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OD(80) 20th Meeting

COPY NO 44

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

MINUTES of a Meeting held at
10 Downing Street on
MONDAY 13 OCTOBER 1980 at 10.00 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the Home Department

The Rt Hon Lord Hailsham
Lord Chancellor

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

The Rt Hon Francis Pym MP
Secretary of State for Defence

The Rt Hon Lord Soames
Lord President of the Council

The Rt Hon Sir Ian Gilmour MP
Lord Privy Seal

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry

The Rt Hon James Prior MP
Secretary of State for Employment

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food

The Rt Hon David Howell MP
Secretary of State for Energy

SECRETARIAT

Sir Robert Armstrong
Mr M D M Franklin
Mr D M Elliott

SUBJECT

FUTURE COMMUNITY STRATEGY: RESTRUCTURING THE COMMUNITY BUDGET

CONFIDENTIAL

FUTURE COMMUNITY STRATEGY: RESTRUCTURING THE COMMUNITY BUDGET

Previous References: OD(80) 7th Meeting; CC(80) 21st Conclusions

The Committee considered a Note by the Secretary of the Cabinet (OD(80) 57) covering a Report by Officials suggesting, as a basis for exploratory contacts with other member states and the Commission, the objectives and the means for attaining them that United Kingdom might pursue in the budget restructuring review to which the Community was pledged as a result of the 30 May settlement. It also had before it a minute dated 10 October on the same subject from the Secretary of State for Trade to the Prime Minister.

In discussion the following points were made -

a. Objectives

There was general agreement that the United Kingdom's broad objectives in the restructuring review 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 recurring source of friction within the Community; and to reduce the resource costs of the Common Agricultural Policy (CAP).

b. Reducing the cost of the CAP

On the two broad approaches set out in the Note - price restraint on products in surplus or quantitative limitation - it was argued on the one hand that a price freeze would be unnegotiable with other member countries and should thus be ruled out as a realistic option. The French had made clear that they wanted a 10 per cent increase in support prices in next years's price fixing; the Danes, whose farm-based economy was in crisis, were looking for a 13.5 per cent increase; the gains made by the Free Democrats in last week's German elections might strengthen the influence of the farming lobby in the Federal Republic; and the Dutch and the Italians, as major beneficiaries from the present CAP regime, would resist any serious attempt to hold prices down. It would also be unacceptable to depress British farm incomes still further; they had fallen for three successive years and were likely in 1980 to be 15-20 per cent lower in real terms than in 1979. Rigorous price restraint would thus destroy large sectors of the British farming industry within a matter of years. In the absence of alternative employment possibilities, such a policy would be blamed on the Community and would have grave political implications for the Government. The only major surplus problem was in the milk sector; here the objective should be to negotiate a phased programme of production cuts over a fixed period of years. This could be achieved through the proposed supplementary co-responsibility levy on excess milk production which, since British milk production was falling, could bring a budgetary benefit. Since the United Kingdom was still less than self sufficient, in milk products, it would be better if the restrictions bore on other member states and the British dairy industry were still free to expand. But given that British milk yields were among the highest in the Community, it might pay to work for a freeze on milk production before the others caught up, even at the cost of accepting some control on British output. It was further argued that, since the CAP had never been intended to produce surpluses on the present scale, a proposal that the cost of disposing of the surpluses should be borne by the country which produced them, could not be said to compromise the principle of community financial solidarity. It would still be for the Commission to dispose of the surpluses, but the bill would be paid by the producing country. This idea should be further studied.

On the other hand it was argued that the problem of surplus agricultural production lay at the heart of the budget restructuring exercise and that for the purpose of getting these surpluses under control price restraint was not an option but a necessity. The objective should be to get the real prices of surplus commodities down gradually each year until they reached market clearing levels. This would not be easy; but all member states were now concerned about the mounting cost of the CAP, all faced the 1 per cent VAT ceiling, and even in France and Germany there were voices expressing concern about further CAP price increases. The British Government should try to get agreement with the German Government on the need to put a ceiling on the cost of the 1981 CAP price settlement by holding FEOGA expenditure to the figures in the 1981 Budget agreed by the September Budget Council.

c. Non-agricultural expenditure

It was agreed that, while increased Community expenditure for non-agricultural purposes could only make a small contribution to the United Kingdom's budget problem, it would be important to look at suitable proposals in this field.

d. A progressive element in VAT

It was strongly urged that there should be no question of conceding any increase in the present 1 per cent VAT ceiling even in order to gain some possible economic advantage through the introduction of progressivity into VAT contributions. The ceiling was a most effective negotiating lever for getting the cost of the CAP down. It should be maintained not only for the Community as a whole but also for individual national contributions.

e. A Community oil levy

It was suggested that the idea of a Community levy on imports of oil, which was already in play as a result of an earlier Commission communication, was worth pursuing in the restructuring context as a new Community policy from which the United Kingdom could expect to be the principal beneficiary. Just as the CAP brought advantage to the main agricultural producers, so might the United Kingdom hope to gain from a Community tax on oil if the proceeds were spent on support for energy investment or other programmes in which the United Kingdom could claim a substantial share. On the other hand it was argued that the production tax which would have to accompany the oil levy would complicate the domestic fiscal regime for North Sea oil and represent a totally unacceptable new burden for British industry in general and the energy intensive industries in particular. It was unlikely to be possible to negotiate a Community oil levy scheme that brought the United Kingdom significant budgetary advantage to set against the many other difficulties to which it would give rise. Given the practical difficulties and the likely reaction of other member countries' ~~partners,~~ the idea might in any case not get very far.

f. Corrective systems

It was agreed that the United Kingdom should seek to keep open discussion of a direct budget adjustment mechanism along the lines illustrated in the Report by Officials, following the ideas already floated on this subject by President Giscard and Chancellor Schmidt.

g. Negotiating style and tactics

It was agreed that, though the United Kingdom should continue to oppo breach in the 1 per cent VAT ceiling, no option for restructuring the should at this stage be excluded from consideration and discussion; would be important to avoid getting into an 8-1 confrontation; and British Government should take advantage of the improvement in relati with the French Government to explore with them, as well as with the German Government and other Community partners, where interests were and where they conflicted.

THE PRIME MINISTER, summing up the discussion, said that the Committee endo the general approach proposed in OD(80)57 and the Report by Officials subje the points made in discussion and agreed that it should form the basis for contacts at official level with the other member states and the Commission explore and influence their thinking on the restructuring exercise. It wou be important to stand firm on the 1 per cent VAT ceiling as an absolute lim on member states' contributions throughout these discussions. The British Government should not advocate an oil levy but internal studies of its feasi should continue on a restricted and confidential basis. In seeking to redu the cost of the CAP British negotiators should retain price restraint as a weapon and seek to secure agreement that those who produced surpluses shoul bear the financial responsibility for their disposal; to this end quantitat limits on production could be accepted if necessary. The support of the Ger Government should be sought for keeping FEOGA expenditure down to the limi in the 1981 draft Budget. Before the Anglo-German Summit the Committee woul need to consider the problem presented by the 1981 CAP price fixing and the objectives for CAP reform.

The Committee -

1. Took note, with approval, of the Prime Minister's summing up of the discussion.

2. Instructed officials to be guided accordingly in exploratory bila contacts on the budget restructuring review, and in their continuing of the options available to the United Kingdom.

3. Invited the Minister of Agriculture, Fisheries and Food to circul a paper for consideration by the Committee before the Anglo-German Sum on 16/17 November suggesting what tactics to be adopted for the 1981 Common Agriculture Policy price fixing and how they might be aligned the wider objectives for Common Agriculture Policy reform.

Cabinet Office

14 October 1980

cc Mr Franklin
Mr Elliott

PRIME MINISTER

FUTURE COMMUNITY STRATEGY: RESTRUCTURING THE COMMUNITY BUDGET

As I shall be abroad when OD meets on Monday to discuss the report by officials on Restructuring of the Community Budget, I am writing to give you a few personal observations.

2. I liked the report by officials: I found the careful examination of our objectives and options valuable and interesting. But the remit given to officials was a narrow one, and we cannot sensibly decide our negotiating tactics without deciding how we want the Community to develop as a political organism.

3. I realise that there are deep but genuine differences of opinion about the Community among colleagues: an excellent demonstration of that division of views arose in Cabinet when two weeks ago we discussed a minor issue relating to Commission powers under Article 90. But it is clear from the whole tenor of the officials' report that, had its authors participated in that interesting debate, they would have come to an opposite conclusion to that reached by Cabinet. Nothing wrong with that - but it is relevant to our approach to budget restructuring which must be wholly political - and not economic.

4. For my part I believe that far too much power already resides with the institutions of the Community (particularly the unelected Commission) and not enough with the elected tribunes of the people. The Council often meets too late to influence decisions which have already been pre-empted by officials. The onward march of unnecessary bureaucracy and harmonisation proceeds regardless

of Ministerial misgivings. This is a central criticism of the Community by the British Parliament, and it is in my view the intuitive reason for the growing disenchantment with the EC in this country. The Commission, which people confuse in their minds with the Community, seems to the majority of British people to be a fundamentally anti-democratic body (beside the British Parliament) because the administrative machine proceeds remorselessly forward, often unchecked.

5. Thus at this very early stage (and I agree it is much too early to decide on our tactics) I would make the following comments.

6. It would be quite contrary to the instincts and views of the British electorate - and therefore damaging to our place in the Community in the longer term - if we were to modify our approach to the VAT ceiling even in order to gain some possible economic advantage as through progressive VAT contributions. It would involve a greater volume of own resources and therefore of "taxation without representation" and prove counter-productive with United Kingdom electoral opinion. The same arguments apply (quite apart from the legal dangers) to oil levies, co-responsibility levies and all the other devices for increasing Community resources whether they bring net benefits to us or not.

7. Similarly proposals to increase expenditure in non-CAP areas, even if they proved to be of minor economic benefit to the United Kingdom, diminish our capacity to control the level of public expenditure and involve a continuing re-distribution of resources by taxation from private spending to public provision. This is in complete contradiction to our domestic policies.

8. My own view therefore is that we should hold absolutely firm as a matter of principle (we need not say this publicly) against any increase in own resources by whatever device even if an increase had some ephemeral Treasury benefit in the short term. It follows that, by whatever tactics are thought appropriate, we should reduce CAP expenditure by every means - price, standard quantities, etc - with the aim of achieving a return to a major degree of national financing (see my minute of 14 November 1979). Only in this way will a proper discipline ever be exerted on the present net beneficiaries of the CAP. One of the misfortunes for me of the Budget negotiations was that we had very nearly achieved this objective as a result of French threats, but we lost the opportunity when we accepted a temporary settlement.

9. Furthermore, it follows that I favour slowing down the move towards enlargement until such time as this objective is achieved: otherwise we will be assuring for ourselves either intolerable friction with Spain and Portugal or intolerable burdens.

10. I realise that some colleagues will profoundly disagree with this approach which is of course "anti-Communautarie" as that phrase is sometimes defined. But I strongly favour our place in the Community; it is inconceivable that we could leave it. My fear is that under pressure from some colleagues the Conservative Government will so distance itself from electoral opinion on Community issues that we will create a real anti-Communautaire spirit in the country as a whole. In the reform of the Budget structure we have a unique opportunity to reform the Community in our own domestic image. If we throw away that chance either for narrow economic gains or for the sake of some easy consensus with our partners it will be the Community, the UK and the Conservative Party that loses in the longer term.

11. I am copying this minute to other members of OD, to Keith Joseph, Jim Prior, Peter Walker, David Howell, John Biffen and to Sir Robert Armstrong.

J. N.
(dictated by the Secretary of State and signed in his absence)

Department of Trade
10 October 1980