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THE BUDGET/CONVERGENCE

Brief by HM Treasury

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1. This brief and the attached notes deal with the main arguments and possible solutions. Tactics are considered in a separate brief.

Objective

2. To put the relationship of the UK to its partners in the EEC on a firm and lasting basis by producing an acceptable level of present and prospective contributions.

Main Argument

3. Unacceptable that UK should contribute more to Community than those who are growing faster and who are already richer.

Counter Arguments

4. These are dealt with in the separate notes attached, and summarised below :

a. North Sea Oil Means the UK Can Afford to Pay

i. Oil alone does not make a country rich, and our oil is not enough to transform either our own economic performance overnight - or play a significant part in the determination of the world price.

ii. If we tried to protect oil resources in the same way that other countries have tried to protect agricultural supplies, we should be seeking arrangements under which we could sell UK oil to the Community at prices several times higher than world levels.

b. <u>UK Should Import Less in Total and More From the Community</u>

i. There is no direct action we can take within Community rules.

ii. Further development of our trade with the EEC will take time and will not solve the problem of our contribution - which is one of receipts as well as payments - in the foreseeable future.

c. <u>Juste Retour</u>

i. We are not suggesting that irrespective of circumstances countries should receive back what they put in. But other, stronger, countries are already getting back as much and more than they contribute.

ii. As the Community has developed it has recognised the need to develop policies which give advantages to the less strong.

iii. On this principle we could claim net benefits from the Budget. But we should be content to achieve broad balance, taking one year with the next, like France.

d. <u>UK is Arguing that the Budget Should Become an Instrument for Redistribution</u>

i. The present budget <u>is</u> redistributive - from the UK to others on a huge scale.

ii. It is the inequity of this which we have to set right.

e. Another Renegotiation

As the Commission's second solutions paper (21 November) points out, 1970 assurances still not fulfilled:

"Should an unacceptable situation arise ... the very survival of the Community would demand that the institutions find equitable solutions."

f. 1% VAT Limit

i. The UK is not asking for expansion of Budget or more new Community expenditure.

ii. UK problem should be dealt with on its merits, separately from the question of the 1% limit.

iii. The ideas now being canvassed for changes in the CAP share of the Budget could leave more headroom.

g. Wider Effects of Membership

i. There are mutual benefits - eg political benefits - in which all countries have shared.

ii. But there are also costs which have borne heavily on the UK. The CAP imposes an additional non budgetary burden on the UK of £ several hundred million because we are a net food importer.

iii. On balance, non budgetary transfers are a considerable extra cost to the UK from membership of the EEC.

The UK Net Contribution

i. Without correction the UK net contribution in 1980 will

- exceed Germany's by 40% (MCAs attributed to importer)
  France's by 13 times (MCAs attributed to importer)

ii. After 1980 it could get further out of line without effective action.

Solutions

5. There will be three papers from the Commission : a background Reference Document of 12 September and two papers (31 October and 21 November) suggesting solutions. The attached table summarises the possibilities drawing on these documents. Separate notes comment on them in more detail.

a. The Existing Financial Mechanism

If it is not possible to reach agreement on a simple comprehensive mechanism the most promising approach would be to build on the proposals in the Commission's second solutions paper. The foundation would be the existing financial mechanism with the removal of :

i. the existing balance of payments constraint
ii. the tranche system
iii. the 3% ceiling

This would give 520 meua net (£350m) in 1980. It would not be robust for later years unless other restrictions, especially the 85% of GDP constraint are also removed. (This would disqualify us after enlargement). Not enough on its own. It only deals with the contribution side. But a good starting point.

b. Enhanced Receipts

Ideally we would like an automatic receipts mechanism under which UK receipts would be brought nearer to the Community average. If this is not obtainable we could make use of the suggestion in the Commission's second solutions paper of a special temporary measure providing increased expenditure which would benefit the UK, in sectors like coal exploitation, transport infrastructure, agricultural improvement and interest rebates if the UK joined the EMS. Putting the EMS on one side :

i. the relevant NCB expenditure is around £560m a year

ii. agricultural improvement schemes not already financed by the Community amount to £140m a year.

iii. Expenditure on roads will be about £1 bn in a year.

Since the Commission have indicated that these are only examples, a fourth category might be regional and social expenditure, some of which could be applied in Northern Ireland.

Provided the money financed existing expenditure plans this proposal could produce large sums and is a better springboard than we might have expected. It would be important not to make it temporary (3 or 4 years) as the Commission at present suggest. But a review after some suitable period would not be unreasonable. Combined with an unrestricted financial mechanism action to bring our receipts in line with our GDP share could produce 1240 meua (£830m), and would be robust in future years.

c. Expenditure Framework

The Italians earlier suggested budgetary guidelines under which structural funds would take 25% of the total, and the Commission have included in their second solutions paper suggestions of a broadly similar kind. We support the idea of changing the proportions, but would like to see this achieved by savings on agriculture within the present ceiling. On its own, action on the overall structure of the budget will not produce a predictable or adequate return soon enough but it is desirable in the longer run to achieve a redistribution of expenditure and is worth pursuing as well as measures to relieve our immediate problem.

d. Weighted Financial Mechanism

This is a way of getting the unrestricted financial mechanism to yield more than 520 meua. It takes account of our relatively low GNP per head. Other countries, especially Germany, reacted adversely when it was mentioned in the first Commission solutions paper; it has been dropped in the second. It is not fully robust because it is confined to contributions. It might have a role.

e. Failsafe on the Net Position

It might also be possible to add something - if only as a failsafe - by restricting the UK net contribution to that of another country such as France. This would not be a popular idea. It could not be done directly but the result might be achieved by an agreement on the lines that no less prosperous country should make a net contribution which, relative to GNP, exceeds that of any more prosperous country. If France was a net contributor this would produce for the UK almost 1500 meua (£1 bn). But if France was a net recipient we should be restricted to the German net contribution - worth in 1980 about 800 meua.

f. Article 131

One Commission proposal is effectively to extend Article 131 for another year. This would limit the UK share of UK contributions to the 1979 level. It acts on the same problem as the financial mechanism but produces less money. Because of this it is difficult to combine with the financial mechanism. It is difficult to extend, does nothing on receipts and is therefore not robust. The Commission second paper more or less dismisses it.

6.

Financing

6. Financing arrangements are subsidiary to solutions. It is for others to decide how they share out the burden. There are two issues :-

i. should a refund be financed inside or outside the Budget?

ii. who should contribute and how much?

The precedents are inconclusive, but the Financial Mechanism is inside the Budget and financed by all. Financing inside the Budget in the normal way might encounter the 1% ceiling, while an extra-budgetary arrangement would involve time-consuming ratification. The best solution might be financing within the Budget through levies scored as "negative expenditure". If the less prosperous were exempt the brunt would fall either on France and Germany, or on the smaller countries with large receipts. There could be different financing arrangements for different components of a composite solution.

HM Treasury
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