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Ref. A02903

PRIME MINISTER

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Community Budget

— In my minute of 1st August, I said that I would let you have further advice  
— on the legal implications of reaching the 1 per cent ceiling. I attach a note which has been agreed with the Foreign and Commonwealth Office, the Ministry of Agriculture, Fisheries and Food and the Law Officers' Department.

2. As you will see the position is complicated even within the agricultural sector alone. This is untried legal territory; but, if the advice given in this note is correct, Member States would have an obligation to meet some forms of expenditure but not others. Thus Chancellor Schmidt's statement that national Governments would have an obligation to meet financial claims if the Commission were unable to do so seems to be partly true and partly not true. It would be worth while exchanging views with the Germans in the course of our bilateral contacts. What does seem likely is that the degree of legal uncertainty would be such that some attempt would be made in the Council to provide legal cover for national Governments who wanted to meet the claims of their farmers and traders for payments in those cases where their ability to do so was in doubt. This would put us in a good position, although we would be under some pressure ourselves. But at the end of the day, if an agreement proved impossible, and Member States were left to decide whether or not to make payments without legal cover, the situation could work out to our financial advantage. At least we would not be paying for other people's intervention purchases.

3. I am sending copies of the note (but not of this minute) to the Foreign and Commonwealth Secretary, the Lord Privy Seal, the Chancellor of the Exchequer, the Minister of Agriculture, the Attorney General and, in view of your meeting on 23rd August, to the Financial Secretary.

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4. It is possible that, at that meeting, the Financial Secretary will refer to the Community draft budget for 1981. I am therefore also sending you a copy of a recent Treasury submission recommending the general line we should take when the Commission's proposals come to be discussed by the Budget Committee and the Budget Council in September. I understand that the Financial Secretary agrees with recommendations in paragraphs 11 and 12 except that he thinks we should not be too active in supporting the Commission's proposals for increasing the size of the Regional and Social Funds. While accepting that we want to keep the Commission's goodwill and show our interest in shifting the balance of the budget towards expenditure on things like the Regional and Social Funds from which we get a net benefit, we do need to show our interest in strict control of public expenditure.



ROBERT ARMSTRONG

15th August, 1980

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LEGAL IMPLICATIONS OF THE EXHAUSTION OF OWN RESOURCES

Introduction

1. The interim report by officials of 31 July 1980 on "The Community Budget, the approach to the 1 per cent ceiling" raised the question of what happens when own resources run out but claims for payment continue to be made. Community law, not surprisingly, does not specify how the rights and obligations of individuals and Member States would be affected in such a situation. Although definite conclusions are not possible, this note tries to assess the legal implications of the present legislation. It is addressed in particular to the proposition mentioned by Chancellor Schmidt that the 1 per cent VAT ceiling would not be an effective check on spending, because it would fall to Member States to meet the claims when Community funds ran out.

2. This note deals with the legal consequences of the exhaustion of own resources in the agricultural sector only, clearly the most important, given the amount of Community expenditure on the Common Agriculture Policy (CAP). Legal issues of a similar nature may be expected to arise in other sectors, where a legal entitlement to payment exists, but these are being examined.

Claims by individuals against the Crown

3. In certain circumstances, Community law provides that identifiable sums shall be paid to individuals. These provisions confer directly enforceable rights on individuals which must be protected by the domestic court. The agricultural regulations in question do not use a consistent formula in specifying the responsible body in the Member State to whom a claim should be addressed. They speak for example of "Intervention Agencies", "the competent authority", "Member States" or are silent. HMG has a general responsibility for carrying out the United Kingdom's obligations under the CAP and has in most cases designated the Intervention Board for Agricultural Produce (IBAP) to discharge its duty. IBAP, under Section 6 of the European Communities Act 1972, is a Government department and it would, therefore, seem not to be material for the purposes of proceedings brought by an individual in the

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United Kingdom courts whether the obligation to pay rests on IBAP or otherwise on the Crown. The essential question then is to determine whether in default of Community funding there is an obligation on the Crown to make payments to individuals.

4. There are three cases which must be distinguished in this connection: cases where payments are prefunded by the Community under existing legislation, cases where payments are made by the national authorities subject to reimbursement by the Community and cases where a transaction is effected by the national authorities out of national funds subject to eventual reimbursement by the Community for the loss made on the transaction. Examples of prefunding arising in the Guarantee Section of the CAP are export subsidies, production subsidies and consumption subsidies. Examples of payments subject to reimbursement are the structure grants paid out of the Guidance Section of the CAP. Examples of the last listed cases are intervention purchases and sales; here the obligation to meet the initial cost of purchases into intervention rests on the Member State. When it later sells the produce out of intervention, it recoups any loss incurred from the Community.

5. There seems to be a fairly strong legal argument for maintaining that in the case of prefunded payments Member States are under no obligation to make payments in default of Community funding. Council Regulation No 729/70 provides in Article 4.2 that:

"The Commission shall make available to Member States the necessary credits so that the designated authorities and bodies may, in accordance with Community rules and national legislation, make the payments referred to in paragraph 1 (ie. export refunds and storage charges incurred during intervention). The Member State shall ensure that those credits are used without delay and solely for the purposes laid down".

and there are other indications in this Regulation which point to the conclusion that payments may be made only out of Community funds. It is also

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arguable that Member States have no right in these circumstances to make payments. Strictly, it would follow from this that if a Member State were to make payments out of its own funds in a crisis to meet these claims, it might not be able to recover the sums expended from the Community.

6. The situation is different in relation to payments made subject to reimbursement and to intervention purchases and sales. Here, the Community Regulations in question impose an obligation on the Member State, or its Intervention Agency, to make payments in defined circumstances and go on to provide that the Member State will be reimbursed or will receive some payment out of Community funds. At first sight, it might seem possible to argue that the Member State's obligation to pay is so closely tied to its right to Community finance that if the Community funds are clearly not going to be available the obligation to pay is abrogated. However, the Member State cannot possibly know that it will not receive Community funds. For example, when it purchases products into intervention it does not know when it will sell them or whether it will do so at a loss, and consequently cannot foretell whether and when the obligation on the Community to make payment to the Member State will arise. Thus, it will not know into which budget year or which part of a budget year the right to Community funds will fall.

7. It could be argued that as, within the structure of the CAP, prefunded payments are closely linked to purchases into intervention the suspension of the obligation to make prefunded payments would necessarily release the Member State from the obligation to make such purchases. However, even if so close a nexus between the two types of payment could be established, this argument is double edged. It could be argued that as we were bound to continue payments in respect of reimbursement schemes, there would be an obligation to continue prefunded payments from domestic funds.

8. If the arguments in paragraph 5 to the effect that there is no obligation and perhaps no right for a Member State to make prefunding payments and in paragraph 6 that there is an obligation in relation to continuing

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purchases into intervention were accepted and acted on by a Member State it could lead to significant practical consequences. If export refunds were not available, sales into intervention might rise dramatically; in other words there could well be a massive switch from areas where payments could be denied to areas where they were not. However if a situation then came about where it was physically impossible to store all the produce sold into intervention it might be argued that the obligation to buy into intervention must then come to an end. Admittedly this argument depends on the acceptance of the doctrine of supervening impossibility in Community law, a novel proposition for which there is no existing authority.

9. Assuming that the individual could establish that some obligation rested on the United Kingdom to make payments in default of Community funding, it is possible that the United Kingdom could plead in its defence that the obligation did not arise at once and that it was not required to make payment immediately. Relatively few Community Regulations specify payment within a certain period; in particular, those on export restitutions do not. Where a period is specified, there is no uniformity from one Regulation to another. Intervention purchases of butter and skimmed milk powder are to be paid for within 40 to 70 days, monetary compensatory amounts within two months but the suckler cow premium only within 12 months.

10. If proceedings were brought against HMG they would undoubtedly be complicated and lengthy and might well involve a Reference to the European Court under Article 177. By the time the claimant had obtained a final ruling, a political settlement might be in sight.

11. Even if the individual eventually succeeded, the Crown is not liable to enforcement procedures. It would, however, be quite unprecedented for the Crown not to give effect to a declaratory judgment of the court.

Claims by an individual against the Commission

12. An individual might have a claim against the Commission in the domestic courts, depending on the Community instrument in question. It is difficult,

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however, to see what could be gained by an individual in such proceedings, as all they would establish would be that the Commission owed a debt.

Attitude of the European Court of Justice

13. However plausible the arguments may be that a Member State would be released from some of its obligations to make payments, it is unlikely that European Court of Justice would be attracted by them - in any event if the Commission were arguing the contrary. The outcome might depend on the way in which the issue came before the court; there being a number of possibilities:

a. A domestic court faced with proceedings taken by an individual against his Government for failure to make a payment in default of Community funding might refer the case to the European Court under Article 177 EEC.

b. A Member State might decide to make payments and the Commission might make reimbursement leading to a challenge being brought against the Commission by another Member State.

c. A Member State might decide to make payments and the Commission might then refuse reimbursement, leading to a challenge being brought against the Commission by that Member State.

It is thought that the chances of the Court finding against the right of a Member State to make the payments and/or to obtain reimbursement are not high in any of these, best in (c) and least in (b).

Conclusions

1. There are legal arguments that a Member State is not obliged and has no right to make payments which would normally be prefunded by the Community.
2. There is a strong argument that in the case of purchases into intervention and payments subject to reimbursement by the Community Member States

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are under an obligation to continue to provide national funds.

3. If the Commission reimbursed a Member State in respect of sums expended in default of Community funding, it is likely that the European Court would uphold the actions of the Member State and the Commission.

Cabinet Office

14 August 1980



*C. M. Franklin*

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1981 PRELIMINARY DRAFT BUDGET OF THE EUROPEAN COMMUNITY

Provisional Analysis by HM Treasury

1. The Annex to this note contains an interim assessment of the Commission's preliminary draft budget (PDB) for 1981. The supporting documents containing the Commission's detailed proposals with their justification have only just been received in London. Our assessment may change when these documents have been properly studied.
2. A start was made with the examination of the Commission's proposals by the Council's Budget Committee in Brussels in the last week before the holiday season. The examination will continue in September in the Budget Committee and Coreper and the Budget Council will "establish" the draft budget on 23 September for transmission to the European Parliament.

Brief Commentary

3. Tables showing the breakdown of the payments and commitments appropriations in the PDB are attached to the Annex. The payments appropriations total 20,051 MEUA (about £12,190 million at current rates of exchange). This is just within the own resources ceiling. The rate of VAT required to finance this total is estimated at 0.95% and the Commission has left a headroom within the 1% ceiling of 550 MEUA (about £335 million).
4. The commitment appropriations total 21,732 MEUA (about £13,211 million). Both payment and commitment appropriations show a big increase over the 1980 budget:-

Payments 28%  
Commitments 25.5%

This is very much higher than the rates of growth between 1978 and 1979: and between 1979 and 1980. It is also very much higher than the rates of growth of the national budgets of the Member States.

5. Part of the explanation (but only a small part) is that the Commission have included in the PDB full provision for payments to the UK under the 30 May agreement in respect of our contribution to the 1980 budget, plus 100 MEUA as an advance payment of the refund due in respect of the 1981 budget.

6. The high rate of growth is not explained by the CAP. In fact, the provision for the Guarantee Section of FEOGA, 12,941 MEUA, is suspiciously low. We think that a figure of 13,500 MEUA would be more realistic. (As is customary, these figures make no allowance for the 1981 price fixing.)
7. A major part of the explanation of the large increase in the payments appropriations is the provision for the three structural funds - Regional, Social and Guidance Section of FEOGA. The rates of increase shown in the relevant table are deceptive. In 1980 the payment appropriations for these funds were cut back because large sums were carried over unspent from the payment appropriations in earlier budgets. It is probable that the sums carried over will be exhausted in 1980 so that a big increase in the payments appropriations in the 1981 Budget will be needed to preserve a steady pattern of expenditure.
8. The big increase in the commitments appropriations is not explained by any such special phenomenon but seems to result from a general expansionism on the part of the Commission. Part of their motive, no doubt, is to provide a substantial increase in non-obligatory expenditure so as to please the European Parliament and further the goal of restructuring the budget. Total non-obligatory expenditure in the PDB (on the definition used by the Council) is 5,045 MEUA in commitment appropriations and 3,513 MEUA in payment appropriations. These represent increases of 31% and 54% respectively. The "maximum rate" of increase for non-obligatory expenditure (as calculated by the macro-economic criteria listed in Article 203 of the Treaty) is 12.2%. (The maximum rate is applied separately to commitments and payments.) An attempt to hold the increase in non-obligatory expenditure within this maximum rate - whether for commitments or for payments - would involve very large cuts in the Commission's proposals.
9. If this year's discussions follow the usual pattern, a majority in the Council will want to cut the Commission's proposals and a majority in the Parliament will want to restore the cuts - possibly going beyond the Commission's proposals.

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The final outcome is likely to be a compromise somewhere between the Commission's and the Council's figures.

UK Attitude - General

10. The chief UK objective in the discussions on the PDB must be to ensure that full provision is included for the refunds due to us under the 30 May agreement in respect of 1980 plus a worthwhile sum for advances in respect of 1981. If the Parliament rejected the draft Budget as they did last year, the payment of these refunds would be likely to be seriously delayed. We therefore have a particular interest in avoiding confrontation between the Council and the Parliament this year. Despite the 30 May agreement, we retain an interest in preserving the Commission's proposals for increases in the provision for types of expenditure which are of net benefit to the UK, in particular the Regional and Social Funds. Even though the 30 May agreement has reduced the net benefit we gain from these Funds, it has not eliminated it. We must also avoid giving other Member States and the Commission the impression that the effect of the 30 May agreement has been to make us lose interest in Budget restructuring. These arguments point to a policy of support for the Commission's figures, at least during the initial round of discussions.

UK Attitude - Particular

11. The main conclusions that emerge from the discussion in the Annex for our initial reaction to the Commission's proposals are:-

- (i) Although the provision for the Guarantee Section is probably too low, we should not challenge it. We should instead aim to exploit this low provision as a way of increasing our chances in 1981 of getting a modest price increase or national financing or genuine economies in the CAP - para. 9.
- (ii) Similarly, we should not challenge the Commission's estimates of the yield of levies and duties even though we suspect they are excessive - para. 3.
- (iii) Our chief objective must be to protect the provision for refunds to the UK under the 30 May agreement - paras. 4-6.

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- (iv) We should, at least during the initial round of discussions, support the Commission's figures for the Regional and Social Funds - paras. 12-21.
- (v) We need not worry if the provisions for the Guidance Section of FEOGA (including fish) and the aid programme are cut - paras. 10-11 and 22-23.

12. At a later stage in the autumn negotiations our policy may need to be adapted in response to the position reached in the Council of Ministers and by the European Parliament.

15 AUG 1980

