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In PM's Mtg  
forwarded 13/5  
cc Press Office

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PRIME MINISTER

COMMUNITY BUDGET

... I attach the Treasury paper on which I spoke earlier today which sets out the latest estimates of the effects on our net contribution of the proposals discussed at Luxembourg.

2. We are all agreed on the need to secure a 3 year settlement with a suitable review clause. A 2 year deal would be difficult to present as an advance on what was offered at Luxembourg.

3. The Treasury paper brings out the importance of securing a settlement that determines the size of our net contribution. Once that is fixed, we are protected from increases due to inflation and the growth of the Community Budget. The importance of this point can be illustrated by developments since Dublin. We have agreed to negotiate on the basis of Commission estimates of our net contribution on an 'importer benefits' basis. The Commission document that was discussed at Luxembourg estimated this as 1683 m.u.a. for 1980 and the Commission has subsequently said that the price package and the higher trend of agricultural expenditure would increase that figure by something

/like 100. But



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like 100. But there is now no reason to suppose that there will in fact be negative UK MCAs in 1980 to justify the reallocation of the 130 meua that explained the difference between the Commission's importer benefits figure (1683) and their exporter benefits figure (1813). There are also one or two other ways in which the Treasury think that the Commission's estimates may be understated. As a result of all these factors, the Treasury's best estimate is that our net contribution before adjustment in 1980 will be over two billion mua.

4. It would not of course be sensible to tell the other countries that we are convinced that the Commission estimates are too low. The larger our net contribution turns out to be, the higher the cost to the other member states of the refund needed to bring it down to the figure agreed.

5. For future years it may be advantageous, at some stage in the negotiations, to show some flexibility, on the method. We must, of course, repeat our willingness to index 538 in line with the increase in the Community Budget. But, if we conceded any increase in the 538, that increase would also be indexed and the resulting figures for 1981 and 1982 could rise quite high. A more favourable formula in these circumstances would be one derived from a suggestion made by the Germans in Luxembourg and referred to in paragraph 6 of the attached paper. This would be as

/follows. Our





follows. Our net contribution would be decided for 1980. The resulting refund would then be calculated as a percentage of the net contribution that we would have made without it. In 1981 and 1982 our unadjusted net contribution would then be reduced by the same percentage.

6. A third possibility would be to set arbitrary figures for 1981 and 1982 (just as 538 was arbitrarily chosen for 1980). We might perhaps offer, if we could not do better, 849 as our net contribution in 1982. This is the same figure as the Commission's estimate of our net contribution in 1979 and it was at one stage suggested by the French as the appropriate net contribution for 1980. (By 1982 it would of course be appreciably smaller in real terms than that sum was in either 1979 or 1980).

7. The Treasury's estimates of the effects on our net contribution of the three formulae mentioned above are set out in the table below. They are based on realistic assumptions and not, of course, on the figures used in negotiations. The figures shown for 1982 are highly speculative because of the difficulty of making sensible assumptions about what will happen when the Community hits the 1% VAT ceiling as it certainly will do by 1982. (This point is explained in paragraph 11 of the attached paper). But the table does at least give an indication of what is at stake for us:-

1980   1981   1982



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	<u>1980</u>	<u>1981</u>	<u>1982</u>
(1) UK net contribution before adjustment	2,027	2,352	2,715
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(2) UK proposal at Luxembourg	538	673	<u>828</u>
(3) Constant percentage reduction (538 implies 73½% reduction on 2,027)	538	624	719 →
(4) Arbitrary figures	538	700	849
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(5) Line (2) starting at 575	575	719	885
(6) Line (3) starting at 575 (which implies 71½% reduction on 2,027)	575	670	774
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8. I take this opportunity to record three more detailed comments on this subject. First, we cannot favour the French idea that the review at the end of our settlement should 'cover limits to the net benefits of the above average GNP countries'. That seems likely to antagonise the Danes and the Benelux /countries and





countries and it seems much better to let their irritation be directed at the French rather than at us.

9. Second, it is possible that during this month's negotiations someone will repeat the suggestion to drop the use of the amended Financial Mechanism and an Article 235 Regulation, and substitute a simple provision determining our net contribution for 1980 etc. If so, we should certainly follow up the opportunity. We should be spared a major bureaucratic effort as well as avoiding risks of delay or shortfall in our refunds. Moreover, such a simple provision would move us away from the test of 85% of average Community GNP per head in the Financial Mechanism, on which we could be at risk if sterling continued strong relative to other Community currencies.

10. Third, when we announce the settlement, we shall need to take precautions to ensure that the net contribution of 538 mua in 1980 is not subsequently attacked as misleading by critics at home who discover that the 538 does not include our contribution to unallocated expenditure (mainly aid financed from the Community Budget) estimated at about 160 mua in 1980. It would not be wise to jeopardise our chances of securing confirmation of the 538 by seeking to change the basis of the figuring in the negotiations; but we shall need to make it clear when announcing the decision at home precisely what the relevant definition of 'net contribution' is.

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11. I am sending copies of this minute and enclosed paper to the Foreign and Commonwealth Secretary and Sir Robert Armstrong.

*GH*

(G.H.)  
12 May 1980



BUDGETARY EFFECTS OF VARIOUS PROPOSALS

DISCUSSED AT LUXEMBOURG

This note provides estimates of the UK's net contributions for 1980 and 1981 (and to some extent for 1982) based on Commission forecasts but taking account of the agricultural proposals discussed at Luxembourg. It also looks at the effects of the two main formulae for a settlement which were suggested by the British and French delegations.

Calculations used in the negotiations

2. The final British proposal was a ceiling on our net contribution of 538 meua in 1980, uprated for 2 years by the growth in the total EC Budget. Assuming a budget growth of 20% this produces a figure of 645 meua in 1981, and 775 meua in 1982.
3. The first French proposal, as reported to us, was for a fixed UK net contribution of 849 meua in each of the three years 1980, 1981 and 1982. The French then had second thoughts and at Luxembourg they proposed 849 meua in 1980 followed by reductions in our net contribution in 1981 and 1982 equal to the reduction in 1980.
4. The final French (and German) proposal at Luxembourg set a ceiling of 538 meua for 1980 only in a two year arrangement, followed by a repetition in 1981 of the reduction given to produce 538 in 1980. President Giscard is said to have estimated that repeating the 1980 reduction would leave the UK with a net contribution of 800 meua in 1981. This was the basis for President Jenkins' claim that the two parties were only 150 meua apart.
5. It looks as if President Giscard was working on the following figures for the uncorrected UK net contribution:

1980	1783 meua (1683 + 100 for the agricultural settlement)
1981	2045 meua (1783 - 538 + 800)



Thus he recognised that the Commission's estimate of 1683 would be raised by a 5% agricultural settlement. Even so, we regard his figures as very much at the optimistic end of the range of possibilities, so that the difference between the British and the Franco-German positions was in fact greater than Jenkins alleged.

6. At an earlier stage in the discussion in Luxembourg, it was suggested to Heads of Government by officials that one possible formula would be to divide the financing of the UK's net contribution each year between the UK and the other eight member countries on a percentage to be agreed. The Germans, who originated this proposal, suggested that a 50/50 division might be appropriate.

Updated figures for the EC Budget and the UK's  
net contribution

7. The agricultural measures described at Luxembourg will affect both the size of the Budget and the UK's net contribution. In addition the Commission have admitted that their previous estimates of agricultural spending in 1980 are far too low. The calculations described above take some account of all this. But the French estimates start from a figure for the UK's net contribution which assumes - unrealistically in our view - that the UK will have negative MCA's in 1980.

8. In fact the UK's uncorrected net contribution to the allocated budget is now likely to be at least 1913 meua in 1980. The increase from the Commission's earlier estimate of 1683 meua arises from our removal of the Commission assumption about negative MCA's (130 meua) as well as from the effect of higher agricultural spending, including the proposed price package (100 meua) and the sheepmeat proposals (trivial in 1980; about 15-20 meua in 1981). Our best estimate is that our uncorrected net contribution is likely to be just over 2 billion eua.

9. Forecasting the UK's net contribution for 1981 is a formidable problem. As part of their Triennial Estimates the Commission have



produced forecasts of the total EC Budget for 1981 on two alternative hypotheses, but no estimate of the UK's contribution. Even on optimistic assumptions about the growth in the EC Budget and other factors affecting our net contribution (eg growth in UK duties and levies and VAT share), the UK's net contribution in 1981 is likely to be higher than in 1980 (about 2090 meua). On more realistic assumptions about the growth in agricultural spending, the Community may exhaust its own resources available within the 1% ceiling and may require special measures eg on the form of national financing, to accommodate a UK refund within the ceiling. This implies a growth in the total budget of about 25%. On this basis our central estimate of the UK net contribution in 1981 would be around 2350 meua.

10. These calculations are summarized in the following table:-

	MEUA			
	Optimistic assumptions		More realistic assumptions	
	1980	1981	1980	1981
Total Budget	15,800	18,950	16,300	20,400
UK net contribution without adjustment	1,913	2,088	2,027	2,352

11. No estimates are offered in this paper for 1982, by which time it seems highly probable that the Community Budget will have reached the 1% VAT ceiling. The most probable outcome appears to be that the momentum of budgetary growth will continue and will, by one means or another, be accommodated. We shall hardly be in a position to resist indefinitely the provision of extra revenue because we shall need a new agreement to refund a large part of our contribution when the 2 or 3 year settlement now in prospect expires. Other members will want to raise the 1% limit for the same reasons as led them at Luxembourg to support a 5% agricultural price increase. In these circumstances, the UK's net contribution is likely to go on rising.



British and French proposals: revised estimatesa. British Formula

12. At Luxembourg a 20% annual rate of growth in the budget was used as a rule of thumb for calculating the effect of an offer to increase 538 meua for 1981 and 1982 in line with budget growth. That gave figures of 645 and 775 meua. Our present view is that growth between 1981 and 1982 is more likely to be nearer 25%, producing 673 in 1981 under this formula. This is a relatively small difference. The refunds to arrive at these figures could vary a great deal however, according to the scale and pattern of our imports and to other factors affecting our net contribution, as well as the growth of the budget.

b. French Formula

13. The effect of the French formulae as presented at Luxembourg (see paragraphs 3-5 above) is of course highly sensitive to the growth in the UK's net contribution before adjustment. On optimistic assumptions, there is not very much to choose between the French and British proposals in 1981. If the 1980 ceiling were set at 538, our net contribution in 1981 on the optimistic case described in paragraph 9 would be 713 meua, compared with 645 meua on the British proposal; with a 1980 ceiling of 849, our net contribution in 1981 would be, on the French formula, just over 1 billion eua.

14. These figures rest on a small rise in our uncorrected net contribution in 1981. On less optimistic assumptions, the difference would be greater. If the first year ceiling were set at 849 meua, the French formula would leave us with a new contribution of 1174 meua in 1981, about 500 meua higher than with the British proposal. Even if the ceiling were set at 538 in the first year, the British formula would be about 190 better than the French. If, as is quite possible, the rise in the UK's uncorrected net contribution were steeper, the difference between the two proposals would, of course, be more pronounced.



15. The above comparisons are summarized in the table below:-

UK Net Contribution

MEUA

	Optimistic assumptions		More realistic assumptions	
	<u>1980</u>	<u>1981</u>	<u>1980</u>	<u>1981</u>
Unadjusted	1,913	2,088	2,027	2,352
British proposal	538	645	538	673
French proposal				
(a) starting with 538 meua	538	713	538	863
(b) starting with 849 meua	849	1,024	849	1,174

Comparison of the proposals

16. The British proposal has two very important advantages for us. By focusing on our net contribution it meets our argument that the Community should consider what is an equitable net contribution for the UK; and it frees us from most of the risks of a steep growth in our uncorrected contribution. The French proposal implies that our contribution after refund will grow between 1981 and 1982 by the same absolute amount in cash terms as it would have done before refund. The British proposal limits the possible rise in percentage terms to the growth in the budget. Unless there is a very dramatic improvement in the balance between our share of receipts and contributions, the British formula will yield more in the second and any subsequent years.