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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EC BUDGET RESTRUCTURING: THE NEXT PHASE OF THE NEGOTIATIONS

Note by the Secretaries

The attached note by officials is circulated for consideration by the Committee.

Signed ROBERT ARMSTRONG
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Cabinet Office

27 July 1981

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EC BUDGET RESTRUCTURING: THE NEXT PHASE OF THE NEGOTIATIONS

Note by Officials

1. The circulation of the Commission's report under the 30 May mandate and the procedural conclusions reached at the June Foreign Affairs and European Councils set the scene for the negotiation proper to begin in September. July is being spent in clarifying and elucidating the many obscurities in the Commission report and getting out onto the table as many as possible of the facts and figures which will be needed for the negotiation. The Special Mandate Group set up by the European Council will start work at the beginning of September. An annotated work programme is to be submitted to the September Foreign Affairs Council, and we hope, approved on that occasion.

2. When Ministers considered strategy for restructuring the Community budget in October 1980 (OD(80)20th Meeting) there was general agreement that the United Kingdom's broad objectives should be to achieve a lasting solution which would bring her budget contribution permanently to a level no higher and, if possible, lower than that resulting from the 30 May settlement and would avoid that contribution being a source of recurring source of friction within the Community; and to reduce the resource costs of the Common Agricultural Policy (CAP). It is against this background that the Commission's Report has to be judged.

The Commission Paper

3. A summary of the Commission's paper is set out in Annex A to the present paper, which also compares Commission thinking on the main points with our own. The Commission paper lacks precision on many points and, as it stands, does not give us what we want. However, it is perhaps rather better than we might have feared and provides us with an acceptable starting point for discussions. What is certain is that we can expect a tough and complex negotiation. Good points from our point of view are:

that it focusses on more or less the same areas as we ourselves have concentrated in our preparatory work and contacts - CAP reform, development of the Community's non-agricultural policies and the need for a budgetary mechanism to prevent the recurrence of an unacceptable situation;

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that much, though not all, of the thinking on CAP reform is close to our own;

that the need for a budgetary mechanism to redress the inequity of the UK's budgetary situation, whatever is done on CAP reform and non-agricultural expenditure, is clearly and unconditionally stated;

and that the temptation to propose an immediate raising of the 1% ceiling has been resisted, although by saying that the Commission will propose the raising of the ceiling when the Community's expenditure makes this necessary and simultaneously making a number of proposals for non-agricultural expenditure the report may be seen as designed to create pressure to raise the ceiling.

Less satisfactory from our point of view are:

the vagueness with which the budgetary mechanism is described and the very wide range of possible financial outturns, ranging from the satisfactory to the entirely unacceptable;

its limitation to the UK alone and references to its temporary nature though it also speaks of the new measure applying for 'long enough for the effects of the new guidelines it proposes to be felt'; and

the inclusion in the section on CAP reform of ideas for an active export policy and for increased support for Mediterranean agriculture which could prove costly to us.

Nor are all the rather vague proposals on non-agricultural items equally welcome to us.

<u>Reactions of other Member States and their probable approach</u>

4. The reactions of other Member States have been muted by government changes in a number of countries (Italy, Ireland, France, Netherlands). The French request for a pause for reflection enabled everyone to avoid revealing their views on the substance at the June European Council; nevertheless some indications of national attitudes are beginning to emerge.

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5. At the negative end of the spectrum the Danes and the Irish have given a frankly hostile reception to the Commission paper. The former have reacted violently to the proposed budgetary mechanism (which would considerably reduce their net benefits under the Community budget), while the latter are concerned to resist any meaningful reform of the CAP. The Benelux countries have been less overtly hostile but it is already clear that, as the main losers from a budgetary mechanism, they will try to limit the impact of it so far as possible. The Dutch in particular have doctrinal objections to a general budget corrective. They firmly support, however, the concepts of CAP reform and the further development of the Community's non-agricultural policies. The Greeks and Italians have welcomed the paper, although it is permissible to doubt whether their welcome is more than a polite gesture. Both countries seem likely to concentrate their efforts on expanding Community support for Mediterranean agriculture and on developing existing policies of benefit to them such as the regional and social funds, rather than on taking a particularly restrictive attitude to the budgetary mechanism, so long as they can be exempted from its impact.

6. The French have managed so far to say nothing at all, and the lack of a clear line in the French press is an indication that this is no mere tactical device. The Mitterrand Administration has not yet got to grips with the issues. It may not be easy for them to establish a position, since France's interests in the negotiation are not entirely clear. The maintenance of the CAP is vital to them; but it is the trade aspect of the policy rather than the budgetary flows from it that are more important. Maintenance of the former is not incompatible with a certain degree of reform particularly if this reform were to contain some of their favoured ideas on export policy. On a budgetary mechanism they will lose but, on almost any hypothesis, they will still only be relatively modest net contributors when their relative size and prosperity is taken into account. French statements that the mandate should be seen in a broader context may presage linkages with wider issues. The development of the German attitude will be of considerable influence on their own. It would nevertheless be wise to assume that French negotiating weight will be thrown against us in most aspects of the negotiation.

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7. The Germans have reacted negatively to the Commission's assumption that they do not have a budgetary problem but have certainly not yet done enough to convince the others that something special will have to be conceded to Germany. In response to a French plea that the substance should not be discussed Chancellor Schmidt did not criticise the Commission report within the European Council itself on 29/30 June, though he did deploy the German case to the press afterwards. Some at least in Bonn would be willing to accept a variant of the Commission's approach which, while virtually exempting them from financing our refunds, would not put a direct limit on their contribution. Others would prefer a general mechanism along the lines we are pursuing. German support for CAP reform, while loudly proclaimed, must also be considered uncertain and some of their preferred remedies are likely to be contrary to our interests.

8. We cannot count on German support. Chancellor Schmidt is subject to conflicting pressures. He has a serious budgetary deficit problem and the Finance Ministry will press strongly for a cut in Germany's contribution. This should favour a tough German stance on net contributions which could be helpful to us; but it will also mean that the Germans will be very determined to limit the cost to them of any solution which finally emerges and this could well work to our disadvantage. Moreover in the present German political situation Chancellor Schmidt is bound to be responsive to the concerns of Herr Genscher who will be concerned about the long term dangers of going too far in inflaming German opinion over the cost of membership, and so reinforcing those elements of public opinion inclined to a less Western-oriented stance.

The UK Position and Tactics in the months ahead

9. The fact that we are in the Presidency gives us some tactical benefits but it is also an inhibiting factor. As Presidency we must press the work forward and if we play our cards well, we can hope at least to make useful progress during our Presidency towards the sort of solutions we want. If we are too overtly nationalistic and alienate other member states we may make no progress at all and may actually prejudice our chances of getting the solutions we want when our Presidency is over. It will be particularly important to keep in close touch with the Germans and the French. The degree of success we achieve during the Presidency will also affect public opinion in the UK.

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10. The following paragraphs suggest the main lines of the UK approach both on substantive and tactical issues in the months ahead:

A. CAP Reform

11. The Commission ideas in their paper (see Annex A(i)) provide an adequate basis for negotiation. To a more or less satisfactory extent they cover all the main elements in our own approach to CAP reform (a rigorous price policy, non-price measures to limit surplus production, financial limits to FEOGA spending, a tougher approach to national aids, a tentative look at income aids to complement price policy). They also include ideas for export policy and Mediterranean agriculture, which we do not like.

12. It is important that we press forward discussion of these proposals firmly and decisively. A number of our partners, particularly the Germans, believe we are less interested in CAP reform than in getting an adequate budgetary mechanism. Taking a firm stance on the CAP now will help us with the Germans and put us in a stronger negotiating position in relation to those Member States, such as the French and Irish which attach importance to CAP and whose net contributions are likely to increase in any solution of the budget problem. The budget restructuring negotiation offers a unique opportunity to get changes in the CAP and such an opportunity will not recur, if we let it slip now.

13. The tactical quandary is how best to pursue our aims. In the end CAP reform will necessitate a large number of detailed decisions on individual commodities, which can only be adequately prepared and taken in specialist bodies. But, we do not think that the Commission ideas should be remitted to such bodies now. The best course would be to aim to set a number of clear guidelines at the November European Council which would constitute a framework within which the Commission would make its proposals for the 1982/83 and subsequent agricultural price fixings and within which the Agriculture Council would take its decisions. Work now being done on various aspects of the Commission's ideas should enable us to take a view on the sort of guidelines on CAP reform we should aim to have adopted by the November European Council.

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14. There is a particular problem over Mediterranean agriculture. The Commission's report promises 'programmes' for the Mediterranean by the end of 1982. Meanwhile, the Commission are expected to produce detailed proposals shortly on changes in the Mediterranean acquis necessary to enable progress to be made in the enlargement negotiations. The Italians, however, may be resistant to discussions on the Mediterranean acquis separately from negotiations on Northern commodities and from the promised 'programmes' where they will be looking for commitments which could prove expensive. We shall need to consider this problem further when the Commission have produced their proposals. Our own negotiating position is likely to be made more difficult if the Commission proposals include a tax on oils and fats in order to finance the application to Spain of the Community's olive oil regime.

B. Non-agricultural policies

15. This section of the Commission's paper is something of a ragbag (see Annex A(ii)). It covers not only non-agricultural expenditure policies with direct budgetary implications (regional, social, energy, research) but also policies that have nothing to do with the budget (EMS, loans, completing the Common Market). None of the ideas is particularly new and so long as the 1% VAT ceiling holds their cost is constrained by that and the proportion of the budget taken up by agriculture. But without savings in the cost of the CAP adoption of some of the policies would put pressure on the VAT ceiling. Some of them, however, go very much in the direction we would like Community policies to do (greater concentration of regional spending, though without recognition that the quota section should cover areas suffering from industrial decline and social fund help for youth employment measures).

16. Existing Ministerial guidance is adequate for the moment to enable us to play a full and reasonably constructive part in the consideration of this section of the report, although we may need to seek further instructions as and when the Commission make their ideas more precise and other Member States inject their own requests. It is important that we work to achieve a positive outcome on at least some of the areas of policy covered by this section of the report and do not unnecessarily thwart the efforts of others to include issues

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which they consider important since it will be necessary for those countries which are going to lose by a budgetary mechanism (Denmark, Benelux, France) to set the outcome of the negotiation in the context of a Community moving forward on a broad front, including decisions, or impetus to future progress, on other Community policies. In the case of France this may be particularly important in the field of social policy. As in the case of CAP reform we should aim for guidelines to be adopted by the November European Council rather than fully worked-up and detailed decisions.

C. Budgetary Mechanism

17. The FEOGA budgetary mechanism proposed by the Commission (see Annex A(iii)) consists of a refund to the UK of a 'fairly high' proportion of the difference between our contribution to FEOGA guarantee expenditure as measured by our proportion of Community GDP and our receipts from FEOGA Guarantee expenditure. It applies only to the United Kingdom and is open to a wide variation of outcomes depending on decisions to be reached on a number of crucial points, none of which is clearly established in the Commission paper. The most significant factors for us are the proportion of the difference to be refunded to the UK, how the refunds are financed (ie whether we have to join in paying for them), and the period used for averaging the calculation of the refunds.

18. Another crucial factor will be the fate of the 1975 Financial Mechanism on whose continuance the Commission report is non committal. Our preliminary calculations suggest that, if we could secure a favourable outcome on all the crucial points discussed above, the FEOGA Mechanism and an amended 1975 Financial Mechanism, run in tandem, could produce a large and continuing alleviation of our net contribution. In tactical terms this conclusion, together with the advantage one gains in the Community from negotiating on the basis of Commission proposals and the likelihood that the Germans will not dismiss them out of hand, point towards our not rejecting this approach out of hand even though there are others that we would prefer and wish to advocate.

19. However, we believe, in the long term for the UK and the Community as a whole, the approach we have ourselves espoused of adjusting the Community budgetary flows to assure a controlled pattern of transfers from the more

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prosperous to the less prosperous Member States on a scale commensurate with their size and relative prosperity is more promising. Under such a system we would either be a modest net beneficiary or, after enlargement to include Spain and Portugal, would roughly break even. It could very well, depending on the overall scale of transfers, be more helpful to the Germans than the Commission system, would deal with the budgetary problems of enlargement, would facilitate Community decision making and would be less vulnerable to arguments that it should be temporary; even though it would probably imply even bigger losses for Denmark, the Benelux countries and France and the acceptance by all these countries, together with Germany, of permanent net contributor status.

20. These very substantial advantages, suggest that we should not abandon our more general adjustment mechanism but should continue to propound its advantages while being at the same time prepared to discuss the Commission ideas and develop their detailed definition to our advantage. It would not however be in our interests to present them as stark alternatives; a possible approach would be to seek to merge them by edging the Commission's approach towards our own more general ideas. The first occasion on which we are likely to need to take a position on the substance is in September when the work programme will come forward for approval. It would make sense on that occasion for the UK spokesman to explain our own preferred approach in general terms while at the same time showing interest in the Commission's approach and suggesting ways in which it could be adapted to marry in with our own.

21. We will also need to watch the legal problems of budgetary mechanisms, which are summarised in Annex B. The Commission's legal experts are themselves not confident that they have found a secure legal basis which will avoid Treaty amendment and the lengthy process of ratification by national parliaments for the Commission's own approach. Our approach would raise similar problems. No doubt these problems could be overcome, given the political will of all Member States to do so. But it is also true that any member state wishing to block progress could find legal objections.

D. 1982 Refunds

22. The 30 May settlement states unambiguously that, if a structural solution to the unacceptable situation problem cannot be found this year, there will be a

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third year of refunds in respect of 1982 on the lines of those decided for 1980 and 1981; but it does not set figures for the 1982 refunds, which are to be decided by the Council on a proposal of the Commission. In the covering letter to the Commission's recent report M Thorn said that appropriate proposals would in any event be put forward 'in the course of 1981'.

23. Given the structure of the 30 May refund system, the overwhelming proportion of any refunds to the UK in respect of 1982 will figure in the 1983 draft budget which will be being discussed the second half of next year. On past precedent there should be provision for advance payments in the 1982 budget itself and we are taking steps to ensure that provisions for advances can be inserted into the 1982 budget as soon as a decision is taken on whether or not a structural solution will be available in time to be applied to the 1982 budget.

24. We shall need to consider nearer the time of the European Council whether to press the 1982 refund issue before the end of the year. To do so at this stage would play into the hands of those who do not want a long term solution and could cause trouble with the Germans, who are concerned about the problems of financing a third year of refunds on the basis of the 30 May system. We do not want to re-establish a Nine-One confrontation which could spill over into the wider discussions and complicate domestic handling of the negotiations. In any case, so long as there is a possibility of our getting a lasting solution which is better for us than the 30 May settlement, it would be in our interest for 1982 to be the first year under a new system rather than the third year under the old one.

E. Timing

25. We have taken the line that the Community should reach decisions at the November European Council and this has been endorsed by the other Member States. As Presidency we should hold to that line, however unpromising the omens and however stickily the preliminary negotiations may go in the autumn although not, of course, at the expense of our substantive national interests. We must seek to ensure that any failure to keep to this timetable is pinned on others and not us. But we must also avoid a situation developing in which public opinion regards delay as a disastrous setback to our substantive objectives. It is clear that in any case the most that could be done in November would be to lay

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down fairly precise guidelines for the completion of the negotiation, with work on legal and other texts to follow. The degree of precision which can be achieved at the November European Council will be important.

F. Procedure

26. We have been successful so far in our aim (which we should maintain) of giving a clear coordinating role to the Foreign Ministers and avoiding a dispersal of the work to specialist bodies. In addition there will be debats d'orientation in the ECOFIN and Agriculture Councils in October. The European Council established a Special Group to assist the Foreign Affairs Council in its preparatory work and this Group will begin work in September. It remains to be seen whether it functions effectively.

Conclusions

27. Ministers are invited to endorse the following conclusions which should guide our policy on budget restructuring in the arly autumn:

(i) CAP Reform. We should work for clear guidelines to be set at the November European Council, within which the Commission and the Agriculture Council would operate at future price-fixings.

(ii) Non-agricultural policies. We should take a constructive attitude and work for development of these policies within the 1% ceiling and on lines helpful to our interests, and aim to agree guidelines for them at the November European Council.

(iii) Budgetary Mechanism. We should maintain our own approach, that the effects of the Community's budget on the Member States should be based on conscious decisions. At the same time we should be prepared to discuss the Commission's ideas, seeking to improve them and to influence their detailed definition in a direction which could be acceptable to us.

(iv) 1982 Refunds. We should consider further the handling of the 1982 refund problem nearer the time of the November Council.

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(v) Timing and Procedure. We should stick to the objective of getting decisions at the November European Council, but should seek to ensure that if we fail, blame for failure is sttributed to others and is not regarded as damaging to our substantive objectives. We should have the work closely coordinated in the Foreign Affairs Council and the newly established Mandate Group.

Cabinet Office
27 July 1981

COMMISSION REPORT ON 30 MAY 1980 MANDATE

GUIDELINES FOR CAP

INTRODUCTION

1. The purpose of this note is to consider how far the Commission's recommended guidelines for the CAP and the supporting material contained in paragraph 18 to 31 of their report accord with our policy objectives for development of the CAP.

PRICE POLICY

2. The Commission state in paragraph 20 that farm income considerations important though they may be, cannot be the sole point of reference for fixing guaranteed prices and that, given the Community's degree of self-sufficiency and bearing consumers' interests in mind, prices must reflect market realities more than they have in the past. In the main statement of guidelines in paragraph 21 they talk of narrowing the gap between Community prices and prices applied by its main competitors in the interests of competitiveness; this could be taken as referring to other exporters' internal market prices as well as their export prices. In paragraph 22 they talk of gradual alignment of guaranteed prices on prices ruling in a better organised world market and use this as a lead-in to discussion of an export policy involving cooperation with other major exporters. The Commission are therefore not setting a clear aim of where Community prices should get to, nor do they specify the period over which they should get there. The guideline set out in paragraph 21 also refers to a hierarchy of prices designed to improve the balance of production: this must be regarded as a secondary point since no further indication is offered of the improvements needed in the present balance. The Commission also point out in paragraph 22 that the policy of common prices presupposes the smooth operation of the European Monetary System and a significant alignment of inflation rates and argue that national and Community policies promoting this alignment must serve to ensure that price decisions do not have to allow for widely differing national situations.

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3. Our own position on price policy as set out in OD(E)(81)(14) is that there should be general price restraint in order to avoid generating structural surpluses. Ministers will need to consider how specific and detailed a guideline on price policy we should seek to have agreed having regard to our national circumstances and the problems of negotiability.

EXPORT POLICY

4. The Commission's second recommended guideline is an active export policy consistent with the Community's international commitments. The further explanation in paragraph 22 includes references to a better organised world market, stabilising world prices by cooperation agreements with other major exporters, and long-term export contracts. There is a reference to not damaging the interests of developing countries. The coherence between the various strands of thought on export policy is none too clear. The Commission also refer to the need to monitor imports that might cause market imbalances and to ensure consistency between commercial and agricultural policies (this is presumably a veiled reference to further import restrictions).

5. We support the Commission's attempts to manage export refunds more economically, particularly where they have a determining effect on world prices, and we are ready to look at proposals to cooperate with other suppliers to maintain the stability of prices on world markets. We support Community participation in international commodity agreements, eg the ISA. But a more active export policy, and long-term contracts in particular, could tend to institutionalise surplus production rather than to reduce the cost of surplus disposal and could aggravate rather than improve relations with other exporters. There are therefore at least potential inconsistencies in the Commission's thinking. Some member states, particularly France and Denmark, will be pressing the Commission to come forward with more specific proposals (there is no necessary link with the price-fixing timetable) and some commitment on this will be a crucial element for them in the package of reforms. Our aim in which we can expect the Germans to support us must be to avoid accepting commitments on export policy which would hinder the overall aim of reducing the cost of surplus disposal. This could be an area where further discussion before November, giving us the opportunity to expose the potential inconsistencies in the Commission's thinking, could be in our interest.

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PRODUCTION TARGETS

6. The Commission's third guideline is the modulation of guarantees in line with Community production targets. A little more explanation is given in paragraphs 23 and 24. The targets would represent a decision on the level of self-sufficiency desired, taking account of import commitments and export possibilities. The mechanisms would vary from product to product but the basic principle is that once Community production targets are met producers would be required to contribute (by levies?) or the intervention guarantee could be reduced (in terms of price?). The existing sugar regime is seen as meeting the requirements; for cereals a lower intervention price would apply for tonnages above a production target corresponding roughly to domestic consumption (of all grains?); for milk the principle of co-responsibility (levies?) should be extended - failing this, other measures will be inevitable (presumably price reductions).

7. The Commission's approach implies the recognition that it is not practicable to solve the surplus problem through price policy alone and that other measures will be needed to influence production and control the growth of expenditure. We agree with this. The problem will be to get effective workable and fair arrangements agreed. The 1981 price-fixing showed the difficulties of this given the conflicting interests of member states. We will need to guard against measures which bear heaviest on larger producers (there will be greater pressure for this from the new French Government) and across-the-board levies which shift the cost on to the consumer. Our preferred mechanism in the milk sector, the super-levy, is not ruled out by the Commission's wording; their failure to mention it explicitly is unhelpful though it is understood that some Commission opinion still supports the concept. The main objective should be to get general endorsement of the principle of additional measures to discourage production in surplus sectors, keeping open the mechanisms to be decided at the 1982 price-fixing.

STRUCTURES

8. The Commission's fourth guideline is an active structures policy tailored to the needs of individual agricultural regimes. Later discussions in paragraphs 27 to 30 suggest that the emphasis would be on the Mediterranean regions, where the

Commission intend before the end of 1982 to propose medium-term programmes covering an integrated policy for incomes, markets, production and structures. This approach is in line with recent experience in the structural sector where we have seen packeages of measures covering a wide spectrum of activities and satisfying mainly regional and social as well as structural criteria. Further structural measures in favour of the Mediterranean regions would be costly to us. But Italy and Greece will clearly regard them as an important element in the restructuring package. They will therefore press for specific commitments sooner than on the Commission's suggested timetable and can be expected to want these included in the conclusions of the November European Council. Our aim must be to avoid any commitments except as a trade-off with measures to limit the cost of the commodity regimes for Mediterranean crops. This will need to be considered further against the background of forthcoming proposals for changes in the acquis in advance of enlargement. In that context we will need to continue to resist proposals for the introduction of a tax on fats and oils.

INCOME AIDS

9. The Commission's fifth guideline speaks of the possibility of income support subsidies to certain producers in specific circumstances. In paragraph 26 it is explained that these should be confined to small producers, subject to Community rules and criteria, and possibly eligible for a Community financial contribution. We cannot object to keeping this possibility alive in the European Council's conclusions although we shall want to test the strength of other member states' interest in doing so. Detailed proposals should only be examined in the context of the price-fixing along with other changes in support regimes, since in our view they could only be justified if they contributed to achieving price restraint.

QUALITY CONTROL

10. The reference in the sixth guideline to improved quality control at Community level is obscure and the further reference in paragraph 25 adds nothing. It is not clear that imposing higher or more rigorously enforced quality standards would do anything to reduce the cost of support but any proposals which the Commission may think useful would be a matter for the price-fixing context.

FINANCIAL CONTROL

11. The sixth guideline also refers to tighter financial control by the Community in the management of FEOGA expenditure. Paragraph 25 states that the Commission should be given its own powers of control in managing the agricultural funds for which it is responsible. We would favour improvements in budgetary control, which will be increasingly necessary if limits on expenditure are to be effective. We are not however aware of any notable lacuna in the Commission's powers. Some clarification will be needed before endorsing any extension of the Commission's powers.

NATIONAL AIDS

12. The Commission's seventh and final guideline is for stricter discipline in relation to national aids to avoid undermining Community policies. There are signs that, in the face of the French disregard for the rules and procedures on state aids and under pressure from us and other member states, the Commission are beginning to refurbish their machinery for monitoring state aids and to take a firmer line with offenders. We would wish to encourage this by focussing on it in the Agriculture Council during our Presidency and by getting the European Council in November to endorse the need for stricter discipline.

BUDGETARY COST OF CAP

13. The Commission state in paragraph 31 that the application of the recommended guidelines will mean that agricultural spending in the years ahead will grow less rapidly than the Community's own resources. Our own position taken at the Agriculture Council price-fixing negotiation (with the support of the Germans and the Dutch) is that the growth of agricultural guarantee expenditure should be markedly lower than that of own resources.

ANNEX A (ii)

COMMISSION REPORT ON 30 MAY 1980 MANDATE:
ISSUES OTHER THAN AGRICULTURE AND THE BUDGET

EUROPEAN MONETARY SYSTEM (PARAGRAPH 10)

1. When the EMS was set up on 13 March 1979 it was agreed that within 2 years it would be consolidated by the creation of a European Monetary Fund and the full utilisation of the ecu as a reserve asset and a means of settlement. This appears to be what paragraph 11 of the Commission's report is calling for. The European Council in December 1980 decided to lift the deadline, and there has been little sign since of any desire for further progress. Thr Monetary Committee and the Central Bank Governors' Committee have been preparing a series of papers examining the technical issues involved but there has been no move to send it back to ECOFIN. The UK will not want to take the initiative on this. If others wish to follow up the passing reference in the Commission report, we could point out that work is already proceeding in the Monetary Committee and Committee of Central Bank Governors following a remit from the Maastricht European Council. If strongly pressed, we should try to arrange for reports on this work to come before the Finance Council at the earliest convenient moment. On no account should work on this subject be remitted to the Commission or any Council Working Group. If others wish to take it forward in the context of the mandate, as Presidency we shall have to take this into account.

2. The Commission reference to "all the Member States participating" is a clear hint that the UK should join the EMS exchange rate mechanism. Whether or not this issue will be pressed remains to be seen.

3. On a more general level, the Commission calls for tighter co-ordination of economic and monetary policies. There is already much discussion of economic policy at Finance and European Councils, but there is little evidence that this influences what Governments actually do. This is principally a matter of political will among the Member States. It does not seem very likely that anyone will want to take an initiative in this field.

INTERNAL MARKET (PARAGRAPH 11)

4. Paragraph 11 on the need for completion of the internal market picks up a recent paper by Commissioner Narjes, which formed a Commission communication to the Council and was discussed at the European Council in Luxembourg, which concluded that a concerted effort must be made to strengthen

the internal market for goods and services. Of the subjects covered by the report, much of the action (for example, proceeding against existing barriers) is for the Commission and the Court of Justice. But during our Presidency we will seek progress in the following areas, which are relevant to the Narjes paper:

(a) Consolidating the internal market for services, in particular the draft insurance services directive and air services.

(b) The proposal for a better exchange of information about new technical barriers.

(c) The draft directive on company accounts.

(d) The "third country" problem which is holding up the programme for harmonisation of standards.

5. The Commission report says that they will take specific initiatives in this field, but it is not clear how work on these can be related to the work on restructuring. Narjes is reported to want to discuss with us the scope for action during 1981 on his paper.

ENERGY (PARAGRAPH 13)

6. We would like to see progress on energy pricing and are prepared to consider ideas for encouraging energy investment (particularly coal). We are content for discussion on measures to deal with oil supply crisis. The reference in the paper to precise targets for energy savings and to production targets is not welcome. We prefer the current flexible guidelines to rigid targets. While we favour informal bilateral exchanges with the oil producers, we are doubtful whether the moment is particularly opportune for the "launching of a constructive debate with oil producers" if this means a negotiation about the price and supply of oil. In any case, negotiations between groups of producers and consumers (eg EC/OPEC) seem unlikely to be fruitful. There will be an Energy Council shortly before the November European Council; the November European Council may wish to review progress.

RESEARCH PROGRAMME (PARAGRAPH 14)

7. The priority research programmes listed either already exist - energy, nuclear safety; have just been agreed - environmental protection; or are already under discussion - biotechnology, the agri-food industry.

8. In 1979 UK Ministers decided that Community R and D was one area where the UK, at minimal cost, could act in a positive manner and demonstrate thereby a communautaire spirit. We thus broadly support the R and D programme and would like to see progress made. However, it is not an area which seems likely to excite great interest among other Member States and we will need to see what the Commission propose before deciding how to take this forward.

NEW TECHNOLOGIES (PARAGRAPH 15)

9. We support the Commission's view that this is a key area where the Community must be able to compete with the Japanese and the U.S. and take advantages of the opportunities offered by the common market. We have already welcomed the Davignon initiative. We hope during our Presidency to make substantial progress on the existing proposals on micro-electronics and telecommunications. We would welcome further practical proposals of the kind suggested in the Commission's report including certain measures for the harmonisation of standards. It would be helpful if we could, in the context of the restructuring discussion, put pressure on the Commission to give a more precise indication of their overall thinking as soon as possible. We should be on our guard against any Community proposals which would inhibit our freedom to encourage incoming investment in high technology industries from the US and Japan.

COMPETITION POLICY (PARAGRAPH 16)

10. We support effective Community policy on State Aids and a reasonably strict application by the Commission of the provisions of the Treaty. We should leave it to the Commission to bring forward proposals to give it better control over other policy areas like transport subsidies and differentiated energy prices. The Germans may possibly wish to push for progress here in the restructuring context.

REGIONAL AND SOCIAL POLICIES (PARAGRAPHS 32-35)

11. Reviews of Regional and Social Policies are due and the report gives some broad ideas. We support the Commission's wish to concentrate our efforts on areas of greatest difficulty and reduce regional imbalances. A better co-ordination of existing instruments is also desirable. We look forward to elaboration by the Commission of the framework set out in this paper. These sectors, and in particular social policies, could assume some importance in the restructuring negotiation, given the new French government's support for them and their, as yet undefined, concept of an "espace sociale Européenne."

REGIONAL FUND (PARAGRAPH 36)

12. We would welcome early proposals for greater concentration of regional fund resources. Greater focus on regions suffering severely from structural under-development, could on the face of it, be intepreted so as to exclude much, if not all, of the UK. We want help for areas in need of structural renewal as well. It is vital that expenditure should not be concentrated in the agricultural areas if we are to continue to draw net benefit from a share in the quota element of the Fund. We believe that the criteria for the non-quota section should concentrate on industrial decline rather than areas which may be affected by the CAP. Only when new criteria have been suggested can we take a view on the relative share which the non-quota section should take. We should not press for proposals to develop a programme approach rather than a project approach, but wait for Commission proposals.

13. The Commission will propose draft Regional Policy Guidelines in advance of the Review. We want these to be available to Member States early in September so that there can be adequate preparation before Foreign Affairs Council discussion in October and November. The Review will have to proceed apace if it is to allow the November European Council to take appropriate account of this area.

SOCIAL FUND (PARAGRAPHS 37-38)

14. We welcome special effort for regions where traditional industries are concentrated and the emphasis on aiding young people. We believe that early

Commission proposals would be helpful; the Commission have said (at the Social Questions Group on 1 July) that they hope to produce an informal note early in September. An expansion of the Social Fund would be to our advantage provided that we continued to derive a net benefit from it. We should leave the Commission to make the running on job creation ideas which we may well not find attractive.

15. The informal meeting of the Social Affairs Ministers in London on 24/25 September will provide the first opportunity to discuss the review of the Social Fund. It would be helpful if the suggested Commission line could be available before then so that Member States could have a well informed discussion. Work could then be remitted appropriately so that progress might be made by the time of the European Council.

COMMUNITY LOANS (PARAGRAPH 39)

16. These make only a negligible contribution to resource transfers between Member States, but are presentationally helpful and can play a modest role in helping businesses. We would welcome an explanation of Commission thinking about ways of helping small and medium-sized businesses. Renewal of New Community Instrument is on the agenda for the September Finance Council.

TRANSPORT INFRASTRUCTURE (NOT IN PAPER)

17. This is not mentioned in the paper and at this stage we should not seek to have it included in work on the Mandate. In principle, we support efforts to strengthen infrastructure links within the Community and improved access between Member States. We now await a separate Commission report on the evaluation of Community interest in this field. Transport infrastructure might still be brought into the restructuring discussions however if this appears helpful at a later stage.

ANNEX A (iii)

COMMISSION REPORT ON 30 MAY 1980 MANDATE

BUDGETARY MECHANISM

1. The Commission's proposal is expressed in general terms, with no illustrative figures. Starting from the proposition that CAP guarantee expenditure is the only part of Community expenditure which raises distributional problems, the Commission suggest -

i. a FEOGA budget mechanism, confined to the UK and limited in time, which would reimburse to the UK a 'fairly high' proportion of the difference between (a) our actual share of FEOGA guarantee expenditure and (b) what our GDP share of that expenditure would have been - this reimbursement to be financed either from own resources or in accordance with FEOGA guarantee receipts shares; and

ii. continuation of the financial mechanism on the revenue side 'if it is needed' - the Commission to make proposals before the end of this year.

EFFECTS ON UK

2. The main point to be made is that the effects of these proposals on the UK would be highly uncertain. They would turn critically on what detailed arrangements we were able to negotiate. The Commission have deliberately avoided tackling the problem of budgetary imbalances head-on, as suggested in the Chancellor's Hague speech, and have preferred instead to suggest a technical adjustment to the Community's budgetary arrangements which is incompletely specified.

3. The attached table illustrates a limited range of possible outcomes, on alternative interpretations of the Commission's proposals. The effects on the UK would depend in particular on:-

a. what proportion of the difference between average FEOGA guarantee and GDP shares the agricultural mechanism would cover - the table illustrates 100 per cent, 80 per cent and 60 per cent;

b. over what period these averages would be calculated - the table assumes three years; and

c. whether or not the financial mechanism would continue - the table illustrates both cases.

The outcome would also depend importantly on a number of more technical details, including the precise rules of the financial mechanism.

/4.

4. If the proposals were already in force in 1981, the UK's net contribution on the assumptions illustrated could be anything between 250 million and 1050 million ecus. Even this range is subject to a considerable margin. If, for example, a slightly different period were used for averaging our shares of GDP and agricultural receipts, and a different assumption were made about the accounting for MCAs, the upper end of the range would rise to some 1300 million ecus.

5. For 1982, the range in the table is from zero to 1585 million ecus. Again, the upper end could easily be higher - for example if our share of Community GDP turns out to be smaller than assumed in the calculations.

6. It is impossible to say that any one of the outcomes illustrated is more likely than any other.

EFFECTS ON OTHER COUNTRIES

7. The report makes no direct recommendations for protecting the Germans' position. By implication it rejects Herr Schmidt's contention that the Germans too have an unacceptable budgetary situation. It does however make a nod in the direction of the Germans by envisaging that the refunds to the UK under the FEOGA corrective mechanism might be based on agricultural receipts shares rather than own resources shares. This could (we think) reduce the Germans' contribution to our refunds by up to some 100 million ecus.

8. If the FEOGA corrective mechanism were of general application rather than confined to the UK, the Germans could in fact benefit significantly from it - by about half (or more) of the amount that the UK benefits. In that event, the main burden of financing the refunds for the UK and Germany would fall on the French and/or the Dutch and/or the Italians, depending on how the scheme was drawn up. But the report specifically confines the mechanism to the UK.

UK NET CONTRIBUTION TO EC BUDGET

	Million ecus	
	1981	1982
1. Before refunds	1990	2710
2. After 30 May agreement	580-730	na
After agricultural correction at:		
3. 100 per cent	420	835
4. 80 per cent	730	1210
5. 60 per cent	1045	1585
After satisfactory financial mechanism as well as agricultural correction at:		
6. 100 per cent	245	0 (net receipts of 40)
7. 80 per cent	555	335
8. 60 per cent	870	710

ASSUMPTIONS

a. The UK does not contribute to its own refunds.

b. Agricultural correction payments in respect of year 0 are determined by:

   i. the average difference between the UK's share of Community GDP and its share of agricultural receipts in years -2, -1 and 0, multiplied by

   ii. total agricultural spending in year 0.

c. The UK's average share of Community GDP is 18.4 per cent in 1979-81 (determining the correction in respect of 1981) and 19.2 per cent in 1980-82 (determining the correction in respect of 1982).

d. The UK's average share of agricultural receipts is, for simplicity, constant at 6 per cent.

e. Total agricultural spending by the Community is 12,675 million ecus in 1981 and 14,200 million ecus in 1982.

f. A 'satisfactory' financial mechanism is one which would reimburse to the UK, in net terms and without qualification, the excess of its share in budget financing over its share in Community GDP in any year, multiplied by the total size of the budget.

g. The UK's share of Community financing is 20.8 per cent in 1981 and 23.3 per cent in 1982.

h. The Community budget is 19,165 million ecus in 1981 and 21,400 million ecus in 1982.

BUDGET ADJUSTMENT MECHANISMS

Summary of Note by Officials on the Legal Issues

(i) A transfer mechanism within the budget, financed by our own resources, would be legally watertight and is the Commission's preferred option. But it would mean raising the 1 per cent VAT ceiling and an amendment to the Own Resources Decision calling for ratification. It would also result in intended net recipients contributing to their own refunds.

(ii) Using negative expenditure to effect the necessary transfers within the budget would be of doubtful legality, since the existing precedents are different in scale and purpose and involve a tax on individuals rather than member states. An amendment to the Own Resources Decision might be required to put the propriety of this course beyond doubt; any such amendment would need to be ratified in all member states.

(iii) A transfer within the budget by the abatement of member states' FEOGA receipts according to an ad hoc key is the Commission's second option. Such a scheme might be satisfactorily based on Articles 43 and 235, if misgivings about its compatibility with the Own Resources Decision and the element of national financing of FEOGA expenditure thereby imposed on certain member states can be suppressed or overcome. It would probably be more difficult to stave off a legal challenge if it were desired to extend the abatement technique to expenditure from the budget as a whole.

(iv) Making transfers within the budget by scoring the necessary contributions as miscellaneous revenue, by analogy with the present arrangements under which adjustments to member states' VAT contributions are effected, would have the merit of drawing on an existing precendent which takes place at member state level. But a transfer mechanism would be a means of altering a correctly managed budget requiring new revenue, and would thus be different in kind and purpose from the relatively small scale adjustments of incorrect payments for which this budget head is currently used.

(v) For a transfer outside the budget, it might be possible to build on the precedent of the informal arrangements agreed between the member states for making ad hoc contributions to the ECSC Budget. If not, a transfer

/outside

outside the budget would require either a Treaty amendment under Article 236, or an intergovernmental agreement, if it were considered that the purpose of the mechanism was to supplement rather than to amend the Treaty. Both would require ratification by national legislatures, and the latter would not be enforceable in the European Court unless specific provisions were included for this purpose.

(vi) An amendment to the Own Resources Decision or an amendment to the Treaty could take two years to complete and would be vulnerable to rejection or delaying tactics by national parliaments. An informal arrangement between the member states could be concluded and implemented much more rapidly but would be unenforceable.

27 July 1981