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PRIME MINISTER

THE COMMUNITY BUDGET

I have been considering the line we should take between now and Dublin on two important questions affecting the Community Budget issue.

2. The first of these is the question of the attribution of MCAs. Our view (and that of the Italians) on the substance of this is quite clear. We believe that MCAs paid on imports of food into the UK should count as a benefit to the exporting member states because they enable them to dispose of their high price agricultural produce on our relatively lower priced markets. The majority of other member states, because they believe that the "common price" for agricultural produce is the "right" price consider that MCA payments are a concession to the importing member state enabling it to apply a price below the common price. This view of MCAs is enshrined in the 1975 financial mechanism and tends to be the one held by the Commission. We have continued to argue our point of view, but in the absence of acceptance of it by our partners, discussion of our net contribution has tended to assume that this will be 1550 meua in 1980 (attributing MCAs to the importer) rather than 1814 meua (attributing MCAs to the exporter).

3. There has not been any possibility of compromise over this argument, although we did succeed in making sure that the



Commission's "Reference Paper" presented the figures on both bases. During the summer, the point lost some of its importance as the combination of green pound devaluations and a strong pound drove our MCAs down. Now however they have risen again to 12 per cent - more than the average of 9 per cent for 1980 assumed in the Reference Paper.

4. Our public expenditure totals reflect the figure of 1814 meua for our net contribution. If the rest of the Community were to concede to us a refund of the whole of our net contribution as they see it - 1550 meua - we would still be some 260 meua (£170 m) short of our goal for the reduction of the public expenditure burden of EEC membership. If in the event our average MCA in 1980 exceeds 9 per cent the shortfall would be greater because our partners will argue that these larger MCAs mean our net contribution should be reckoned to be less than 1550 meua.

5. If it were possible to remove this complication from the Dublin discussions on satisfactory terms, there might be advantage in doing so. If we had to argue it seriously in Dublin, it could prove a distraction, in which we could look for support only from Italy. However I see no prospect of a compromise between our view and the majority view in the coming weeks. This means there is nothing for it but to maintain our view until and at Dublin. If then a settlement is obtainable which, taken as a whole, is acceptable, we could simply leave the point on one side. If there is no, or no immediate settlement, it pays us to maintain our view. How important the point is depends on the one hand on the nature and mechanics of the solution offered to us; and on the other on whether our MCAs in fact remain substantial. It could be important if they do.



6. The second issue is the 1 per cent ceiling. My officials have just produced a new assessment on when the Community is likely to reach the 1 per cent VAT ceiling. They agree with the Commission that it is likely that the Community will need to levy the full 1 per cent in 1981 to cover planned expenditure. A radical reduction in the rate of growth of CAP expenditure could postpone this to as late as 1983. The annual rate of increase in agricultural spending would have to come down from the 22 per cent experienced in 1975-79 to 10 per cent for 1980-82 for this to be possible, and 1981 or possibly 1982 are the more likely years.

7. In 1980 the headroom under the 1 per cent ceiling is at the moment estimated by us at 2,000 meua and by the Commission at nearer 1,000 meua: though these estimates are extremely speculative and variable. Unless the growth of CAP expenditure comes down, there will be no headroom for new expenditures in 1981. Some of our partners will no doubt want to argue both that any relief for the UK must be financed by repayment from the 1981 Community Budget, and that it must be subject to the 1 per cent ceiling. The present financial mechanism operates by repayment in arrears. Any relief to us in 1980 would require a supplementary budget, though there are precedents enough for this. But all this means that we are unlikely to be able to keep entirely separate in Dublin the two issues of our Budget claim and the 1 per cent ceiling.

8. Our starting point should clearly be that we seek relief from our 1980 contribution in 1980 (when there is more room for it within the 1 per cent ceiling). At the same time we shall want to oppose other increases in expenditure, especially on the CAP, not only on the merits but also in order to give as much headroom as possible in 1980 and 1981. It would be



much more difficult to get new expenditure into the Budget once the 1 per cent ceiling was biting, because other expenditure would have to be cut to accommodate it. We could also argue that in our view there are ways of meeting the UK's problem without increasing the size of the Budget; and that this is wholly appropriate for what is a redistribution, not true expenditure. My officials have identified a number of financing possibilities outside the normal own resources arrangements which, notwithstanding the Commission's dislike of such possibilities, might provide a way of meeting the UK's problem without breaching the 1 per cent ceiling if there were political will among our partners to do so. But some of these possibilities do resemble the proposals we are beginning to hear for accommodating more CAP expenditure without breaching the 1 per cent.

9. My conclusion is that we have to be careful to avoid a situation in which the 1 per cent limit is used as a means of defeating or substantially limiting our budgetary refund. We should certainly not rule out the financing of part or all of our refund outside the Budget, but we should face the possibility, perhaps probability, that financing will be inside the Budget. That is what the Commission are leaning towards, it is how the present financial mechanism works and it is what our partners will go for. This situation makes it all the more necessary that we should secure a solution to our problem before the ceiling is reached. It also suggests that we should not take the lead on the inviolability of the 1 per cent until we get a settlement. Once we achieve a settlement we have every interest in upholding the 1 per cent. I think at that stage it may be found that some of our partners, including the French, are not so keen on enforcing it, especially if their electoral situation makes domestic legislation to raise it rather easier.



10. I am copying this to OD(E) colleagues. I would be grateful to know whether you and they are content with the line on these two issues that I have set out. A copy also goes to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'G.H.' with a flourish.

(G.H.)

13 November 1979