. He did not feel that this would damagingly build in degressivity; and Sir Michael Butler suggested that our partners could not in logic press their case on "trop paye" without accepting the 66 per cent base. If, by 1984, it was clear that the 1 per cent lever was proving ineffective, and that the review of "own resources" was going to end unsatisfactorily, he accepted that we would have to take stock again. But he was not despondent about the chances of having made satisfactory progress by then.

Negotiating tactics

9. The Secretary of State thought that we should so contrive matters than the Commission came forward with negotiating proposals. In his own bilateral contacts, he would however set out our position firmly and clearly.



10. The Chancellor, agreeing that formal proposals should emanate from the Commission, thought that we should seize every opportunity to state our case at all levels, and in all convenient fora, including ECOFIN. The Secretary of State thought that it would certainly be right for both him and the Chancellor to press our case, he was less sure that a wider orchestra should be brought into play at this stage. The Minister of Agriculture reported that Thorn, in a recent private talk, had suggested that it would be helpful to him to have a detailed discussion with someone enjoying the Prime Minister's confidence.

OD Papers

11. It was agreed that the Chancellor's paper on "withholding" should go forward to OD. It would be accompanied by a joint paper by the Chancellor and the Foreign Secretary, setting out the questions for OD; and the answers which they would recommend. Some of the answers would be jointly recommended: on others views would still differ, though the area of disagreement had been satisfactorily narrowed.

JOK

J O KERR
14 July 1982

Distribution:

Mr Coles: No.10	Sir M Butler (UKREP)	PS/CST, PS/FST
Mr Fall: FCO	Sir B Hayes (MAFF)	PS/EST, Sir D Wass,
Mr Lawson: MAFF	Sir A Acland (FCO)	Sir K Couzens, Mr Little
Mr Wright: Cabinet Office	Mr Hancock (Cabinet Office)	Mrs Hedley-Miller
	Lord Bridges (FCO)	Mr Kemp
	Mr Hannav (FCO)	Mr Ridley
		Mr Edwards

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Prime Minister

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Qz.02639

MR COLES

*W. J. R. 7/5/6
Please
not*

There will be a number of papers to
OD on 22 July. You may like
like to read this important, but
lengthy, paper now or at the
weekend.

A.J.C. $\frac{14}{7}$

cc: Mr Wright

EC BUDGET: CONTINGENCY PLANS FOR WITHHOLDING THE UK CONTRIBUTION

OD is meeting to discuss Community policy issues on 22 July. The agenda is heavy and there will be no time to go into each subject in depth. The third item on the agenda is "withholding" and the Chancellor intends to circulate a paper as requested by OD. The Chancellor's paper will, I understand, concentrate on how best to use withholding or a threat to withhold as a means of securing equity for the UK in the Community budget arrangements. It will refer to a detailed contingency plan prepared by officials but the plan will not be on the agenda.

2. I have asked Departments to submit copies of the plan to their Ministers before the OD meeting and to report any significant reactions. I thought that the Prime Minister might also wish to see it. A copy is attached. The plan has been prepared by the Treasury after consultation with the Departments principally concerned which are the Legal Departments, MAFF, Industry, Employment, Trade, Transport and Energy.

3. There is obviously no need for the Prime Minister to read the whole paper at this stage, though I think she would wish to do so if the Government intended to announce an intention to withhold or an explicit threat to withhold in certain circumstances. For the present I would call attention to the following points:-

- (i) On pages 17-19 (paragraphs 49 and 50) there is a list of major points for Ministers to know and questions that would need to be answered before the plan could be implemented. It would be prudent for the Government to take decisions on most of these points before making an explicit threat

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to withhold. If OD decided on 22 July that withholding should be used in the autumn negotiations, a further meeting would be required before the recess to go through this list of questions.

- (ii) One of the more important of these questions is whether the Government legislate at the outset, as strongly recommended by the Attorney General, or wait until events compel. This point is discussed in paragraphs 19-24 on pages 7 and 8.
- (iii) A draft bill has been prepared - the text is on pages 21-24 and a commentary follows. It differs from the bill prepared 2 years ago in that it now incorporates a number of features that will help the Government argue that the UK is not breaking the spirit (as well as the letter) of the Accession Treaty but only taking steps to protect UK citizens from the consequences of a temporary failure by the rest of the Community to remedy an "unacceptable situation".
- (iv) The annexes include detailed assessments by the Departments chiefly concerned of the scope for retaliation by the Commission and other member states and what the Government would need to do in response. These annexes are summarized on pages 11-14 of the main paper. Departments are submitting the whole document to their Ministers calling attention to the points of particular importance to each. I will let you know if any Minister makes an important comment. Mr Walker's reaction will be especially significant. He has always been in favour of a tough negotiating line on the budget but, as Annex G clearly shows, his Department will run the risk of retaliation that could in certain circumstances create important political difficulties (for example if, despite our best endeavours, individual traders and farmers lost out).

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4. Paragraphs 30-33 on page 10a summarize Annex E, which includes an analysis of the effect of withholding on Community finances. The significant point for the Prime Minister to note is that it will take a considerable time, possibly as much as a year or even more, before the Commission actually run short of money.

D.H.

D J S HANCOCK

13 July 1982

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*Spare copy of this note
is filed in Yellow Files
at back of this file
24/7/82*

EC BUDGETCONTINGENCY PLANS FOR WITHHOLDING THE UK CONTRIBUTIONNote by officials

This paper discusses what specific actions should be taken in the event of a Government decision to 'withhold' our contributions to the Community budget. Various options are identified, and some assessment is made of the likely effects on the Community's operations. The paper is not concerned with the strategic decision on whether and in what circumstances to withhold; but the practical implications which it discusses are relevant to such a decision.

2. The paper is divided into five main sections:

- i. Broad objectives.
- ii. Modalities.
- iii. Legal issues.
- iv. Effects on rest of Community and UK.
- v. Retaliation.

3. The paper concludes with a checklist of principal points which Ministers would need to note or decide. The annexes include a draft Bill (Annex A) and a recent Opinion by the Attorney General (Annex C).

Broad objectives

4. The paper assumes that the Government's broad objective in withholding our net contribution, in whole or in part, would be to promote an early and satisfactory settlement on the budget and other matters under dispute. It is assumed that Ministers would want if possible to avoid a long-drawn out crisis in which the other member states and the Commission would run the Community without regard to UK interests. The paper assumes, accordingly, that the aim would be, not to cripple the Community's finances immediately

(the UK anyway has no means of achieving this), nor to disrupt other Community policies, but to let Community business proceed as normal - in particular Community payments to UK recipients - while controlling the net outflow of funds from the UK to the rest of the Community. It is also assumed, however, that, since there could be no guarantee of achieving an early settlement, Ministers would be prepared to continue withholding over a substantial period if necessary (possibly for a period of years) and to defy any adverse judgments from the European Court.

Modalities of withholding (see further Annex D)

5. We assume that withholding would apply only to the general budget of the European Communities (the 'Community Budget') and that our financial relationships with the European Investment Bank, the European Coal and Steel Community and Euratom would not be affected. So far as the general budget is concerned, there would be three broad options:

- i. to stop (in whole or in part) our normal monthly payments of levies and duties and VAT into the Commission's EEC No 1 Account with the Paymaster General;
- ii. to stop (in whole or in part) payments by the Commission out of this account across the exchanges* and
- iii. to stop both (once again, in whole or in part).

6. Under the option of stopping payments in, the Commission would still be able to transfer across the exchanges the balances in the account when the withholding decision was announced. They would likewise be able to transfer across the exchanges any amounts we paid into the account subsequently, if we limited our payments-in rather than stopping them altogether. To prevent this, it would be necessary to stop payments-out as well as payments-in. Option iii. above consequently 'dominates' option i.

7. Stopping payments in raises two further problems, potentially at least. First, if all payments into the account were stopped, the account would rapidly be drawn down and the Commission would be encouraged, if not obliged, to retaliate by cutting off payments to UK recipients of Community funds. This problem need not arise, however, if we limited payments-in rather than stopping them

*This phrase should be interpreted throughout as including transfers of sterling to accounts overseas. The Commission sometimes convert sterling into foreign currency only after it has been transferred abroad.

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altogether. Second, the UK would be liable to interest charges for late payments which could amount to £300 million a year.

8. The option of stopping payments out of the EEC No 1 Account across the exchanges would be less provocative to the Commission and other member states, since it would not affect the normal collection and payment of own resources. It would act directly on the problem of our net contribution, while avoiding the difficulties discussed above. The Commission would be given no incentive to retaliate against British recipients of Community funds; since our gross contributions would continue to be paid into the No 1 Account in the normal way, there would be ample money in the account to finance payments to British recipients, and retaliation against them would anyway do nothing to mitigate the Community's internal financial problems. The problem of 'unscrambling' the financial consequences of our withholding after settlement was reached would be reduced; and there is no statutory provision for payment of interest on sums 'blocked' in this way (though the European Court might conceivably seek to impose such a payment).

9. The problem with the option of stopping payments out alone is that, if withholding continued for a substantial period, very large sums would accumulate in the Commission's account. These sums would belong to the Commission, who would have the satisfaction of knowing that they would be able to withdraw them eventually, after resolution of the crisis. In the view of Treasury officials, our bargaining position when negotiating a settlement would be greatly weakened compared with a situation in which we had also limited the amounts paid into the account to an 'acceptable' level. FCO officials do not agree with this. In their view the Commission would derive no satisfaction from having large balances which they could not withdraw without the UK Government's permission. They would know that there would be no question of lifting these UK controls without a legal commitment to pay us refunds.

10. A further problem with stopping payments out alone is that, if the Commission retaliated by reducing or stopping payments to normal UK recipients of Community funds, there would be a strong case (see below) for deducting the amount of the 'lost' receipts from our gross contributions to the No 1 Account. If this were not done, there would be a substantial addition to public expenditure, which at the extreme could amount to some £2½ billion a year (see further Annex F).

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11. Given the above balance of considerations, the paper assumes that withholding would initially take the less provocative form of blocking payments out of the No 1 Account across the exchanges. It is also assumed, however, that the Government would wish to keep open the option of limiting or stopping payments into the No 1 Account as well.

12. The mechanics of blocking payments 'out' would be that Ministers would instruct the Treasury Accountant to disregard some or all instructions from the Commission to transfer money from the EEC No 1 Account across the exchanges. The Commission might seek to frustrate the Government's intentions by ordering payments to other accounts in the United Kingdom and transferring the money across the exchanges from these. To prevent this, the Treasury would need to have discretion as to what payment orders from the Commission they did and did not accept. Officials believe that there should be no great difficulty in identifying regular recipients of Community funds - in practice, these consist mainly of IBAP, other government departments and Commission offices in the UK - and in limiting payments out of the No 1 Account to such recipients.

13. Within the option of stopping payments 'out', it would be possible either -

- (a) to block all payments across the exchanges (ie to withhold the whole of our net contribution) or
- (b) to limit such payments so as to produce what Ministers considered an 'acceptable' level of net contributions

Sub-option (a) would be straightforward. Sub-option (b) raises the practical problem that there is no simple relationship between our net contribution in respect of a particular year's allocated budget and net cash outflows across the exchanges during that year. Our budget refunds for any given year, in particular, are paid in the following year, mostly in the first quarter. Because of this, it would probably be best to limit the net cash outflow from the No 1 Account over the UK financial year (eg 1983-84) to a level we considered acceptable for our net contribution in respect of the calendar year budget (eg 1983). The actual figure would need to be decided at the time, with due regard to the negotiating situation and other relevant factors. By way of illustration, Ministers might think it reasonable, as well as making our normal contribution to the unallocated budget

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(about 200 million ecus a year), to make a modest net contribution to the allocated budget (say X million ecus a year). The aim would then be to limit the net cash outflow during 1983-84 to 200 + X million ecus. In the first quarter of 1983, we may expect to receive the bulk of our budget refunds for 1982, and there should be net inward transfers across the exchanges into the No 1 Account. If our withholding began at the end of 1982 or early in 1983, therefore, it might be best to block all outward transfers up to the end of March 1983, before permitting the net outflow of (say) 200 + X million ecus during 1983-84.

14. The choice between options (a) and (b) above would depend on the nature of the political signal which Ministers wished to convey. Withholding all further payments across the exchanges would more effectively convey the UK's sense of injustice and the strength of our feelings and determination. Limiting the amounts withheld in the ways discussed above would emphasise the Government's wish to avoid unnecessary provocation. We could argue that our action was 'proportionate': we would continue to make what we considered to be an acceptable level of net contributions. On the other hand, the 'acceptable' figure which we set would come to be regarded as the UK's starting position in subsequent negotiations. And the more we limited our withholding, the longer it would be before the Community's finances were seriously affected (see further below).

15. If Ministers decided to stop payments into the EEC No 1 Account as well as payments out, there would be a similar choice to be made between stopping all payments and stopping only some. If the Commission were continuing to make normal payments to UK recipients, there would be a strong case for limitation rather than a total stop. Otherwise, as noted in paragraph 6, the No 1 Account would run out of funds and the Commission would be forced to retaliate against UK recipients. (The mechanics of stopping payments into the Account are set out in more detail in Annex D.)

16. Before actually withholding, Ministers would have the option of threatening to withhold. Such threats could be made over a shorter or longer period and could be more or less explicit. The tactics would need to be decided in the context of the Government's general

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strategy. It would even be possible, in principle, to take legislative powers to withhold without (initially) using the powers - a course which would enable the Government to introduce withholding with legislative backing while Parliament was in Recess (but see further the next section). The more explicit the advance warning, the more likely the Commission would be to take forestalling action by reducing their balances in London to a minimum, even though Article 12(3) of Regulation 2891/77 provides that balances should so far as possible be distributed between member states in proportion to their gross budget contributions. We assume, however, that Ministers would not wish to rule out giving advance warning on this account. The Commission would be quite likely to take forestalling action anyway, in any situation of tension.

Legal aspects (see further Annexes A, B, and C)

17. There are three main purposes for which legislation might be needed:

- (a) to provide cover under UK law for the Government's action in disregarding Commission instructions to transfer money out of the EEC No 1 Account across the exchanges and/or limiting payments from the Consolidated Fund into the No 1 Account;
- (b) to enable the Government to take over the Community's role in the UK, by making substitute payments and taking any other necessary measures, in the event of retaliatory action by the Commission; and
- (c) to prevent the UK courts from hearing claims that the acts of withholding or substitution are unlawful.

It should be noted that the potential need for (b), and the part of (c) which relates to substitution, arises only if and when there is retaliatory action by the Commission to stop its normal payments in the UK and the UK Government then decides to undertake substitution. The need for (a), and the part of (c) which relates to withholding, arises on the initial act of withholding, subject to the considerations set out below.

18. At the request of officials Parliamentary Counsel has provided an informal draft of a Bill covering all the requirements together. This draft Bill is attached at Annex A, with a commentary at Annex B.

19. The most urgent matter for decision would be whether legislation, at least to cover withholding, should be introduced at the outset or only when compelled by events such as an unfavourable verdict by the European Court of Justice or English Courts. There are several factors involved in this decision: legal considerations, domestic political implications and Community reactions.

20. The Attorney General and Lord Advocate have advised (see Annex C) that the only safe course from a legal point of view would be to introduce legislation at the outset. They have grave reservations about the propriety of Ministers instructing the Treasury Accountant without any covering legislative authority to pursue a course of action which, in the Attorney General's and Lord Advocate's judgment, would be illegal. They have advised that there is a risk that proceedings might be instituted in our own courts, even before the Commission had sought a ruling from the European Court and might be successful; that the Government could not defy a judgment by a UK court; and that there would be strong legal objections to legislating with retrospective effect or paying up after an adverse judgment and then legislating for the future.

21. There seems in practice to be a high probability that we could get any case introduced into a UK court referred to Luxembourg and that the latter court would not deliver judgment for several months. If we could rely on settling the matters under dispute within this timescale, that might be considered to affect the decision on the timing of legislation. But there must be some risk that things would go wrong in the courts. We have also to consider the likelihood of the dispute dragging on for a long time, so that legislation would eventually become inevitable. At some stage the Commission would almost certainly bring proceedings in the European court, and the court would almost certainly find against the UK. If a UK court held, either on the strength of this or independently, that the Government's action was unlawful in UK law, the Government would then have to choose between (a) retrospective legislation, in order to justify what had been done, and (b) agreeing in the middle of a continuing dispute to pay the (possibly large) sums withheld up to the time of the UK court's judgement, but

(though there would be an element of retrospectivity in this also) legislating to cover withholding thereafter. The Law Officers have stressed the damage that would result if things did go wrong, and have argued that if retrospectivity is to be avoided the Government should legislate before proceedings leading up to judgment are even instituted.

22. The decision also involves important domestic political implications. On the one hand, the legislation proposed would have the effect, for the duration of the withholding at least, of overriding the European Communities Act 1972, which is the legal foundation of our Community membership. Its introduction would create a potentially very damaging precedent, which would be avoided if it proved possible to reach a budget settlement before we were compelled to legislate. If such legislation were introduced, public and Parliamentary opinion would inevitably be aroused against the Community and it could be extremely awkward for Ministers to handle legislation in the House at the same time as negotiating with our Community partners. On the other hand, if we did not legislate at the outset but had to do so later the political difficulties could be even greater (see preceding paragraph).

23. It is also necessary to consider the reactions of our Community partners. The Bill as drafted goes out of its way to emphasise the temporary nature of the powers being taken and to relate them explicitly to the 'unacceptable situation'. Nevertheless, there is a risk that our Community partners would see legislation as a major escalation of the dispute, going beyond the simple act of withholding. At a time when we would still be aiming for a negotiated settlement, this would give an opening to other member states to argue that we had embarked on a course which could only lead to withdrawal and that there was no point in making further concessions.

24. In the event of a decision to withhold, Ministers would need to weigh carefully these legal and political considerations about the timing of legislation.

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25. If Ministers decided to introduce a Bill at the outset, the further question would arise whether it should deal with Government action in the event of retaliation by the Commission as well as providing legal cover for the action of withholding itself. In terms of the draft Bill at Annex A, should the Schedule be included as well as the Main Bill?

26. The case for limiting the initial Bill to legislative cover for the act of withholding is that there would be a certain awkwardness in publicly contemplating the possibility of retaliation by the Commission against UK recipients of Community funds at a time when no such retaliation had yet taken place. There seems a reasonable chance (see further below) that the Commission would decide not to retaliate, and the UK would do its best to encourage this. The case for introducing one comprehensive Bill at the outset is partly that this would signal the firmness of the Government's purpose and partly that, if there should be trouble in Parliament over passage of the Bill, one packet of trouble might be preferable to two. A single, comprehensive Bill would be likely to use up less Parliamentary time than two Bills and would enable the Government to initiate during the Parliamentary Recess any action which might be needed in the event of retaliation by the Community.

27. A further issue for consideration is whether the Government ought to try to buttress the act of withholding by initiating an action against the Community at the European Court of Justice (ECJ), probably under Article 175 of the Treaty. There could be advantage in initiating an Article 175 action to improve our posture before the Court in the event of Commission proceedings against us for withholding. In the judgment of officials, however, the European Court would be unlikely to uphold an action based on the Community's failure to provide an adequate longer term solution to the UK's unacceptable situation. We assume that Ministers would wish to have the Law Officers' advice on the specific circumstances before reaching a decision.

CONFIDENTIAL

28. A decision to withhold would need to be implemented as quickly as possible. If Ministers decide that a Bill should be introduced at the outset, therefore, the aim should be that announcement of a decision to withhold should be accompanied immediately by the introduction of the Bill. Until the Bill is enacted, the Treasury could seek by administrative delay to ensure that the Commission was unable to transfer sums across the exchanges.

29. It would be for decision which Minister or Ministers should be responsible for presenting the Bill and piloting it through the House. The main responsibility would presumably fall on a Treasury Minister; but the Attorney General and a Foreign Office Minister might also need to be involved.

Financial effects on rest of Community (see further Annex E)

30. In reaching a strategic decision on withholding, Ministers will wish to consider the likely financial effects on the Community and other member states. The funds available for financing Community expenditure in countries other than the UK would be significantly reduced, and this would in time raise some thorny budgetary and cash-flow problems. But it seems unlikely that our withholding would cause a major cash crisis in the Community in either the short or longer run. What seems more likely is that we would create unilaterally a situation in which other member states would be obliged, in one way or another, to make good the amounts which we were declining to pay.

31. In the shorter term, the Commission would be unlikely to encounter serious cash difficulties. They would be able to draw on the very large cash balances which they generally maintain with other national treasuries and private banks. They would also have considerable scope for husbanding their resources if necessary. Depending on the amount we were withholding, they might very well get by for a year or more in this way.

32. When these shorter term expedients were exhausted, we believe that the Commission and the other member states could still avert a cash crisis by means of budgetary expedients which would make good the shortfall of net receipts from the UK. They might, for example, reduce the figures ^{for} gross contributions by the UK, either in the main annual budget or by means of an amending budget.

33. We cannot predict what precise expedients the Community would choose. There would doubtless be protracted and painful discussions. As noted above, however, the effect would be that other member states, if they wished to maintain planned levels of expenditure in the rest of the Community, would have to provide what we were declining to provide - whether in the form of reductions in Commission balances in member states or higher contributions.

Effects on public expenditure (see further Annex F)

34. At home, the effect of withholding on public expenditure would depend on what form it took, whether the Community retaliated and how we responded to retaliation. Thus:

- If we simply blocked payments out of the No 1 Account across the exchanges, and there was no Community retaliation, there would be no effect on public expenditure.
- If the Community retaliated by reducing or cutting off payments to the UK, public expenditure would rise by the amount of these 'lost' receipts. The amount involved could be some £1 $\frac{1}{4}$ -1 $\frac{1}{2}$ billion a year (less any associated reductions in our gross contribution) plus UK budget refunds lost.
- We could however offset such increases in public expenditure by deducting the amount of receipts 'lost' from our gross contributions to the Community (see further below).
- Stopping or reducing payments into the No 1 Account, regardless of retaliation, would reduce public expenditure.

On present conventions, there would be savings on the PSBR and balance of payments current account during the period of withholding.

35. On cessation of withholding, all these effects ought in principle to be unwound. But the outcome would depend on the terms we negotiated. As explained below, it might be difficult to recover, or recover in full, receipts lost during the period of withholding, especially if we continued to pay our full contributions into the EEC No 1 Account as usual. If we deducted receipts lost from our gross contribution, it might be difficult to obtain 'legitimation' after the event. In either event, there could be adverse effects on public expenditure, the PSBR and the balance of payments over the period as a whole.

Retaliation against the UK (see further Annexes F-M)

36. It would be necessary to reckon with the possibility that the Commission or other member states would retaliate against the UK. We cannot expect to predict accurately all the forms which retaliation might take, with all their possible ramifications. ^{obvious areas are:} But the three /

- i. policies;
- ii. trade; and
- iii. payments to UK recipients.

37.. A considerable degree of policy discrimination against the UK, whether stated or unstated, must be regarded as probable. The UK's budget refunds would be an obvious target. The Commission and other member states would be quite likely to block both the instalments of our refunds for 1981 not yet paid to us (currently some 350 million ecus gross) and the refunds for 1982 recently agreed. There would also be scope for the Commission and

other member states to take decisions disadvantaging the United Kingdom in all the main areas of Community policy. On agriculture, there would be early scope for such decisions in areas subject to Commission competence under the Management Committee procedure - these include for example certain aspects of the beef and sheepmeat premium schemes. We should have to expect decisions damaging to the UK on the Regional and Social Funds, where longer-term reforms are under active discussion. There is little scope for planning in advance against retaliation in this form. We should just have to fight the necessary battles as they came along. This could be sooner rather than later.

We could then take action - then - to us.

38. On trade, there could be material disruption to UK exports to other member states. It is less likely - at least initially - to take the form of a deliberate campaign of retaliation (eg the denial of Community status to UK goods) than of opportunism in the shape of random but probably embarrassingly widespread 'difficulties' on which formerly we could have counted on prompt Commission support (eg the Triumph Acclaim) or have been able to lodge effective bilateral protest (eg the prominence given to whisky in the FRG's anti-alcohol campaign). It not only is difficult to recapture such markets once lost but, more important, to contain wider disruption of confidence among suppliers and consumers alike. Retaliation in kind (if it could be effected) would offer only vicarious satisfaction to traders affected.

39. As regards payments to UK recipients of Community funds, the Commission would be bound to consider going beyond the policy discrimination discussed above and cutting off Community payments to UK recipients - for example, UK refunds, IBAP payments and grants from the Regional Development and Social Funds. They might also decline to help the UK authorities to make substitute grants and payments, eg by cutting off usual information and generally refusing to do what they would have done under normal circumstances.

40. Provided that we continued to pay our gross contributions into the EEC No 1 Account so that there was more than enough money in the account to make payments to UK recipients as usual, there

seems a reasonable chance that the Commission would stop short of cutting off payments to UK recipients in general. Especially in the area of 'obligatory' expenditure, such as CAP guarantee, they would not have any obvious legal basis for cutting payments off. They might prefer not to put themselves in the wrong. They would probably be concerned not to risk breaking the Community up. They could also perceive a shared interest in continuing business as usual, as far as possible, so as to minimise the 'unscrambling' problems, potentially formidable, when the dispute was settled. The Commission might well, therefore, decide not to retaliate in this way. But one cannot be sure. Some Commissioners might see political advantage in picking up the gauntlet. And there might be pressures from other member states. The possibility of such retaliation cannot, therefore, be ruled out even in the area of obligatory expenditure. In other areas such as UK budget refunds, and in areas where the Commission have a measure of 'discretion' such as the Regional Development and Social Funds, retaliation to a greater or lesser degree is virtually certain.

41. We assume that Ministers would wish -

- (a) to dissuade the Commission from retaliating, but
- (b) if this fails, to be prepared in appropriate cases to take over the Commission's role vis à vis UK recipients of Community funds - both in areas covered by existing Community Regulations and in areas where new Community Regulations would normally have been made.

42. Further to (a) above, we assume that Ministers would want all reasonable efforts to be made to encourage the Commission to maintain normal business in the UK so as to avoid unnecessary escalation and leave a situation in which normal business could be resumed with minimum difficulty when the argument is concluded. There would be a case for approaching the Commission at the outset and emphasising the limited nature of our proposed withholding.

43. In the event of retaliation, the Government departments responsible for all the main areas of Community business would need to be in a position in appropriate cases, with the approval of Parliament, to carry out the Community policies and make payments which would normally be made by the Commission. The Schedule to the draft Bill at Annex A, together with Orders made under that Schedule, would provide the necessary statutory authority.

44. The coverage and detailed implementation of the substitute regimes and payments would depend on the nature of the Commission's retaliation and would need to be finally decided at the time after discussion between the responsible departments and the Treasury. Annexes G-M discuss the problems in the main areas of agriculture, the Regional Development Fund, the Social Fund, trade, transport and energy. We assume that the broad objectives would be -

- (a) to disturb normal implementation of Community policies as little as possible;
- (b) to minimise the problems of 'unwinding' at the end by means of maximum cooperation with the Commission and meticulous following of normal Community procedures;
- (c) by the same means, to maximise the chances of recovery of funds paid out by the Government on the Community's behalf during the period of withholding; and
- (d) consistently with the above, to be as economical as possible in making substitute payments.

The Commission would largely share the interests at (a) and (b) above. The UK ought therefore to try to work out with the Commission at the earliest possible stage arrangements which would help to promote the above objectives.

45.. Ministers would need to decide at the time how to respond in financial terms in the event of a Commission decision to discriminate against, or cut off payments to, UK recipients - including a decision to cut off UK budget refunds. The options would be -

- (a) to continue paying our gross contributions in full into the EEC No 1 Account, accepting the increase in public expenditure which would result from the loss of Community receipts; or
- (b) to deduct from our gross contributions to the EEC No 1 Account the sums which we judge the Commission would normally have paid to us, thus neutralising the effect of the Commission's action.

Under both options Departments would need to ask Parliament for Supplementary Estimates provision to cover the substitute payments which we decided to make on the Community's behalf. Under option (b), however, we would reimburse ourselves both for these payments and for the losses of receipts not requiring substitute payments (such as UK refunds) by deducting appropriate amounts from our gross contributions.

46.. Option (a) would have the great advantage of preserving intact the principle that we were continuing to pay our gross contributions in full into the Commission's account. It would however have two major disadvantages. First, the public expenditure total would rise by an amount approaching the amount of the Community receipts we lost (which could be some £1 $\frac{1}{4}$ -1 $\frac{1}{2}$ billion in a full year plus UK refunds lost)*. The funds accumulating in the EEC No 1 Account would be available, interest-free, to finance the increase in expenditure; but the practical and presentational difficulties associated with any increase in public expenditure would remain. The second disadvantage is that our bargaining position vis à vis the Commission when trying to recover subsequently payments made by Government departments on their behalf or UK budget refunds not paid over, could be extremely weak. We should have to ensure that the issue of recovery formed part of the final settlement; but we might not have a strong hand to play.

*See further Annex F

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47. The above problems would in principle be solved, or partially solved, by option (b) above. If we deducted from our gross contribution the receipts which the Community ought to have paid to us, the increase in public expenditure would be avoided. And our bargaining position in negotiating a settlement on 'recovery' or 'legitimation' would be substantially strengthened compared with a situation in which we had surrendered all these sums to the Commission. If the Community declined to pay us budget refunds which had been agreed, deduction would arguably be a 'proportionate' response. We would in principle, however, be liable to pay interest (see paragraph 6) on the shortfall of our gross contributions (though we could argue that the sums we had deducted were limited scrupulously to the amounts which the Commission had failed to pay us). And collaboration with the Commission would inevitably be made more difficult if we countered a provocative act by the rest of the Community with this provocative act of our own.

48. There would be no need to resolve this issue firmly at the outset. In the event of retaliation, however, Ministers would need to decide between the two options.

Checklist of points for Ministers to note and decide

49. Ministers are invited to note the following points which are relevant to any decision on withholding:

- (a) Although there can be no certainty in such matters, officials would not expect withholding to cause a serious cash crisis in the Community in either the short or longer run. The Commission would be able in the short run - possibly for a year or more, depending on how much we withheld - to draw on the very large cash balances which they hold with member states. Thereafter the Community would probably avert a cash crisis by means of budgetary expedients implying higher contributions by other member states.
- (b) What the UK could expect to do is to set a unilateral limit on the amount of our net contribution / ^{which would} oblige other member states to provide the amounts which we were declining to provide if they wished to maintain planned levels of expenditure.
- (c) We should have to expect retaliation in the form of discrimination against the UK in the development of Community policies, and there could be administrative action, by governments or the Commission, damaging to UK trade and other interests. In addition, our refunds for 1981 and for 1982 would be likely to be cut off, and retaliation in the form of stopping other payments to UK recipients could not be ruled out.
- (d) If the Commission did retaliate in these ways, Government departments would need to provide substitute payments in appropriate cases. Public expenditure would rise by the amount of the refunds and other Community receipts lost (the latter could be of the order of £1 $\frac{1}{4}$ -1 $\frac{1}{2}$ billion a year) unless we countered such retaliation by deducting the amount of receipts lost from our gross budget contributions. We would run the risk of not being able to recover (or retain) these sums in full subsequently.
- (e) Annexes G-M discuss more fully the kinds of retaliation to be expected in the fields of agriculture, the Regional Development Fund, the Social Fund, trade, transport and energy.

50. In the event of a strategic decision to withhold, Ministers would need to decide the following points:

CONFIDENTIAL

- i. Is it agreed that the broad objective would be to promote a satisfactory budget settlement by means of action which would indicate the strength of the UK's feelings and determination and control on a temporary basis the net outflow from the UK to the rest of the Community, without causing major disruption in the shorter term? (Paragraph 4)
- ii. Is it also accepted that the Government would have to be prepared to continue withholding over a substantial period if necessary? (Paragraph 4)
- iii. Is it agreed that, initially at least, withholding should take the form of an instruction to the Treasury Accountant to stop some or all payments out of the Commission's EEC No 1 Account across the exchanges? (Paragraphs 6-11)
- iv. Should the Government nevertheless take powers to stop some or all payments in as well? (Paragraphs 9-11)
- v. Should the aim be to block all payments out of the No 1 Account across the exchanges (ie withhold our total net contribution) or to limit the amounts withheld so as to produce some 'acceptable' level of net contribution? (Paragraphs 13-14)
- vi. ^{that} Is it agreed/there could, depending on circumstances, be a case for threatening withholding ahead of the actual deed, despite the risks of forestalling by the Commission and domestic criticism subsequently? (Paragraph 16)
- vii. Would Ministers wish to introduce legislation at the outset to provide cover in UK law for withholding or to postpone such legislation until events compel? (Paragraphs 19-24)
- viii. If the decision is to introduce a Bill at the outset, should it empower the Government to act as necessary in the event of Community retaliation as well as providing legal cover for the act of withholding itself? Or should the former powers be left over for subsequent legislation if necessary? (Paragraphs 25-26)

CONFIDENTIAL

- viii. Subject to vii. above, are the draft Bill and Schedule at Annex A broadly acceptable? (see further Annex B)
- ix. Should an action be initiated with the European Court under Article 175? (The decision would have to depend on the circumstances and the Attorney General's advice at the time.) (Paragraph 27)
- x. Is it agreed that Treasury Ministers should take responsibility for the Bill, in conjunction with the Attorney General and a Foreign Office Minister as necessary? (Paragraph 29)
- xi. Is it agreed that the Treasury should aim to withhold by administrative action pending the passage of any legislation? (Paragraph 28)
- xii. Is it agreed that the aim should be to dissuade the Commission from discriminating against or cutting off payments to UK recipients? (Paragraphs 41-42)
- xiii. Is it agreed that, if persuasion fails, Government departments should still aim to collaborate with the Commission as far as possible and carry out the Community's policies, making substitute payments where appropriate, with the aim of minimising the problems of disturbance and 'unwinding' at the end and maximising the chances of recovering later the Community receipts lost? (Paragraphs 43-44)
- xiv. Is it agreed that, in the event of retaliation against normal UK recipients of Community funds, the question of whether to ^{deduct} / from our gross contribution to the EEC No 1 Account amounts reflecting our 'lost' receipts should be left over for decision at the time? (Paragraphs 45-48)

ANNEXES

- A. Draft of European Communities (Temporary Provisions) Bill
- B. Commentary on the Draft Bill
- C. Attorney General's Opinion of 23 March 1982
- D. Modalities of withholding: supplementary notes
- E. Financial effects on rest of Community
- F. **Public expenditure implications**
- G. Action in the event of retaliation : agriculture
- H. " " " " " : Regional Development Fund
- J. " " " " " : **Social Fund**
- K. " " " " " : Trade
- L. " " " " " : Transport
- M. " " " " " : Energy

EUROPEAN COMMUNITIES (TEMPORARY PROVISIONS) BILL

D R A F T

O F A

B I L L

T O

Make temporary provision for the withholding by the United Kingdom of certain payments to, or to the order of, the European Communities; and for connected purposes.

Be it enacted, etc.

Withholding
of United
Kingdom
contri-
butions to
European
Communities.

1.-(1) If it appears to Her Majesty -

(a) that an unacceptable situation has arisen in respect of the United Kingdom contribution to the budget of the European Communities; and

(b) that those Communities have failed to remedy that situation,

Her Majesty may by Order in Council appoint a day for the coming into force of subsection (2) below.

(2) While this subsection is in force no payment shall be made into or out of the EEC No.1 Account kept by the Paymaster General except with the consent of the Treasury.

(3) Her Majesty may at any time by Order in Council provide that subsection (2) above shall cease to be in force but, subject to any such Order, that subsection shall continue in force for the period of one year beginning with the date appointed under subsection (1) above and may be continued in force thereafter by Order in Council for periods of not more than one year at a time.

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(4) Any Order in Council under subsection (1) above shall be laid before Parliament after being made; and no recommendation shall be made to Her Majesty to make an Order in Council under subsection (3) above unless a draft of the Order has been approved by a resolution of each House of Parliament.

Legal proceedings.

2.-(1) Subject to subsection (2) below, no court shall -

- (a) entertain proceedings to enforce or declare any Community obligation the implementation of which has been or could be directly or indirectly prevented under section 1(2) above or to enforce or declare any right arising out of or related to such an obligation; or
- (b) refer any question relating to such an obligation or right for determination by the European Court.

(2) Where in accordance with a consent given by the Treasury under subsection (2) of section 1 above payments of any description can be made -

- (a) out of the Account mentioned in that subsection; or
- (b) out of money paid out of that Account to any Minister or other authority,

subsection (1) above shall not preclude a court from entertaining proceedings to enforce or declare any right in respect of any payment of that description but no question relating to such a right shall be referred for determination by the European Court.

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Short title
and supple-
mentary
provisions.

3.-(1) This Act may be cited as the European
Communities (Temporary Provisions) Act 1982.

(2) The Schedule to this Act shall have effect in
connection with section 1 above.

(3) Subsection (2) of that section and the other
provisions of this Act shall have effect notwithstanding
anything in the European Communities Act 1972.

1972 c.68.

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Section 3(2)

SCHEDULE

SUPPLEMENTARY PROVISIONS

Preliminary

1.-(1) In this Schedule "relevant authority" means the Treasury, the Secretary of State or the Minister of Agriculture, Fisheries and Food acting jointly or separately.

(2) The consent of the Treasury shall be required for any exercise by the Secretary of State or that Minister of the powers conferred by paragraph 2 below.

Payments

2.-(1) A relevant authority may out of moneys provided by Parliament make such payments as appear to it to be necessary or expedient in consequence of any act or omission by a Community institution which appears to that authority to be a direct or indirect consequence of the withholding by the Treasury of its consent under section 1(2) of this Act.

(2) A relevant authority may by order make provision (whether by means of schemes or otherwise) with respect to the making of payments under this paragraph, including, in the case of payments in respect of produce within the meaning of Part I of the Agriculture Act 1957, any such provision as is authorised by section 5 of that Act in connection with payments under section 1 of that Act.

(3) Without prejudice to sub-paragraph (2) above, any payment under this paragraph may be made as a grant or loan and may be made subject to such conditions as to repayment, accounting and otherwise as may be imposed by the relevant authority in question.

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Other consequential measures

3.-(1) A relevant authority may by order make such provisions as appears to it to be necessary or expedient in consequence of any act or omission (or proposed act or omission) by a Community institution or other person, whether in the United Kingdom or elsewhere, which appears to that authority to be a direct or indirect consequence of the withholding by the Treasury of its consent under section 1(2) of this Act.

(2) An order under this paragraph may provide for the imposition of levies or duties payable into the Consolidated Fund.

(3) Subsection (1) of section 2 of this Act shall apply to any enforceable Community right the enforcement of which is prevented by an order under this paragraph as it applies to any such right as is mentioned in that subsection.

Provisions as to orders

4.-(1) Without prejudice to the generality of paragraphs 2(2) and 3 above, an order under this Schedule may impose prohibitions, restrictions and obligations, including obligations as to the giving of information.

(2) An order under this Schedule may suspend the operation of any other enactment and may contain provisions having retrospective effect.

(3) Any order made under this Schedule by a relevant authority shall be revoked by that authority when it considers that the provisions of the order are no longer required.

(4) The power to make orders under this Schedule shall be exercisable by statutory instrument.

(5) No order imposing any levy or duty shall be made under paragraph 3 above unless a draft of the order has been approved by a resolution of the House of Commons; and any other order under this Schedule shall be subject to annulment in pursuance of a resolution of either House of Parliament. 24 A

ANNEX B: COMMENTARY ON THE EUROPEAN COMMUNITIES
(TEMPORARY PROVISIONS) BILL

1. The Bill has been divided into those provisions which will require immediate introduction (assuming that Ministers agree that there should be legislation at the outset) appearing in the body of the Bill and those provisions, contained in the Schedule, which will be needed ^{only} / if and when the Community retaliate in any way, for example by failing to authorise payments out of the EEC No.1 Account to UK beneficiaries.

2. Clause 1 introduces conditions for the coming into effect of the operative provision of the Bill - Clause 1(2) which authorises withholding. These conditions repeat the wording of the May 30 1980 Agreement.

3. It will be noted that Clauses 1(3) and (4), taken together, provide for the appointed day Order not to be subjected to any parliamentary procedure, except laying, and for the Order terminating the operation of sub-section (2) to be subject to the affirmative procedure requiring the approval of both Houses of Parliament. As drafted, the Bill will remain in force for only one year unless renewed for not more than a year at a time by Order in Council which will also be subject to similar approval by the affirmative procedure. Ministers ^{may wish} / to consider whether the policy behind these sub-sections, emphasising the temporary duration of the Bill, and the proposed parliamentary procedures are satisfactory.

4. Clause 2 of the Bill (and paragraph 3(3) of the Schedule) are concerned with the ouster of jurisdiction of the courts to hear claims which bring into question the validity of the UK's action in withholding, the lawfulness of the Bill or any Order made under it. Sub-section (2) is designed to ensure that the ouster of jurisdiction, a major constitutional step, is limited to what is necessary.

5. Clause 3(3) of the Bill provides for the Bill to have effect notwithstanding anything in the European Communities Act 1972. This, of course, is a particularly controversial provision.

6. The Schedule confers two Order making powers on the Treasury, of State the Secretary/and the Minister of Agriculture, Fisheries and Food. First there is the power, in paragraph 2, to make payments in substitution for the Community. Secondly, there is the power, in paragraph 3, to react to any other retaliatory measures taken by the Community. Both these powers are drafted very broadly and should give Ministers sufficient flexibility to be able to react to various circumstances. It will be noted, in particular, that paragraph 3(2) makes it clear that Orders made under the paragraph may provide for the imposition of levies or duties (in substitution for Community levies or duties).

7. Orders made under the Schedule may suspend the operation of any enactment and may be retrospective in their effect. Unless they impose levies or duties, the Orders will be subject to the negative

parliamentary procedure of each House of Parliament (paragraph 4(5)). Orders imposing levies or duties will be subject to the affirmative procedure in the House of Commons only. But Ministers may wish to consider whether the provisions relating to parliamentary procedure in the Schedule are satisfactory.

8. It should be noted that the Bill and Schedule, as drafted, would not give the Government powers to reinstate any schemes discontinued by the Community before the UK began withholding its net contribution. If the Government wished ^{to} /reinstate such schemes, a separate Bill would be necessary.

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23 March, 1982

Dear Richard,

EC BUDGET: WITHHOLDING

1. You wrote to me on 12 March enclosing Instructions for the Attorney-General and the Lord Advocate (whom, for convenience, I shall refer to in this letter as "the Law Officers") to advise on certain questions relating to the possibility of our withholding our contributions to the Community Budget. I duly put the Instructions to the Attorney-General together with my minute to him of 15 March, a copy of which I circulated under cover of my letter to Michael Kerry of 15 March (copied to you and others). I also showed the Attorney-General Andrew Edwards's letter to you of 11 March and, subsequently, David Hannay's letter to me of 16 March which commented on it.

2. On 18 March, the Attorney-General had a consultation with the various departmental lawyers concerned (Michael Kerry, supported by Bill Godwin and you, and Ian Sinclair, supported by Fred Burrows.) Unfortunately, the Lord Advocate could not get down from Edinburgh for the consultation though he was represented at it by Norman Adamson and Douglas Duncan. However, he has had a full report of what was said at the consultation and he and the Attorney-General have subsequently discussed the matter and are in full agreement on it. I am therefore authorised to say that this letter records their joint advice.

3. As the Attorney-General indicated at the consultation, he entertains some uncertainties or reservations - which the Lord

/Advocate

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-2-

Advocate shares - about some of the assumptions of fact which, expressly or implicitly, underlay the questions put to them. In particular, it is not clear whether we still envisage - as the Law Officers were advised in 1979/80 - that the Commission would, if we withheld our contributions, almost immediately institute infraction proceedings in Luxembourg and that these would result in an early finding against us on the legality of our withholding and perhaps a very early order of interim measures calling on us to make the withheld payments. The Law Officers have not been given any grounds for questioning this previous prediction. If it still holds, the Law Officers consider that it follows that we should also envisage a relatively short duration for Stages 1 and 2 and therefore that we might find ourselves, once the decision to withhold had been implemented, having to deal with the domestic consequences of Stages 3 and/or 4 without much time for further reflection or preparation. At the same time, the Law Officers point out that we cannot assume that the legislation which might be introduced to deal with those consequences could be put through Parliament "on the nod": at least a week, perhaps more, might have to be allowed for this. The critical date for our purposes is, in the Law Officers' view, not when the Bill is introduced but when it is enacted, since only then will it be effective to prevent the courts reaching a decision adverse to the Government.

4. Another assumption of fact which the Law Officers are doubtful about is that no domestic proceedings would be instituted, let alone pursued to judgment, in Stages 1 and 2. This is no doubt what is very likely to happen, if only because most potential private litigants would be deterred by their doubts about their locus standi and would be content to wait for the outcome of the infraction proceedings in Luxembourg. But it may be that not all potential litigants would be deterred by these considerations - Blackburn or his latter-day counterparts might not be able to resist the opportunity for

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-3-

publicity for their views - and the Law Officers emphasised that the critical point for our purposes is the inception of the proceedings and not the judgment. If any proceedings were still pending at the time when, perhaps for quite different reasons, legislation of the kind we have in mind was introduced, and if that legislation had retrospective operation so as in effect to extinguish those proceedings, we should certainly be heavily criticised on that ground and the Law Officers consider that it would not avail us to say that we were satisfied that, for locus standi or other reasons, the proceedings were in any event doomed to failure.

5. Bearing in mind these reservations as to the facts to be assumed, the Law Officers advise on the questions put to them in the following sense. For convenience, I shall deal first with the possible need to legislate in order to avert a challenge in our domestic courts.

6. The Law Officers accept that in Stages 1 and 2 the probability is that there would be no litigation in our courts and therefore no need to legislate to avert it. They also accept that there is no practical risk of any such litigation being pursued, during Stages 1 and 2, to a final judgment - at any rate, not unless Stages 1 and 2 were prolonged beyond our present assumptions. But they are not prepared to say that the risk of litigation (probably in the form of an action for a declaration but there are other possibilities) being instituted by a private person is, even in Stages 1 and 2, so fanciful that it can completely be ignored. It is correct that a private person would have great - perhaps, in the end, insuperable - difficulty in establishing a sufficient locus standi, in the sense of a personal interest that would at that point be adversely affected by our withholding. But -

- (a) we cannot be sure that the courts would treat lack of locus standi as sufficient reason to strike the action out; and

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-4-

(b) whatever the prospects of the claim being eventually rejected by the Courts, if the proceedings were still on foot when legislation had to be introduced we should be exposed to serious criticism for legislating retrospectively - though this criticism might be less severe if the legislation took effect before any judgment on the merits had been pronounced, even if the argument on locus standi had already been dealt with.

7. The Law Officers are therefore not prepared to advise that it would be absolutely safe to defer legislation (ousting the jurisdiction of the Courts) during Stages 1 and 2. There is a risk, albeit a small one, that we should be caught out. If we were caught out, we should have no option but to legislate retrospectively, which the Law Officers would regard as very undesirable and very embarrassing. (The possibility of legislating in such a way as not to affect proceedings that had already been instituted and therefore not to expose ourselves to criticism on grounds of "retrospectivity" was considered by the Law Officers primarily in connection with the case where the proceedings had already resulted in a judgment - a case which, as stated above, the Law Officers regard as not a practical risk in Stages 1 and 2 but more likely to happen in Stage 3 - and I therefore report their views on it in the context of what I say below about Stage 3. The relevant considerations would be the same if the question did in fact arise, in relation to proceedings that were still pending, in Stages 1 and 2.)

8. I add here that a consideration which weighed very heavily in the Law Officers' minds on this aspect of the problem, but which is also relevant to other aspects, is that, though the risk of things going wrong might be very small, the damage that we should suffer if they did go wrong would be very great. The choice then facing us would be between, on the one hand, the Government persisting in a course of conduct which our own courts had already declared to be in breach of our legal obligations (a possibility which the Law Officers regard as quite unacceptable) and, on the other hand, backing down

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-5-

from our decision to withhold. Faced with the danger of that situation, the Law Officers consider that the risk of its happening would have to be so small as to be virtually non-existent - and they do not think that it is - before they could advise their colleagues that it was safe for them to incur it.

9. Turning then to Stage 3, the major risk here is assumed to be an action in our domestic courts brought by the Commission itself. The Law Officers point out, however, that the risk of proceedings by a private litigant at this point, though still small, might be significantly greater than in Stages 1 and 2. But this is not considered to affect materially the question which they have to consider in this context since the risk of proceedings by the Commission is itself enough to bring into play what the Law Officers regard as the two overriding considerations:

- (a) We cannot contemplate defying a judgment (including a declaratory judgment) of a UK court and must therefore - if we wish to avoid having to choose between doing so and making the payments which we had originally withheld - legislate to give ourselves the necessary cover.
- (b) We ought not - both on principle and because of the criticism which it would attract - legislate with retrospective effect so as to deprive a claimant of legal rights which he had already established or even merely asserted in our courts.

10. In connection with (b) above, the Law Officers have considered the possibility, canvassed in paragraph 16 of the Instructions, that retrospectivity could be avoided by complying with any judgment already given but then legislating so as to prevent any further such judgment being obtained. Quite apart from the possible political disadvantages that have been suggested - which the Law Officers appreciate but which they consider are not for them to assess and which they did not take into account in arriving at their own

/conclusions

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-6-

conclusions - the Law Officers consider that this would not be satisfactory from a purely legal point of view. The form of the legislation that we have in mind is legislation to oust the jurisdiction of the courts to grant relief. The point of the decision that the legislation should take that form was precisely to prevent our being put in the position where the courts of this country had declared what the Government's legal obligations were; where nothing had happened to remove or qualify those obligations; but where the Government nevertheless refused to comply with them. (The alternative course of legislating so as to abrogate or suspend the obligations, which would have been an equally effective course, was rejected on practical and presentational grounds and the Law Officers see no reason to question that decision.) The course suggested in paragraph 16 of the Instructions would therefore run counter to the very object of the legislation: while we should have satisfied the judgment as regards the particular plaintiff who had obtained it and as regards the particular payment to which it related, we should clearly be flouting the legal obligations that the judgment had established (and this would be particularly clear if the judgment were a declaratory judgment) in all other similar cases; and the fact that we were doing so would not be concealed by our having prevented the courts from reiterating their view of the law in those other cases. While what we were doing would not technically be a defiance of our courts, it would in substance be a defiance of the law as they had declared it to be.

11. Accordingly the Law Officers consider that the course proposed, though it might get us off the hook of consideration (b) above (retrospectivity), would impale us more firmly on the hook of consideration (a) (defiance of a judgment of our own courts). They therefore do not regard it as acceptable. In their view, if we are not going to cave-in after the first judgment against us, we must

/legislate

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-7-

legislate to prevent that judgment being given; and, if we are to avoid retrospectivity, we should legislate before the proceedings leading up to that judgment are even instituted.

12. As regards Stage 4, the Law Officers endorse the analysis put forward in paragraph 17 of the Instructions.

13. Turning now to the separate question of whether legislation would be necessary from the outset not for the purpose of averting litigation but simply for the purpose of authorising the refusal of the competent UK authorities to honour the Commission's instructions to make the payments out of their account, the advice of the Law Officers can be expressed in the following propositions:

- (a) It could scarcely be asserted with any credibility or respectability that our withholding was anything other than a violation of Community law. The Attorney-General has not overlooked the fact that he said in October 1979 that he would, very reluctantly, be prepared to try to defend its legality if it resulted in infraction proceedings against us in Luxembourg. But he would find it impossible, consistently with his duty to the House of Commons (and the same applies to the Lord Advocate in relation to the House of Lords), to maintain that position as expressing his own view of the law - it is not his view of the law - in any statement which he made in the House; and it would not be possible for anybody to maintain it in any forum once the ECJ had found against us or had made an interim order for payment by us.
- (b) The Law Officers accept that what is said in (a) above is not conclusive of whether our refusal would also be unlawful in terms of domestic law.
- (c) They are not, however, persuaded by the argument suggested in paragraph 10 of the Instructions which is further developed in Fred Burrows's minute to Ian Sinclair of 19 March and Michael Kerry's letter, commenting on that minute, of the same date (both of which the Law Officers have of course seen). Even if the relevant

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-8-

provisions do not have direct effect in our own law so as to confer rights on individuals that are enforceable by them in our courts, it is arguable that they create rights which could be so enforced at the suit of the Commission itself (however improbable it may be that the Commission would choose to bring such a suit). In any case, even if the provisions in question are unenforceable, in the sense used here, by anybody in our courts, it does not follow that they do not create legal obligations which are Community obligations within the meaning of section 2(1) of the 1972 Act and which, if the issue were raised in a suit properly before our courts, would be recognised by them to be legal obligations - with the result that our failure to comply with them could truly be said to be unlawful in terms of our own law.

- (d) The highest that the Law Officers are prepared to put the position in support of the argument is that it could, as a matter of respectable advocacy, be got on its feet in defence of the contention that the withholding was not unlawful in the law of this country. They do not think that that argument would succeed if it were tested in a court and they do not themselves believe it to be correct. They therefore would not be prepared to say to Parliament, or to authorise their colleagues to tell Parliament that they had been so advised, that the withholding was lawful. Nor would they think it right for officials to be ordered to effect the withholding if those officials were unwilling to do so without such an order. Nor do they think that it would help in Parliamentary terms for Ministers to take direct responsibility (by withdrawing the relevant authority from officials) for carrying out what they knew to be a possibly unlawful act.
- (e) How real the risk is of our being called upon (eg in Parliament) to defend the withholding in terms of its lawfulness rather than its propriety or expediency is not a legal question. But the Law Officers' own assessment is that the risk is significant.
- (f) If this assessment is shared by their colleagues, the Law Officers consider that the only safe course is to legislate at the outset (ie before the first withholding takes place) on the lines of Clause 2(1) of the draft Bill.

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-9-

14. For the sake of speed I am copying this letter only to Michael Kerry, Ian Sinclair and Norman Adamson, leaving it to each of you to give it such wider distribution within your own departments (or elsewhere) as you think necessary.

Yours ever,
H. Steel

H. STEEL

M Saunders Esq
Treasury Solicitor's Department
Matthew Parker Street
London, SW1

MODALITIES OF WITHHOLDING : SUPPLEMENTARY NOTES

This annex supplements the discussion in the main paper on the modalities of withholding.

EEC No 1 Account : Payments 'in' and 'out'

2. The UK pays its gross contributions to the Community budget into the Commission's 'EEC No 1 Account' held with the Paymaster General. Gross contributions have two main components:

- i. Levies and duties. We pay over the actual proceeds from customs duties and agricultural levies. Customs and Excise 'establish' and collect the amounts due from traders, in accordance with Community regulations, and pay the amounts collected into the Consolidated Fund. The Treasury Accountant transfers these sums into the Commission's EEC No 1 Account in the third week of the month.
- ii. VAT. The Commission and the member states estimate before the beginning of each year what the proceeds would be from levying VAT on a consistently defined base, or 'assiette', of expenditure in all member states. The Treasury Accountant then transfers a sum equal to one-twelfth of the estimate for the UK from the Consolidated Fund into the EEC No 1 Account at the beginning of each month. In August of the following year, a correction or 'VAT adjustment' is made to take account of differences between the initial estimates and new estimates based on outturn data for expenditure included in the harmonised VAT base.

3. The Commission use the money in the EEC No 1 Account to finance Community payments to UK recipients - notably the Intervention Board for Agricultural Produce and Government departments. Since we are net contributors, the EEC No 1 Account tends to accumulate surpluses. These are transferred from time

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to time to the Commission's accounts in Brussels or in other member states: the total so transferred broadly corresponds to our net contribution.

4. The Commission make all their drawings on the EEC No 1 Account by issuing instructions to the Treasury Accountant to pay specified sums to specified recipients. Transfers across the exchanges are effected by instructing the Treasury Accountant to pay specified sums to -

- (a) the Commission's account at the Bank of England, or
- (b) the Commission's 'drawing' account in Brussels, or
- (c) accounts held with private banks in London for onward transfer.

Stopping payments into the EEC No 1 Account

5. The more extreme options under this heading include:

- i. cutting off all transfers from the Consolidated Fund into the EEC No 1 Account;
- ii. cutting off VAT payments while continuing to transfer levies and duties;
- iii. refusal to 'establish' or collect levies and duties.

6. These options share the following drawbacks:

- (a) the Commission could respond by transferring across the exchanges the balances in the account at the time when the decision to withhold was announced.
- (b) The Commission would be more or less obliged to retaliate against UK recipients of Community money, because our blocking of payments into the account would mean that it would soon run out of money.

- (c) Community Regulation 2891/77 provides for a payment of interest on late payments of own resources into the Commission's accounts with national treasuries. The payment is charged at a rate equal to the highest rate of discount ruling in the Community on the due date, and it rises thereafter by one quarter of a percentage point for each month of delay. These provisions could lead to an interest charge totalling some £300 million over a whole year.

7. Option (iii) would have further disadvantages:

- (a) traders would have a temporary tax holiday which would be bound to be disruptive;
- (b) the PSBR would suffer as a result of the failure to collect levies and duties;
- (c) the problems of 'unscrambling' once a settlement had been reached and withholding discontinued would be multiplied.

8. With option (ii) the general drawbacks in paragraph 6(b) and (c) would be mitigated to some extent. But the drawback at 6(a) would be greatly aggravated, since the Commission would be able not only to transfer the initial balances in the account but also the levies and duties which we subsequently paid in.

9. The above analysis suggests that none of the options for stopping payments into the EEC No 1 Account would be appropriate ways of implementing a decision to withhold if this were the only course of action followed. However, many of the difficulties with this option disappear if it is implemented in conjunction with a stop on payments out of the Account. This is further explored in the main paper (paragraph 6).

Stopping payments out of the EEC No 1 Account

11. As explained in the main paper, the principal options under this heading would be:

- i. to stop all transfers which the Treasury Accountant has reason to believe might flow across the exchanges.
- ii. to limit such transfers in such a way as to produce a predetermined total corresponding to that which Ministers judged to be an 'acceptable' level for our net contribution.

Mechanics of stopping payments into or out of the Account

12. A partial or complete block on payments into the Account could be implemented as follows. Own resources would continue to be established and paid into the Consolidated Fund in the normal way. But the Treasury would prepare a formal Treasury Minute which would instruct the Treasury Accountant how much to pay over into the EEC No 1 Account each month, and the Treasury Accountant would limit transfers from the Consolidated Fund to the No 1 Account accordingly. The Consolidated Fund Accounts would have a footnote appended setting out the amounts withheld in this way. At the end of the dispute, the settlement would presumably be enshrined in a Community Regulation. The Treasury Accountant would then be able, on the strength of this Regulation and the European Communities Act 1972, to pay over into the EEC No 1 Account whatever sums had been agreed.

13. The mechanics of blocking or limiting payments out of the Account would be similar. The Treasury would again prepare a formal Minute instructing the Treasury Accountant to block or limit payment requests from the Commission which he had reason to believe might find their way across the exchanges. On settlement of the dispute, this instruction would be rescinded.

FINANCIAL EFFECTS ON REST OF COMMUNITY

This annex considers in more detail what might be the financial effect on both the Commission and the other member states of the UK withholding its contribution.

Commission's cash position

2. The Commission maintain substantial cash balances, both in their accounts held with member states national treasuries and with private banks. Table 1 shows end-year balances for 1979 and 1980. The average level during the year is probably rather higher: average balances during 1981 may have been of the order of £1 billion. By using these balances, the Commission could continue to carry out normal operations for a substantial period after a UK decision to block transfers across the exchanges out of the EEC No 1 Account.
3. The existence at any one time of substantial Commission balances with national treasuries reflects the fact that expenditure out of the accounts is both lower and later than own resources payments into the accounts. There are five specific explanations for this:
 - (a) The budget contains several entries which are financed but cannot be spent because of the lack of a basic decision - eg because Parliament has entered money as an inducement to the Council to take a decision.
 - (b) Even on those programmes which are agreed, there is frequently an element of over-estimation; this has recently applied particularly to FEOGA Guarantee, which has been significantly underspending.
 - (c) In the early part of the year the Commission retains in its accounts the cash surplus from the previous year; in the second half of the year it retains the VAT adjustment until December.

COMMISSION CASH BALANCES

	£ million		
	<u>National Treasuries</u>	<u>Private Banks</u>	<u>Total</u>
End-1979	560	120	680
End-1980	230	145	375
Average 1981 (estimate)	800-850	100-150	900-1000

Notes and sources

1. The end-year figures come from the Commission's accounts: accounts for 1981 not yet available.
2. The estimate for the average 1981 cash balance has been derived as follows. Article 12(3) of Regulation 2891/77 lays down that the Commission's balances with national treasuries should so far as possible be distributed among the member states in proportion to their gross contributions to the budget. The average end-month balance on EEC No 1 during 1981 was of the order of £175 million. Multiplying on the basis of the UK's gross contributions share and assuming that the Commission broadly fulfils the requirements of Article 12(3) suggests that the average total cash balance held with national treasuries during 1981 was in the region of £800-850 million. We have assumed that balances held with private banks were of roughly the same magnitude as they were at the end of 1979 and the end of 1980.
3. The relatively low end-1980 figure reflects the fact that contributions by member states to the second supplementary budget for that year were not paid until the beginning of 1981; also the VAT adjustment for 1980 was paid back to member states by means of a reduction in the VAT rate in December of that year.

(d) At the end of the year, the Commission frequently writes down the value of FEOGA stocks, which has the effect of increasing recorded but not actual expenditure. Their cash balances are then increased similarly.

(e) Seasonally, expenditure is concentrated in the latter part of the year, while revenue is distributed more or less evenly.

4. There are also two specific ways in which the Commission could act in the short term to offset the shortage of cash resulting from a UK decision to withhold:

(a) As a general rule, there is considerable scope for the Commission to husband its resources by slowing down the rate of expenditure, for example on agriculture.

(b) They can, under Article 12(2) of Regulation 2891/77, overdraw their accounts with national treasuries. The Regulation sets no ceiling or time limit on the amount of this overdrawing, although it does say that the Commission should warn member states before taking such a step.

5. Apart from running down their balances and the two interim palliatives mentioned above, the Commission could avert a cash crisis in the longer term by taking budgetary action to offset the effects of a UK block on transfers out of the EEC No 1 Account across the exchanges. For example, they could reduce the provision for UK gross contributions by the amount which we were withholding in a supplementary or amending budget during the year. Alternatively, they could make provision for a low level of UK gross contributions in the annual budget.

The effect would be that the other member states would make good the loss of the UK's net contributions by paying higher VAT contributions than they would have done otherwise.

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This could in principle cause problems in relation to the 1 per cent VAT ceiling. But there are various actions which the Community take to stay within the ceiling (such as increasing or extending coresponsibility levies).

Amounts involved

7. The amount involved in UK withholding is substantially less now than it was before the UK received budget refunds. In 1981, annual gross transfers across the exchanges out of EEC No 1 Account ran at roughly half the rate of earlier years (see table 2). In 1983, the outward transfers from the EEC No 1 Account which we could block might total something of the order of £500-600 million. This is only a little over half our estimate for the average 1981 total of Commission cash balances (excluding those with the EEC No 1 Account itself. Hence the Commission could probably keep going without having to take action as outlined above for a considerable period, especially if we allowed outward transfers to be made as usual up to some specified limit, rather than blocking them altogether.

TABLE 2

EEC No 1 Account : Transfers across the exchanges

£ million

	<u>Inward</u>	<u>Outward</u>	<u>Net outward</u>
1979 Q1	-	150	150
Q2	-	290	290
Q3	-	300	300
Q4	-	100	100
Total	-	840	840
1980 Q1	-	275	275
Q2	-	305	305
Q3	-	235	235
Q4	-	120	120
Total	-	935	935
1981 Q1	250	25	-225
Q2	-	90	90
Q3	-	330	330
Q4	-	25	25
Total	250	470	220
1982 Q1	545	330	-215
Q2	-	250	250

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Longer-term threat

8. The above analysis suggests that the Community should be able to cope fairly readily with the direct financial effects of withholding by the UK. That is not, however, the whole story. If other member states feared that our withholding might be a prelude to possible withdrawal by the UK from the Community, they would then perceive it as a much more serious threat, in financial as well as political terms. UK withdrawal would cost other member states very much more than financing an acceptable level of refunds. Table 3 illustrates the point.

Table 3

PERCEIVED CONSEQUENCES OF UK WITHDRAWAL : SAVINGS (+) TO UK
AND COSTS (-) TO OTHER MEMBER STATES

million ecus

	UK refund percentage of:			% share of additional cost
	0%	66%	90%	
UK	+2450	+1260	+830	-
Germany	-862	-444	-292	35.2
France	-755	-388	-256	30.8
Italy	-409	-210	-139	16.7
Netherlands	-162	-83	-55	6.6
Belgium	-118	-60	-40	4.8
Denmark	-64	-33	-21	2.6
Greece	-51	-26	-17	2.1
Ireland	-24	-13	-8	1.0
Luxembourg	-5	-3	-2	0.2
Total	-	-	-	100.0

Notes

1. The figures are based on estimates of the UK's net contribution to the 1982 Community budget of 1800 million ecus (allocated) and 250 million ecus (unallocated).
2. The table also allows for an estimate (put at 400 million ecus) for the budgetisation of the non-budgetary gains which the rest of the EC now make from CAP trade with the UK.
3. The costs to other member states, which are based on 1982 VAT shares, are additional to those of financing the UK refunds in the first place.

PUBLIC EXPENDITURE IMPLICATIONS

This annex discusses:

- (a) the effects of withholding on public expenditure, on various hypotheses;
- (b) provision for substitute payments in the event of Community retaliation against normal UK recipients of Community funds; and
- (c) the effects on the PSBR and the balance of payments.

Effects on public expenditure during period of withholding

2. Public expenditure is deemed to take place under programme 2.7 when payments are made from the Consolidated Fund into the EEC No 1 Account, and to be reduced when the Commission makes payments out of the No 1 Account to the UK public sector. The effects on public expenditure during the period of withholding would thus depend on how these and related payments were affected. Specifically, it would depend on what form our withholding took, whether the Community retaliated against UK recipients and how we reacted to such retaliation.

3. The four hypotheses listed below cover the main possibilities:

- Hypothesis 1: we block transfers from the No 1 Account across the exchanges, and the Community does not retaliate

On this hypothesis (which is likely to correspond to the initial situation after withholding begins), payments from the Consolidated Fund into the Commission's No 1 Account would continue as usual, and likewise payments by the Commission to UK recipients. Hence the public expenditure total would not be affected.

- Hypothesis 2: we block transfers from the No 1 Account across the exchanges; the Community retaliates against UK recipients; we continue to make payments into the Account as usual

Public expenditure under programme 2.7 would rise by the amount of the lost Community receipts (less any consequential reductions in our gross contribution); but if the Government did not substitute in full for Community payments lost, there would be some savings on other programmes.

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- Hypothesis 3: we counter Community retaliation against UK recipients by deducting the amount of Community receipts lost from our gross contributions to the No 1 Account

The increase in public expenditure resulting from Community retaliation would be broadly offset by the reduction resulting from our reduced payments into the No 1 Account.

- Hypothesis 4: the Community does not retaliate but we reduce payments into the No 1 Account as well as blocking transfers across the exchanges

Public expenditure would be reduced by the amount of the reduction in our payments into the No 1 Account.

Amounts involved

4. On Hypotheses 1 and 3, withholding should not lead to any change in public expenditure, while on Hypothesis 4 there would be some saving. On Hypothesis 2, however, there could be a large increase in public expenditure, which would need to be charged to the contingency reserve. If the Commission cut off all payments to UK recipients, the gross amounts involved would be as shown below (based on estimates for 1982):-

	£ million
FEOGA guarantee	725
FEOGA guidance	75
Social Fund	125
Regional Fund	175
Own resources refunds	135
Other	<u>100</u>
Sub-total	1335
UK budget refunds (gross)	<u>1050</u>
Grand total	2385

5. The actual increase in public expenditure, even under Hypothesis 2, would almost certainly be less than this, for several reasons. First, the Commission would not necessarily cut off all payments: FEOGA guarantee payments, for example, might well continue. Second, there might eventually be some reduction in our gross budget contribution to the extent that cutting off payments to UK recipients was reflected in a reduction in the Community's total expenditure. Third, the Government might decide (as noted in the previous section) to cut back on some of the programmes normally financed by the Community.

Effects on cessation of withholding

6. The effects on public expenditure described above relate only to the period of withholding. On cessation of withholding, the effects would depend on what settlement we had negotiated. If the settlement took the form that -

- (a) the Commission would be able to transfer across the exchanges sums previously blocked;
- (b) any 'lost' Community payments to UK recipients would be restored in full; and
- (c) we would pay into the No 1 Account sums previously deducted from our gross contributions, if any, without interest penalties,

then the effects described in the preceding section would be unwound.

7. In practice, it would probably prove difficult to recover fully from the Commission the receipts which we had lost during the period of withholding. It would be hard to establish the amounts involved - particularly receipts lost as a result of policy discrimination against the UK - and the Commission and the audit court might rebel against the idea of legitimising retrospectively payments made by the UK authorities on their behalf. They might also try to charge interest. If we were unable to resolve these problems satisfactorily, there could be a net addition to public expenditure over the period of withholding and the subsequent settlement, taken as a whole.

Provision for substitute payments

8. If the Community reduced or cut off payments to UK recipients, Ministers would need to decide, after the usual consultations between the Treasury and Departments, what substitute arrangements should be made and in particular what payments the Government should make in substitution for Community expenditure. The need to provide substitute payments, and to seek extra Parliamentary provision, would arise regardless of whether or not the Government decided to deduct 'lost' receipts from our gross contributions to the No 1 Account.

9. The case for making substitute payments, and seeking extra Parliamentary provision, would vary depending on the type of payment. Thus -

- (a) In the case of UK budget refunds, or Regional Development or Social Fund payments where the Community monies are not passed on to final recipients but (notionally) used by the Government to finance payments to those recipients, there would be no need for substitute payments or supplementary estimates provision. The Consolidated Fund extra receipts showing Commission receipts would fall short of the amounts forecast in Estimates; but there would be no effect on Vote or sub-head totals.

- (b) In cases where Community monies directly finance expenditure which the Government would make anyway and the Community receipts are netted off within the Vote totals or as Appropriations in Aid, supplementary Estimates would be needed to make good the deficiency of Community receipts. The bulk of Community related expenditure by IBAP and the Agriculture departments would presumably fall in this category.

- (c) In other cases, such as some of FEOGA guidance and Social Fund grants to the private sector, it would be a matter for discussion and decision whether substitute payments should be made. It would also be for consideration whether grants should be made to local authorities and nationalised industries to cover their extra interest charges. Supplementary Estimates would be needed wherever Ministers decided in favour of making such payments.

10. Where supplementary Estimates are needed, it would be for consideration whether these should be framed in the expectation that retaliation would continue for the whole of the financial year, or whether it might be more appropriate to seek smaller amounts of supplementary provision in the first instance despite the risk of repeated requests to Parliament.

11. In quite a number of cases, it might be necessary to make drawings on the Contingencies Fund until supplementary Estimate provision became available. This requirement could arise either because the substitute payments were thought to be sufficiently different in kind from the existing payments to be regarded as a new service (for example where votes are currently being used to make agency payments) or because there was insufficient provision elsewhere in the vote to meet substitute payments in the interim period. The amounts involved are potentially substantial. If they became too large to accommodate within the statutory limit on advances from the Contingencies Fund, it might become necessary to present special supplementary Estimates, and a special Consolidated Fund Bill, outside the normal timetable. This could not be done during a recess.

12. In a very few cases, principally involving grants from the Regional Fund which are appropriations in aid, cash limits might need to be increased. But the great bulk of the relevant expenditure, eg on agriculture, is not cash limited: the total which is affected by cash limits is only a few million pounds.

Amounts involved

13. For the reasons explained above, the amount of substitute payments which the Government would need to provide in the event of Community retaliation would be substantially less than the total loss of gross receipts. The amounts ^{in a full year} required (based on 1982 estimates) might be of the following order:

	£ million
FEOGA guarantee	700
FEOGA guidance	55
Social Fund	25
Regional Fund	17
TOTAL	797

Effects on PSBR and balance of payments

14. Under present conventions, the effects of withholding on the PSBR would differ from those on public expenditure. The reason for this is that the balances held by the Commission in the No 1 Account are regarded as reducing the Government's borrowing

ACTION IN EVENT OF COMMUNITY RETALIATION: AGRICULTURE AND FISHERIES

Summary

1. The two most likely forms of retaliation are
 - (i) the withholding by the Commission of Community funding of the CAP and CFP in the UK;
 - (ii) Commission (and possibly Council) decisions on agricultural and fisheries policy and market management which damage UK interests.

A third type of retaliation designed to make it impossible for us to continue applying the CAP and CFP in the UK seems much less likely.

2. Ministers will no doubt wish to use the powers contained in the draft Bill to make up the funds necessary to continue to apply the CAP and CFP in the UK and to counteract any unacceptable effects on UK interests of policy or market management decisions taken by the Commission or the Council in retaliation against our withholding.

Forms of possible retaliation

3. Three main types of retaliation can be envisaged in the agriculture and fisheries sectors:
 - (i) the Commission could cut off payments to the for Agricultural Produce (IBAP) Intervention Board/and the Agriculture Departments;
 - (ii) the Commission through Management Committee procedure, and possibly the Council by majority vote, could take decisions on the common agricultural and fisheries policies and on the management of markets damaging to UK interests;

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- (iii) the Commission could, by withholding information normally provided and/or by excluding UK from participation in meetings, make it impossible for us to continue to operate the CAP and CFP in the UK.

Of these three types, only (i) and (ii) seem likely to arise at least so long as the dispute over our budget contribution does not widen into a dispute over our continued participation in the Community. Type (i), withholding payments, would be a logical response to our own withholding. But it would be without any clear legal basis, so that the Commission are likely to think hard and long before taking this course. It would be difficult to operate selectively in these sectors since only a limited category of payments is subject to individual Commission decision. Type (ii), retaliation through policy or market management decisions, covers a wide spectrum of possibilities, many of which would be secure against legal challenge. More detail on the three types of retaliation are given in paras. 4 to 6 below.

4. Type (i): withholding payments: All Community monies for support of agriculture and fisheries in the Member States come from the European Agricultural Guidance and Guarantee Fund which the Commission administer. Payments in the UK are made to IBAP and to the Agriculture Departments (Ministry of Agriculture, Fisheries and Food, Department of Agriculture and Fisheries for Scotland, Welsh Office Agriculture Department and Department of Agriculture for Northern Ireland). The UK expenditure to which these payments relate may be categorised as follows:-

- (i) prefunded expenditure: ie expenditure consisting wholly or partly of FEOGA funds advanced to IBAP or the Agriculture Departments:
 - (a) support expenditure under Community regulations, for which no individual Commission decisions are required: this category covers the overwhelming bulk of total expenditure;
 - (b) expenditure on individual projects, where individual Commission project approval is required.
- (ii) expenditure subject to reimbursement: this is expenditure on UK schemes under Community directives where a proportion of the expenditure is reimbursable from FEOGA.

In the case of category (i)(b), individual projects, the Community legislation does not lay down quotas for Member States, so that it would be relatively straightforward for the Commission to cease to approve UK projects whatsoever. This could in theory be open to attack in the European Court as a misuse of powers; but the amounts involved are small, and anyway legal proceedings would not produce results quickly enough to be useful. In the case of the other categories there would appear to be no legal basis for the Commission to stop payments to the UK in the absence of Council regulations enabling them to do so.

5. Type (ii): policy or market management decisions: The Council regulations on the CAP and the CFP leave a good deal of discretion to the Commission to make detailed rules and to fix rates of payment to producers, processors and traders, normally through the procedure of consultation with a Management Committee

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composed of representatives of the Member States. There are a number of areas of the CAP where because of particular UK interests in the agricultural and food sector (eg cane sugar refining; maize starch manufacture; synthetic alcohol distilling) or because of particular schemes devised to meet UK requirements (eg the beef and sheepmeat premiums) we are particularly vulnerable to damage by action under Management Committee procedure. We can normally rely on our relationship with the Commission and the balance of negotiating interests within Management Committees to secure satisfactory decisions. But in the event of a serious and continuing dispute involving the withholding of our net contribution we can expect first that our influence over market management disappears so that we are unable to protect our interests where they conflict with those of other Member States, and then that decisions of a more clearly vindictive character are taken against us. The point may be reached where the same process is transferred to the Council level where because of the Council's much wider powers the damage could be much greater. The sort of damage we could suffer includes: a shift in the balance of Community expenditure away from us, the imposition of additional costs on UK consumers, the creation of competitive disadvantages for sectors of UK agriculture and industry on both Community and world markets and even the removal of arrangements essential to their continued viability.

6. Type (iii), obstacles to continued operation of CAP and CFP in the UK; as indicated above it seems unlikely that the Commission or other Member States would see it as in their interests to make it impossible for us to continue to operate the CAP and CFP in the UK except in the context of a dispute about our continued participation in the Community as a whole. Nor would it be easy in practice for the Commission to do so simply by withholding information. The administration of the CAP and CFP is for the most part highly devolved to the competent authorities in the Member States and all that is required from the Commission in Brussels is the notification of decisions taken eg on rates of export refund, import levy, monetary compensatory amount etc. Notification is normally received by telex from the Commission but even if this rapid link was broken the decisions are normally published in the Official Journal in a matter of days, as well as being available from the specialised press. The worst which the Commission could do by withholding notification would probably be to cause the UK Departments concerned (principally IBAP and Customs) minor administrative delays and difficulties as well as some windfall profits and losses for commercial operators. Were the Commission however to go further and to cease taking decisions on matters affecting the UK only (such as the rate of MCA applicable in the UK) or to exclude UK operators from participation eg in tenders for export refunds, they would thereby create lacunae in the operation of the CAP and CFP. HMG would need to consider how to deal with these problems. The legal basis of any such action or inaction by the Commission would of course be doubtful. The Commission could hesitate before taking action which is patently open to legal challenge; but it could be impossible to mount a challenge quickly enough to be useful.

Need for substitute payments or other action

7. If, in spite of our efforts to encourage the Commission to maintain normal business in the UK, they do proceed to retaliate against our withholding on the lines indicated in paras. 3 to 6 above, it is assumed that Ministers' general aim would be to prevent such retaliation affecting individuals and groups in the UK. In the case of retaliation of type (i), withholding FEOGA payments, it would be necessary to provide substitute funding to IBAP and the Agriculture Departments and to enable them to continue making payments to UK producers, processors and traders as before under the Community regulation: this expenditure, categorised under (i)(a) in para. 4 above, absorbs the overwhelming bulk of FEOGA expenditure in the UK. It is assumed that Ministers would allow expenditure under category (i)(b) to dry up save for continuing payments on projects already approved by the Commission rather than take over the Commission's responsibility for project approval: the volume of expenditure is small and, although important to the viability of the individual beneficiary projects, it is of little significance for the agricultural, fishing and food industries as a whole. This assumption might however need to be reviewed in the light of what Ministers decide on other, more important project-based expenditure, eg under the European Regional Development Fund. Finally, payments falling within category (ii) in para. 4 above would not be affected by Commission retaliation, since they are made under UK legislation: it is only the subsequent reimbursement from EAGGF which might be withheld.

8. In the case of retaliation of types (ii) or (iii), involving the distorting of the CAP and CFP against UK interests or rendering it impossible to apply the CAP and CFP in the UK, Ministers'

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general aim would presumably be the same but it would be a matter for judgement in the particular circumstances what the likely consequences of the retaliatory action would be and how best to offset them. For example, if the Commission were seriously to restrict the application of the variable slaughter premium for beef (as they could without reference to the Council), Ministers would need to consider whether to reinstate the provision in its previous form or to rely on market intervention in conformity with Community legislation. Similarly, if the Commission were to introduce some tightening up of intervention qualify standards for barley despite UK opposition /in the Management Committee, Ministers would have to consider whether unilateral action to restore the previous standards was necessary and worthwhile.

Financial aspects

9. The expenditure potentially subject to retaliation on the lines indicated above is included in the net Votes of IBAP and the Agriculture Departments. These Votes provide for receipts from FEOGA, both from Own Resources through the EEC No. 1 Account and from receipts obtained direct and classified as "negative expenditure" (these are receipts from MCA levies on imports, the milk co-responsibility levy and the clawback of sheepmeat premium on exports to other Member States). The annual amounts (on the basis of 1982-3 Estimates which do not take account of certain additional expenditure resulting from the 1982 CAP prices settlement) for which additional provision would need to be made if EAGGF receipts were withheld are:

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(1) Agriculture

<u>IBAP</u>	£m
Beef premium (part prefunded)	8
Butter subsidy (prefunded)	60
Pre-funding of Agriculture Depts. spending on:	
- non-marketing of milk and conversion premium	18
- annual ewe premium	45
- suckler cow premium	17
Food Aid (prefunded)	26
Other Agricultural Support (prefunded)	528
<u>Agriculture Departments</u>	
Guidance Section projects (prefunded)	14
Other Guidance Section schemes (agriculture structure, brucellosis)	41
<u>Total</u>	<u>757</u>

(The figure given above for "Other Agricultural Support" by IBAP assumes that the Board will continue to make direct use of the following estimated receipts classified under Community regulations as "negative expenditure":

	£m
MCA levies	73
Milk co-responsibility levy	65
Sheepmeat clawback	5
<u>Total</u>	<u>143</u>

"Negative expenditure" receipts are not credited to the Commission's EEC No. 1 Account but to the Board's FEOGA Advances Deposit Account maintained at the Bank of England by the Paymaster-General. The procedure under which these receipts are intercepted by the Board in this way to reduce their requests for advances from the EEC No. 1 Account is

authorised under Community regulations and can therefore presumably continue unless and until those regulations are changed. In the event of the Community institutions altering the financial regulations or procedures so as to deprive IBAP of access to "negative expenditure", consideration would need to be given whether to legislate, under the powers in the draft Bill, to allow the present procedure to continue or to seek additional Vote provision.)

(2) Fisheries

<u>IBAP</u>	£m
Compensation for withdrawals and export refunds (prefunded)	3
<u>Agriculture Departments</u>	
Vessel building and modernisation grants (prefunded)	1
Formation grants for producers' organisations (not prefunded)	..
<u>Total</u>	<u>4</u>

10. As well as the additional provision of funds from Parliament in substitution for receipts from FEOGA, IBAP and the Agriculture Departments will need a clear authority to make payments under Community regulations on the CAP and CFP, notwithstanding that the authority to make such payments contained in the regulations themselves may be conditional on the existence of pre-funding by EAGGF. This could be provided in subordinate legislation under the draft Bill.

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Administrative arrangements

11. Assuming retaliation is confined to type (i), the withholding of EAGGF payments, and the UK response to making good the gap in IBAP's and the Agriculture Departments' funding, there should be no significant effect on administrative arrangements.

Accounting arrangements may need some limited modification but this should not be onerous in administrative terms, once the initial modification has been carried out.

12. In the event of wider retaliation (eg of types (ii) and (iii) in para. 3 above) there may be administrative repercussions but it is impossible to forecast these in any detail. Much will depend on the nature of the retaliation and the UK response to it.

Clearly if the Government decided to fill in on a continuing basis significant lacunae left by the Commission in CAP and CFP arrangements applicable in the UK, eg fixing UK MCAs

or awarding export refunds to UK applicants, this could create unpredictable but probably

/ severe strains particularly on MAFF legal, economic and statistical services and commodity policy divisions. These

strains would result from the imposition of new and unfamiliar tasks on to existing small and tightly-complemented units.

Given that Ministers' general aim will be to keep business running as before there should be no new large-scale administrative requirements.

Legal cover

13. The draft Bill in its revised form is considered to provide sufficient powers to enable Ministers to take whatever action may be necessary to counteract retaliation along the lines indicated. In particular it will provide powers which can be used to continue payments with substitute funding, to reinstate CAP and CFP schemes of interest to the UK in the event that these

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are abolished or restricted by the Commission or the Council, and to fill in any lacunae which the Commission may leave in the application of the CAP and CFP to the UK. For these purposes it will be essential that the powers in the draft Bill to make subordinate instruments should (as presently drafted) cover:

- retrospective application
- fixing of amounts by executive order
- raising of levies
- powers of entry (extension of powers already available in relation to Community payments)

14. The draft Bill, subject to the changes envisaged, is also considered to be capable of dealing adequately with the limitation of legal proceedings. Where Community law has been set aside by the draft Bill or by subordinate legislation made under it, it will be essential to avoid the possibility of such action being challenged in a domestic court or referred to the European Court of Justice. But insofar as Community law has not been set aside and in respect of substitute provisions made under the draft Bill, individual producers, processors or traders in the UK should retain their rights and obligations, including their entitlement to payment, and be free to enforce them. In substance, they would lose only the possibility of referring to the European Court as a step in any domestic action.

Problems of "unscrambling" and recovery of substitute payments

15. In the case of pre-funded expenditure (the overwhelming bulk of the expenditure in question), there will be no automatic entitlement to reimbursement from FEOGA of any substitute payments made, although we shall no doubt be seeking to negotiate an arrangement providing for partial or complete reimbursement. In the event of substitute payments to IBAP and the Agriculture Departments in place of FEOGA prefunding withheld by the

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Commission, it will thus be necessary for those Departments to account for such payments in a way which distinguishes them from correctly pre-funded expenditure (so as to avoid any disallowance of FEOGA funding of the latter) but which makes clear their use for the funding of payments under Community regulations (so as to maximise the chances of negotiating reimbursement). The accounting arrangements will therefore need to be such as to make a smooth, but distinct, transition from Community funding to substitute funding and back again. Further detail on these arrangements is contained in Annex F.

16. No problem is foreseen in retaining our eligibility for eventual FEOGA reimbursement of the small items of expenditure (category (ii) in para. 4 above) normally reimbursable.

17. Depending on the extent to which we have had to introduce substitute legislative provisions in place of Community provisions abolished or distorted against us, there could be wider problems of "unscrambling", perhaps involving a period of transition from the substitute regime back to a suitably reinstated Community regime. It is impossible to forecast the likely position in any detail. It is clearly essential that the legal authority to maintain substitute provisions and payments should outlast the immediate period of withholding (as provided in the draft Bill in its latest form).

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EUROPEAN REGIONAL DEVELOPMENT FUND

Summary

The ERDF is now worth about £220m annually to the UK and receipts are rising. Commitments are made on a Commission decision, and payments then made against claims. It is unlikely that the Commission would suspend payments on decisions already taken if the UK withholding were strictly limited; but they might refuse to make any new commitments, probably with the support of the multilateral Fund Management Committee. About £130m goes to local authorities and other public undertakings who would have to borrow to replace it; compensation would thus be limited to the costs of loan servicing by these bodies, or about £17m annually, and might be avoided if the dispute were short-lived.

Form of retaliation

Community expenditure under this heading falls into three categories.

- i. Grants to projects committed under a Commission decision.
- ii. Grants towards programmes committed under a Commission decision.
- iii. New applications.

The Commission alone is responsible for making the payments under (i) and (ii) above and need not refer its decision outside the Commission. If the UK's withholding comprised only a limited action, it seems unlikely that the Commission would wish to revoke decisions already taken. They are, however, aware that whereas payments in respect of infrastructure projects are passed on to the local and other public authorities carrying them out, payments in respect of industrial projects are retained by the Government. It would therefore not be unreasonable for the Commission to decide to continue payments to local and other public authorities whilst withholding payments to Government Departments. Since these payments are in respect of expenditure which would be undertaken irrespective of ERDF assistance, only bookkeeping action would be needed.

The third category, new projects, offers more scope for Community retaliation. Draft Commission decision to support projects or programmes are submitted to the European Regional Development Fund Management Committee, which may adopt opinions thereon. A qualified majority against a draft Commission decision would require the



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Commission to refer it to the Council before making payment; otherwise the Commission may proceed as it wishes. There is reason to suppose that the Commission and the Management Committee would treat a failure to implement Community obligations as a reason for withholding payment decisions on new projects. Given the attitude frequently displayed in the Management Committee, the likelihood of retaliation in this field must be considered high.

Substitute payments

The losers in any retaliation involving ERDF grants would be local and other public authorities undertaking infrastructure projects; they would be forced to replace the ERDF grants by borrowing and thus incur servicing charges. There could also be some limited losses on the part of private sector organisations which might otherwise have secured assistance under Article 4 of the non-quota regulations. The amount involved in the latter category would be small and compensation probably unnecessary. It would be undesirable to make substitute ERDF grant payments in respect of new projects. Compensation should be limited to the service charges on grants which might otherwise have been expected. There would be a risk of nugatory expenditure in respect of projects which did not in the event secure Commission approval when normal business was resumed. If the withholding period were short (say 2 or 3 months) compensation might be avoided.

Amounts involved

The full annual amount of service charges saved by recipients, at the expected 1982 rate of ERDF receipts, would be about £17 million, but this level would not be reached immediately. The Department of the Environment, the Territorial Departments and, perhaps, others, (eg Energy, Transport) would need supplementary estimates.

Administrative arrangements

It is assumed that new applications for infrastructure and industry grants would continue to be submitted to the Commission as hitherto. If the Commission were to announce a decision not to approve any new projects, and if the dispute threatened to delay payment for a substantial period, the Departments concerned would be able to approve compensation payments without additional administrative machinery by assuming that each project submitted to the Commission would eventually be approved.

Legal cover

Sufficient legal cover for compensation payments would be provided by the proposed bill.



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Winding up arrangements

Compensation would be limited to the service charges incurred on loans contracted as a consequence of the non-arrival of the ERDF grants on the anticipated date. It would be a relatively simple matter to evaluate these claims against proof of payment. The charges concerned would be lost forever and there would be no question of recovery in the case of projects which were subsequently approved by the Commission. Recovery would have to be considered in the case of projects which were not approved by the Commission, although compensation would obviously cease from the date on which the Commission's decision became effective.

Staffing implications

There would be few staffing implications. DOE might require 2 extra staff mainly for centrally administered winding up arrangements, depending on the procedure adopted.

EUROPEAN SOCIAL FUND (ESF)

Retaliation

1. Commission retaliation in this context could take the form of

- (i) The exercise of its discretion to the disadvantage of the UK, particularly in deciding upon our applications or claims for payment but also when framing proposals for the review of the Fund which is due to take place later this year.
- (ii) Refusal to make decisions on our applications; and
- (iii) Withholding payments in respect of all or some of our approved applications.

2. The Social Fund does not operate on the basis of quotas or a guarantee system, and it is moreover heavily over-subscribed. Given the resulting competition between countries for Fund support, other Member States may encourage the Commission to retaliate, for example by way of their membership of the tripartite Social Fund Advisory Committee.

3. It is difficult to judge how far the Commission would go, particularly as the present Commissioner for Social Affairs is British - Mr Ivor Richard. The rules of the Fund require the Commission to reach decisions on all applications and to make payments in respect of approved applications. The most likely form of retaliation appears to be the exercise of discretion - and delay - by the Commission with respect to UK applications and claims for payment. Should the Commission decide to withhold payments or refuse to consider our applications, they are more likely to do so in the case of applications from Government than from non-Government organisations.

Substitute payments

4. The level of UK ^{national} training and employment schemes is only indirectly

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linked to Fund allocations made in respect of them; non-additionality applies. Few problems would therefore arise if the Commission decided to withhold payments or approvals in respect of such applications, which currently make up over 90% of total UK allocations (which ran at £141m in 1981).

5. However, difficulties could arise if the Commission chose to retaliate in respect of non-Government applicants (for whom additionality applies). Fund payments of this sort, though relatively small, are often of great importance to the organisations concerned, who can be expected to protest publicly if their Fund support dries up. Some of this protest would be directed at the Government, in part because it has been UK policy to encourage such bodies to interest themselves in the Fund.

6. It therefore seems advisable that, as the need arose and for the limited period of the dispute with the Commission, the Government should be in a position to make good any shortfall in support for non-Government applicants which occurred as the result of Commission retaliation. Under this arrangement, the Government would make substitute payments in respect of applications approved but not funded by the Commission and could, if it chose, act as a proxy for the Commission in deciding applications in the cases where the outcome under normal circumstances was reasonably clear. This would apply particularly to projects which were addressed to social or employment needs with claims to priority treatment and had no alternative means of obtaining Central Government aid.

Expenditure implications

7. The level of such substitute payments would be unlikely to exceed £25m per year at current prices. Provision would be sought through Supplementaries, and any finance before **Parliamentary Approval** would be a charge on the Contingencies Fund. The extra provision would be built into an existing financial sub-head.

Administration

8. On the assumption that any dispute with the Commission would be relatively short-lived, little change would be necessary in present administrative arrangements. Some small increase in staff resources might

be necessary for publicising the interim arrangements, reconnection of supply once the dispute was over, and scrutiny of financial claims from applicants in lieu of that normally conducted by the Commission.

Legal cover

9. The draft Bill and Schedule attached to this paper at Annex A would put Ministers in a position to act in lieu of the Commission by way of the general enabling power contained in paragraph 1 of the Schedule and the Schedule's provisions whereby detailed arrangements could be introduced through secondary legislation subject to negative resolution. Should Ministers decide to make substitute payments, the possibility cannot be ruled out of legal action by disappointed applicants against the Government.

Unscrambling

10. The problems of unscrambling are of course less to the extent to which the Commission conducts business as normal. Even if the Commission chose formally to withhold payments or approval of applications, it might be possible to secure their informal indication of how they would act once the dispute was over. The Department of Employment would continue to send UK applications to the Commission to enable normal circumstances to resume as soon as possible.

11. In so far as the flow of ESF receipts resumed in respect of schemes for which substitute payments had been made, the receipts would simply be paid into the account or sub-head from which the substitute payment had been made or into the CFER if financial year accounts had been closed. Against the possibility that substitute payments might need to be recovered from applicants, it is suggested that the payments should be made in the form of loans convertible to grants. However an attempt to recover the loans could cause difficulties, not least because payments made under the Social Fund in normal circumstances always take the form of grants.

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Background

11. The ESF provides assistance towards schemes of training, employment and resettlement mainly to help the unemployed. The Fund will match public authority support for a scheme, up to a maximum of 50% of eligible expenditure. UK applications are made through the Department of Employment. On the advice of a tripartite Social Fund Advisory Committee, the Commission reaches decisions on applications against the Fund's Regulations and annual guidelines, the latter being drawn up administratively by the Commission to determine priorities.

12. The UK average share of the Fund has been nearly 24%. Most of our allocations are in respect of national schemes run by the Manpower Services Commission or the Northern Ireland Manpower Authorities. A relatively small proportion (less than 10%) is paid over to private bodies and such other non-Governmental organisations as local authorities and Industry Training Boards.



RETALIATION - DISRUPTION OF UK TRADE WITH OTHER MEMBER STATES

Retaliation

1. British commercial interests could be expected to suffer both indirectly and directly. Indirectly we would expect to find the other Member States and the Commission becoming less ready to accommodate British views in the formation of Community trade policies, and less forthcoming in responding to British representations about the implementation of existing policies and the application of existing Community law.
2. More specific, direct damage to our trade could be expected from the removal of the sense of political and legal obligation to accord reasonably prompt and full Community treatment to the trade of the United Kingdom as a fellow Member State. This could lead most frequently to delays in customs clearance, safety certification or technical inspections; sometimes to deliberate administrative obfuscation; and at its worst to positive neglect of Community obligations which we should find difficult to challenge eg. if we suspected that public authorities in other Member States were deliberately declining to purchase British goods or services. We could possibly also expect some measure of consumer reluctance to buy British. All this would do lasting damage to channels of trade established by painstaking effort over many years.
3. There might, but probably only a later stage, even be some suggestion that, because the Community had not received import duties and levies due on goods arriving in the United Kingdom from non-Member States, consignments which might include such goods should be liable, on importation from the UK into another Community country, to special Customs verification and even the payment of charges.



Redress

4. In circumstances where the United Kingdom had lost the political goodwill of the rest of the Community, by withholding (in one way or another) resources due to the Community, the normal remedies of diplomatic representation, appeal to the Commission, and if necessary recourse to the European Court, would not effectively be available.

Counter-retaliation

5. A policy of "counter-retaliation" against the rather elusive disruption of United Kingdom trade described in paragraph 2 above would not really be possible. Some types of direct discrimination or interference with trade could be reciprocated; but interference with trade by administrative action would tend to be less effective in the UK than in some continental countries, because of the differences of law and procedure identified in the recent report by officials on "UK trading policy" (Cabinet Office, 10 December 1981).

Conclusion

6. Seriously damaging disruption to United Kingdom exports to other Member States, with long-lasting detriment to British manufacturing industry, must be feared. The rest of the Community could far more readily contemplate interference with that 8% of its trade that it does with the UK than Britain could afford to jeopardise the markets which take 43% of her visible exports.

Department of Trade
14 June 1982

EC BUDGET. CONTINGENCY PLANS FOR WITHHOLDING UK CONTRIBUTION
EFFECTS OF COMMUNITY RETALIATION: TRANSPORT

Introduction

1. In the transport sector retaliatory action would, at present, take the form primarily of action at an administrative level rather than through direct financial penalties. On the most general plane it would be possible for other Member States to work against UK interests in Council negotiations on Proposals for developing the Common Transport Policy. But while there are a number of measures currently on the table on which UK could at some stage be vulnerable (eg the Draft Directive on Vehicle Weights and Dimensions, or the draft Transport Infrastructure aid Regulation), the policy interests of several other Member States normally coincide with our own, and we could expect to be able, in most instances, to continue to protect UK interests.
2. Transport projects are recipients of a significant proportion of EC funds channelled through ERDF, and of supplementary measures repayments. The considerations set out in the main paper and in Annex H could therefore be of particular relevance to transport projects.

Administrative Action

3. We identify the following potential problem areas, in some of which retaliatory action against us could have long term effects:

Withdrawal of EC Multilateral Road Haulage Permits

4. The withdrawal of EC permits would be unlikely to take effect until 1983, because the Commission have already issued the 1982 permits, and would have to instruct numerous authorities to ignore them. More practicable from the Commission's point of view might be a decision to stop permits for 1983.
5. The quota of permits available annually to each Member State is laid down in an EC Directive; revision is agreed annually through a Supplementary Directive. A decision to exclude UK entirely from an increase in the permit quota would depend on the agreement of all Member States in the Council of Ministers. It is doubtful whether such action would be practicable, or in compliance with the provisions of the base Directive. Exclusion would therefore probably have to be

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on the basis of an administrative Decision by the Commission; again the legality of such a move is doubtful.

6. In 1981 UK hauliers moved 400,000 tonnes using EC permits. About one-third of the 31,000 or so consignments which comprised the total were carried between countries other than the UK, and the rest were bi-lateral consignments. The vast majority of this multilateral trade would be lost if permits were withdrawn, some of it permanently, because it depends on growing contacts with European shippers. Some firms who rely heavily on the trade would go out of business. We cannot say what percentage of all European traffic conducted by UK hauliers this would represent because some of it is permit free. The Commission estimate, however, that traffic carried out under EC permit represents only about 5% of all international road haulage in Europe. For UK, permits issued under bilateral agreements are significantly more important in terms of volume of trade carried, but because of their greater flexibility, our 418 EC permits are "worth" about 15,000 bi-lateral permits - about 15% of the total number of permits available in the relevant countries, France, Germany and Italy. Thus to be really effective, any withdrawal of EC permits would have to be coupled at least with a refusal to increase bi-lateral quotas for that year on the part of the countries concerned.

7. The impact on jobs is hard to evaluate. About 500 driving jobs are probably tied up in EC permit traffic but they require the support of others. A guessed total of 1000 jobs would be reasonable.

Remedial Measures

8. Users would probably find other means of transporting their goods, although there would be some disruption to begin with and a few shippers of specialist goods might have temporary difficulty. It is reasonable to suppose that costs would rise, so long as the best available price is being obtained now. There would be no permanent administrative and staffing consequences, but in the immediate aftermath it would be necessary to issue bi-lateral permits, for essential purposes, to replace lost EC permits. If the need for this came at IRFO's busiest period (the turn of the year), two or three extra staff might be needed on a temporary basis.

International Coach Journeys

9. Most international coach journeys involving UK vehicles come within the scope of EC Regulations. The vast majority of trips are "occasional" journeys which are liberalised and do not require any approval, so that they should be affected only by a serious breakdown in goodwill in the Community. However, for regular and shuttle coach services the EC Regulations require that the approval of all countries affected by the service should normally be obtained. We thus rely to a large extent on, particularly, French agreement for these services. There have been difficulties in the past in giving approvals but more recently they have accepted nearly all applications which have been submitted. But they are clearly concerned about the large growth in UK coaching (French coaching is kept in check as a result of the pro-rail policy) and would no doubt seize on any new opportunity to introduce restrictions or quotas. As most of our coach services go through France any retaliation would have serious consequences for the UK industry, and for UK coach travellers.

The Community Driving Licence Directive

10. This comes into operation on 1 January 1983, when all EC countries are to allow new residents holding driving licences of another Member country to exchange these for their own. A Working Group in Brussels is handling the detailed arrangements. UK is already much less generous than the rest of the Community about exchange of licences; a delay in the introduction of the Directive provisions would tend to affect adversely nationals of other Member countries coming to UK rather than UK nationals going abroad. There would be some administrative complications for DVLC in the event of a delay, through wastage of forms etc.

Motor Insurance Directive

11. There is a remote possibility that the rest of the EC might suspend the benefits of the First Motor Insurance Directive for UK registered vehicles. This could result in long delays at EC frontiers for commercial as well as private vehicles for checks on insurance, and insistence on Green Cards. Drivers of vehicles possessing only a domestic certificate of insurance (which is recognised under the Directive) might be obliged to take out insurance at the frontier. Any delays in current work on a second Directive would be of no great significance.

ENERGYSUMMARY

1 Total UK receipts from the Community in the energy sector are expected to be between £30 and 35 million *p.a.* However they are not readily susceptible in the short-term to action by the Commission in retaliation for the UK's withholding budget contributions. Most payments are for research and are contracted direct to UK non-governmental organisations. A breach of contract by the Commission is unlikely. The most credible Commission sanction would be to sign no new contracts, and it would take time before this had a significant effect on the flow of payments.

2 Other substantial payments unlikely to be affected are to JET, a Community Joint Undertaking; and from ECSC, whose budget is financed largely by levies on the industries rather than by contributions by Governments.

CATEGORIES OF UK RECEIPTSGas and Electricity:ERDF Grants

3 In 1981/82 BGC received £2.7m (of total investment of £534m) and the electricity supply industry £4.0m (of £1,200m) in ERDF grants for the development of infrastructure in the regions. It is unlikely that suspension would lead to the industries halting or not starting work on these projects so the industries would themselves bear the cost, which in practice would be absorbed within their EFLs. Payment of these grants is routed through HMG, which might increase the risk of suspension by the Commission.

Nuclear Research:

4 JET: This is a Community Joint Undertaking and it is highly unlikely that it would be the object of any retaliatory action. Indeed the Commission has said that JET would continue even if UK left the Community. In 1981 UKAEA's receipts were £5.92m and its own payments £5.02m.

5 Non-JET fusion: In 1981 UKAEA received about £4m of support at rates of 25% and 45% of its own fusion programme, which it would probably wish to continue even if payments were suspended, although progress reached at the time of any such suspension would influence decisions.

6 Other nuclear R & D: In 1981 UKAEA received about a further £4m under contracts with the Commission. In the unlikely event of suspension, some work might be terminated.

Non-Nuclear R, D & D

7 A large number of UK firms, universities etc have relatively small contracts for research into or demonstration of energy conservation, alternative energies or hydrocarbon projects. Payments are frequently made over time under long-term contracts as part of multi-annual Commission programmes. Suspension is unlikely, would not directly affect HMG, (except on a small minority of projects jointly supported by the Community and HMG), and might lead to UK contractors seeking direct legal redress from the Commission. We have no information on receipts as such but believe that the annual rate is probably well below £10m.

Coal

8 The UK is a net beneficiary under the ECSC Budget (£66m receipts in 1981 for coal and steel but only £19m payments), which is financed largely by levies on the coal and steel industries (in recent years "topping-up" state contributions have also been raised on an ad hoc basis and for 1981 a special transfer of funds was made from the general EC Budget). It would not therefore seem sensible to withhold contributions; nor would the Commission be likely to suspend ECSC payments to UK if we withheld contributions to the EEC/Euratom Budget.

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 P+19 Public Expenditure



A.S.C. 14/17.

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

13 July 1982

A.J. Coles, Esq.,
 No.10 Downing Street

New Paper,

PUBLIC EXPENDITURE SURVEY AND NET CONTRIBUTIONS TO
 EUROPEAN COMMUNITY

The Chancellor has asked me to send you a note about the figures for net contributions to EC institutions which will appear in this year's survey report. These are summarised in the table below.

Net Payments to EC Institutions (excluding aid)

	£ million			
	1982-83	1983-84	1984-85	1985-86
Last White Paper/baseline (Cmnd 8494)	500	580	600	[624]
New figures	635	430	514	687
Difference	+135	-150	-86	[+63]

Underlying the new figures is a somewhat more favourable projection for our net budget contribution before refunds than implied by the last White Paper. The 1 per cent VAT ceiling is assumed to be maintained.

The main change, however, is a new assumption about UK budget refunds for 1982, based on the recent agreement. The last White Paper made the 'stylized' assumption that, following the precedent of the 30 May agreement for 1980 and 1981, we would receive each calendar year refunds equivalent to 66 per cent of our net contribution before refunds for the previous year. The new figures make the same assumption for 1983 and subsequent years but take account of the recent agreement on budget refunds for 1982, which was less favourable to the UK. This affects both the amount and the timing of our refunds. The total amount is reduced by some £120 million, and some £115 million of the net refunds which we expected to receive during the current financial year are now expected to come in during 1983-84 or 1984-85.

/The point



The point which particularly concerns the Chancellor is the risk that the actual figures for 1983-84 and the later years could be much worse than the survey report figures. As explained above, and in the report itself, the survey figures assume that, for 1983 and later years, we shall again receive refunds equal to 66 per cent of our uncorrected net contribution, as implied by the 30 May 1980 agreement for 1980 and 1981, as against the 55½ per cent figure implied by the 25 May 1982 agreement for 1982. The figures make no allowance, moreover, for any repayments by the UK on account of the so-called 'overpayment' of refunds for 1980 and 1981. The Chancellor hopes that the outcome will indeed be as favourable as this, or more so, but feels that we can by no means count on it. The others may well try, for example, to impose on us a deal which -

- (a) gives us a basic refunds percentage of around 55 per cent, as for 1982, and
- (b) obliges us to repay (say) £300-400 million over a period of (say) two or three years on account of the so-called 'overpayment' for 1980 and 1981.

The Chancellor hopes that we would not feel obliged to accept such a deal. If we did, however, the outcome for 1983-84 onwards could be some £250-£350 million worse each year than the survey report implies, and the net contribution could be running at around £1 billion a year by the mid-1980s. The run of figures might then look something like this:-

	£ million			
	<u>1982-83</u>	<u>1983-84</u>	<u>1984-85</u>	<u>1985-86</u>
Net payments to EC institutions	635	725	800	1000

The Chancellor believes that Ministers will need to have the above risks in mind in the forthcoming discussions on the Survey. The existence of such risks must clearly affect the decision on the size of the contingency reserve for the later years.

An alternative way of allowing for the above risks would have been to construct the survey figures on a more pessimistic assumption. But this would have raised two problems. First, there is no clear basis for such an assumption. Second, it would have meant inviting Ministers to take decisions on one set of figures in the Survey and then to publish another in the White Paper. The White Paper will have, for negotiating reasons, to show figures based on the assumption of 66 per cent refunds with no extra adjustments for the so-called 'overpayment': the UK could not afford to signal to others in the Community a willingness to contemplate anything less favourable than this.

I am copying this letter to the Private Secretaries of Members of the Cabinet, and to David Wright in the Cabinet Office.

J. O. Kerr
J. O. KERR



FCS/82/100

CHANCELLOR OF THE EXCHEQUER

1. I quite agree with you that we need to clear our minds soon about the forthcoming negotiations in the Community so as to guide us in informal contacts with colleagues in the Community over the next few months and I am grateful to you for sending me the two papers you have been working on for the discussion in OD on 22 July. These raise issues which need careful consideration and, at a first glance, I think there are a number of points on which I take a rather different view from you. But I quite agree that it would be useful if you and I and Peter Walker were to get together and talk about these problems. I hope the three of us can meet early next week.

2. Copies of this minute go to the Prime Minister, to Peter Walker and to Sir Robert Armstrong.

FP

(FRANCIS PYM)

Foreign and Commonwealth Office
8 July, 1982

Prime Minister

To note.

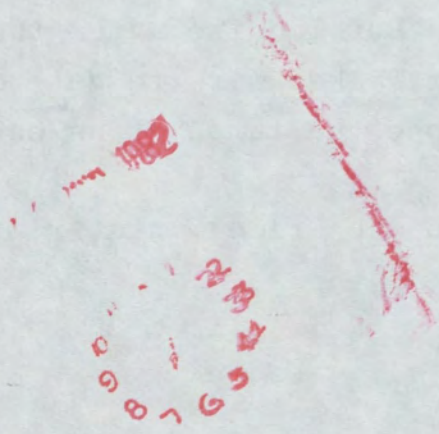
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Ref. A08937

PRIME MINISTER

Cabinet: Community Affairs

Unless it has been covered under Foreign Affairs, you may wish to inform the Cabinet of the outcome of your discussions on Community topics with the Italian Prime Minister at the Anglo-Italian Summit on Wednesday 7th July.

2. A short discussion of EC export policy at the Informal Meeting of Agriculture Ministers on 5th/6th July, at which the United Kingdom was represented by the Parliamentary Secretary, MAFF, produced nothing of interest to Cabinet. The Minister of Agriculture, Fisheries and Food may however wish to report on his bilateral discussions in London on 6th July with Madame Cresson, the French Agriculture Minister.

3. Next week the Finance Council meets on 12th July and the Energy Council on 13th July.

RA

ROBERT ARMSTRONG

7th July 1982

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CASC

Prime Minister (2)

MCS 7/7

Treasury Chambers, Parliament Street, SW1P 3AG

01-233 3000

FOREIGN SECRETARY

EC BUDGET

We do not expect to resume negotiations in the Community until September or October. But we need well before then to begin to concert our ideas. A particular reason for clearing our minds soon is that this will help guide us in informal contacts with colleagues in the Community over the next couple of months.

.... 2. I have been working on two papers for possible discussion in OD, but I think it would be valuable if you and I, and perhaps Peter Walker, could talk about them together as a first step.- The first paper on "The Autumn Negotiation" sets out my worries and leads me to the conclusion that we need to explore thoroughly the possible course of withholding our contribution. The second paper, on "Withholding", steers through some of the practical and presentational problems of withholding, with the idea of getting a clearer judgement of what would be involved, as a basis for considering whether it would be right at some stage to adopt this course.

3. I have read with interest- and I think this ought also to be on our agenda when we meet - the letter of 29 June which Sir Michael Butler sent to you. Much of his analysis is persuasive, but I remain unconvinced on two important points. First, I doubt whether we have anything to offer which would effectively transform the attitude of several other Community governments towards the United Kingdom. Secondly, and perhaps more important, I am rather less sanguine about the possibility of our developing, in the context of enlargement and a review of Community "own resources", either sufficient opportunities or sufficient leverage to win agreement to a satisfactory long-term solution to the budget problem

will request is required

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at that stage. I therefore fear that to accept an unsatisfactory interim solution now, in the hope of a successful negotiation two years hence, would be a mistake.

4. Copies of this minute go to the Prime Minister, to Peter Walker, and to Sir Robert Armstrong.

J. H. G.

*Approved by the Chancellor
and signed in his absence.*

G.H.

6 July 1982

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Draft.

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OD(82)

COPY NO

July 1982

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EC BUDGET PROBLEM : THE AUTUMN NEGOTIATION

—————
Note by the Chancellor of the Exchequer
—————

1. The Foreign and Commonwealth Secretary's note of 17 June (OD(82)55), described the background to the forthcoming negotiations and lists some issues for consideration. In this note I set out my present views on these and related issues.
2. I start from the assumption that the objective is to stay in the Community, but in circumstances which would finally reconcile the British people to membership. There are issues on which the British people cannot be expected to go on accepting solutions adverse to their interests which are arrived at, in effect, by Franco/German collusion. Certainly what happened over the Luxembourg Compromise on 18 May, and over the Budget settlement for 1982 were examples of their effective domination. This no doubt reflects the power structure of the Community. But an equitable and durable Budget settlement is an essential British interest on which the public will expect us to demonstrate our firmness of purpose - as the French would do. None of us would want a row for its own sake. But if we proceed in the next stage in a way which seeks to avoid a major row, I see great risk of our being forced to accept another poor settlement, leading to further bouts of contention and argument, and the continued imposition of a burden on our people which is unjust and ultimately insupportable. Perhaps an analogy is with an untreated appendix. The alternative of a major row is hazardous, and would require strong nerves. But it may be

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better to face up to it - unless we can find a third course which avoids this unpalatable dilemma.

The Prospect

3. We shall start the new negotiation from weakness:-

(a) the basic rate of refunds in the settlement for 1982 was 55½ per cent against the 66 per cent implied by the 30 May Agreement: we have presented the 1982 deal as .66 per cent less an allowance for the "overpayment" (see (d) below), but this is not how the others are likely to see it;

(b) the risk-sharing provisions were less favourable than for 1980 or 1981;

(c) we can expect even longer delays in payment;

(d) there is an effective commitment to making some kind of adjustment for the so-called "overpayment" for 1980 and 1981.

4. And we no longer have the agricultural prices veto.

5. Moreover, as the Foreign and Commonwealth Secretary says, the other member states are likely to take a continuing tough line. Having succeeded - from their point of view - in improving so markedly on the terms for 1980 and 1981, they will be concerned to maintain the "degressive" trend, and are likely to offer us an even worse deal for 1983 and beyond; probably limited to one year or two.

The Figures

6. Before the latest developments, we had been willing to think in terms of refunds of some 75-80 per cent of our uncorrected net contribution as being - barely - adequate. The difference between this and the best offer the others are likely to make could be in

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the region of £400-500 million a year by 1985. I would guess that, at best, they might offer a 55 per cent refund coupled with repayments by the UK of £300-400 million on account of the "overpayments" for 1980 and 1981, spread over three years. That would raise our net contribution to around £1 billion for 1985 (comparable in magnitude to our overseas aid programme). Adverse developments on Mediterranean agriculture and enlargement could make matters even worse. And these figures take no account of the costs to the British housewife of the Community's particular form of agricultural protection: the country loses some £200-250 million a year as a result of having to pay Community prices for food imports from other member states.

7. Sums like £400-500 million are important in relation to our expenditure plans, already fraught with difficulty and made more intractable by the costs of the Falklands operations. Such sums, repeated each year, are also very important in relation to what we can hope to do (or avoid doing) on taxation at the margin. Reductions in our Community budget contribution also give us public expenditure savings without our having to make painful cuts in UK public services to achieve them.

8. We hear plenty of arguments by other member states seeking to justify the status quo - the sanctity of own resources, the anathema of juste retour, the UK's failure to apply Community preference and so on. But the reality is simpler: they are merely anxious to preserve the gains to them which are the counterpart of the burden on us.

Ways of Improving the Prospect

9. We have repeatedly sought Communautaire ways of lessening the perversity of the financing arrangements. We have tried to tackle the financial imbalance by seeking important changes in the way the CAP operates. But the prospects for really significant reduction in the financial and resource burdens of the CAP on the UK are minimal. We invested considerable effort on this section of the "Mandate" discussions last year. There was no effective support from any other member country. Not all ever intended to try.

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Although the rate of increase in CAP expenditure has slowed down markedly in the last two or three years, that is largely attributable to a conjunctural narrowing of the gap between world prices and EC support prices and, during 1981, a fall in the growth rate of milk production. These temporary favourable influences could easily be reversed and the prospect must be that the CAP will become still more expensive, particularly for Mediterranean products, as a result of this year's price fixing. Nor can we expect significant further increase in the share of our receipts from the CAP. Over the last few years there has indeed been a rise in our share of Community agricultural spending, from 5-6 per cent to 9-10 per cent; but a good deal of this is attributable to once-for-all gains from the introduction of the sheepmeat and whisky regimes.

10. There might be advantage at some stage in suggesting a Community-funded deficiency payments scheme for cereals, confined to the-UK - on the analogy of the sheepmeat regime. I suspect, however, that this idea has more promise as a tactical move than as a real possibility for change.

11. M. Mitterrand's remarks about a special status might be considered as giving us an opportunity to remove most of the financial disadvantages of Community membership by contracting out of the CAP. But it is hard to believe that - even if we wanted it - we could have a la carte membership of the Community. The move would be seen in the UK and in the rest of the Community as a proposal to change our relationship to associated status rather than full membership. The difficulties, both internal and external, seem insuperable. I do not see this course as consistent with the objective I rehearsed at the beginning of paragraph 2 above.

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12. We are always on the alert for possibilities of redressing the balance by increasing UK receipts from programmes other than those related to agriculture. There is at present an exercise in progress to renegotiate the Regulation governing the Regional Development Fund. UK representatives are seeking there the best deal they can get. They continuously seek ways of enhancing receipts from the Social Fund. But there is no realistic prospect of producing an acceptable financial outcome on the Budget from the development of UK receipts from other policies so long as the CAP takes the lion's share of expenditure. The other programmes, and the UK's share in them, would have to be expanded to an unthinkable degree.

13. I am ready to support^a search for other initiatives. The Secretary of State for Energy is considering whether we might frame and propose an oil levy which would both show the UK's approach to the Community to be constructive and have results beneficial to the UK. I am very willing to look at this again. I see the possible analogy with the agricultural arrangements. But earlier work about an oil levy does not leave me optimistic that the UK would engage enough sympathy from the other member states to secure adequate benefit in the end from arrangements which would have to be toughly negotiated all the way.

The 1 Per Cent Ceiling

14. I am not confident that the approach to the limit of own resources, as the 1 per cent ceiling is reached, will decisively improve our bargaining position. I would certainly be strongly opposed to the UK taking any initiative to try to trade willingness to raise the 1 per cent ceiling in return for a Budget deal. That would be hazardous. It could alienate the Germans, and might increase their reluctance to see a fair solution to the British problem.

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15. I can see that if the Commission or another member state sought to link the issue of our refunds and the 1 per cent ceiling there might in principle be useful leverage.

16. But I have misgivings about giving up, or relaxing, this discipline on Community expenditure in any circumstances : Community expenditure is exceedingly difficult to control.

17. In any event, to bring effective leverage to bear would not be easy. First, timing. There would be little leverage unless and until the Community felt threatened by a shortage of funds. I doubt whether this will be the case in the near future, especially in 1983, when the situation will be eased by the reduced level of UK refunds. And the Community has always a considerable range of options for postponing the crisis.

18. Second, the attitude of others. The Commission might propose to raise the 1 per cent VAT limit, or to introduce some new form of own resources which would relieve the pressure on the 1 per cent. The Germans might well argue strongly against either. In that event there would be no leverage for the UK.

19. But if the Germans were persuaded by the French and others to accept an increase in the 1 per cent, the UK would be back in the familiar 9:1 situation. We would be trying to insist on - say - a lasting "Hague speech" approach to Budget refunds in return for agreeing to an increase in the 1 per cent ceiling or some other way round it. But the others would be determined to drive a hard bargain. So far from accepting ideas for a radically new approach, they might try to make our agreement to raising the own resources ceiling a condition for any continuing refunds. They could argue that if we stood alone in refusing to raise the ceiling it would be our refunds which should be squeezed out.

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20. So I am sceptical whether even when the constraint of the 1 per cent is felt more urgently, we could count on using the leverage it affords to obtain a permanent and satisfactory solution to our Budget problem. A UK veto could prolong still further the prospect of bitter dispute. We would have to fight every inch of the way about any ideas for new own resources. There could be no promise of a satisfactory outcome.

Duration

21. The question of the 1 per cent ceiling, or the invention of other own resources, is relevant to the Foreign and Commonwealth Secretary's question whether we should go for an interim settlement covering a relatively short period, rather than continuing to work for a medium-term settlement.

22. The idea of an interim settlement has diminished appeal if there is justified doubt about the leverage available from an eventual veto on raising the 1 per cent ceiling. But an interim settlement would be unattractive in itself, for :-

a. in the aftermath of the 1982 deal, including the commitment on "overpayments", the kind of interim settlement over a year or two which we could realistically expect to negotiate would be unfavourable;

b. it would look hollow, after all the debate and discussion of the past four years, and the history of the 30 May Agreement which looked forward to restructuring beginning in 1982, for the UK to say now that we were seeking only an interim arrangement pending a more thorough-going review later;

c. the political timetable here makes an interim solution particularly risky.

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Withholding

23. As I have indicated above, I have no objection to further work by officials, as suggested by the Foreign and Commonwealth Secretary, on possible courses which might suggest a way out of what I see to be our dilemma.

24. But since the experience of the last few years leaves me pessimistic about the outcome of approaches to the Community Budget problem which rest on agreement or consensus rather than leverage, I shall be circulating some considered views on the option of withholding, as we agreed at OD recently. I am sure that we must examine this possibility. The underlying premise would be a determination to secure an outcome which was in essence right for the UK and for the Community. We would want to make it emphatically clear both that we were not going to be forced out of the Community; and that we were not going to continue to put up with a situation in which we were subject to terms of membership which disadvantaged us to a unique extent.

Conclusion

25. So the main conclusions which I reach at this stage are :

- (i) the prospect is that we shall be offered / settlement another Budget which is inequitable for the UK, in circumstances which leave the British people resentful about our apparent second class status within the Community;
- (ii) while we can ask officials to examine the various possibilities aired, none appears to offer sufficient promise of significant improvement in the prospect;
- (iii) we are unlikely to obtain an acceptable outcome unless we are able to reconstitute some form of leverage and demonstrate our firmness of purpose;

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(iv) there is no guarantee that the 1 per cent VAT own resources ceiling will provide suitable or sufficient leverage;

(v) as agreed in OD, we need to examine the withholding option further.

HM Treasury
July 1982

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D R A F T

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OD(82) COPY NO

July 1982

CABINET
DEFENCE AND OVERSEA POLICY COMMITTEE
EC BUDGET PROBLEM: WITHHOLDING

Note by the Chancellor of the Exchequer

This paper does not attempt a recommendation whether or not to withhold. It is clear that withholding is potentially both a powerful and a dangerous weapon. It would be wrong to embark on it except as part of a deliberate strategy, if one can be developed, which would have definite objectives and could be pursued in ways which would minimize the risks and maximize the prospects of achieving them. The paper explores what the elements of such a strategy might be, as a basis for more thorough consideration. Technical background is set out in a paper by officials on contingency plans, CPW(82)3.

Objectives

2. The ultimate objective would be to obtain an agreement of the whole Community to some new and durable system of arrangements to prevent excessive net budgetary contributions by the U.K. (and there should be advantage in generalising this to apply to any individual member state).

3. The most important immediate and continuing objective would be to make it clear that the U.K. insists on remaining a full Member of the Community and is seeking a positive and constructive outcome in the long-term interests of the Community as a whole, not simply negotiating a sum of money.

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4. Before spelling out these objectives, and the ways in which they might be pursued by withholding, it is important to recognise the nature of the financial effects that could result.

Effects of Withholding

5. Withholding of the whole net U.K. contribution would be unlikely to cause any immediate crisis of general Community financing. This is because:

- the Commission tends to carry, and is at present carrying, large unspent balances - probably sufficient in size to ensure that there would be no necessity to call up increased contributions from other Members for a year or more; and
- the benefit the Community is receiving from the U.K. now is much less than the unadjusted net contribution, by reason of the refunds which have been negotiated (and which must be likely to cease if the U.K. withholds).

If the U.K. were to withhold part only, rather than the whole, of its contribution, the cash-flow impact would be further muted.

6. This is not to say that there would be no very early impact at all on the finances of other Members. The Commission normally holds its unspent balances with the various Members, and accelerated drawings on these might involve some inconvenience. Moreover all would be conscious that the situation would need extra revenue in some form in a year or so, and they would need to start planning ahead. To avoid cash flow problems, they would set about devising expedients to cover any financial shortfall, effectively at the expense of other member countries, but disguising this if they could.

7. There are clear implications, both negative and positive:

- the U.K. could not rely on the immediate financial impact of its withholding to force other Members quickly to the negotiating-table;
- all concerned could afford to take a little time to work out their responses calmly.

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8. What the withholding of the U.K. net contribution positively can do from the outset, and would be best designed to do, is to fix unilaterally whatever limit the U.K. itself desired to see placed on the total net contribution actually made, ranging from zero to some higher figure thought appropriate and justifiable. Other things being equal, this unilateral limit could be maintained, or adjusted from time to time, over an indefinite period.

Timing

9. These considerations point to the use of withholding less as a means of getting a very quick settlement than as a means of persuading the Community to focus on soundly-based structural changes in long-term financing arrangements. A speedy response is however not wholly to be ruled out; others would see the dangers and uncertainties of a long period of withholding, and a realistic threat of this could be worth trying.

10. It could also be a weapon for reversing the degressive trend in the amount of our refunds, and could be appropriate in the context of a negotiation for a long-term settlement which had, as an integral part of it, a shorter-term element. It would not be realistic to think of using it in the context of each of a series of interim settlements - and such a series would be a highly undesirable prospect for other reasons.

Modalities

11. As already indicated, it may be worth considering a period of threat of withholding, preceding and with the hope of avoiding actual implementation. But it would be vital to demonstrate that the threat was a real one, and to this end to be able and willing to show that the U.K. had worked through plans and processes and their implications. Indeed if the threat was to be used it would probably be desirable to explain in detail the legislative, administrative and other action which would be involved and their immediate effects, as well as the objective.

12. At the stage of implementation, and to some extent during a period of threat as well, it would be necessary to decide what form

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the withholding should take and how much of our net contribution should be withheld.

13. The details are explained in the paper by officials. I would envisage that initially we would stop or restrict payments out of the EEC No. 1 Account across the exchanges, while continuing to make payments of our gross contributions into the account as usual. If however the Community retaliated by cutting off our refunds or other payments to U.K. recipients, there would be a strong case for deducting appropriate sums from our payments into the No.1 Account as well. This might also be the right response if withholding lasted a long time and we had no refunds coming in after those for 1982: we could deduct these from payments into the account.

14. As regards amounts withheld, one possibility would be to allow no payments across the exchanges at all. This would maximise the financial impact on the rest of the Community and their incentive to negotiate. It would at the same time be the most demanding and hostile version of withholding. Variants would be to use this as the initial threat, and possibly as the initial basis of implementation, while reserving a more conciliatory posture for a later, but perhaps still early, successor stage; or to indicate, initially or later, that we were prepared to make a reasonable contribution in the context of genuine negotiations aimed at a settlement.

15. The alternative would be to decide on a figure which we considered a reasonable amount for our net contribution, and from the outset to limit the amounts we withheld to the excess over that. We might, for example, allow transfers equivalent to the U.K. share of the unallocated budget plus, say, about 150 million ecus per year towards the allocated budget. This would fit well with the emphasis on continued U.K. membership coupled with insistence on reasonable terms, especially in a long-drawn-out struggle. We would have to recognise, however, that the figure we set as an 'acceptable' net contribution would be regarded as our starting position in any negotiations towards a settlement. The final settlement would almost inevitably be less favourable to us.

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Risks

16. Withholding would be a strategy needing strong nerves, probably over a long period, in the face of strong pressures to give way, adverse European Court judgments, some counter-actions, and waves of troublesome international and domestic opinion. Once embarked on this course, we could not afford to lose our nerve before others did.

17. There would be important particular risks:

- retaliation in the form of refusal to finance normal Community expenditures in the U.K., including agricultural support. Departments have examined the implications on a contingency basis. The Government could, although with growing problems as time passed, counter by carrying out as public expenditure what would normally be Community activities, offset by holding against future claims for reimbursement all revenues due to the Commission;
- other Members could deliberately pursue decisions against U.K. interests in many fields, some of which could be troublesome, while keeping within the terms of the Treaty;
- there would be no guarantee in advance that financial and other potential claims and losses would all be made good at the end of the day; as time passed there could be a growing scale of such problems to be resolved and make an ultimate harmonious settlement more difficult to achieve.

18. The ultimate risk is that the continued status of the U.K. in the Community would be under threat.

Presentation

19. It would be a grave mistake to allow an operation of this kind to appear on an ad hoc/^{reaction.} On the contrary it must be seen as a deeply-considered move, conducted openly and with due warning, clearly explained in advance and with objectives and implications set out clearly.

20. Important points from the outset would be:

- insistence on the U.K.'s determined attachment to the Community, recognition of the unhappy political impact of the action proposed or taken, and determination that, at the end of the day, an improvement in the overall position and strength of the Community must result;
- emphasis on the continuity of normal Community business, making a virtue of the fact that the form of withholding chosen need not and should not immediately disrupt Community financing generally.

21. Although the U.K. could content itself with any response which gave a satisfactory and durable way of dealing with the U.K. budget problem alone, it would be important to insist throughout that the objective was a fairer distribution for all, that the U.K. would itself sympathize with any fellow-Member which might in future find its own position similarly burdensome, and that a broader-based general solution applying to all countries would be welcome to the U.K.

22. It would be worth considering whether to offer, either at the outset or later, a more ambitious context for the U.K. objective, something which could be presented as a British "relance". This would invoke the Treaty objectives of harmonious economic development, and the occasional initiatives by various members to promote a wider economic unity. It would offer the opportunity to relate to our general philosophy the reasoning which leads to our concept of what an equitably modest net contribution from the U.K. would be.

23. It would be reasonable to argue that the Community needed to develop the beginnings of a fiscal policy, at least in the limited sense that the transfers produced by the Community Budget were not perverse; and perhaps also to regulate the scale of transfers which could be imposed on net contributors (now Germany and the U.K., but perhaps also France and others under enlargement). We could pick up the German point that the Community cannot in the end thrive on the basis of having only two net contributors. These principles would not mean any further encroachment on the sovereignty/ ^{of member states:} on the contrary they

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would limit on a rational basis the extent to which arbitrary transfers could happen through the Budget in reduction of that sovereignty. There would be no intention to undermine the advances already made in the development of the "own resources" revenue and existing patterns of Community expenditure. Nor would the U.K. be suggesting arrangements to neutralise the impact of Community operations in financial terms (another definition of the "juste retour"). We might say that while in the last analysis we would have to content ourselves with arrangements which protected only the U.K., we would much prefer the solution for the U.K. to be in a wider context of a real advance in the organisation and administration of the Community.

24. If we were to bring out the positive elements in our position on the lines of paragraphs 22 and 23 it would very probably be necessary to publish a Government statement, presumably a Green or White Paper.

Summary

25. This paper has sought to bring out the following points about withholding:

(a) It would not immediately disrupt the working of the Community: but it would mean that the U.K. was not paying excessively. By seizing the initiative on finance, we would have put the onus on the others to devise financial expedients.

(b) It would probably involve a long-drawn-out battle, so it would need strong nerves and determination. We could not give in before the others did.

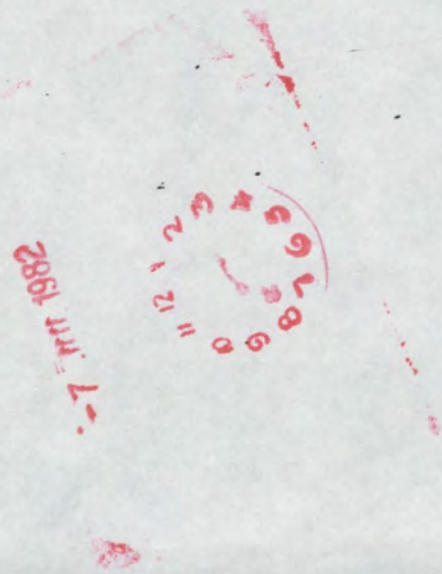
(c) It would be for consideration whether to continue, or to offer in certain circumstances to continue, to transfer across the exchanges an amount equal to our idea of a suitable net contribution (bearing in mind that any figure we chose might have to be increased as part of the final settlement).

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(d) In any event it would be essential, and could serve to reduce the risks, if we went out of our way to demonstrate that our whole approach was not that of a hasty reaction in anger, but part of a considered philosophy embracing the need for a thriving Community to have soundly based and equitable financial arrangements, and the U.K.'s determination to remain a part of such a Community.

(e) It would probably be desirable to publish a White or Green Paper on the issues and the Government's approach to them.



H.M. Treasury
July 1982

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ACTION

PRIME MINISTER :

PERSONAL MESSAGE

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FM FCO 021600Z JULY 82
TO IMMEDIATE BONN
TELEGRAM NUMBER 324 OF 2 JULY 1982
AND IMMEDIATE TO UKREP BRUSSELS
NORTHERN IRELAND HOUSING REGULATION

1. PLEASE DELIVER THE FOLLOWING MESSAGE FROM THE PRIME
MINISTER TO CHANCELLOR SCHMIDT:-
BEGINS

HAD WE HAD MORE TIME WHEN WE MET RECENTLY IN THE MARGINS
OF THE EUROPEAN COUNCIL, THERE IS ONE MATTER WHICH I WOULD
HAVE WISHED TO RAISE WITH YOU. THIS IS THE QUESTION OF THE
DRAFT NORTHERN IRELAND HOUSING REGULATION TO WHICH I
UNDERSTAND YOUR GOVERNMENT HAS SO FAR BEEN UNABLE TO AGREE.
THE DRAFT REGULATION IS AN INITIATIVE OF THE COMMISSION,
ACTING ON A RESOLUTION OF THE EUROPEAN PARLIAMENT. IT HAS
BEEN UNDER DISCUSSION IN BRUSSELS FOR SOME TIME, AND IS NOW
SUPPORTED BY NINE MEMBER STATES.

I ATTACH VERY CONSIDERABLE IMPORTANCE TO THIS DRAFT
REGULATION - FOR BOTH POLITICAL AND ECONOMIC REASONS. THE
AMOUNT OF MONEY INVOLVED IS NOT LARGE, BUT IT WILL MAKE A
CONSIDERABLE CONTRIBUTION TO INCREASING THE BADLY NEEDED HOUSE
BUILDING PROGRAMME IN NORTHERN IRELAND: IT WILL ALLEVIATE
THE MISERY OF HUNDREDS OF FAMILIES, FROM BOTH PROTESTANT
AND CATHOLIC COMMUNITIES IN BELFAST, AND WILL HELP TO SUPPORT
THE EFFORTS WHICH WE AND THE COMMUNITY ARE MAKING TO
REGENERATE THE NORTHERN IRELAND ECONOMY. THE POLITICAL
IMPORTANCE OF THE DRAFT REGULATION ALSO AFFECTS BOTH SIDES
OF THE NORTHERN IRELAND COMMUNITY, CATHOLICS AND PROTESTANTS
ALIKE HAVE BEEN NOTABLY SCEPTICAL ABOUT THE BENEFITS OF
COMMUNITY MEMBERSHIP AND DIRECT COMMUNITY ASSISTANCE ON
SUCH A PERSONAL MATTER AS HOUSING WILL ENCOURAGE MUCH MORE

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POSITIVE ATTITUDES TOWARDS THE COMMUNITY. THE REGULATION HAS BEEN KEENLY ANTICIPATED IN NORTHERN IRELAND AND FAILURE TO IMPLEMENT IT WILL BE POLITICALLY DAMAGING TO THE COMMUNITY AND, I BELIEVE, TO BOTH OUR GOVERNMENTS.

I APPRECIATE YOUR GOVERNMENT'S CONCERN THAT THE REGULATION COULD SET A PRECEDENT FOR COMMUNITY'S ASSISTANCE FOR HOUSING: I AM CONVINCED THAT THE REGULATION NEED NOT HAVE THIS RESULT, AND I NOTE THAT THE OTHER MEMBER STATES APPEAR TO BE WILLING TO SUPPORT THE INSERTION OF A SUITABLE DISCLAIMER IN THE COUNCIL MINUTES. DESPITE THIS I UNDERSTAND YOUR GOVERNMENT REMAINS ANXIOUS, AND I KNOW THAT YOU HAVE PUT FORWARD SUGGESTIONS FOR OTHER WAYS OF GIVING ASSISTANCE TO NORTHERN IRELAND. WE HAVE OURSELVES TRIED TO CONSIDER WHAT ALTERNATIVE APPROACHES MIGHT BE ADOPTED BUT WE HAVE NOT SO FAR BEEN ABLE TO IDENTIFY ANY REALISTIC ALTERNATIVE THAT WOULD ATTACK THE PROBLEM OF HOUSING CONDITIONS AND MAKE SUCH DIRECT IMPACT ON PEOPLE IN NORTHERN IRELAND.

THE EXCEPTIONAL SITUATION IN NORTHERN IRELAND REQUIRES AN EXCEPTIONAL RESPONSE FROM THE COMMUNITY AND I SEE THIS DRAFT REGULATION IN THAT LIGHT. I DO HOPE YOUR GOVERNMENT WILL FEEL ABLE TO RECONSIDER THEIR POSITION AND ALLOW THE REGULATION TO BE AGREED.

ENDS

PYM

DIST

FRAME SOCIAL

ECD(I)

RID

MR HANNAY

COPIES TO

MR BURNS

MR WILKINSON

MR HANCOCK

MR LAMBERT

MR COLES

NIO

NIO

CAB OFF

CAB OFF

NIO



10 DOWNING STREET

From the Private Secretary

2 July, 1982

Dear Sirs,

EC Aid for Northern Ireland Housing

Thank you for your letter of 1 July. The Prime Minister agrees to send a message to Chancellor Schmidt on the lines of the draft which you enclosed with your letter. The last sentence of the penultimate paragraph should read as follows:

"We have ourselves tried to consider what alternative approaches might be adopted but we have not so far been able to identify any realistic alternative that would attack the problem of housing conditions and make such direct impact on people in Northern Ireland."

Bx 11 I should be grateful if Francis Richards, to whom I am copying this letter and enclosure, would arrange for the message to be delivered.

I am copying this letter and enclosure to Private Secretaries to other members of OD(E), as well as to Nick McInnes (Department of Trade) and David Wright (Cabinet Office).

Yours ever

R. L. Cole.

M. W. Hopkins, Esq.,
Northern Ireland Office

SW

Brussels, 2 July 1982

Head of the Private Office
of
the Secretary-General

NOTE

for the attention of

- Permanent Representatives
- Secretary-General of the Commission

Attached please find a conclusion text prepared by the Presidency following the meeting on 1 July of the representatives of the Ministers for Foreign Affairs on compensation to the United Kingdom for 1982..

P.S. Christoffersen
P.S. CHRISTOFFERSEN

Ann.

T

Please cc - Mr Little

Mr Hedley-Miller ←

Mr Donovan

Mr Peat

Mr Shore

Comments passed,
as shown, to FCO
& UKref

AJde
5/7

CONCLUSIONS OF THE FOREIGN MINISTERS ON COMPENSATION
TO THE UNITED KINGDOM FOR 1982

1. On the basis of the Commission's estimate (*), compensation for the United Kingdom for 1982 is fixed at 850 million ECU (net).
2. Corrections to be made for 1980 and 1981 in the light of the actual figures will be taken into account when negotiating the subsequent solution.
3. At that time, adjustments will be made in the event that the actual figure proves to be higher or lower than the 1982 base referred to in point 1.

o/c | If the actual figure is higher than 1 530 million ECU but lower than 1 580 million ECU, the net compensation to the United Kingdom is unchanged. If the actual figure is higher than 1 580 million ECU but lower than 1 730 million ECU the net compensation is increased by 50% of the differences between the actual figure and 1 580 million ECU. If the actual figure is higher than 1 730 million ECU, the net compensation is increased by 75 million ECU plus 75% of the difference between the actual figure and 1 730 million ECU.

If the actual figure is lower than 1 530 million ECU, but higher than 1 480 million ECU, the net compensation to the United Kingdom is unchanged. If the actual figure is lower than 1 480 million ECU, the net compensation to the United Kingdom is reduced by an amount equal to 75% of the difference between the actual figure and 1 480 million ECU.

4. The budgetary effect of the present agreement on compensation to the United Kingdom for 1982 on the

.../...

(*) 1 530 million ECU

Community Budget for 1983 will be limited to the amount corresponding to the net compensation mentioned in point 1.

- Let's know the figure
5. Compensation to the United Kingdom will amount to million ECU gross. (*) It will take the form of additional measures within the meaning of Regulation n° 2744/80. Appropriations to this end will be entered in the Community budget for 1983.

If the financial mechanism yields any payment to the United Kingdom for 1982, the amount of such payment will be deducted from payments to the United Kingdom under the additional measures.

6. Financial support will be granted for projects or measures of Community interest in Germany, to take account of the need to improve the budgetary impact of common policies in that country.

The support will amount to million ECU gross. (*) It will be financed from the surplus of the 1981 budget and paid in 1983.

Payments will be made on the basis of a Regulation based on Article 235 to be proposed by the Commission, which will also stipulate the timing of such payments.

7. The Ministers undertake to take a decision before the end of November 1982 on a solution for 1983 and later.

(*) Adjustment of these figures for changes in the VAT base as well as the possible adjustment of the figures in paragraph 6 to take account of the possible corrections foreseen in paragraph 3 will be entered into the budget for 1984.

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⁹
by Nine Member States

DECLARATION CONCERNING PAR. 6

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The financing from the surplus of the 1981 budget set out in par. 6 is made in anticipation of the advantage to the Community budget which can be foreseen as a result of the corrections indicated in par. 2.

DECLARATION

Ministers declare that in the development of the common structural policies, as foreseen by the European Council in November 1981, the Community will increase its efforts to manifest solidarity vis-à-vis its least prosperous members. Decisions to this effect will be reflected in the budget as of 1983.

UK to require that some way must be found of compensating UK for any extra funding required as a result of this.



NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

John Coles Esq
10 Downing Street
LONDON SW1

Prime Minister

Agree to send this
message to Chancellor
Schmidt?

1 July 1982

Dear John.

Yes not A.J.C. 1/7

EC AID FOR NORTHERN IRELAND HOUSING

Since I wrote to you this morning, enclosing a draft letter for the Prime Minister to send to Chancellor Schmidt, we have learned that Dr Paisley called on the German Ambassador yesterday to express his strong support for the draft Regulation; and that Mr John Hume made similar representations to the Germans last week during a visit to Bonn. The German Embassy in London have told us that the response was the same in each case - the Germans were not opposed to giving special help to Northern Ireland, but were opposed to the idea of giving help through a special housing Regulation, and suggested that consideration should be given to some alternative financial mechanism. Dr Paisley (but not Mr Hume) has told my Secretary of State, and Mr Hurd, of his approach to the Germans.

In the light of these developments we have re-cast the draft letter to Chancellor Schmidt to emphasise that the draft Regulation is of the same political, and economic, interest to the Protestant community as it is to the Catholic community in Northern Ireland; the draft also acknowledges that the Germans have suggested that we might look for alternative approaches, but comments that we have not so far been able to devise an alternative approach which would serve the same purpose as the existing draft Regulation. (The main point, though this is deliberately excluded from the draft letter, is that we cannot have any confidence that an alternative mechanism would actually bring a net financial benefit to the United Kingdom; whereas we are satisfied that the existing approach does produce a net benefit, which is consequently reflected in an increase in the Northern Ireland housing programme).

I am sending a copy of this letter and enclosure to Private Secretaries to members of OD(E), Nick McInnes (Department of Trade) and David Wright (Cabinet Office).

Yours,
Stephen Byrnes

for M W HOPKINS

KW

DRAFT LETTER

FILE NUMBER.....

ADDRESSEE'S REFERENCE.....

<p>To</p> <p>Chancellor Schmidt</p> <p>(Full Postal Address)</p>	<p>Enclosures</p> 	<p>Copies to be sent to</p> <p>(Full Address, if Necessary)</p>
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LETTER DRAFTED FOR SIGNATURE BY PRIME MINISTER
(Name of Signatory)

EC REGULATION ON NORTHERN IRELAND HOUSING

Had we had more time when we met recently in the margins of the European Council, there is one matter which I would have wished to raise with you. This is the question of the draft Northern Ireland Housing Regulation to which I understand your Government has so far been unable to agree. The draft Regulation is an initiative of the Commission, acting on a resolution of the European Parliament. It has been under discussion in Brussels for some time, and is now supported by nine Member States.

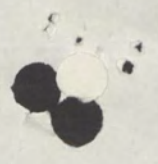
I attach very considerable importance to this draft Regulation - for both political and economic reasons. The amount of money involved is not large, but it will make a considerable contribution to increasing the badly needed house building programme in Northern Ireland; it will alleviate the misery of hundreds of families, from both Protestant and Catholic communities in Belfast, and will help to support the efforts which we and the Community are making to regenerate the Northern Ireland economy. The political importance of the draft Regulation also affects both sides of the Northern Ireland community, Catholics and Protestants alike have been notably sceptical about the benefits of Community membership and direct Community assistance on such a personal matter as housing will encourage much more positive attitudes towards the Community. The Regulation has been keenly anticipated in Northern Ireland and failure to implement it will

be politically damaging to the Community and, I believe, to both our Governments.

I appreciate your Government's concern that the Regulation could set a precedent for Community assistance for housing; I am convinced that the Regulation need not have this result, and I note that the other Member States appear to be willing to support the insertion of a suitable disclaimer in the Council minutes. Despite this I understand your Government remains anxious, and I know that you have put forward suggestions for other ways of giving assistance to Northern Ireland. We have ourselves tried to consider what alternative approaches might be adopted but we have not so far been able to identify any alternative realistic approach that would attack the problem of housing conditions ~~in Northern Ireland~~ and make such direct impact on people in Northern Ireland.

The exceptional situation in Northern Ireland requires an exceptional response from the Community and I see this draft Regulation in that light. I do hope your Government will feel able to reconsider their position and allow the Regulation to be agreed.

SECRET
30 JUL 1985



The following information is being provided to you for your information. It is requested that you review this information and advise the Bureau of any changes or corrections that may be necessary. This information is being provided to you for your information and is not to be used for any other purpose.

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30 JUN 1982

From: THE PRIVATE SECRETARY



NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

John Coles Esq
10 Downing Street
LONDON SW1

1 July 1982

Overlater.

ARZ

f.a.

Dear John,

We understand that the Prime Minister did not have time when she saw Chancellor Schmidt recently in the margins of the European Council to raise the question of the EC Regulation on Northern Ireland Housing. I believe, however, that she indicated her willingness to write about the issue if that were desirable.

Mr Prior attaches great importance to getting agreement on this Regulation in July. It is believed that the Germans need a clear indication of the political importance HMG attaches to this matter, and we therefore suggest that the Prime Minister should write to Chancellor Schmidt in the terms of the attached draft letter.

I am sending a copy of this letter and enclosure to Private Secretaries to members of OD(E), Nick McInnes (Department of Trade) and David Wright (Cabinet Office).

Yours sincerely

Mike Hopkins

M W HOPKINS

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DRAFT LETTER

FILE NUMBER.....

ADDRESSEE'S REFERENCE.....

<p>To</p> <p>Chancellor Schmidt</p> <p>(Full Postal Address)</p>	<p>Enclosures</p>	<p>Copies to be sent to</p> <p>(Full Address, if Necessary)</p>
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LETTER DRAFTED FOR SIGNATURE BY PRIME MINISTER
(Name of Signatory)

EC REGULATION ON NORTHERN IRELAND HOUSING

Had we had more time when we met recently in the margins of the European Council in Bonn, there is one matter which I would have wished to raise with you. This is the question of the Northern Ireland Housing Regulation. This Regulation has been under discussion in Brussels for some time, but at the Foreign Affairs Council of 20/22 June Dr Corterier felt unable to lift his reserve on the Regulation, which is supported by all other Member States.

The Regulation was not proposed by the United Kingdom in the first place but by the Commission, acting on a resolution of the European Parliament. All this discussion in Europe has of course been followed most closely by the people in Northern Ireland.

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I attach very considerable importance to this Regulation, for political rather than financial reasons. The amount of money involved is not large. While it would help to alleviate Northern Ireland's serious economic and social problems, the Regulation would also encourage much more positive attitudes towards the Community in a region which has been notably sceptical about the benefits of Community membership. The Regulation has been keenly anticipated in Northern Ireland and failure to implement it would be that much more politically damaging, especially when the Catholic/Irish Nationalist element (who suffer some of the poorest housing) will blame my Government for not trying hard enough for the Community support which they have been led to believe is available.

There are, in my view, no grounds for fearing that the Regulation would set a precedent for Community assistance for housing, which I understand is a worry in Bonn. If necessary, a suitable disclaimer could be put in the Council minutes.

The exceptional situation in Northern Ireland requires an exceptional response from the Community and I see this Regulation in that light. I do hope your Government will feel able to reconsider their position and allow the Regulation to be agreed.

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PART 16 ends:-

NIO to Asc + att 1.7.82

PART 17 begins:-

RTA to PM A08873 30.6.82

