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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

EEC BUDGET: FORMS OF PRESSURE

Note by the Secretaries

The attached note by officials is circulated for consideration at the Committee's meeting on 25 January 1980.

Signed ROBERT ARMSTRONG  
R L WADE-GERY  
R M HASTIE-SMITH

Cabinet Office

22 January 1980

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EEC BUDGET: FORMS OF PRESSURE

Note by Officials

1. The attached papers deal with the possibilities of withholding contributions to the Community budget or obstructing Community business if what we are able to achieve at the next European Council is so inadequate as to justify such a shift in our negotiating strategy.

2. The four papers are -

Annex A. a note by the Official Steering Committee on European Questions on the action which could be taken to obstruct Community business during 1980;

Annex B. a note by the Treasury on the practicabilities and implications of withholding some or all of the United Kingdom's gross contribution to the Community Budget;

Annex C. a note by the Foreign and Commonwealth Office on the effects which withholding or obstruction might have on our position within the Community and the prospects for a successful outcome of the budget negotiations.

Annex D. the advice of the Law Officers on the legal implications of withholding in domestic law (Mr de Winton's letter of 17 January). Earlier advice from the Law Officers on the implications in Community law was circulated with OD(79)35.

3. These papers are designed to enable Ministers to assess the merit and demerits of alternative courses of action on a contingency basis. Whether either of the alternatives will be necessary will depend on the readiness of other member states to move towards our position and the decisions of Ministers as to what an acceptable outcome to the negotiations would be. Although the withholding of contributions could of itself achieve the purpose of reducing our net contribution to acceptable proportions, it is assumed that neither withholding nor obstruction would be an end in itself but a means to secure a satisfactory negotiated settlement on the budget issue, and that once that objective is achieved the action would be discontinued.

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Ministers will accordingly want to choose the course of action which seems most likely to be effective in bringing the negotiations to a speedy and satisfactory conclusion.

4. It is not necessary and indeed may not be desirable for Ministers to take final decisions at this stage about which course of action they would if necessary take. It will make a good deal of difference whether after the next European Council we are very close to, or very far from a satisfactory solution; and whether we are isolated, in a minority, or in a majority. We shall need to assess whether to lower our rights or whether our aims can be best achieved by shock tactics, or by phasing in the cost to the rest of the Community. In all this we shall need to take account of the economic and political prospects in the Community and the state of expectations and political opinion in the United Kingdom. During the course of the next few weeks we may obtain fresh evidence about the likely reactions within the Community. But the Prime Minister will wish at this stage to discuss with her colleagues the ranges of action we would take or threaten to take if the meeting itself proves to be unsuccessful. These papers primarily concern the period between the next European Council and the one scheduled for June.

5. The paper on obstruction (Annex A) rejects the policy of the empty chair and suggests that the choice lies between -

- i. a policy of generalised obstruction
- ii. a policy of blocking all Council decisions involving major increases in Community expenditure which did not reduce our net contribution
- iii. selective obstruction directed at individual member states or individual issues judged at the time to be susceptible to pressure.

Course iii. would be the most appropriate if only one or two member states were holding out against a solution acceptable to us and the majority of the rest of the Council. This is not however a very likely prospect. Course ii. would be the easier to defend and, although it might still bring us into conflict with the European Parliament, would in practical

terms be only slightly less effective than i, provided that our Community partners were willing to recognise our right to invoke the Luxembourg compromise to block the decisions in question. None of them could be pursued without difficulty for the United Kingdom, though the risks in i. would obviously be greater than in the others. Even blocking the 1980/81 agricultural price fixing, which is probably the most significant issue we would be able to block, would not be painless for the United Kingdom.

6. The paper on withholding (Annex B) suggests that the point at which to act would be in stopping transfers from the EEC No 1 Account with the Paymaster General to the Commission's account at the Bank of England, from which transfers across the exchanges are made. The simplest course would be to block all such transfers. We would announce our intention to withhold for "the time being" without specifying how much would be withheld or how long the policy would continue, and we could relate our policy to the circumstances in force at the time of the Council. At the same time we could make it clear that in our view the United Kingdom had a strong case for reform under the terms of the Treaty. It would be possible thereafter to release payments as a flexible response to any signs of movement towards our budget target. A second possibility, favoured by the FCO, would be to calculate the amounts due in such a way as to limit the amount withheld to our VAT contribution. A third possibility would be to make no remittances initially but to indicate at the outset that it would not be our intention for the year as a whole to withhold a sum in excess of our VAT tranche. On the Commission's now rather outdated figures, this is likely to be about 1522 million EUA in 1980, compared with a net contribution estimated at 1814 million EUA or 1552 million EUA, depending on the attribution of MCAs.

7. The earlier advice of the Law Officers (in OD(79)55) made it clear that it would be impossible for us to argue successfully before the European Court that we were entitled to withhold our contribution, and that there was a real risk of the Court making, almost immediately, an order for interim measures which might allow the Commission to withhold payments due to us or require us to make, on a provisional basis, the very payments we were claiming to withhold. It follows from this advice of the Law Officers

that in the absence of prior domestic legislation (in practice, an amendment of S.2 of the European Communities Act 1972, a decision to withhold could thus involve Ministers in giving directions (which would themselves be unlawful) to officials to act in breach of their legal duties or in formally relieving officials of responsibility for acting illegally and assuming that responsibility themselves.

8. The Law Officers have now advised (Annex D) that the risk of the Commission or an individual instituting successful proceedings in the United Kingdom courts is too significant to be disregarded. Unless it was decided to run that risk, and legislate only in the event of such proceedings, prior legislation would be required if withholding were to be the chosen course. In the view of the Law Officers the inevitable effect of such legislation would be to suspend to some extent the operation of Section 2(1) of the European Communities Act 1972 and thus to deny the supremacy of Community law over domestic law. The advance introduction of legislation along these lines would be an act of the highest political significance. It would be seen at home and abroad as calling into question the Government's commitment to the Community, and might well produce adverse reactions among our partners of a totally different quality from those aroused by the act of withholding itself. It would also be bound to reopen in Parliament and in the country at large the debate about our membership of the Community and the sovereignty of Parliament.

9. The question whether we have a case in Community law under Article 175 (which enables a member state to bring an action against the Council or the Commission for failing to act, in infringement of the Treaty) has already been raised and the Attorney General is reassessing the prospects on the basis of a further paper by the Treasury. In brief, the argument would be that the effect of the budgetary arrangements and the Community's policies is to frustrate the achievement of the Community's objectives by making it more difficult for the United Kingdom's economic performance to converge with that of the other member states and more difficult for the United Kingdom to fulfil its own treaty obligations. This is certainly a case that could in any case be deployed politically in support of either withholding or obstruction, whether or not we took the issue to the European Court ourselves. But there is no doubt that, were we to take such a case to the

Court (which would require us first to call on the Council to act within the two months prescribed in Article 175) effective negotiation within the Community would be suspended until the Court had ruled and our negotiating hand would be gravely weakened if we lost.

10. Annex C on the consequences of withholding or obstruction draws attention to a range of possible reactions by the Commission or other member states. It is clear that, if taken, these could sooner or later create serious difficulties for us; see paragraph 10 of Annex C. The FCO paper takes the view that, although there would be some scope for delaying such action, it would be likely to follow if we were either to obstruct or to continue withholding following a ruling of the European Court against us. It concludes that a policy of obstruction - particularly if limited to financial obstruction - would be more effective than withholding in bringing about a budget settlement and would be less damaging to our general position in the Community.

11. It has not been possible to arrive at an agreed assessment either about the risks of the two courses of action or about their effectiveness in achieving the objective of a satisfactory settlement. This is hardly surprising. We would be entering largely uncharted waters. The decision of the French Government to defy the European Court judgement on sheepmeat has undoubtedly created a new situation but there is no agreement on whether it is a precedent which we could exploit to negotiate a settlement even after an adverse ruling from the Court. Whether other Member States would be more annoyed by obstruction than by withholding can only be a matter of conjecture, when for obvious reasons we cannot ask them. The FCO paper argues that withholding would be regarded by our partners as a much graver affront from obstruction. Against the analysis in the FCO paper it can be argued that the inherent strength of our case must have affected the climate of opinion in Europe and hence that the reaction even to withholding would not be so violent; that a policy of obstruction would be more annoying and obtrusive than withholding; and that, since possession is nine-tenths of the law, withholding our contribution could be more effective in bringing about a final settlement as well as easing the PSBR constraint at home.

12. The judgement of the Community's attitude is relevant to our decision which method to choose and how to present it. If it were the case that the rest of the Community would take less offence at straight withholding than the disruption of Community business, then it would be possible to deploy the argument with them that we were resorting to temporary withholding in the hope of minimising the disruption inside the Community. If, on the other hand, the Community would consider withholding to be the more heinous, then it would be more sensible to try the tactic of obstruction first and hold the possibility of withholding in reserve. We might in any case also find it difficult to limit our pressure to withholding and to claim to be co-operative in all other areas, if on their merits we found it necessary during the same period, eg to block the CAP price fixing or the 1980 Budgets.

13. As regards the internal political considerations, the crucial issue in the light of the Law Officers advice would seem to be the point at which it might be necessary to resort to domestic legislation to avoid the risk of action in the United Kingdom courts. It would be highly embarrassing for the Government to have to back down if, following a Government decision that legislation affecting Section 2 of the European Communities Act would be politically unwise, a United Kingdom court were to find against them in an action resulting from withholding. There could be no guarantee that such a situation would not arise before we reached a settlement; yet the considerations set out in paragraph 8 above suggest that it would be even more embarrassing if the Government felt obliged to legislate before withholding.

14. On timing, we are publicly committed to a solution which is effective as from 1980, although the Prime Minister has noted that the United Kingdom's financial year 1980/81 runs into the Community's budget year 1981. Both the papers on withholding and obstruction effectively assume that, in the first instance, we are dealing with the period between the next European Council and the one scheduled for June. Ministers will need to judge the effect on domestic political opinion and attitudes towards the Community of shock tactics on the one hand and a long drawn out argument on the other. Different considerations might in any case apply,

particularly in the agricultural field, if obstruction were to be continued beyond June; for example, if we were to block a decision to extend the sugar quotas after they expire on 30 June the result would be that France would gain and we would lose. These considerations would need to be examined in detail, once Ministers had taken a decision between withholding and obstruction.

15. The conclusions which emerge from these papers are -

i. Withholding would have the great merit of enabling us to reduce our net contribution to the budget ourselves. But it would be illegal. It could also have politically serious implications if we were obliged to amend the European Communities Act, either in advance or as a result of developments, as a protection against or a response to action in the United Kingdom courts.

ii. A campaign of obstruction as described in these papers would be legal and might be capable of more flexible application than withholding, but its effectiveness would depend on the willingness of other member states to acquiesce in our invoking the Luxembourg compromise to block in particular the 1980 and 1981 Community Budgets and the CAP price-fixing.

iii. Both courses of action would have an impact on the negotiations but counter-measures would be likely to follow in either case. Withholding is, by its illegal nature, a higher risk policy than obstruction.

iv. Decisions on the appropriate course of action will be determined by the outcome of the next European Council, but the Prime Minister will wish to have a clear picture, and to be in a position to give some indication at that Council, of what further steps we would take in the event of failure.



v. If it is decided to obstruct, the best course would probably be to block all proposals for major new Community expenditure which did not improve our budget position.

16. We are not able to offer an agreed assessment as to how quickly or vigorously the rest of the Community would react to a decision by HMG to withhold or to obstruct (and therefore how damaging that would be to our long-term position within the Community); nor whether withholding would be more or less likely than a policy of obstruction to shift the negotiating position of our Community partners in our favour.

17. The questions remaining for consideration in the light of the assessments in these papers and the advice of the Attorney General are therefore -

i. Which course of action is more likely to be effective in bringing about a satisfactory negotiated settlement of our net contribution problem? .

ii. If withholding is thought to be the more effective, do its merits in this respect, plus the fact that it would give us control over our own contributions (ie enable us to keep the money), outweigh the political and legal consequences that it would entail both at home and in the Community?

iii. If these political and legal consequences tilt the balance against withholding, should contingency planning continue on the basis that obstruction of expenditure decisions which do not improve our Budget position should be tried first and that withholding should be kept in reserve?

Cabinet Office  
22 January 1980

FOLLOW UP TO DUBLIN EUROPEAN COUNCIL CONTINGENCY PLANNING  
OBSTRUCTION WITHIN THE COMMUNITY

Note by Officials

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PURPOSE OF THIS PAPER

1. This paper suggests how, in the event that the next European Council fails to solve the Budget problem and in the event of a Ministerial decision so to do, we could obstruct Community business in a way which would hurt or inconvenience other Member States more than ourselves. The aim would be to bring home the gravity of the problem and the strength of our resolve, and to put effective pressure on other Member States to agree to a satisfactory solution on the Budget. The paper assumes that the period of obstruction would begin at the end of February 1980.

HOW WE WOULD OBSTRUCT

2. The power of a single Member State to block is extensive but not absolute. There is no difficulty in blocking Community adoption of instruments which require unanimity. It is usually possible also to block progress on instruments which can under the Treaties be adopted by a qualified majority vote. In the last resort, if other Member States are determined to take a decision and to apply a voting procedure, we can invoke the Luxembourg Compromise (essentially an agreement to disagree) in order to oppose the taking of a vote. It is not certain what would happen if one Member State attempted to use the Compromise repeatedly in order to bring large areas of Community activity to a stand-still. The Compromise has no legal force, and it must be assumed that other Member States and the Commission would aim to find a way around the obstacle. The French have hitherto firmly upheld the principle that a vote cannot be taken if one Member State opposes it on the grounds that an important national interest is at stake. But if a Member State used the Luxembourg formula not to protect national interest on the issue in question but to block progress on another (the budget), or in a way which threatened (for example) the continued operation of the CAP, practical interest might outweigh the principle of the formula. It should however be noted that it was failure to agree on CAP financing which caused the Compromise to be formulated originally.

3. The Annex to this paper summarises and analyses the main Community business likely to come up for decision in the period March to August 1980. While obstruction on some of these issues would cause real problems for other Member States, and there are some where retaliatory action by others would cause real problems for us, there is a number of subjects on which our obstruction, at least for a period of a few months, would cause real damage to neither the UK nor other Member States; but would irritate and delay Community business. The effect would be cumulative. The sense of frustration and the need to find ways round each new obstacle would create and deepen a real feeling of crisis within the Community without actually bringing it to a halt.

4. The analysis shows where there could be a budgetary cost to the UK if we agreed to the proposals coming up for decision in the period, and it seeks to identify those proposals which would increase our budgetary deficit, as candidates for obstruction.

#### THE OPTIONS

5. There are essentially three options:

- (a) obstruction across the board;
- (b) obstructing all measures which would involve a significant additional net budgetary contribution by the UK, subject possibly to minor exceptions - for example to take account of effects on our relations with third countries;
- (c) limited obstruction designed to block only proposals where other Member States' interests would clearly be hurt (thus putting pressure on individual Member States) or proposals where a clear UK interest existed in avoiding concessions allowing progress.

6. Whichever, if any, of these courses we might adopt, we would need throughout to stress our desire to return to full co-operation as soon as the solution to the budget problem was agreed. Any campaign would have to be carefully managed in the light of the following considerations:

- (a) need to avoid damage to ourselves or the Community as a whole on a scale such as to prejudice solution of the budget problem and the resumption of full co-operation;
- (b) desirability of achieving some flexibility of response, to take account of the developing situation;
- (c) possibility of escalation of obstruction.

7. As regards general obstruction, we could in theory imitate the policy of the empty chair which the French adopted between July 1965 and January 1966. But this is not an attractive option and the Prime Minister has already come out against it in Parliament. General obstruction therefore means pursuing legal and procedural devices to secure delay as a deliberate act of policy on all Community business. A variant of this is obstruction on all matters other than those where there was a clear UK interest. The practical effect would however be the same as general obstruction. Other countries would not let us have the decision which suited us if we were being generally obstructive. A policy of general obstruction, slowing down or even paralysing a large number of activities could do a great deal of damage to the Community; and other Member States would be increasingly dismayed by the effects. These options would risk producing early and vigorous retaliation. We would have to depend on the effects of our actions being sufficiently damaging to reduce the other states to submission in a relatively short time. The prospects for this are not good.

8. Option 5(b) (blocking all measures which would involve an additional net budgetary contribution by the UK) has the attraction that it is logical. Our public position would be simply that it is for us, in the absence of a budget solution, not possible to accept measures which involved an increase in our net budgetary contribution, notably on agricultural price increases and the 1980 and 1981 budgets. We could argue in the Community that we had no wish to disrupt the Community or its relations with other countries.

9. Option 5(c), limited obstruction on specific proposals where other Member States' interests would clearly be hurt, would put pressure on individual Member States, possibly those who had been least helpful on the budget. It would not hold up Community business as a whole.

10. The degree to which these policies would be likely to attract retaliation is an important consideration. It is discussed in a separate paper.

Cabinet Office

3 January 1979

A. INDIVIDUAL MEASURES WHICH COULD BE BLOCKED: BUDGET AND CAP

1. The two most important activities which could be blocked are the Community Budget itself and CAP price increases. The third area is the whole range of other current Community business.

(a) The Community Budget

With the European Parliament's rejection of the 1980 Budget there could now be opportunities to block or delay agreement. Our partners, other than perhaps the Italians, are likely to want early adoption since the Commission will probably not be able to meet its commitments on CAP spending, at least after April. This may be a useful point of pressure; it is now clear the new 1980 Budget will not be established until after the next European Council. On the 1981 Budget it would be theoretically possible (provided our resort to the Luxembourg Compromise was accepted) to veto all of it or substantial parts of it. Vetoing provisions on the milk sector for example could well attract Italian and Parliamentary support. This might be more effective than blocking the Budget as a whole since, if the Council were ready to establish the Budget without an entry for the milk sector, it would not lead to the "provisional twelfths regime". But decisions on the 1981 Budget are not taken by the Member States until July at the earliest. A stated intention to oppose all or parts of the 1981 Budget could demonstrate our determination within the period we are considering, but effective action would fall outside it.

(b) CAP prices

We could attempt to block an increase in CAP prices on which negotiations are likely to be in full swing in the months March to August. To block prices one of three conditions would have to be met:

- (i) the Commission initially propose a total freeze and, with our support, refuse to change their proposal; or

- (ii) the Italians support us in preventing a qualified majority for any increase in any of the major products; or
- (iii) we successfully invoke the Luxembourg Compromise to block agreement even though the Commission and all other Member States are united against us. It should be remembered that the text of the Luxembourg Compromise specifically provides that common prices for milk, beef and veal, rice, sugar, olive oil and oil seeds shall be adopted by common consent. A successful blockage would have the same effect as a freeze i.e. current prices would continue.

There is little doubt that blocking action on CAP prices will cause bitterness and there is a grave danger that other United Kingdom interests, particularly in agriculture, will suffer. The most difficult problem will be to secure access for New Zealand butter after 1980; it will be very hard to get this issue settled before the price-fixing. Failure to obtain a satisfactory settlement will be most damaging to the New Zealand economy and failure is very likely if we insist on a price freeze. (We might want a green pound devaluation but this is less likely in 1980.) As long as we refuse to agree to any price increase, there will be greater difficulty in obtaining reforms of the CAP - and more than a price freeze will be needed to reduce surplus production. But the Commission's proposals for economies are particularly unsatisfactory for United Kingdom agriculture and the essential basis of CAP reform must be a sustained price freeze. Such a freeze is also the most powerful lever we have to secure a satisfactory solution on the Budget.

(c) CAP Programmes

We could also block progress on any new CAP programmes likely to be under discussion. These are: sheepmeat, potatoes, alcohol, structure. Sheepmeat and alcohol could give us a net resource benefit. But we will get no net financial benefit from structures (budget contributions circa £65m over five years) and we have other reservations about alcohol (despite a resource gain, £6m per annum). Negotiations on the potato regime are at too early a stage to determine whether a regime of benefit to the UK can be achieved, but we have lost the ability to control imports of main crop potatoes.

- (d) The routine operation of the CAP involves a large number of routine decisions which are made by the Commission on the advice of the Management Committees. We need the good will of the Commission and Member States on these decisions to prevent damage to our agricultural industry. We need to maintain a reasonably amicable day-to-day relationship on the detailed working of the CAP.

## B. MISCELLANEOUS MEASURES WHICH THE UK COULD OBSTRUCT

2. This section of the paper summarises areas of Community business where decisions are expected in the period after March 1980 and where obstruction by the UK seems feasible. The items at the top of the list appear to be better candidates for UK obstruction than those at the bottom.

(a) Implementation of Three Wise Men's Report

Considerable scope for obstruction. No real damage would be done to the interests of any Member State, including the UK. Likely to be under discussion in Foreign Affairs Councils leading up to next European Council. But no logical link with the Budget.

(b) Company Law

We intend to obstruct work on the Scission directive (annoying the French) and could obstruct the European Company Statute (annoying the French and the Commission), which are of no interest to us. The directive on group accounts is unsatisfactory in its present form and we could live with delay.



(c) Research Council

There will probably be a Research Council on 12 May 1980, which will resume discussion of the Joint Research Centre and the Fusion Programme, both of which were blocked largely through French intransigence at the 20 December Research Council. Other Member States are on the whole keener on these projects than the UK. Blocking them would cause us no real damage. The Italians would be the most affected and would resent UK obstruction. We have a strong interest in continuance of the JET programme.

(d) Social Affairs

There will probably be a Social Affairs Council on 3 June. Belgium and other Member States will probably continue to want extended Community measures on work-sharing and to alleviate unemployment. We are not convinced that such measures will make a practical difference to unemployment problems and our interests would not therefore be damaged if no progress were made on them. Though clearly our opposition would not seem clearly to arise from the budgetary issue. The Italians are likely to revive the illegal immigration directive (which makes employment of illegal immigrants a criminal offence): this is strongly opposed by the UK and delay would be welcome. The Council could also consider health and safety measures, the UK supports this programme but no damage would come from delay. We could also obstruct on the review of family benefit principles requested by the Germans. This could backfire on the extension of the Social security regulations to the self- and non-employed, which is a UK initiative. Taking an obstructive line at this stage could undo some of the progress made towards consensus on the proposals. More generally obstruction in the social area will lay us open to retaliation by the Commission through management of the Social Fund. There are no assured national quotas and the Commission will be able, within the rules, to give preference if it wishes to applications from other Member States over our own. They could also make difficulties by delaying payments when they are due.

(e) European Court Staff

We could go on blocking the increase in the number of Advocates-General. This would offend all but the French. It would adversely affect our standing with the Court and cause delays in litigation. We could also obstruct an increase in the number of Judges. This would please most other Member States, particularly if blame could be put on us.

(f) Community Staff Pay

Decisions will be required in June 1980 for the interim pay awards expected by Council regulation with effect from 1 January 1980 and may provide some scope for UK blocking. But the Council acts on qualified majority and pay is non-obligatory expenditure.

(g) Obstructing Selection of a successor to Mr Jenkins as President of the Commission

Unanimity will be required by the nine Governments for the appointment of Mr Jenkins' successor. Discussions on this are likely to start in mid-1980. Denmark and the Netherlands are likely to be among the countries hoping to nominate one of their nationals as his successor. If we blocked discussions there could be increasing concern from about May 1980, particularly on the part of Governments who want their nominee accepted.

(h) Consumer Policies

We are already opposed to two Commission consumer proposals, have reservations on others, and are generally thought to be negative on consumer policy. A policy of intensified obstruction over a period of a few months, while it would do us no harm, would have little impact.

(i) Transport

There will be a Transport Council on 6 May. Issues on which decisions may be due include harmonisation of 1981 summertime dates, Commission proposals on Community financing for infrastructure (due to be taken in the May Council), proposals from the Commission

and UK on air services. Lack of progress on shipping issues would have little effect. If we adopt a policy of selective obstruction on these Councils the UK would suffer some damage. Most proposals offer the prospect of some UK benefit. Delay on air services could seriously damage the longer term UK interest. A suitable Regulation on Transport Infrastructure could possibly provide a net benefit to the UK but progress on it is in any case unlikely to be rapid, given our own reservations and those of other Member States. Since we have an interest in the longer term progress of Community decisions on transport this is not an attractive field for obstruction and it offers little scope for inflicting damage on other Member States.

Caseous emissions from vehicles could be ripe for decision at a Council in May or June. We are under considerable pressure to agree but have no particular interest in doing so, so this would be a suitable proposal to block.

(j) Environment

An Environment Council is planned for the end of May. Issues which the Italians hope to have ripe for decision include major industrial hazards ("Seveso"), and the directive on discharges of mercury and 'drins into water. On balance other Member States are likely to attach greater importance to reaching a decision than the UK, so there is prima facie scope for delaying tactics and UK interests would not be damaged by a few months delay on any of the issues. The Italians would also like to make progress on lead in air and on Environmental Impact Assessment, but they know that we have reservations on both these items that make decisions by May unlikely.

The Commission's proposal for a ban on the import of primary whale products (on which it is hoped to reach agreement before May) could be imperiled. In view of the UK initiative on this at the December Council it would be difficult for us to obstruct progress.

The Italians would also like to hold an informal Council in late March, mainly to discuss EEC coordination on environmental issues in OECD, ECE, etc. We are not yet convinced of the need for such a meeting and UK interests would not be affected if it were not held. Arrangements are to be finalised at a Working Group meeting on 24/25 January.

(k) Enlargement

We could put a brake on the enlargement negotiations with Portugal and Spain. But this, far from bringing pressure on our Community partners, would probably be welcome to France, and perhaps also Italy, while likely to cause considerable problems in our bilateral relations with Portugal and Spain. Pre-accession aid to Portugal is, meanwhile, an issue where blocking could save us money.

(1) External Relations

At the Foreign Affairs Councils on 10/11 March, 1 April, 5/6 May and 16/17 June there are likely to be several items under discussion on the external side, eg EEC agreements with Yugoslavia, Romania, Cyprus, Turkey and India. We have worked hard for progress on, for example, Cyprus. Experience shows that UK bilateral interests in each of the third countries concerned would suffer since their governments often attach great importance to the successful conclusion of their negotiations with the Community. Proposals for new Community spending on aid to such countries, which would affect the size of the budget, will be made early in 1980. The Mediterranean financial protocols expire over a period from October 1981, and the Commission's ideas for successor arrangements will probably be expensive (Malta has already asked for 68 mma new aid). We shall have to react to these fairly early, although decisions will not be taken at the earliest till the second half of the year. Other Member States will have (differing) interests in getting reasonably generous allocations agreed. The official group on overseas aid has recently recommended to Ministers in its Aid Policy Review that our general aim should be to cut back on our multilateral commitments as far as possible in future negotiations and specifically that we seek to limit further expansion of EEC aid programmes. They have also recommended that our attitude should be guided by our general approach to negotiations on the EEC budget.

(m) Energy

Energy Councils are provisionally arranged for 19 February and 24 June. Energy is a field in which we are very vulnerable to retaliation by the Commission against UK interests (notably on North Sea oil landing requirements etc.), if we adopt a policy of obstruction in the Community and challenges would be legalistic and could bring European Court judgements against existing practices. Of measures likely to come up for decision after February 1980, few would be blocked without causing equal or greater harm to the UK. It does not prima facie therefore seem a good candidate for inclusion in a programme of partial blocking. We have already made clear that we would only support an extension of the present coking coal decision unchanged. We are already blocking a Community Hydrocarbon Exploration Scheme, which particularly upsets the Irish. We are going slow on a Community regulation on the siting of power stations on which there is a French general reserve which we could join. We could block new tranches of expenditure on energy conservation and alternative energy demonstration projects, but this could be inconsistent with the general aim of reducing dependence on oil which we share with other Community and IEA countries. It would suit us to block the proposed register of oil products imports: but this would involve difficulties in the IEA as well as the Community and we would probably be isolated in both organisations.

(n) Fisheries

Fish is another area in which we could expect retaliation by the Commission if we obstructed Community policies. Broadly we are seeking concessions from other Member States in our efforts to achieve a CFP which is fairer to Britain than present arrangements or proposals. There will be plenty of scope for obstruction at Fisheries Councils in the period (provisionally planned for 29 January, 3 March and 16 June). Early in the year there will also be Council discussions on reciprocal fishing arrangements with Third Countries. We may wish to reserve on some of these on their intrinsic merits. But our position on the individual aspects of the CFP, including the external agreements is part of our negotiating strategy on the CFP as a package, on which it is in our interest to secure progress. Adding an element of obstruction for budget reasons would almost certainly act against that interest.

(o) Insurance

We could block work on insurance harmonisation. This would annoy others, but damage our own interests (through delay of services directive). Work on the EEC/Swiss agreement could be delayed without damaging UK interests, but this would have little impact on other Member States either.

(p) Industrial and Regional

Proposals for the use of the non-quota section of the ERDF are currently under discussion. We are seeking a substantial increase in the share proposed for the UK (26.5% of 220 mEUA over 5 years). To block the proposals would damage the French but, in the absence of agreement to increase our share, we would benefit marginally if the sums involved were transferred to the quota section where we get 27.03%. But blockage would have undesirable political repercussions vis-a-vis the Irish, in so far as it could affect a cross-border tourism project, due to be financed from the non-quota section. Political friction of this sort would be undesirable during present discussions on the political future of Northern Ireland. The Fund Regulation should be reviewed before 1981; if blocked the Regulation continues in its present form. The Council should make provision for Greece after her Accession to be aided through the Fund. To block that would mean our existing share would be safeguarded but we could expect retaliation and perhaps a reduced total Fund appropriation which would harm us. The Regulation on Industries in crisis failed to achieve agreement. New proposals are expected in 1980 and we should receive a net benefit. The content, timing and sums involved are not yet known and would depend on the political climate then existing.

The Commission proposals for a "Scrap and Build" Shipbuilding scheme are anyway likely to run into the sands in the new year. It would not worry any Member State if these proposals failed.

(a) Spierenburg Report

The main proposals affecting the Commission, the few which will have to be discussed and decided in the Council particularly on the number of Commissioners, will be subsumed in discussion of the Three Wise Men's Report (see (a) above).

(r) The Unforeseen

Other matters will come up in this period we are considering, often problems over which other Members will need our co-operation. Some of these may provide targets of opportunity in a very selective campaign, or victims in a general one.

EEC CONTRIBUTION: WITHHOLDING

(Note by HM Treasury)

1. In her statement to the House on 3 December 1979, the Prime Minister made clear that if there was no progress at the next European Council on the issue of the UK net contribution to the budget, one possible course, which had not so far been seriously considered, would be to withhold contributions.
2. This would be the only way in which the Government could secure the reduction in the Public Sector Borrowing Requirement (PSBR) towards which our campaign on the budget is directed, in spite of the resistance of our main EEC partners. It could also contribute towards eventually bringing about a satisfactory settlement of the issue.

Mechanics

3. There are four main stages by which customs duties, agricultural levies and VAT (the three components of the Community's "own resources") are collected in the UK and transferred to the Community. All but a small part of the UK's receipts from the Community are financed out of these sums collected in the UK, and in addition a substantial part of them (equivalent to our net contribution) is remitted out of the UK to finance the receipts of other member states. The four stages are:-

- i. "establishment" and collection of the duties and levies; "establishment", which includes calculation and notification to the payer, is a term of art in Community regulations;
- ii. payment of these duties and levies into the Consolidated Fund;
- iii. transfer from the Consolidated Fund to the EEC Account with the Paymaster General. Transfers of Customs duties and agricultural levies have to be made by the 20th of each month. The transfers relate to sums established 2 months earlier (ie in



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December we pay in the amounts established in October). In the case of the Community's VAT share we make payments on the first working day of each month which represent 1/12th of the estimate made by the Commission at the beginning of each year on the basis of the Community budget for that year. An adjustment is made after the end of the year. Failure to make these transfers on the due dates attracts an interest penalty which is at present 17%, increased in respect of the whole period by 1% for each month's delay. From this EEC Account, the Commission makes payments in sterling within the UK (eg payments under the Regional Fund and payments to finance purchases into intervention from UK farmers);

iv. at intervals the Commission instruct the Treasury to make transfers from the EEC Account with the Paymaster General to their account with the Bank of England. It is from that Bank of England account that the Commission make remittances overseas.

4. If we are to resort to withholding, there seem to be overwhelming advantages in achieving it by stopping transfers from the EEC Account with the Paymaster General to the account at the Bank of England (the first part of stage iv above). A stop on establishment could only apply to customs duties and agricultural levies, not to VAT. Even so, this would be a very drastic course: a dismantling of the external tariff of the Community. It would look like a permanent breach with the Community. It would also stop the flow of duties and levies into the EEC Account with the Paymaster General which is used to pay our own farmers and other EEC beneficiaries. The Government would have to make good part or all of that to them out of public expenditure, unless statutory rights were set aside. Moreover the normal working of customs staff would be disrupted.

5. Stopping payments of duties and levies once "established" into the EEC Account with the Paymaster General would attract the interest rate penalty. It would not of itself immediately stop the flow of money overseas, to the extent that balances remained in the EEC Account. And it would endanger the flow of funds to our own EEC beneficiaries.

6. Interfering with flows out of the EEC Account at the Bank of England would also be unattractive. The Bank might well fear the precedent of interference with a customer account. Use of the statutory power of direction to the Bank to block this Account would appear to be ultra vires the power of direction.

7. The Treasury is required by Community regulation to comply "as soon as possible" with instructions to transfer money from the EEC Account with the Paymaster General to the EEC Account at the Bank of England. There is no prescribed interest rate penalty for delay, though the European Court might award such a penalty if it were sought. By stopping transfers at that point we would effectively stop transfers abroad; we would leave untouched the bulk of the funds out of which UK beneficiaries are paid. Provided normal arrangements continued to apply, we would ourselves retain the use of the money, since the whole balance of the EEC Account with the Paymaster General is re-lent without interest charge to the UK Government. And any problem of "unscrambling" if a settlement is reached is kept to a minimum.

#### Scale and Scope of Withholding

8. This would need to be decided finally in the light of the position after the next European Council. The main possibilities are:-

- i. A "token" withholding for, say, one month. By that stage, however, this would have little relevance.
- ii. To withhold up to the amount of our estimated net contribution for 1980 on an exporter benefits basis (1814 meua).
- iii. The same, but on an importer benefits basis (1552 meua).
- iv. To withhold up to the amount of our VAT tranche.

9. There would be a strong case for relating the amount withheld to the demand the UK is putting forward. If, after the next European Council, the UK is still demanding "broad balance" on an

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exporter pays basis, it might be appropriate to withhold amounts to the extent required to reduce our net contribution to nil (exporter pays basis) in a full year. This can most simply be achieved by stopping all remittances out of the UK, as suggested above. However this would not be sufficient to achieve a nil net contribution in 1980 if the action did not start before March of that year.

10. Our action need not necessarily be related to a period of one full year, or any other precise period. If in the search for the "genuine compromise" to which the Prime Minister has referred, we were to modify our overall demand, it would still be consistent with that to block all remittances leaving the UK. In taking this action, Ministers could say that they were confident an early settlement would be reached; but if it were not, our intention would be, after some months, to adjust the amounts withheld so that (if the process continued that long) in a full year we would not withhold more than the amount required to reduce our net contribution to our latest declared objective.

11. It has been suggested that our partners might find it less offensive if we were to withhold only the VAT tranche and not the duties and levies which are "own resources" par excellence. This distinction is made, for example, in the existing Financial Mechanism. But a simply withholding of the VAT tranche month by month would not by itself block all remittances out of the UK, since the VAT tranche is an equal amount each month fixed at the beginning of the year, and requests for remittances are often greater than this in any particular month.

12. It would be possible for Ministers to say that if the withholding had to go on for as much as a full year, it would be our intention that it would not exceed the total VAT tranche for that year. This would be likely over a full year to result in withholding somewhat less than our full net contribution, but several months would pass before our withholdings equalled our total VAT tranche for a year. On the other hand, Ministers may consider it undesirable to appear implicitly to reinforce the Commission doctrine that the duties and levies are a more sacrosanct form of "own resources" than the VAT tranche.

Starting the Process

13. The withholding can be started by Ministers at any time by instructing the Treasury to ignore Commission instructions to transfer sums from their Account with the Paymaster General to their Account at the Bank of England. These instructions are received at irregular intervals, but on average about once a month. So the process could be started on receipt of the first Commission instruction following the next European Council.

14. The Government's public posture would be that our action in withholding pending a settlement of our problem was justified because the situation is fundamentally inequitable and inconsistent with the Treaty of Rome (see paragraph 31 below).

Reaction of the Commission and other Member States

15. Faced with a potential crisis in the Community, the Commission is likely to try to work for a negotiated settlement and to avoid actions which could lead to the UK being driven to withdraw from the Community. But the Commission will need to take the minimum action required to keep the Community going financially (see paragraphs 16-22 below). It would also be open to the Commission to take proceedings against the UK in the European Court and they might come under pressure to do so (but see paragraph 24 below). Proceedings against the UK might also be taken by another Member State, though the position of the French, who would be most likely to think in these terms, would be interesting; (see paragraphs 30-33 below for the legal position).

Financial Effect of Withholding on the Rest of the Community

16. The Commission has no general power to borrow to finance expenditure (though it has specific borrowing powers for defined purposes). Nor, so far as we can at present see, is there any way within the terms of the Treaty in which the Commission could alter their banking arrangements in the UK so as to put their present Account with the Paymaster General beyond the reach of HMG, although the Commission might well try to devise one.

17. Nor would a proposal to reduce the budget be likely to resolve the Commission's problem. To achieve such a reduction would need a "Rectifying Budget", proposed by the Commission and having to go through

all the budget stages including consultation with the Parliament. Since qualified majority voting would apply, the UK would have to rely on the "Luxembourg compromise" to block the Commission's proposals. It is not certain that the compromise could be successfully invoked in the Budget context, especially in these circumstances. However, if a reduction were agreed, the revenue side of the Budget would also have to be adjusted at the same time and there would be a consequential reduction in the VAT tranches of member states, including the UK. So the Commission would still be left with a financing gap.

18. However, there are a number of other measures the Community could take to deal with the financial shortfall created by the withholding of remittances by the UK:-

i. The Commission maintains balances in its Account in each of the other member states, on which it could draw. These balances fluctuate sharply and it is difficult to estimate how long it would be before they were exhausted. Our best guess is that the balances could amount to at least 1 billion eua at the beginning of 1980. Our best guess is that, even without any other action by the Commission to meet the situation (see below) they would enable the Community to continue to finance budgeted expenditure in full for up to 8 months before serious difficulties arose.

ii. In practice, the Commission would probably not rely wholly on these balances, but would at an early stage begin to take other action. They might, for example, engineer an underspend on the budget (as distinct from reducing the budget itself) by delaying payments to qualified recipients. This might increase the period during which they could "get by" but could not be relied on indefinitely.

iii. Alternatively, the Commission might propose a supplementary budget. If adopted, the effect of this would be to raise the VAT shares of all member states including the UK. We would continue to block remittances to the Community, but the higher

VAT payments of the other member states would be available towards financing the original level of budgeted expenditure (though there would be a shortfall compared with the supplementary budget). There would appear to be room for such a device within the 1% VAT ceiling for 1980 (though probably not for subsequent years). It would require the voluntary cooperation of other member states and the Parliament, which might be difficult to obtain, though it would no doubt be presented to them as a temporary measure. Since qualified majority voting would apply, the UK could only prevent it if the Luxembourg compromise could be successfully invoked.

19. The Commission could be expected to propose some combination of these measures to overcome the financial problem caused by loss of the British net contribution. They might not be wholly successful, and they would need in some cases to get the support of other member states and the Parliament, which might be a problem. But it would be difficult to stop them being sufficiently successful to extend the period during which the rest of the Community could "get by" financially to up to a year.

20. The rejection by the Parliament of the 1980 budget will also affect the position. The provisions for constraining the Community's expenditure and revenues in a situation where there is no legally adopted budget will have the net effect of improving the balances available to the Commission by more than 65 meua per month (about 40% of the UK's average monthly net contribution). This would significantly help the Community's financial problem if we withheld. On the other hand without a legally adopted budget no supplementary budget can be adopted, so course (iii) in paragraph 18 above is closed to the Commission.

21. The fact that the Community could survive financially for some time without the UK net contribution could reduce the effectiveness of withholding it. Any early legal judgments that might be reached against us (see below) could result in the UK coming under pressure before the rest of the Community. On the other hand, the

very fact that the rest of the Community would not come under immediate financial pressure might make it less likely that legal proceedings would be taken against us, and more likely that our partners would return to the negotiating table. Ministers could reasonably maintain that our action was not designed to put our partners under duress, but rather to enable further negotiations to take place within an appropriate timetable to achieve a satisfactory settlement. In the meantime, the objective of reducing the PSBR would have been achieved (see paragraph 25).

#### Payments to UK Beneficiaries

22. If the Commission could not make ends meet by the above methods (and possibly only if, but this is uncertain) they might consider stopping payments to UK beneficiaries. Financially, this would not significantly help their problem, since the bulk of these payments are financed out of their Account with the Paymaster General in the UK. (They might nevertheless take such action, which could cause certain domestic problems for us - see <sup>para.25</sup> below). There are certain minor payments to UK beneficiaries which are not financed out of the Account with the Paymaster General, and they might try to cut these off (however, these are mainly in respect of services rendered to the Commission, and contractual difficulties could arise). But in general cutting off payments to UK beneficiaries would not help the Commission's financial difficulties if we continued to ignore all requests to remit money out of the UK.

#### Other Retaliatory Action

23. Our partners might combine to ensure that no decisions advantageous to the UK were taken by the Council of Ministers. In the ultimate, they could seek effectively to exclude the UK from the Community decision-making process by reaching "gentleman's agreements" on issues outside the formal Council procedure. There are precedents for such agreements.

24. It is unlikely that the Commission or our partners would want to go to the extreme lengths of trying to raise the Common External

Tariff against the UK, or of taking steps to restrict UK imports into the Community. Such steps would clearly be contrary to the Treaty of Rome and would amount to an attempt to force the UK out of the Community.

Effects of loss of Commission Co-operation

25. More time is needed to assess the administrative problems that could arise, and the cost involved. It is unlikely, at least in the early stages, that the Commission would take action which, pressed to the ultimate, could result in the UK for practical purposes ceasing to function as an effective member state of the Community. However, after seven years of operating as an integral part of the Brussels machinery, there could be administrative difficulties in taking over the calculation of payments due under Community instruments in the UK ourselves. There could, for example, be significant difficulties in running an agricultural price support policy ourselves if the Commission cut off the daily flow of information from Brussels, and any errors made in payments because of these difficulties could lead to the expenditure being regarded by Community auditors as ineligible for Community financing. This could involve the Exchequer in financial losses if the final settlement was made on the basis that payments we had made during this period were to be regarded as Community payments subject to Community audit.

PSBR and Government Expenditure Implications of Withholding

26. The balance in the Commission's Account with the Paymaster General is under present arrangements treated like a Departmental balance and is available to reduce the PSBR without an interest charge. Payments are at present only "scored" against the PSBR when they are made out of the Account.

27. If the Commission cut off payments to UK beneficiaries by failing to send instructions to make such payments out of their Account with the Paymaster General, Ministers might want the Government to step in to finance these payments. The bulk of them (eg guaranteed farm prices, regional development grants) are the subject of statutory rights. Such payments by the Government would be a charge on the PSBR.

28. The broad net effect of a strategy of blocking transfers from the Commission's Account with the Paymaster General to its Account at the Bank of England would be that in a full year the PSBR would be



reduced by the amount of the net contribution to the EEC budget the UK would otherwise have made. However, the Government could come under pressure also to make good those payments to UK beneficiaries which are not made out of the Account with the Paymaster General (see paragraph 22 above) if the Commission cut them off. If this were done, these payments would add to the PSBR.

29. The Government expenditure position is that contributions to the European budget are "scored" as Government expenditure when they are paid from the Consolidated Fund into the Commission's Account with the Paymaster General. So if in addition to these payments the Government had to make payments to British beneficiaries, Government expenditure would technically be increased, although the balance in the Commission's Account would at the same time rise. It would be necessary to explain this in any Public Expenditure White Paper or other public presentation of Government expenditure figures.

#### The Legal Position

30. In refusing to comply with a valid instruction from the Commission to transfer money to the Commission's Account at the Bank of England the UK would be failing to carry out various obligations under the Treaties and their subordinate legislation. If the Commission took the UK to the European Court they might obtain from the Court within a matter of weeks an interim order directing the United Kingdom to make payments.

31. It would be an essential part of any strategy of withholding, unless it is to have only a token effect, that Ministers should be prepared to defy such a Court order, and any further judgments the Court may reach. The French defiance of the Court on lamb would be a helpful precedent, although the French (and some others) will argue that the cases are not comparable in size or in principle,

32. Our public posture would be that our action in withholding pending a settlement of our problem was justified because in our view the institutions of the Community had failed in a duty to redress a situation inconsistent with certain basic provisions of the Treaty. We could also use such arguments in any proceedings before the European Court ( a detailed presentation of this line of argument is being worked up separately). The Attorney General has expressed the firm view that we stand no chance of the European Court accepting that the budgetary provisions are no longer binding in the United Kingdom and that the United Kingdom can therefore legitimately withhold all or part of the contributions required. Nor is there any possibility of advancing an argument in law that the relevant sums are our money which we are entitled to retain until the Community establishes its entitlement to them.

33. There is a separate question whether the UK should itself initiate an action in the Court against the European institutions (the Council and/or the Commission), under Article 175 of the Treaty, on the grounds that they have infringed the Treaty by allowing the budgetary arrangements to develop in a manner inconsistent with its basic provisions. In such an action we would claim that the Community institutions are under a duty to amend the financial arrangements in recognition of this inconsistency. The Attorney General's provisional view is that such an action would be likely to fail, although he will be studying the more detailed presentation of our basic case now being prepared before reaching a final view. Even if it failed, such an action could provide a useful platform for deploying our case, although it would not legally justify us in withholding contributions while the case was being heard. On the other hand, if judgment went against the UK in an action we had ourselves initiated, our overall negotiating position would be weakened. It would be more difficult subsequently to defend defiance of a Court ruling against us in a separate action on withholding, when we had previously been prepared to submit our case to the Court's judgment.

#### UK Domestic Legislation

34. The main question that arises is whether it would be necessary to amend or suspend the operation of section 2(1) of the European

Communities Act 1972 in so far as it bites on problems arising out of the withholding of contributions by the UK. Unless this is done the legality of the Government's action could be tested in our courts, and the Attorney General has already advised that it is unacceptable to contemplate putting ourselves in the position of refusing to implement a judgment given by a UK court.

35. Such an action could arise in a number of ways:

or an aggrieved trader of another member state  
i) The Commission might take action in a UK court to enforce a judgment obtained in the European Court. In the case of the Commission, at least, such action may be unlikely. They might fear that it would provoke the Government into national legislation.

ii) Even if the Government makes good the shortfall of Community funds to UK beneficiaries, there might well be individuals who, relying on directly enforceable Community rights in various circumstances, sought to enforce them in our courts or sought a declaration as to the legality of the Government's actions.

36. In certain of such actions the plaintiff (including the Commission) would be relying on Community rights directly applicable in the UK by virtue of section 2(1) of the 1972 Act.

37. Possibly other sections of the Act might also need amendment. However such amendments (including amendments to section 2(1)) would amount to a violation of a basic element of the Treaties and a negation of the supremacy of Community law.

38. The risks of such action being taken are presently being assessed by the Attorney General, who is also advising on the legislative amendments needed if it is decided that legislation needs to be taken at the outset.

39. It might in addition be thought desirable to legislate in broad terms creating a general authority to "make good" payments to British beneficiaries previously made by the Commission. However, unless such payments had to continue for a considerable period, the Government might be able to rely on the authority granted by Appropriation Acts

in making them. This is essentially a matter of constitutional propriety. On the other hand, the Appropriation Acts would not provide authority to erect the enforcement machinery which would normally be required if the Government took over these payments, and specific legislation might be needed for this. The Attorney General will be examining these issues.

Summary: Points for Decision

40. If Ministers wished to consider withholding all or part of the UK's net contribution, the main points to be decided would be:

- i) At what stage in the budgetary process the withholding should operate (paragraphs 3-7 above).
- ii) The scale and scope of the amount to be withheld and, in particular, whether the amount withheld should be limited to the UK's VAT tranche (paragraphs 8-12).
- iii) When the withholding should start (paragraph 13).
- iv) The Government's posture with our European partners, and publicly (paragraphs 14, 21, 32).
- v) Whether and to what extent the Government should assume responsibility for payments to UK beneficiaries if the Commission cut them off (paragraphs 26-29).
- vi) The Government's posture in the face of an adverse judgment by the European Court (paragraphs 31-32).
- vii) Whether the Government should itself bring an action before the European Court under Article 175 of the Treaty of Rome (paragraph 33).
- viii) The extent of domestic legislation necessary to support a withholding operation (paragraphs 34-39).

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14 January, 1980

POLITICAL CONSEQUENCES OF UNITED KINGDOM WITHHOLDING CONTRIBUTION  
TO THE COMMUNITY BUDGET AND OBSTRUCTION WITHIN THE COMMUNITY

Note by the Foreign and Commonwealth Office

INTRODUCTION

1. This Note considers the political consequences within the Community of:

- (a) withholding all or part of our contribution to the Community budget and,
- (b) a policy of partial or total obstruction.

In particular it assesses the effects of each on our position in the Community and on the prospects for a successful outcome of the budget negotiations. It also considers the measures which our partners might take in each case in reaction and the consequences of these measures for the United Kingdom together with the effect on our bilateral relations with our Community partners, especially France and Germany.

2. On withholding we make two assumptions:

- (i) that we would be taken quickly to the European Court of Justice for doing so and that the Court might order interim measures against us within a few weeks and would find against us within a matter of months;
- (ii) that, if it did, we would not comply until a satisfactory solution had been found to our budget problem. This point is considered further in paragraph 16 below.

## GENERAL EFFECT ON UK POSITION IN THE COMMUNITY

## A. WITHHOLDING

3. We are already thought not to understand or sympathise with the notion of "own resources". To withhold part or all of our contribution would appear to be a direct attack on a principle of importance to all the other members. We would make play at the political level with arguments justifying our action (see separate Treasury paper) particularly in the period before the Court had reached a decision. But once the Court had ruled against us, even if we made it clear we intended to comply with its judgement as soon as a satisfactory budget solution had been reached, we should be regarded as having deliberately broken one of the central provisions of the Community legal order and thus to have attacked the fabric of the Community itself. It would conflict with the Prime Minister's comment in the House on 23 October that we will observe Community law on our budget contribution and cannot go outside it. It is hard to see how we could reconcile defiance of the Court with the Government's policy of commitment to the Community. These reactions would be all the more certain if, in order to underpin a decision to withhold, we felt obliged to amend the European Communities Act.

4. French defiance of the Court's recent judgement against their obstruction of British lamb imports might be helpful to us on a political level. But it would not be an adequate precedent. The two cases would not be regarded as comparable by other Member States. The French action in prolonging an absence of free trade in this narrow sector is seen as objectionable and selfish in principle but in the eyes of our partners would be less serious in political terms than British defiance of the Court on a question affecting the Community's very foundation. In any case, the French might decide - particularly if the UK defied the Court - to settle for some form of sheepmeat regime acceptable to the Commission and other Member States. That would leave us even more in isolation. Moreover, it would seem to many in Europe that, in adopting such an illegal measure, we were abandoning our traditional high standards of respect for Treaties and the rule of law.

5. A further assumption is that it is not the Government's intention that the United Kingdom should leave or be excluded from the Community. It is, however, difficult to foresee exactly where withholding might eventually lead. If such pressure failed to produce a solution to the budget problem, there would be a risk of a major change in UK public attitudes to the Community. Under these circumstances, the Government's commitment to the Community might be difficult to sustain. Defiance of the Court would reverse the stand taken by the Government in accepting judgements on issues such as tachographs and open the door in Britain to disrespect for Community law. Equally, there is a risk that our partners might eventually conclude that their own interests were better served by our absence from the Community. They might take the view that a partner capable of acting with so little regard (as they see it) for principle and the acquis communautaire calls into question the value of his own membership of the Community. We would give much additional strength to those who have always regarded us as unfitted for membership, and basically unconverted to Community principles.

#### B. OBSTRUCTION

6. A policy of total obstruction would similarly have very damaging consequences on the UK's position in the Community and it too would risk a major change in UK public attitudes to the Community. But it is open to question whether the effect would be as serious as the reaction of our partners to withholding, even if this was accompanied by a willingness to co-operate in other areas. An essential difference would be that we would be operating within the Community legal order and would not have to act in defiance of a judgement by the European Court of Justice against us. It is true that, where there is a provision for qualified majority voting, we would need to resort to the Luxembourg Compromise by which it is customary not to take a vote if one Member State opposes it on the grounds that an important national interest is at stake. There is of course no provision in the Treaty for this. But resort to the Luxembourg Compromise should not bring us into conflict with the Court. The worst that could happen would be that our partners might decline to recognise our right to use it in the given circumstances. Our attempt to veto would then be ineffective.

7. Total obstruction would be significantly more damaging to the UK's position in the Community than selective obstruction, most realistically the blocking of all measures which would involve an additional net budgetary contribution by the UK ("financial obstruction"); see separate paper on obstruction. This too would rest on the extensive use by us of the Luxembourg Compromise and that in fields where a tradition of effective majority voting is firmly established. The practical effect of this latter course would be to cause annoyance, frustration and possible actual damage to the interests of others at every level of Community discussion where it is applied. There is clearly a possibility that it would be misrepresented as a policy of deliberate wrecking. It could create an atmosphere of bitterness in our relations with the Community which would complicate the handling of Community business in other areas. But it would be, and be seen to be, directly related to the cause of our complaint. There would be risk of our partners combining to brush aside our veto. But this might be less if they believed that to do so would precipitate withholding.

#### FRENCH IDEAS ON UK ASSOCIATE MEMBERSHIP

8. There has been some evidence recently that President Giscard may be thinking of UK associate membership of the Community as one possible option if the budget negotiations fail and the UK resorts to disruptive tactics. On the available evidence, French ideas on the exact form of any new relationship do not seem to have been fully worked out. Giscard's motive may be partly to prepare his own position both domestically and in the Community in the event of an impasse and partly as a warning to HMG on the need for compromise. But even if the threat is meant seriously, it would be difficult to implement: first, because we could not be forced against our will to accept second rate status; second because we do not believe that the French would in the event put forward an alternative which was attractive either to the UK or to the other Member States; and third because the French would in any case have difficulty in getting the whole of the rest of the Community to



co-operate in their plan, particularly if they were isolated, or in a small minority, in refusing to accept a budget settlement. Much would depend on the exact circumstances in which the French launched their idea. But we believe that they would be more likely to attract support if we were in breach of a Court judgement than if we were being obstructive, particularly if such obstruction was not across the whole range of Community business.

#### PROSPECTS FOR A SUCCESSFUL OUTCOME OF THE BUDGET NEGOTIATIONS

9. The following factors are relevant in deciding whether a policy of withholding would be more likely to lead to a satisfactory settlement of the budget issue than a policy of obstruction. Withholding would make substantial savings in public expenditure in 1980-1. Our objective, however, is a settlement acceptable to all, which is a separate question.

- (i) how much would each policy actually hurt our Community partners and how soon?

The Treasury's broad conclusion on withholding is that it might be up to 8 months or so before our withholding created actual financial stringency for the Community. It would not therefore bite before a Court judgement at least of an interim character had been given against us. Thereafter there would be ways of prolonging the period during which the Community would "get by" without our contribution. This would enable us to take some credit for minimising the difficulties for our partners.

The conclusion of the EQS Note on obstruction is that a policy of general obstruction could do a great deal of damage to the Community. Blocking all measures involving an additional UK net budgetary contribution, particularly if this included a block on agricultural price increases, would also be a powerful lever, though one which might not be painless for the UK. It would be likely to bite on other Member States well before they would feel the effects of withholding.

/(ii) what

- (ii) what effect would each policy have on our partners' willingness to compromise?

Withholding would relate to the cause of the problem. Provided we made clear that we were intending to continue to co-operate wholeheartedly in Community business while we were withholding, it might not therefore generate the same degree of bitterness as a policy of total obstruction. On the other hand limiting obstruction to the blocking of measures which added to the UK net budgetary contribution would also relate to the cause of the problem. It would not have side effects in unaffected areas of Community business. If we withheld, our partners would probably seek to prolong the budget negotiations until the Court had ruled against us. They would then find further compromise particularly difficult. On this view financial obstruction is to be preferred.

We have considered whether our partners would react differently if we withheld only our VAT contribution or at least indicated that we would not, for the year as a whole, withhold more than the amount of our VAT tranche. It might be argued that given that duties and levies are generally regarded in the Community as a more sacrosanct form of "own resources" than the VAT tranche, action by us which respected this distinction would be resented less, particularly by the Commission. It would be seen as less inconsistent with our policy of wholehearted commitment to the Community, and would be likely to have a less damaging effect on our partners' willingness to compromise. If withholding is decided, we would for these reasons prefer limiting it to the VAT tranche; but we believe it would be open to the same general objections as are described in paragraphs 3-5 above.

(iii) which policy is the more flexible?

We believe that a policy of obstruction, whether total or partial, could be applied more flexibly than withholding. The exact degree of obstruction could be adjusted gradually. HMG would remain more fully in control of the situation. Once a decision to withhold had been taken, the only choice left, on the assumption that only the VAT tranche was withheld at first, would be between withholding levies/duties as well and climbing down. Furthermore obstruction would still leave intact the option of withholding as a last resort. The converse may not be true, because, once we had begun to withhold, there would be less disposition in the Community to meet our needs on other issues and we might thus be driven to obstruct them.

#### POSSIBLE MEASURES OF REACTION AGAINST THE UK AND THEIR CONSEQUENCES

10. Annex A sets out the most likely options which the Commission and our partners would have in taking action against us and their consequences. The most serious on Community business are as follows:

- (i) the Commission could cut off or delay payments to the UK. But this would expose them to legal action by us. Moreover the bulk of payments to UK beneficiaries are financed out of money collected in the UK. In any case the financial effect could be neutralised given that, as net contributors, we should always be able to withhold a greater sum than would be spent on the Commission. They might therefore be deterred from such action. But if not this could quickly lead to a total suspension of UK payments to the Commission and vice versa. The Community's financial arrangements would in effect have ceased to apply to the UK at all. This could be the first step of a loosening of the UK's ties with the Community - see paragraph 5 above.

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- (ii) The Commission could cause a reduced level of payments to the UK under EEC schemes, notably the Social Fund and the RDF non-quota section.
- (iii) The Commission could obstruct or simply take an inflexible line on decisions on UK requests for approval of state aids, regional development schemes, etc.
- (iv) They could also obstruct proposals for new schemes which would benefit the UK.
- (v) The Commission could obstruct the effective implementation of measures of protection against low cost or disruptive imports from third countries.
- (vi) Our partners could withhold agreement to the continued import of New Zealand butter when the present arrangements run out at the end of 1980.
- (vii) Prospects of getting an acceptable Common Fisheries Policy could suffer; and the Commission and other Member States could initiate further legal action against our national conservation measures.
- (viii) The Commission and other Member States could initiate legal action against us on our North Sea oil arrangements.

Some of these options, notably (iv)-(viii) above, could not be brought into immediate effect.

#### LIKELIHOOD OF REACTION AGAINST WITHHOLDING

11. Neither the Commission nor our partners would be likely to take measures against us until the Court had found against us. Once this happened, however, we consider that both would seek to take early action. The measures they chose would probably be confined at least initially to Community business but could include sooner or later all the options listed in paragraph 10 above. Much would depend on how long our action lasted and

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whether it was indeed confined to our VAT contribution. The longer our action the worse and the longer-lasting the adverse reactions. Similarly if we suspended levies and duties the reaction would be sharper.

12. There might also be repercussions in our bilateral relations with our Community partners. An earlier widespread feeling in all Community countries that the Community would be better off without Britain - a feeling considerably allayed by the positive attitude of the present Government - would return in strength. This popular reaction would powerfully reinforce the inclination of Ministers in individual Community countries to be as unhelpful as possible to British interests across the board. The effect would be most striking in France, but would also be palpable in the FRG and the other Member States. The Franco/German relationship would be further strengthened at our expense. It would be more difficult to get our partners to take sympathetic account of our political interests outside the Community, eg. over Southern Africa and Gibraltar. Pressures on the Government of the Republic of Ireland in favour of close co-operation vis-à-vis Northern Ireland could be weakened. More generally withholding would impair co-operation between this country and important Community members (FRG, France, Italy) which is an essential feature of international life, eg. the Economic Summits, the energy problem, and the current crises over Iran and Afghanistan.

#### LIKELIHOOD OF REACTION AGAINST OBSTRUCTION

13. Here too the reaction would depend on the degree of obstruction. The EQS note on obstruction considers that a policy of general obstruction would risk producing an early and vigorous reaction. It could include most of the options in paragraph 10 above. But, since we should still be operating within the Community legal order (paragraph 3 above), it would probably not provoke the Commission to cut off payments to the UK (paragraph 10(i) above). On the other hand obstruction limited

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to a block on measures which would add to the UK net budgetary contribution would be likely to attract a significantly lower level of reaction. The risk might be limited to Commission obstruction of proposals for new Schemes which would benefit the UK and the continued arrangements for imports of New Zealand butter (10(iv) and (vi)).

14. We believe that a policy of general obstruction could also affect bilateral relations with our Community partners (paragraph 12 above) but the risk of reaction in the bilateral field would be greatly diminished if we obstructed in the financial field only.

#### MORE EXTREME REACTION

15. As a more extreme measure, the Commission or our partners might seek the authority of the Court for interim defensive measures which might include raising the Common External Tariff against us or even restriction of UK imports into the Community. We are vulnerable here since 38% (in 1978) of our exports go to the other Eight, while in aggregate they depend on the UK for only 8% of their total exports (or 1% if their exports to each other are excluded). We doubt, however, whether there is a serious risk of such action at least until virtually all prospect of achieving a settlement has disappeared and there is a near total breakdown in Community life. The Commission in particular would be reluctant to take such a step which would result in the view of many in the UK ceasing to be an effective Member State.

#### UK ACCEPTANCE OF A COURT JUDGEMENT

16. The analysis above assumes (paragraph 2(ii)) that we would defy a Court judgement against withholding until a budget settlement was reached. There would be little advantage (except greater publicity for our moral case) in incurring odium for withholding only to back down before a Court judgement a month or two later. We should then be faced with a choice between compromising on our demands and moving to a policy of obstruction. It would be best to make that choice in the first place.

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## CONCLUSIONS

17. We draw the following main conclusions:

- (i) Both withholding and obstruction risk serious damage to UK interests and to the Community. There would be a wide international effect diminishing the influence of this country in Western counsels.
- (ii) Withholding might damage our general position in the Community more seriously than would obstruction. Damage by the latter would be significantly less if it was limited to blocking measures which would involve an additional net budgetary contribution by the UK (financial obstruction).
- (iii) Withholding is the only course sure of achieving an acceptable level of UK financial contribution; but this would not amount to a settlement of the problem.
- (iv) A policy of obstruction (particularly if limited to financial obstruction) would be more likely to lead to a satisfactory settlement of the budget issue than would withholding. It would be less likely to provoke our partners into refusing to negotiate at all.
- (v) A policy of obstruction would not preclude a subsequent decision, or use of the threat of a decision, to withhold. But a policy of withholding, with obstruction held in reserve, would be less credible.
- (vi) If withholding is decided, it should in any case be limited to the VAT tranche if the most adverse consequences are to be avoided.
- (vii) The Commission and our partners could take a number of measures which would have damaging consequences for both us and the Community. The likelihood of their doing so would probably be greatest if we withheld. Financial obstruction would provoke a significantly lower level of reaction.

FOREIGN AND COMMONWEALTH OFFICE

14 January, 1980

## POSSIBLE MEASURES AGAINST THE UK AND THEIR CONSEQUENCES

## FINANCE

1. Here the most likely action that our partners and the Commission would first take would be in the financial field. The main possibilities are:

- (i) the obvious first move would be to cut off payments to the UK. [The Treasury paper considers the implications in further detail.] Since, however, we are a net contributor it will always be possible for us to withhold a greater sum than would be spent by the Commission in the United Kingdom and to make good payments to beneficiaries in the UK;
- (ii) in the alternative our partners could try, by using a qualified majority, to devise a Community Budget for 1981 involving even less expenditure in the UK than the present Budget. But other Member States, eg the Italians, have an interest in items in the Budget from which we also benefit. And the Parliament too might object to such action. In any case, we could attempt to use the Luxembourg Compromise to block decisions against us. The same considerations apply in respect of the 1980 Budget, if one has not yet been established, and of any 1980 supplementary budget that may be needed;
- (iii) loans to an from the Commission: The Commission could theoretically seek to block UK capital tied up in the Community eg in the EIB where we shall have £87 million by end April 1980, a sum which will grow by about 10-11 mEUA every six months. The Commission could also seek to deny the UK any benefit under the EIB facility. But we doubt if they would go so far: the capital is there for the benefit of the EIB, not Member States. In any case even if they did

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although this would be a limitation on UK resource management, it would not be one of great consequence. Equally, denying us benefit under the Ortoli facility would have no significant economic effect. There are no other significant possibilities.

- (iv) European Monetary System: Any decision by the Eight to change exchange rates without reference to the UK would have little monetary effect. We could block any attempts to alter the make-up of the ECU (which requires unanimity). This might be necessary since the ECU is the Unit of Account for the CAP. The Community would not be able to get its hands on the UK gold and dollar reserves swapped for ECU's since they are kept in the Bank of England and remain legally in UK hands.

## AGRICULTURE

2. Other Member States are probably as vulnerable to measures taken by us as we are to measures taken by them. The two main issues post-March 1980 will be the price-fixing and decisions on the Commission's economy package. We would stand to gain most overall by blocking the price-fixing proposals because existing prices would continue, ie a de facto freeze. But we want changes in the economy package and have an overall interest in a successful outcome. The other Members could also stimulate the Commission to pursue court cases more actively against the UK, for example over our ban on milk imports.

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## FISH AND CONTINENTAL SHELF

3. Here there is broad scope for obstruction particularly by the French, Germans, Danes and Irish. The UK has an interest in negotiating reasonably soon - and certainly before the deadline of 1982 - a revised Common Fisheries Policy which gives the UK improved fishing opportunities at the expense of other Member States. To that extent we are the demandeurs and other Member States can block changes which would be to our advantage. These negotiations are likely to be active post-March 1980. Key elements of the CFP negotiation on which we would be vulnerable to retaliatory action are quotas (on which we want an increase for the UK) and our demands for preferential access for UK fishermen in waters off the UK. Other Member States might also decide to ignore UK national conservation measures and simply overfish the existing stocks, the majority of which are to be found in UK waters. They might contemplate discriminatory measures against UK fishing in their waters, but we could challenge this before the European Court. We depend on Commission co-operation to get the Common Fisheries Policy into an acceptable shape.

4. The Germans could put more muscle behind their hitherto half-hearted attempt to get a Community regime for our continental shelf (in the UNLCSO context). But this would hurt the Irish as well as ourselves.

## ENERGY

5. There is probably little mileage in action on the energy (including nuclear) front in the course of Community business: other Members who might wish to block activities of interest to us would have to take into account the possibility that we would react in kind.

6. The arrangements we have made to secure supplies of North Sea oil to the UK (participation agreements, ring fences, the landing requirement) are vulnerable to legal challenge. A challenge might well be more likely in a period of worsening relations with the Community but could take time to mount. At worst, such an indication

that foreigners were after "our oil" might contribute substantially to anti-Community feeling in this country, and provide an attractive weapon to those who would like to get us out. At best, it would be found that we could compete successfully for North Sea oil through the price mechanism (tax and royalty arrangements ensure that a good bit of the increment returns to HMIG) and that the elaborate arrangements were not really necessary. There would, however, be upward pressure on oil prices generally, which might encourage the less moderate members of OPEC and do no good to Western economies in general.

OTHER INTRA-COMMUNITY BUSINESS

7. There is considerable scope for action by our partners and the Commission in a number of other fields:

- (a) the Commission could refuse to be flexible or could delay decisions on UK requests for approval for state aids, regional development schemes, etc. There are likely to be a number of politically sensitive proposals of the kind (shipbuilding, steel, enterprise zones, fiscal incentives for small firms, etc) on which we will need Commission goodwill. On shipbuilding there are likely to be a number of occasions when we shall need Commission approval for subsidy levels in excess of 25% for individual orders. Following their review of UK regional policy which is outstanding the Commission could, if they wished, require substantive changes in the Regional Development Grant Scheme, as well as refusing to approve the upgrading or designation of Assisted Areas: The Commission will be examining our request for approval of additional Government aid for British Leyland and could delay approval and attempt to obstruct the Layland/Honda agreement.
- (b) The Commission or our partners could obstruct proposals for new schemes which would benefit the UK - and which we ourselves would presumably not wish to obstruct. Examples are the coal subsidy scheme, support for transport infrastructure, agriculture investment aids

of benefit to Britain, aid for Northern Ireland, etc. Our partners could of course block new measures requested by the UK in these areas.

- (c) The Commission could, by use of administrative devices, delay payment under the regional and social funds in respect of UK projects. This would not affect industrial projects when the receipts are retained by the Treasury but infrastructure projects may be affected (but see paragraph (i) above).
- (d) There are no significant opportunities for action by our partners against the UK on environment questions or on transport matters other than infrastructure projects (see (b) above).

#### COMMUNITY EXTERNAL RELATIONS

8. The main risk in this field is over access for New Zealand butter. The present arrangement runs out at the end of 1980 and the Community's commitment to arrangements thereafter is of a weak and general kind. Specific arrangements for the continued import of New Zealand butter post-1980 will therefore require the agreement of our Community partners. It seems unlikely this would be given if we were still in breach of a Court judgment on the Budget.

9. We could also find ourselves in difficulties if the Commission were systematically obstructive over the effective implementation of measures of protection against low cost or disruptive imports from third countries when such measures are required. Over textile imports, in particular, we depend on the Commission effectively to police the quotas agreed under the Multi Fibre Agreement and to take safeguard action when necessary against imports from preferential suppliers, either around the Mediterranean (eg cotton yarn from Turkey) or among the ACP (eg jerseys from Mauritius). Even if the Commission could be persuaded that safeguard action by them was needed their decision could be overturned by a qualified majority in the Council.

10. We doubt if there is much scope for action against us elsewhere

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in the external field. For example, it is not likely that any other Member States would now hold up ratification of the Second Lomé Convention which has the effect of contractually protecting until 1985 (with the partial exception of sugar) the special UK interest in the Community's relations with the 29 Commonwealth members of the ACP. And, although the sugar arrangements under the First Lomé Convention fall to be re-examined in about a year's time, we could probably block any unwelcome changes.

#### POSSIBLE BILATERAL ACTION AGAINST THE UK AND ITS EFFECTS

11. (i) All Whitehall Department would notice an immediate effect on their bilateral exchanges at a political as well as official level, both in number and in their frankness/intimacy. The Anglo/German Summit in March and the Knigswinter Conference could be frosty occasions and the proposed Franco-British Conference to be attended by the President and Prime Minister in the autumn might be a casualty.
- (ii) Current attempts to develop our links with France and the FRG as an essential counterpoise to the Franco-German axis in Europe would be frustrated. The Franco-German relationship would, as the direct consequence of our action, be further strengthened at our expense. Both France and the FRG would probably calculate that our tactics would not succeed and that they would consequently have less to lose by standing up to us than by giving way. But the FRG, also set more store by their bilateral relations with the UK than the French do, would probably try to minimise the damage.
- (iii) It would be more difficult to get our partners to take sympathetic account of our political interests outside the Community eg over Southern Africa, Rhodesia, Gibraltar or Northern Ireland (see below).

(iv) The readiness of continental firms (at least inside the public sector) to do business with us could be adversely affected. Governments could find it harder to justify to their own public opinion major collaborative ventures involving Britain. Inward investment by our partners in the UK would also be affected.

(v) The French in particular might be reluctant to enter into serious negotiations on collaboration in the nuclear field with the UK, eg on fast breeder reactor development. But they do not seem to have made up their minds on whether they want to collaborate with us; nor is it clear that lack of collaboration with French would have a serious effect on our fast breeder programmes.

Any direct action against UK defence interests is unlikely. Action affecting eg British Forces Germany would almost certainly harm the interests of our other Allies as much as our own.

12. We have considered whether there are any measures in the banking field which would be open to our Community partners. Combined EEC sterling balances are relatively small (less than £200 million) and their withdrawal which we would regard as very unlikely, would have no serious effect. We are unable to think of any other counter measures in the banking field that would be conceivable in the situation envisaged.